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USURY LENDING LIMITS

GOVERNMENT

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HEARING

BEFORE THE

COMMITTEE ON

BANKING, HOUSING, AND URBAN AFFAIRS

UNITED STATES SENATE

NINETY-SIXTH CONGRESS

FIRST SESSION

ON

S. 1988

TO EQUALIZE COMPETITION BETWEEN STATE AND NATIONAL
BANKS AND FOR OTHER PURPOSES

DECEMBER 17, 1979

Printed for the use of the
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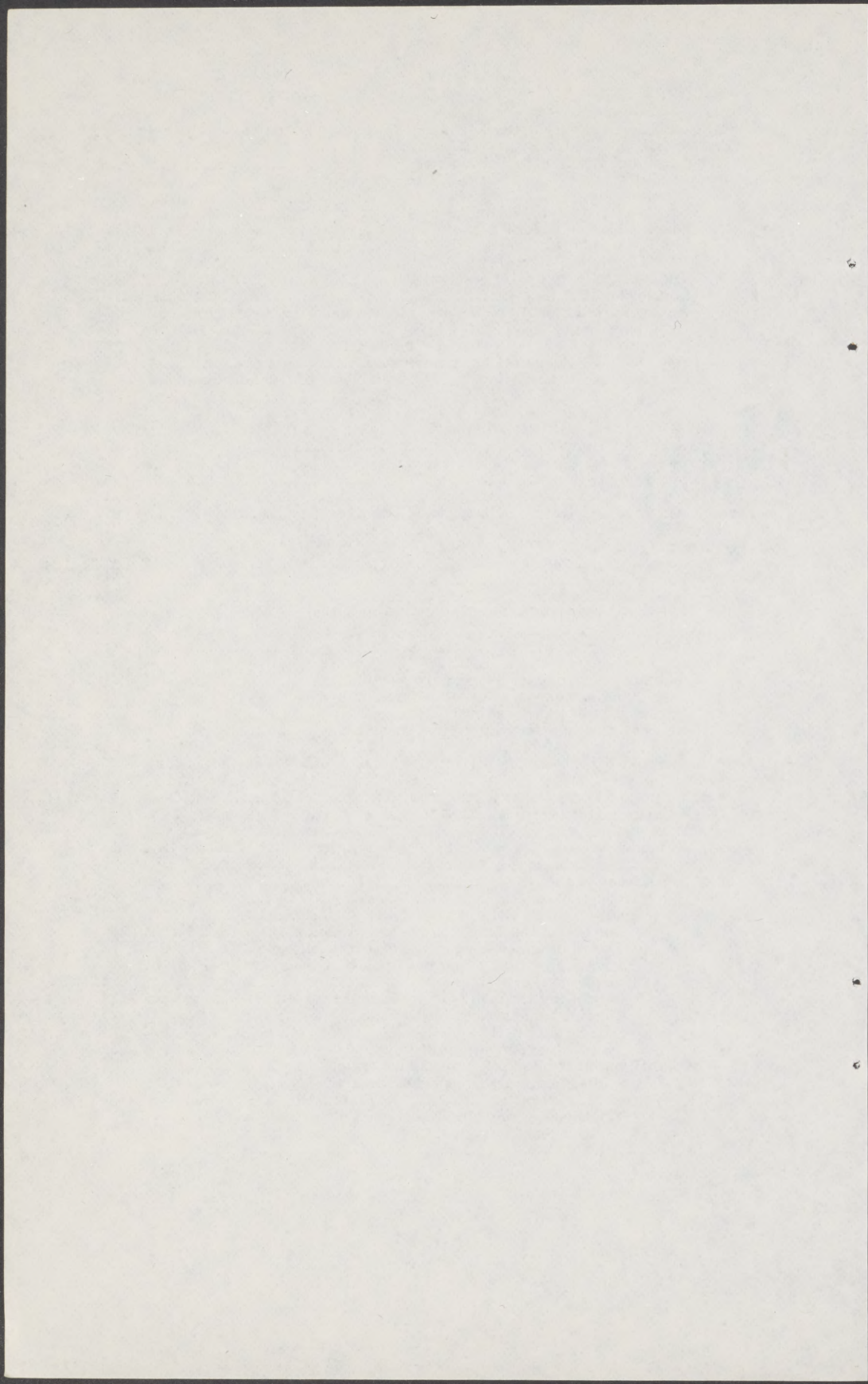
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USURY LENDING LIMITS

MONDAY, DECEMBER 17, 1979

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

The committee met at 10:05 a.m., in room 5302, Dirksen Senate Office Building, Senator William Proxmire (chairman of the committee) presiding.

Also present: Senators Bumpers and Pryor.

OPENING STATEMENT OF CHAIRMAN PROXMIRE

The CHAIRMAN. The committee will come to order.

This morning we take testimony on legislation that will provide competitive equality among all financial institutions with respect to State usury lending limits.

Usury limits have become economically counterproductive, if they ever had any purpose. It seems to me we should know now they don't work. There's a great illusion in this country that all you have to do to achieve something is pass a law and that's it, whether it's holding prices down, or having a stronger defense force, or whatever. But I think we have learned, certainly with respect to interest rates at least, this just does not work.

Most usury limits were established during the depression and bear no reasonable relationship to today's circumstances. Borrowers are hurt, not helped, by unrealistic lending limits and also homebuilding, small business, or agricultural purposes, if they are restricted to rates below the market rate. The homebuilding industry is particularly disadvantaged by usury limits. Chairman Janis suggests that usury limits could depress housing starts next year by 85,000 units. The impact will be most severely felt by younger, lower-income prospective homeowners.

The Senate has already passed legislation to relieve the restrictive effects of usury limits. I hope the House will enact that legislation. I was disappointed that some soundings indicated that the House would not move on it and I would hope that those here this morning who have an interest in this legislation—and I'm sure there are many—will do their best to persuade House Members to recognize the economic realities of life.

I welcome Senator Pryor. Is Senator Bumpers here?

Senator PRYOR. Senator Proxmire, I think he's on his way.

The CHAIRMAN. Fine. I might say, no two Senators have worked harder or more effectively on these two issues. We were able to get some action with respect to Arkansas that was largely due to Senator Pryor's and Senator Bumpers' efforts, and you both de-

serve a world of credit for having done so. I particularly welcome them to lead off the hearings this morning.

STATEMENT OF DAVID PRYOR, U.S. SENATOR FROM THE STATE OF ARKANSAS

Senator PRYOR. Senator Proxmire thank you very much. As you will remember, in a colloquy on the Senate floor we decided that it would be good to have separate legislation. On November 7 this legislation became Senate bill 1988 in the area of parity. And due to your generosity you consented to hold an early hearing on it.

We have a number of very, very outstanding witnesses, Mr. Chairman, who will appear. Because of that, I would only ask consent if I can submit my statement for the record.

I do want to take a moment, Mr. Chairman, to sincerely thank you and the other members of the Banking Committee for taking the time to receive this testimony on the problems resulting from present unequal treatment of national banks on one hand and of other financial institutions on the other. I know that with your current preoccupation with the Chrysler bill and the Fed membership legislation your time is at a premium, and I am especially grateful for the consideration that you're giving us.

Mr. Chairman, I would like to enter into the hearing record at this time testimony by the Governor of Arkansas, Bill Clinton; by our State Banking Commissioner, Mr. Beverly Lambert who is with us today; and by the chairman of the Banking Committee of the Arkansas State Senate, Olen Hendrix.

Once again, Mr. Chairman, we express to you our sincere appreciation for the generous and cooperative way you have treated us with our specific problems and for holding this hearing today.

The CHAIRMAN. Thank you very much, Senator Pryor.

[Attachments to the statement of Senator Pryor and additional material, including copy of the bill being considered, follow:]

STATEMENT OF BILL CLINTON, GOVERNOR, STATE OF ARKANSAS

My name is Bill Clinton, and I am the Governor of Arkansas. I appreciate the opportunity to share my thoughts with you regarding S. 1988. This legislation is to promote competitive equality among competing financial institutions by allowing federally insured banks, savings and loans, credit unions, and small business investment companies to pay and receive interest at rates comparable to those granted national banks by Federal law.

As Governor, I am concerned about the well-being of the State of Arkansas. Every facet of her growth and vitality is an area of concern to me. I consider S. 1988 vital to the economic well-being of Arkansas, both at the present and in the future. It is legislation which deserves your most serious consideration.

The need for this law is acute at the present, and will worsen in the future. Arkansas has a constitutional limitation on interest rates. The State's constitution was enacted in 1874. Providing a strict 10 percent interest limit upon all loans, this usury provision has the stiffest penalty of any State in the union. I believe it was directed at valid concerns when it was enacted; but our constitution address the economic realities of a 100 years past, and it is simply not pertinent now. Indeed, its existence has caused hardship for Arkansas in recent times.

The people of my State will be presented with the question of whether this provision should be changed in the immediate future, as a new constitution will be submitted to them for approval. I wholeheartedly support the efforts that are being made to revise or repeal the prohibition on interest rates. I hope that the people of Arkansas will recognize the realities of our current economic situation, and will adopt a solution which will protect the little man from unfair interest rates and yet provide a fair return for lenders, recognizing the interstate nature of money as a commodity.

Yet all constitutional processes take time. Until the people of Arkansas address this question, Arkansas will be beset with problems which stem from both Federal law and the tight money conditions which currently plague our Nation.

The interaction of Arkansas usury provision with the tight money conditions presently prevailing affects Arkansas economy in several ways. Capital flows from out State to seek higher returns available elsewhere. Lenders are unable to obtain money at competitive rates, and are forced to curtail their lending activity. Marginal borrowers, such as young people and the poor, the first to be hit with restrictive lending policies. Housing starts and other commercial activity virtually ceases. And, as the availability of credit is restricted, a lack of money ripples through the economy of Arkansas, often forcing the State to lead the Nation into periods of economic hardship.

The recent passage of Federal legislation allowing national banks and savings and loans to charge 5 percent over the Federal discount rate on commercial and agricultural loans of more than \$25,000 has helped. But I must point out that this legislation provided no relief to the small State banks scattered about Arkansas; those banks rarely make loans approaching \$25,000. This is also the case with most credit unions, as they usually make smaller loans. And the savings and loan institutions are primarily lenders of residential funds; this legislation will help them very little. It was clearly a much-appreciated step in the right direction, but we need further relief.

Arkansas is a capital-poor State. It is rural, having little industry, with agriculture serving as the principal source of wealth and the livelihood of most of the population. Because of this specialization, periods of tight money impact heavily upon Arkansas economy, and anything which emphasizes or exaggerates the harsh effects of a national credit crunch in Arkansas merely increases our burden that much more.

This occurs due to the disparity created by the Federal law allowing national banks to charge higher interest rates than those allowed to be charged by State financial institutions under State law. For example, State savings and loans in Arkansas operate under an upper limit of 10 percent on all loans. National banks, of course, may charge 1 percent above the prevailing Federal discount rate. For the same loans, these competing institutions are allowed to obtain differing rates of interest. The domicile of their charter is the controlling factor, nothing more. Thus interaction of Federal and State law promotes an imbalance in Arkansas financial community, skewing the financial resources of Arkansas from the State system of institutions to nationally chartered banks.

Indeed, the results which must flow from allowing one system of financial institutions to charge more interest on loans and pay more on deposits than others are easy to predict, and they are occurring now. Funds flow from the various State chartered institutions to the national bank system, and national banks become the primary source of loans. This leads to the concentration of capital in urban areas. This is normally the case, because that is where the demand for such capital is greatest. This trend, however, is worsened, and the capital-poor rural areas of Arkansas become that much poorer.

In addition, institutions such as State banks and savings and loans are forced to curtail their operations, and to refrain from doing things they would normally do. Therefore, their ability to serve their immediate community is impaired, and ultimately their profitability and financial stability suffers. I need not say that such institutions are heavily involved in Arkansas rural economy. Places like Horatio, Waldron, Stamps, Bald Knob, and Alma cannot depend on banks with national charters to serve their communities. These communities are simply too small to support the capital necessary to obtain a national charter, and, indeed, are often lucky to have a State bank or savings and loan at all. State chartered institutions exist to fill this void, and their ability to do so is threatened by the competitive disadvantage which they face.

Therefore, capital concentrates. Our largest institutions get larger while the smallest get smaller or grow at slower rates than ordinarily possible. Our ability to share and redistribute wealth within the State is curtailed, and, of course, Statewide growth is thus restricted. To the extent that the State institutions as a whole suffer, the State suffers.

I believe there are no sound reasons of public policy to maintain the interest rate differential between State chartered entities and national banks. Such State institutions are, on the whole, sound. Almost all are insured by the various types of Federal deposit insurance, and to that extent, their depositors are protected. And national banks do not require this historical protection, having proven that they are adept at surviving in adverse financial times. My focus therefore moves to the

people of Arkansas. As I have stated, when the State chartered institutions suffer, the communities in which such institutions are located also suffer. To the extent that growth in a local community is impaired, the opportunities of Arkansas citizens are impaired.

Finally, the systems of State chartered financial institutions are the primary means we have of keeping the wealth of the local communities in those communities and at work where needed, keeping Arkansas capital in Arkansas. And the system by which we chartered such institutions allows local people to assess local needs, and to allocate new banks and services to areas where they are needed. While I cannot speak for other States, I state unequivocally that our State institutions must not be kept at this unwarranted competitive disadvantage.

Therefore, I urge this committee's favorable consideration of S. 1988. It provides a fair means of insuring the economic well-being of State chartered financial institutions and indirectly the economic well-being of Arkansas. I am proud of the way these institutions have contributed to the economic growth and vitality of Arkansas, and I do not wish to see their contribution impaired in the future. I urge passage of this much-needed legislation.

ARKANSAS STATE BANK DEPARTMENT,
Little Rock, Ark., December 14, 1979.

Hon. WILLIAM PROXMIRE,
Chairman, Banking, Housing, and Urban Affairs Committee, Dirksen Senate Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: You are considering today S. 1988 which is the most important legislation that has ever been before the Congress so far as the 191 State banks that I supervise are concerned.

Our national bank friends in Arkansas realize how unfair this disparity is and are strong in their support of this legislation.

I respectfully urge the support of the committee and hope this bill will pass without amendment.

Respectfully,

B. J. LAMBERT, Jr.,
State Bank Commissioner.

— STATEMENT OF B. J. LAMBERT, JR. —

My name is Beverly Lambert, and I am presently the Bank Commissioner for the State of Arkansas. I wish to thank you for allowing me to come before you today to testify regarding S. 1988.

I have been intimately connected with State banks and banking for most of my career. I have been president of the Arkansas Bankers Association, and president of two State banks, The Bank of West Memphis and the First State Bank of Crossett. In addition, I have been a member of the Arkansas Industrial Development Commission, and have served in various other public and private positions.

The Arkansas State Bank Department, which I head, is responsible for the supervision and regulation of Arkansas system of State chartered banks. There are 191 such banks, and the system they comprise is an integral part of Arkansas economic vitality.

As this Committee is aware, Arkansas has the most stringent usury provisions and penalties of any State in the Union. There is an absolute prohibition against the paying and receiving of interest above 10 percent. At present, the Federal discount rate is above the 10 percent usury limitation contained in the Arkansas constitution. Arkansas, as are other States, is experiencing tight money across the board. The numbers of small consumer loans have been squeezed almost to extinction. Residences are not being built. Arkansans are having to forego purchases they would ordinarily make, such as the replacement of durable goods and necessities. Indeed, without recent Federal legislation allowing national interest rates to apply on large commercial and agricultural loans, there would be no lending activity in Arkansas whatsoever.

The Federal legislation recently passed allowing national banks and savings and loans to charge 5 percent over the Federal discount rate on commercial and agricultural loans of more than \$25,000 has eased the situation somewhat. But it also has worsened the situation which S. 1988 is to alleviate. This legislation provides little relief to Arkansas State banks. These institutions tend to be smaller than their nationally chartered competitors, and rarely do they make loans approaching \$25,000 in amount. Therefore the competitive advantage which national banks

already possess, which I will address in detail, is heightened. I supported this legislation wholeheartedly, and I welcomed its passage. But it is only an initial advance, and it must be followed.

Indeed, more is needed. As the members of this distinguished committee are well aware, title 12, section 85, of the United States Code allows national banks to charge 1 percent above the Federal Reserve discount rate. State banks, however, are bound by the more stringent constitutional usury provision. An imbalance has been created. For the exact risk and credit, one bank in Arkansas can charge more than another simply because it has a different charter.

That is why I am here today. I am here to speak solely for State banks, and to provide you with the results of my experience in regulating Arkansas State bank system. S. 1988 in essence has a simple purpose. It is to provide competitive equality among the competing institutions of the financial community of Arkansas and other States. Federally insured banks, savings and loans, and credit unions will be allowed to receive and pay the interest rate allowed national banks by Federal legislation, 1 percent above the Federal Reserve discount rate. Small business investment companies are also covered, in order to provide small businesses with a steady flow of funds, and to prevent discrimination against them in the market. In addition, an equality of penalties is provided: The present penalty applicable to national banks is forfeiture of interest if unlawful interest is charged but not paid, and a penalty of twice the interest paid if unlawful interest is in fact received by the national bank. S. 1988 will apply these penalties to the institutions named above.

The proposed legislation further provides that all such institutions may not raise any usury defense available to them under State constitutions or statutes to avoid any obligation which they may incur at interest rates higher than those provided in such State provisions. And, finally, the legislation is not mandatory. Each State is given a chance to decide whether or not it desires to receive the benefits which this legislation will confer. The various State legislatures are given the ability to curtail the operations of this legislation with respect to their own particular States and situations.

This legislation is badly needed. It is needed to preserve our dual system of State and national banks. In Arkansas, that system is threatened.

As interest rates have risen to highs unknown in this country's recent financial history, State bankers have increasingly voiced their concern to me about their competitive disadvantage in the market place as against national banks. These State bankers have now begun to give serious consideration to obtaining a national charter so that they may compete effectively with their neighbors, who are often just down the street. I must state that I cannot blame them for considering this course of action. The distinction drawn on the basis of the domicile of their charter is arbitrary, and works a disadvantage on their ability to serve effectively their customers and their community, and upon their ability as prudent bankers to earn a fair return on their assets. When they come to me and ask why they should not be allowed to charge an interest rate equal to that given for the same loan and credit risk by a bank just down the street or just across the block, I must admit I have no answer for them.

Therefore the dual system of banking in Arkansas is threatened. And that system is important, both to Arkansas and to the Union. First, it provides competition within the industry. Second, the State banks in Arkansas serve areas of Arkansas that the nationally chartered banks, which are located in our major urban areas, cannot reach. Thus, they respond to local conditions and needs which nationally chartered banks are unable to serve. Third, the system of State banks allows a degree of State control over the local economy, affording an opportunity to gather information and to seek out areas where additional capital or services are required. Fourth, the system by which most States grant charters, that is by allowing State banking departments to pass upon the viability of charter applicants, allows local people familiar with the needs of the various areas of Arkansas to act to insure that such needs are met. And finally, the availability of credit and financial services, the touchstone of the banking industry in the United States, is enhanced by the availability of two competing banking systems. As we are aware, and have implemented in our economy, competition brings out the best in people and institutions. Both the national bank system and the system of State banks are improved by the competition provided each by the other, and the public is the ultimate beneficiary.

If the present tight money and high national money market rates were an isolated event, I would not be before you today. I am deeply worried, however, about the future. All the economists which one reads today indicate that interest rates will not remain at their present high level, but will return to a cycle of peaks and

valleys as historically has been the case in the United States. These economists, however, agree on one thing: that higher interest rates are with us now, and will be so in the future. In other words, the peaks and floors of interest rates will be higher in succeeding years. High interest rates are with us to stay.

Therefore, State banks such as those in Arkansas will continue to see the gulf widen in their competition with their national bank neighbors. There will be continued pressure upon them to seek a Federal charter. The profitability of the State banks will suffer, because the competitive advantage presently enjoyed by national banks will translate into an ever stronger competitive position versus the State banks who will continue to lose ground. This will inevitably lead to a situation in which State banks will be unable to serve the community in which they are located, and ultimately in which their financial stability will be threatened. In short, this problem will not go away. It is a question of public policy which we must deal with if we are to avoid having a majority of national banks in my State.

I see this happening now. State banks are being forced to turn down favorite customers seeking loans, and, if such banks act in good conscience, to send such customers to their national bank competitors, where funds may be available at the higher rates of interest allowed by Federal law. Understandably, this is somewhat demoralizing. And it constitutes a steady drain on the financial stability of these banks, who are forced to watch both deposits and favorite customers move in search of available funds and returns. The problem is immediate and serious.

Therefore, I urge your favorable consideration of S. 1988. It provides a fair and simple solution to a complex problem by promoting competitive equality among the competing financial institutions which handle the lion's share of our Nation's financial needs and assets. It will correct an unnecessary and unplanned economic imbalance, and strengthen the dual nature of the American banking system. To the extent that I can speak for the banks in my State, Mr. Chairman, those banks do not fear competition from their national bank neighbors. To the contrary, they welcome it. All they ask is a chance to compete on an equal footing, and this will be provided by S. 1988. I urge your favorable consideration of this bill, and its speedy transmittal to consideration by the full Senate.

STATEMENT OF OLEN HENDRIX, SENATOR, 11TH DISTRICT, ANTOINE, ARK.

Good morning, Mr. Chairman, and members of the Senate Banking Committee. My name is Olen Hendrix. I deeply appreciate the opportunity to testify regarding S. 1988, as introduced by Senators Pryor and Bumpers of Arkansas.

I have been a member of the Arkansas Senate since 1959, and I presently represent five counties in southwestern Arkansas. I am Chairman of the Standing Senate Committee on Insurance and Commerce, which has legislative jurisdiction over the system of Arkansas State banks. My profession is that of farming and banking: I am presently President of the Bank of Delight, Arkansas. My experience in the legislature and in my profession has provided me with a variety of insights into the operations and problems faced by the banking community of Arkansas.

Mr. Chairman, the need for this legislation is acute. The legislation before you addresses an imbalance which is not the result of any policy decision by the citizens of Arkansas, but rather is attributable to actions of the Federal Government. I speak of course about the disparity of allowable interest rates created by the interaction of Arkansas constitutional usury provision with the Federal legislation enabling nationally chartered banks to charge 1 percent over the prevailing Federal Reserve discount rate.

A quick example will illustrate. An Arkansas-chartered bank is limited by the Arkansas constitution to charging an upper limit of 10 percent on all loans it makes, regardless of type or source. On the other hand, for exactly the same loan, an Arkansas bank with a national charter can charge 1 percent above the prevailing Federal discount rate. Therefore, for exactly the same quantum of risk, a national bank may charge more interest than a state bank. The national bank can earn more, and can put more at risk. These rates of interest therefore translate directly to the institution's bottom line profitability. The State banks suffer.

I submit to you that this result is both unintended and unjustified. Arkansas constitutional prohibition on usury was passed in 1874. The relevant section of the United States Code, section 85 of title 12, was not passed until 59 years later, in 1933. The framers of Arkansas 1874 constitution could not have been aware when they acted that subsequent Federal legislation would create an economic imbalance between banks chartered in Arkansas and those chartered by the United States. I think it safe to say that if those men had been aware of this possibility, our present Arkansas constitution would read differently.

In addition, Mr. Chairman, the problem of unequal interest rates was created almost inadvertently. While national money market rates were low, there was no problem. State banks could compete effectively with national banks. But now, with the Federal discount rate above Arkansas 10 percent usury limit, the problem which was once dormant is upon us in full force. And it is a question of public policy which has never been adequately studied, nor completely explored. We have just drifted into our present situation, Mr. Chairman, and it is now time to take a hard look at where we are.

Across the State of Arkansas, State banks are finding themselves increasingly hamstrung by their inability to compete with federally chartered institutions. Mr. Chairman, these State banks are the backbone of Arkansas rural economy. They are usually locally held and run. They are usually small. State banks serve areas of Arkansas that the larger federally chartered institutions, which tend to be located in urban areas, simply cannot serve. Indeed, a loss of a steady customer or a medium-sized deposit affects the ability of these banks to do business. And the community in which they are located suffers.

It is those communities and the people who live there that I wish to focus your attention upon. These people depend upon their State banks. People in my town of Delight cannot drive to Little Rock every time they need a loan, and Arkansas is still a rural State. There are few other major urban areas; few other places to go. These people depend upon their bankers for crop loans, business loans, and money for the basic necessities of life. These people, Mr. Chairman, don't want to lose these banks and what they mean to their communities. We in Arkansas are proud of our State banks, and of the contribution Arkansas banks have made to the development and growth of Arkansas. It is the State banks in States such as Arkansas who are now threatened.

But the system of the State-chartered banks in Arkansas is under tremendous pressure. Time and time again in my position as a legislator I have heard of State banks and bankers giving serious consideration to applying for Federal charter. Simple market economics are forcing this result, Mr. Chairman, and it is a result that will work to the detriment of Arkansas. We are heading toward a monolithic banking system.

Mr. Chairman, S. 1988 addresses institutions other than State-chartered banks. I have addressed only the needs of the State-chartered, federally insured banks, with whose problems I am most familiar. This legislation is a logical, just and timely resolution of a complex problem that will only worsen in the future. I urge this committee to give it every favorable consideration and to send it on to full consideration by the Senate with the highest recommendations.

Mr. Chairman, I will be delighted to answer any questions that you or other members of the committee may have.

96TH CONGRESS
1ST SESSION

S. 1988

To equalize competition between State and national banks, and for other purposes.

IN THE SENATE OF THE UNITED STATES

NOVEMBER 7 (legislative day, NOVEMBER 5), 1979

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

A BILL

To equalize competition between State and national banks, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 TITLE I—INTEREST RATE AMENDMENTS RE-
4 GARDING STATE USURY CEILINGS ON CER-
5 TAIN LOANS

6 SEC. 101. The Federal Deposit Insurance Act (12
7 U.S.C. 1811–1831) is amended by adding at the end thereof
8 the following:

1 “SEC. 26. (a) In order to prevent discrimination against
2 State-chartered insured banks with respect to interest rates,
3 if the applicable rate prescribed in this subsection exceeds the
4 rate such State bank would be permitted to charge in the
5 absence of this subsection, a State bank may, notwithstanding
6 ing any State constitution or statute, which is hereby pre-
7 empted for the purposes of this section, take, receive, re-
8 serve, and charge on any loan or discount made, or upon any
9 note, bill of exchange, or other evidence of debt, interest at a
10 rate of not more than 1 per centum in excess of the discount
11 rate on ninety-day commercial paper in effect at the Federal
12 Reserve bank in the Federal Reserve district where the bank
13 is located or at the rate allowed by the laws of the State,
14 territory, or district where the bank is located, whichever
15 may be greater.

16 “(b) If the rate prescribed in subsection (a) exceeds the
17 rate such State bank would be permitted to charge in the
18 absence of this paragraph, and such State fixed rate is there-
19 by preempted by the rate described in subsection (a), the tak-
20 ing, receiving, reserving, or charging a greater rate of inter-
21 est than is allowed by subsection (a) when knowingly done,
22 shall be deemed a forfeiture of the entire interest which the
23 note, bill, or other evidence of debt carries with it, or which
24 has been agreed to be paid thereon. If such greater rate of
25 interest has been paid, the person who paid it may recover in

1 a civil action commenced in a court of appropriate jurisdiction
2 not later than two years after the date of such payment, an
3 amount equal to twice the amount of the interest paid from
4 the State bank taking or receiving such interest.”.

5 SEC. 102. Title IV of the National Housing Act (12
6 U.S.C. 1724–1730(f)) is amended by adding at the end there-
7 of the following:

8 “SEC. 414. (a) If the applicable rate prescribed in this
9 section exceeds the rate an insured institution would be per-
10 mitted to charge in the absence of this section, such institu-
11 tion may, notwithstanding any State constitution or statute,
12 which is hereby preempted for the purposes of this section,
13 take, receive, reserve, and charge on any loan or discount
14 made, or upon any note, bill of exchange, or other evidence
15 of debt, interest at a rate of not more than 1 per centum in
16 excess of the discount rate on ninety-day commercial paper
17 in effect at the Federal Reserve bank in the Federal Reserve
18 district where the institution is located or at the rate allowed
19 by the laws of the State, territory, or district where the insti-
20 tution is located, whichever may be greater.

21 “(b) If the rate prescribed in subsection (a) exceeds the
22 rate such institution would be permitted to charge in the ab-
23 sence of this section, and such State fixed rate is thereby
24 preempted by the rate described in subsection (a), the taking,
25 receiving, reserving, or charging a greater rate of interest

1 than that prescribed by subsection (a), when knowingly done,
2 shall be deemed a forfeiture of the entire interest which the
3 note, bill, or other evidence of debt carries with it, or which
4 has been agreed to be paid thereon. If such greater rate of
5 interest has been paid, the person who paid it may recover, in
6 a civil action commenced in a court of appropriate jurisdiction
7 not later than two years after the date of such payment, an
8 amount equal to twice the amount of the interest paid from
9 the institution taking or receiving such interest.”.

10 SEC. 103. Section 308 of the Small Business Invest-
11 ment Act of 1958, as amended (15 U.S.C. 661), is amended
12 by adding at the end thereof the following:

13 “(i)(1) In order to facilitate the orderly and necessary
14 flow of long-term loans and equity funds to small business
15 concerns, as defined in the Small Business Act, if the maxi-
16 mum interest rate permitted by the Small Business Adminis-
17 tration exceeds the rate a small business investment company
18 would be permitted to charge in the absence of this subsec-
19 tion, such small business investment company may, notwith-
20 standing any State constitution or statute, which is hereby
21 preempted for the purposes of this section, take, receive, re-
22 serve, and charge on any such loan, interest at a rate of not
23 more than 1 per centum in excess of the discount rate on
24 ninety-day commercial paper in effect at the Federal Reserve
25 bank in the Federal Reserve district where the small business

1 investment company is located or at the rate allowed by the
2 laws of the State, territory, or district where the small busi-
3 ness investment company is located, whichever may be
4 greater.

5 “(2) If the rate prescribed in paragraph (1) exceeds the
6 rate such small business investment company would be per-
7 mitted to charge in the absence of this subsection, and such
8 State fixed rate is thereby preempted by the rate described in
9 paragraph (1), the taking, receiving, reserving, or charging a
10 greater rate than is allowed by paragraph (1), when know-
11 ingly done, shall be deemed a forfeiture of the entire interest
12 which the loan carries with it, or which has been agreed to
13 be paid thereon. If such greater rate of interest has been
14 paid, the person who paid it may recover, in a civil action
15 commenced in a court of appropriate jurisdiction not later
16 than two years after the date of such payment, an amount
17 equal to twice the amount of interest paid from the small
18 business investment company taking or receiving such
19 interest.”.

20 SEC. 104. Section 205 of the Federal Credit Union Act
21 is amended by adding at the end thereof the following:

22 “(f)(1) If the applicable rate prescribed in this section
23 exceeds the rate an insured credit union would be permitted
24 to charge in the absence of this section, the credit union may,
25 notwithstanding any State constitution or statute, which is

1 hereby preempted for the purposes of this section, take, re-
2 ceive, reserve, and charge on any loan, interest at a rate of
3 not more than 1 per centum in excess of the discount rate on
4 ninety-day commercial paper in effect at the Federal Reserve
5 bank in the Federal Reserve district where the federally
6 chartered financial institution is located or at the rate allowed
7 by the laws of the State, territory, or district where the credit
8 union is located, whichever may be greater.

9 “(2) If the rate prescribed in paragraph (1) exceeds the
10 rate such credit union would be permitted to charge in the
11 absence of this section, and such State fixed rate is thereby
12 preempted by the rate described in paragraph (1), the taking,
13 receiving, reserving, or charging a greater rate than is al-
14 lowed by paragraph (1), when knowingly done, shall be
15 deemed a forfeiture of the entire interest which the loan car-
16 ries with it, or which has been agreed to be paid thereon. If
17 such greater rate of interest has been paid, the person who
18 paid it may recover, in a civil action commenced in a court of
19 appropriate jurisdiction not later than two years after the
20 date of such payment, an amount equal to twice the amount
21 of interest paid from the credit union taking or receiving such
22 interest.”.

23 SEC. 105. If any provision of this title or the application
24 of such provision to any person or circumstance shall be held
25 invalid, the remainder of the title and the application of such

1 provision to any person or circumstance other than that as to
2 which it is held invalid shall not be affected thereby.

3 TITLE II—APPLICABILITY OF STATE USURY
4 CEILINGS TO CERTAIN OBLIGATIONS IS-
5 SUED BY BANKS AND AFFILIATES

6 SEC. 201. Section 19 of the Federal Reserve Act (12
7 U.S.C. 461 et seq.) is amended by adding at the end thereof
8 the following new subsection:

9 “(2) No member bank or affiliate thereof, or any succe-
10 sor or assignee of such member bank or affiliate or any en-
11 dorser, guarantor, or surety of such member bank or affiliate
12 may plead, raise, or claim directly or by counterclaim, setoff,
13 or otherwise, with respect to any deposit or obligation of
14 such member bank or affiliate, any defense, right, or benefit
15 under any provision of a statute or constitution of a State or
16 of a territory of the United States, or of any law of the Dis-
17 trict of Columbia, regulating or limiting the rate of interest
18 which may be charged, taken, received, or reserved, and any
19 such provision is hereby preempted, and no civil or criminal
20 penalty which would otherwise be applicable under such pro-
21 vision shall apply to such member bank or affiliate or to any
22 other person.”.

23 SEC. 202. Section 18 of the Federal Deposit Insurance
24 Act (12 U.S.C. 1828) is amended by adding at the end there-
25 of the following new subsection:

1 (2) No insured nonmember bank or affiliate thereof, or
2 any successor or assignee of such bank or affiliate or any
3 endorser, guarantor, or surety of such bank or affiliate may
4 plead, raise, or claim, directly or by counterclaim, setoff, or
5 otherwise, with respect to any deposit or obligation of such
6 bank or affiliate, any defense, right, or benefit under any pro-
7 vision of a statute or constitution of a State or of a territory
8 of the United States, or of any law of the District of Colum-
9 bia, regulating or limiting the rate of interest which may be
10 charged, taken, received, or reserved, and any such provision
11 is hereby preempted, and no civil or criminal penalty which
12 would otherwise be applicable under such provision shall
13 apply to such bank or affiliate or to any other person.”.

14 SEC. 203. Section 5B of the Federal Home Loan Bank
15 Act (12 U.S.C. 1425b) is amended by adding at the end
16 thereof the following new subsection:

17 “(f) No member or nonmember association, institution,
18 or bank or affiliate thereof, or any successor or assignee, or
19 any endorser, guarantor, or surety thereof may plead, raise,
20 or claim, directly or by counterclaim, setoff, or otherwise,
21 with respect to any deposit or obligation of such member or
22 nonmember association, institution, bank, or affiliate, any de-
23 fense, right, or benefit under any provision of a statute or
24 constitution of a State or of a territory of the United States,
25 or of any law of the District of Columbia, regulating or limit-

1 ing the rate of interest which may be charged, taken, re-
2 ceived, or reserved, and any such provision is hereby pre-
3 empted, and no civil or criminal penalty which would other-
4 wise be applicable under such provision shall apply to such
5 member or nonmember association, institution, bank, or affili-
6 ate or to any other person.”.

7 SEC. 204. Section 205 of the Federal Credit Union Act
8 is amended by adding at the end thereof the following:

9 “(g) No insured credit union or affiliate thereof, or any
10 successor or assignee, or any endorser, guarantor, or surety
11 thereof may plead, raise, or claim directly or by counter-
12 claim, setoff, or otherwise, with respect to any deposit or
13 obligation of such insured credit union or affiliate, any de-
14 fense, right, or benefit under any provision of a statute or
15 constitution of a State or of a territory of the United States,
16 or of any law of the District of Columbia, regulating or limit-
17 ing the rate of interest which may be charged, taken, re-
18 ceived, or reserved, and any such provision is hereby pre-
19 empted, and no civil or criminal penalty which would other-
20 wise be applicable under such provision shall apply to such
21 insured credit union or affiliate or to any other person.”.

22 TITLE III—APPLICABILITY

23 SEC. 301. The amendments made by these titles shall
24 apply to any loans or deposits made or obligations issued in
25 any State after the date of the enactment of this Act unless

1 and until such State legislature adopts a law stating in sub-
2 stance that such State does not want such amendment or
3 amendments made by these titles to apply with respect to
4 such loans, deposits, and obligations.

5 SEC. 302. The amendments made by these titles are in
6 addition to, and shall not supersede the provisions of Public
7 Law 96-104 or any other provisions relating to business and
8 agricultural loans of \$25,000 or more.

The CHAIRMAN. We have also a statement from Congressman S. William Green which we will insert in the record at this point. [Statement follows:]

STATEMENT OF S. WILLIAM GREEN, REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Mr. Chairman, I commend this Committee for holding hearings on the serious question of limits on mortgage lending rates. Because of the recent surge in interest rates and our disappointingly high rate of inflation, mortgage rates in many states have reached usury limits. The result has been that funds intended for the mortgage market have been diverted to higher yield investments.

One clear example of this problem is the housing industry in New York State. A study done at the New York State Banking Department ("The Impact of New York's Usury Ceiling on Local Mortgage Lending Activity") published in January 1976, showed that institutions subject to restrictive usury limits sharply increased their holdings of our-of-state and commercial loans. The switch to commercial loans results because corporate borrowers are generally exempted from usury restrictions. This evidence supports the statement that restrictive usury limits divert the flow of funds away from residential lending and into areas that are not subject to rate limitations.

As funds are diverted from housing, housing production tends to decline. Several empirical studies have demonstrated the negative effects of usury limits on home building. The findings of each of the studies showed significant negative effects on home building. Restrictive usury limits lowered construction activity anywhere from 11 per cent to 23 per cent, depending on the differential between the usury ceiling and the then current mortgage rate. Three notable studies are:

France, Charles F., "Pennsylvania's Floating Usury Ceiling: An Economic Evaluation," Working Paper No. 1, Federal Home Loan Bank of Pittsburgh, August 1975.

Ostas, James R., "Effects of Usury Ceilings in the Mortgage Market," Journal of Finance, June 1976.

Robins, Philip K., "The Effects of State Usury Ceilings on Single Family Home Building," Journal of Finance, March 1974.

Because the housing industry is an integral part of the U.S. economy, a slow-down in production of housing will have a far-reaching negative effect on the rest of the economy, which is not a desirable event.

Finally, the constraint on mortgage rates has placed the thrift institutions in a serious financial bind. Although they can issue money market certificates at competitive rates, they can not make mortgage loans at current market rates. The result is that return on assets has been reduced dramatically at savings institutions. Some relief, even the limited improvement of parity with nationally chartered commercial banks, which are allowed to make mortgage loans at one per cent above the discount rate, must be provided.

All lenders, not just the thrifts, would benefit from the Bumpers-Pryor bill. Considering the emergency situation we are facing in the housing industry, I urge this Committee's speedy and favorable consideration of this bill.

The CHAIRMAN. Senator Pryor, because it's such an excellent object lesson to the rest of the country, will you describe to us the effect on lending institutions, the effect on borrowers and the effect on business, in Arkansas for the months before we were able to take action here.

Senator PRYOR. In Arkansas our usury limit is specifically set forth in the State constitution—not merely in statutes which may be altered fairly easily as conditions warrant. In 1874, the drafters of our constitution set a lending limit of 10 percent on any type of loan, and that limit remains in effect today.

OUTWARD FLOW OF ECONOMY

In the past several months the State of Arkansas has seen an outward flow of money and job opportunities which has crippled

the State's economy. We have seen our home building business literally dry up; we have seen the savings and deposits of Arkansas citizens go to other States in search of higher rates of return; we have seen our own financial institutions survive only because of their basic soundness and because of a drastic reduction of in-State lending.

We have been given some temporary relief with your help, Mr. Chairman, through the Borrowers' Relief Act, but this relief, which is limited to business and agricultural loans of \$25,000 and above, runs out in July 1981, or perhaps earlier. The people of Arkansas are going to be faced with a decision in November 1980 on whether to change the usury limit once and for all. I do think that for the first time the people of our State realize the harm that the State usury rate of 10 percent has done and the shackles it has placed on our State's economy and the development of our State.

S. 1988 is not in itself a usury bill, but it addresses a problem which is brought to light by a combination of usury laws and high interest rates. Right now in the State of Arkansas national banks are allowed by Federal law to charge 13 percent on the loans they make, while State banks and other financial institutions may charge no more than 10 percent. Leaving the question of usury aside, many people believe that the basic principle of competitive equality is violated by the double standard applied to national banks and to other financial institutions. In practice, State banks are finding it increasingly difficult to compete with national banks, which are able to offer greater lending services. Our bill simply seeks to put all financial institutions on equal footing.

The CHAIRMAN. I want to think you very much, Senator Pryor, for coming in and giving us that excellent testimony. It's very helpful.

Senator PRYOR. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Bumpers hasn't come, but I'm going to ask the panel to come forward and when he does come we will ask Senator Bumpers to make this statement.

We have now the Honorable Harold A. Black, member of the Board, National Credit Union Administration; the Honorable Jay Janis, Chairman, Federal Home Loan Bank Board; the Honorable Frederick H. Schultz, Governor, Federal Reserve Board; and the Honorable Irvine R. Sprague, Chairman, Federal Deposit Insurance Corporation.

I might point out that Mr. Heimann, the Comptroller of the Currency, has submitted a statement for the record supporting the legislation, and his entire statement will be printed in full in the record at this point. Mr. Heimann has been in the forefront of those seeking to update restrictive and counter productive usury limits.

[Statement of Mr. Heimann follows:]

STATEMENT OF JOHN G. HEIMANN, COMPTROLLER OF THE CURRENCY

I appreciate the opportunity to present the views of the Office of the Comptroller of the Currency regarding S. 1988. While these comments necessarily reflect only the views of our Office, we understand that the Administration is developing a position on the usury issue.

This bill would authorize state chartered insured banks, insured lending institutions under Title IV of the National Housing Act, Small Business Investment

Companies and federally chartered credit unions to charge on any loan, interest at a rate of 1 percent in excess of the Federal Reserve Bank discount rate in effect in the Federal Reserve District where such a financial institution is located. The provisions of S. 1988 are similar to Section 85 of Title 12 of the United States Code which governs the rate of interest that national banks may charge on loans.

We have stated our opinion to the Congress several times this year that State usury laws should be repealed, preempted, or substantially modified because they create arbitrary distortions in our capital market system. Furthermore, as S. 1988 recognizes, competitive equity dictates that financial institutions offering similar products should be subject to similar rules. Although we would prefer to see Federal legislation that would phase out usury ceilings in an orderly manner, the more limited approach of S. 1988 is certainly a major step in the right direction. Therefore, we strongly endorse the purposes of this proposed law and support its immediate enactment, with certain minor modifications, to assure the continued availability of credit from all lending institutions on an equitable basis.

Impact of usury ceilings

Evidence collected over several years overwhelmingly indicates that the elimination of restrictive usury limits would be in the public interest. Generally usury laws:

- Fail to accomplish their desired objectives,
- Have an adverse effect on production and employment,
- Distort allocation of credit among markets and among States, and
- Impede payment of fair rates of interest on deposits.

Usury laws are intended to protect small and low-income borrowers from unscrupulous money lenders and to limit the power of lenders to charge whatever interest rate they want. These goals are important, but usury laws have had unintended and adverse effects on borrowers, financial institutions and the public-at-large. When market interest rates are above usury ceilings, low-income borrowers and higher-risk borrowers generally have been unable to obtain loans from commercial banks or other financial institutions and credit has flowed to markets not subject to usury ceilings. This has occurred during every period of high interest rates over the last 15 years. For example, since October many credit unions in the Greater Washington, D.C. metropolitan area have been unable to extend any credit to their members. This inability stems partly from the fact that usury ceilings on loans are currently less than market rates of interest on funds, thus making lending unprofitable. In addition, credit unions have been losing deposits because they are unable to pay competitive market rates on share accounts.

Restrictive interest rate limitations have closed off conventional credit sources to high-risk, generally low-income borrowers. When lenders are unable to charge rates sufficient to yield a reasonable rate of return, they generally stop lending to high-risk borrowers. Good risks may also be unable to obtain credit because the cost of making small loans exceeds usury ceilings. Both groups of borrowers may either forego obtaining credit, go to loan sharks where loans are available above usury rate limits, or seek nonmarket sources of credit such as family or friends. These conclusions have been documented in several studies of consumer finance companies, commercial banks, and mutual savings banks. Similar studies of new automobile, mortgage, and personal loan markets offer the same conclusions. The results are consistent—low-income consumers are denied access to conventional credit when market rates exceed usury ceilings.

Firms which must operate in markets subject to usury restrictions feel the impact on both costs and revenues. In the consumer finance industry, where rate restrictions abound, low-rate ceilings tend to result in fewer and larger loans because credit is allocated to low-risk consumers and because larger loans are less costly to make. When low legal loan size limits are combined with low ceilings on interest rates, the number of loans increases, but low-income, high-risk customers still find it difficult, if not impossible, to obtain credit. Instead, good risk customers are forced to "double-up" by acquiring costly multiple loans to get the amount of credit they desire.

Usury limits have also had adverse effects on the economies of certain States. For example, one study shows that Tennessee's economy grew at a faster rate than the national economy except when market interest rates rose above the State usury ceilings. At that point, Tennessee's economy slowed substantially. The same study calculated that between 1974-76, the annual loss in production averaged \$150 million, the annual loss of jobs averaged 7,000, the annual loss of retail sales averaged \$80 million, and the annual loss of assets in financial intermediaries averaged \$1.25 billion.

Because usury ceilings are set by each State, variations in usury rates distort the geographic distribution of credit. This is apparent from the types of financial insti-

tutions which exist in various States. For example, Arkansas, which has a 10 percent constitutional usury limit, has few consumer finance companies. Because credit is an essential ingredient to commerce, restrictions that limit its availability, such as usury ceilings, tend to dampen economic growth. This occurred in Missouri from early 1973 to early 1974 when the mortgage rate ceiling was 6 percent. New mortgage loans at Missouri savings and loan associations declined 37 percent, compared to a 6 percent decline in neighboring states. The usury limit in Missouri was raised in 1974.

The inescapable conclusion to all of this, I think, was stated well 115 years ago by the first Comptroller of the Currency, Hugh McCulloch, in his initial report to Congress: "Where money is abundant it is cheap, where scarce it is dear; and no legislation has been able to control the effect of this general law."

Many States have revised usury statutes in response to market realities, but some have not or could not because usury ceilings were mandated in their constitutions. Recent Federal legislation was enacted temporarily overriding State constitutional usury restraints on certain loans.

Another problem with usury ceilings is that during times when market interest rates are above the ceilings, institutions cannot afford to pay market rates on deposits for very long. Simply put, the cost of funds and the cost of operations exceed permissible lending rates. Because of this and other problems primarily related to the funding of long-term mortgages with short-term savings deposits, savers are paid below market rates. Regulators, concerned about depository institution profitability, particularly that of thrift institutions, have been reluctant to raise savings interest rate ceilings to market levels.

Especially at issue in this connection is the welfare of the small saver. Today few would contest the argument that depositors are entitled to a fair return on their money. For a fair return to be paid, basic economic principles dictate that the institution entrusted with the deposits have a corresponding ability to earn a fair return on its assets.

Historically, large depositors have not had a problem. Bolstered by rate limitations on small deposits under Regulation Q, they have wielded sufficient influence to command a fair return on their deposits. Only recently has some relief been forthcoming for the small saver in the form of money market funds and shorter-term, lower minimum amount certificates of deposit. If our traditional savings institutions are to satisfy the growing demand of the small saver for higher yields, market forces must be free to operate on both sides of the ledger.

To compete effectively, depository institutions must be able to pay market rates for funds and obtain market rates on loans. Elimination of usury laws, coupled with diversification of thrift institution powers, will improve the earnings flexibility of thrifts and will enable thrifts, as well as other types of lenders, to be more responsive to the needs of their customers.

Intent of 12 U.S.C. section 85

Section 85 provides that a national bank may receive on a loan the interest rate allowed by the State, territory, or district where the national bank is located, or at a rate of 1 percent in excess of the Federal Reserve Bank discount rate in effect at the Federal Reserve District where the bank is located, whichever is greater.

This alternative rate was added to section 85 by the Banking Act of 1933. The intent of Congress, as expressed in the Senate and House Committee Reports, was to permit national banks the option of adhering to the limits of a State's usury law or charging 1 percent above the discount rate during periods of restricted credit availability in which the discount rate approaches the applicable usury ceiling. Therefore, when the discount rate equals or exceeds statutory usury rates, the interest rate which a national bank may charge under the existing law may be sufficient to justify a loan transaction by the bank. When the rate at which banks borrow from the Federal Reserve Bank by discounting their paper approaches the State's usury ceiling, the discount function must otherwise cease because a bank cannot reasonably borrow money at a price equal to or higher than the rate it can lend. Since 1933, however, national banks have been permitted a choice in the interest rates they may charge under Section 85—that option is not presently available to other lenders.

Temporary Federal preemption of certain State usury ceilings

Approximately 40 years later, Congress enacted legislation effecting a similar purpose. In the Financial Amendments Act of 1974, Congress adopted a temporary provision allowing federally insured lenders to charge 5 percent above the discount rate on business and agricultural loans of \$25,000 or more. In addition to the recently enacted legislation temporarily preempting State constitutional usury

limits on certain loans, the Senate is currently considering legislation to restore authority similar to that granted in 1974 to national banks and to other lenders. We support that legislation but caution that it should not be considered to be a substitute for S. 1988 which would affect a broader range of loans.

The temporary 1974 amendments were enacted for essentially the same reasons as the 1933 amendment; that is, to assure that lenders could continue to lend money at rates that cover the costs of their funds. As the Senate Committee Report accompanying that legislation stated, financial institutions would not be able to continue lending during periods of restricted credit and remain solvent without such flexible authority. Both of these Federal actions reflect the policy decision of the Congress to assure the continued availability of funds rather than to allow state usury laws to effectively preclude lending activity.

Suggested modifications to S. 1988

We suggest that the language of S. 1988 be clarified as to the penalties imposed upon lending institutions for usurious transactions. Section 86 of Title 12 of the United States Code provides that, if a national bank knowingly charges a rate of interest greater than the rate allowed under 12 U.S.C. 85, the bank shall forfeit the entire interest of the note. The proposed bill contains a similar provision regarding all other lenders. Under Section 86, the borrower paying the usurious rate of interest or his or her legal representatives may also recover twice the amount of the interest paid through an action brought within 2 years from the time the usurious transaction occurred.

The language of the proposed law differs slightly, however, from that of Section 86. The bill provides that: "If a 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 2 years after the date of such payment * * *." Our concern lies with two small points. First, the language of S. 1988 may only permit recovery by the person paying the usurious amount of interest. Second, the language of S. 1988 provides a seemingly different statute of limitations than does 12 U.S.C. 86. The statute of limitations provided in S. 1988 begins to run when the last payment is made. In contrast, under 12 U.S.C. 86 the statute of limitations begins to run "from the time the usurious transaction occurred." It is the apparent intent of the bill to provide similar interest rate flexibility to national banks and other financial institutions. We suggest in order to minimize confusion among borrowers and differing institutions that the language of S. 1988 be modified to provide for identical penalties for usurious transactions.

CONCLUSION

We believe that a competitive marketplace in which all providers of a financial service may compete on an equal footing is a desirable goal to pursue. While S. 1988 is a significant step forward, it does not lessen the urgency of working towards the removal of all artificial credit restraints on financial institutions. In proceeding with an orderly phaseout of antiquated usury laws, we must be mindful, as well, of the legitimate concern for the small, financially weak borrower who may fall prey to disreputable lending practices. In those parts of the country where credit markets are not yet reasonably competitive, the need to safeguard the rights of those most vulnerable is pressing.

We would welcome the opportunity to work with the committee in resolving these difficult issues.

The CHAIRMAN. Is Mr. Black here?

Mr. BLACK. Yes, sir.

The CHAIRMAN. Fine. You can go right ahead, sir.

STATEMENT OF HAROLD A. BLACK, MEMBER OF THE BOARD, NATIONAL CREDIT UNION ADMINISTRATION

Mr. BLACK. Thank you, sir.

Mr. Chairman, members of the committee, I am pleased to be here today to testify on behalf of the National Credit Union Administration on S. 1988, a bill to equalize competition between State and National banks and for other purposes.

It is indeed ironic that we face today a usury law problem of such a nature that it is actually doing a disservice to the very

people it was designed to protect. I am sure that the drafters of most such usury statutes could not have foreseen the day when these protections would, through a series of rapid economic changes, turn into obstacles in the course of doing business. Clearly, legislative remedies to this situation should be sought. In the past, State usury laws were an appropriate exercise in State economic self-determination. However, as our Nation and its economy have evolved, these ceilings are now affecting interstate commerce and monetary policy implementation, powers reserved to the Federal Government by the U.S. Constitution. Money flows caused by such ceilings no longer recognize State boundaries which results in distortions of the money flows and in the availability of credit. For both constitutional and economic reasons, unrealistic usury ceilings should no longer be permitted to cause such interference.

The bill before us today would address this situation by granting to all State chartered financial institutions, including credit unions, the same latitude enjoyed by national banks. Federal credit unions do not appear to be covered by the present language of this bill. The bill, if so enacted, would certainly address the parity issue and I am supportive of those efforts. Clearly, such unintended inequities should be promptly addressed, and S. 1988 would appear to be a good vehicle to accomplish this purpose.

In our deliberations on this issue, it became apparent that there were additional dimensions to the matter of loan rate ceilings for financial institutions especially with regard to credit unions.

LOAN RATE CEILINGS

The first pertains to the subject of loan rate ceilings in general. It has been our observation that loan rate ceilings, while meritorious in purpose, may actually be losing their value in addition to causing unforeseen problems. Certainly, the Truth-in-Lending Act coupled with the rapid growth of consumer education has made it less likely that the magnitude of the unscrupulous loan activities which prompted usury ceilings would again be reached. There is an ever-increasing sophistication among both borrowers and savers. Additionally, the ceilings themselves have always constituted an artificial restraint on the free market system. Finally, there is a very undesirable effect which occurs as market rates approach the ceilings; namely, credit rationing. The 30 studies we have examined indicated that loan rate ceilings tend to restrict the supply of credit and result in the kind of rationing that excludes the less qualified borrower from the market. We have not determined what the magnitude of this effect is among credit unions, but for institutions chartered to provide loans to persons of moderate means this could certainly be an undesirable outcome.

The second dimension which became apparent, Mr. Chairman, pertains to the statutory 12 percent—1 percent per month—ceiling for Federal credit unions. I would point out that when Congress established the 12-percent ceiling, small personal loan rates were 40 percent or more while bank rates on short-term loans to their most creditworthy customers were consistently below 6 percent, rates on money market instruments never rose above 5 percent, and personal savings account rates were limited by regulation Q to

3 percent or less. By comparison, in today's market, the credit union ceiling would be over 20 percent.

Credit unions are primarily consumer lenders and, as such, are offering consumer loans in an environment of an 18-percent rate charged on most credit cards and many other consumer loan rates up to 36 percent. Each shortage of loans at 12 percent undoubtedly will mean many additional loans at unnecessarily high rates as credit union members do their borrowing elsewhere. Contrary to the congressional mandate for credit unions to be a source of credit to their members, the ceiling will continue to force credit unions to lend to banks and the Government instead of their members. Increasing pressures would result in credit unions becoming more of a conduit than a lender.

Not coincidentally, Mr. Chairman, the National Credit Union Administration has been studying the problems, current and anticipated, with respect to Federal credit unions and the statutory ceiling of 1 percent per month. After noting the increase in requests for conversions to State charters, the reduction in loan activity, the persistent outflow of shares, the increased investment activity, an updated economic assessment from our office of policy analysis, further communications from the credit unions themselves, and, particularly the regulatory actions taken last week, the chairman of the NCUA Board last Friday sent a communication to you, Mr. Chairman, and the chairman of the House Banking Committee in which the latest information on this situation was made available to the committee members.

NEW TIME DEPOSIT

The most significant regulatory action taken last Friday was the creation of a new time deposit with no minimum denomination, a maturity of 2½ years or more, and bearing an interest rate tied to the yield on Treasury securities maturing in 2½ years. The most recent yield on such Treasury securities is 11.4 percent. When this is viewed in light of the statutory 12-percent ceiling, a new urgency is introduced into this issue. It appears to me that further steps may be necessary beyond including Federal credit unions in the provisions of S. 1988.

The CHAIRMAN. Mr. Black, can you finish in a minute or two?

Mr. BLACK. Yes, Mr. Chairman. I thank you for the opportunity to comment on this legislation and I thank you for your indulgence in permitting me to expand the scope of the proposal to include this related and important matter pertaining to Federal credit unions. I will be happy to answer any questions you might have.

[Complete statement follows:]

TESTIMONY OF HAROLD A. BLACK, BOARD MEMBER, NATIONAL CREDIT UNION ADMINISTRATION

Mr. Chairman, members of the Committee, I am pleased to be here today to testify on behalf of the National Credit Union Administration on S. 1988, a bill to equalize competition between State and national banks and for other purposes.

It is indeed ironic that we face today a "usury law" problem of such a nature that it is actually doing a disservice to the very people it was designed to protect. I am sure that the drafters of most such usury statutes could not have foreseen the day when these protections would, through a series of rapid economic changes, turn into obstacles in the course of doing business. In some States, because State chartered

financial institutions have been forced to radically reduce lending due to the interest ceilings, national banks are the only source of loans. This has occurred because of the 1933 statute which permits national banks to charge 1 percent above the discount rate. Such an event is an obvious distortion of the usury protections as well as a restriction on the free enterprise system. Clearly, legislative remedies to this situation should be sought. In the past, State usury laws were an appropriate exercise in State economic self determination. However, as our Nation and its economy have evolved, these ceilings are not affecting interstate commerce and monetary policy implementation, powers reserved to the Federal Government by the U.S. Constitution. Money flows caused by such ceilings no longer recognize State boundaries which results in distortions of the money flows and in the availability of credit. For both constitutional and economic reasons, unrealistic usury ceilings should no longer be permitted to cause such interference.

The bill before us today would address this situation by granting to all State chartered financial institutions, including credit unions, the same latitude enjoyed by national banks. Federal credit unions do not appear to be covered by the present language of this bill. The bill, if so enacted, would certainly address the parity issue and I am supportive of those efforts. Clearly, such unintended inequities should be promptly addressed, and S. 1988 would appear to be a good vehicle to accomplish this purpose. As far as State chartered credit unions are concerned, our research shows that, if national banks are permitted to charge up to 13 percent, there would be 12 States in which state credit union/national bank inequities would exist unless this legislation were enacted.

Additional issues

However, in our deliberations on this issue, it became apparent that there were additional dimensions to the matter of loan rate ceilings for financial institutions especially with regard to credit unions.

The first pertains to the subject of loan rate ceilings in general. It has been our observation that loan rate ceilings, while meritorious in purpose, may actually be losing their value in addition to causing unforeseen problems. Certainly, the Truth-in-Lending Act coupled with the rapid growth of consumer education has made it less likely that the magnitude of the unscrupulous loan activities which prompted usury ceilings would again be reached. There is an ever increasing sophistication among both borrowers and savers. Additionally, the ceilings themselves have always constituted an artificial restraint on the free market system. Finally, there is a very undesirable effect which occurs as market rates approach the ceilings; namely, credit rationing. The 30 studies we have examined indicate that loan rate ceilings tend to restrict the supply of credit and result in the kind of rationing that excludes the less qualified borrower from the market. We have not determined what the magnitude of this effect is among credit unions, but for institutions chartered to provide loans to persons of moderate means this could certainly be an undesirable outcome.

Federal credit unions

The second dimension which became apparent pertains to the statutory 12 percent (1 percent per month) ceiling for Federal credit unions (12 U.S.C. 1757) and the related effects which S. 1988 might produce. I would point out that when Congress established the 12 percent ceiling, small personal loan rates were 40 percent or more while bank rates on short-term loans to their most creditworthy customers were consistently below 6 percent, rates on money market instruments never rose above 5 percent and personal savings account rates were limited by Regulation Q to 3 percent or less. By comparison, in today's market, the credit union ceiling would be over 20 percent. While the bill does achieve parity between State chartered institutions and national banks, it produces other results when comparing State chartered credit unions to federally chartered credit unions. According to our information, the credit union interest rate picture as it currently exists would be as follows:

Interest rate ceilings

[National banks 1 percent above discount rate assume current rate of 12 percent + 1 percent = 13 percent]

Federal credit unions, all States (percent)	12
States with credit unions below 12 percent	1
States with credit unions at 12 percent	18
States with credit unions above 12 percent	28

(There are four States with not credit union laws; Puerto Rico is included in this table.)

As can be seen from this table, there currently exist two imbalances; one between credit unions and national banks and one between State and federally chartered credit unions. At present, all Federal credit unions have a lower ceiling than national banks; 19 States are lower than national banks and 28 States are above Federal credit unions.

The following would occur if S. 1988 were enacted:

Interest rate ceilings

[National banks 1 percent above discount rate assume current rate of 12 percent + 1 percent = 13 percent]

Federal credit unions, all States (percent)	12
States with credit unions below 12 percent	0
States with credit unions at 12 percent.....	0
States with credit unions above 12 percent ¹	47

¹In this case, 13 percent or higher.

As can be seen, the problem of parity between national banks and State credit unions is resolved; the inequity between Federal credit unions and national banks remains; and the inequity between Federal credit unions and State credit unions is increased by 19 States to a total of 47 creating a further imbalance.

Finally, there is the problem which would exist even if Federal credit unions were included in the provisions of S. 1988. Credit unions are primarily consumer lenders and, as such, are offering consumer loans in an environment of an 18 percent rate charged on most credit cards and many other consumer loan rates up to 36 percent. Each shortage of loans at 12 percent undoubtedly will mean many additional loans at unnecessarily high rates as credit union members do their borrowing elsewhere. Contrary to the Congressional mandate for credit unions to be a "source of credit" to their members, the ceiling will continue to force credit unions to lend to banks and the Government instead of their members. Increasing pressures would result in credit unions becoming more of a conduit than a lender.

Not coincidentally, Mr. Chairman, the National Credit Union Administration has been studying the problems, current and anticipated, with respect to Federal credit unions and the statutory ceiling of 1 percent per month. The NCUA Board has on two occasions received presentations on this matter from our Office of Policy Analysis. There is little doubt that Federal credit unions are experiencing significant pressures which are aggravated by the 12 percent ceiling. After noting the increase in requests for conversions to State charters, the reduction in loan activity, the persistent outflow of shares, the increased investment activity, an updated economic assessment from our Office of Policy Analysis, and further communications from the credit unions themselves, the Chairman of the NCUA Board is preparing a communication to you Mr. Chairman and the Chairman of the House Banking Committee in which the latest information on this situation is to be made available to the Committee members. The economic conditions appear to have reached the point where Congressional reexamination of the traditional credit union principle of not exceeding 1 percent per month may be necessary.

I recognize that this is a serious departure from a very fundamental provision of the Federal Credit Union Act and we are, of course, hopeful that economic conditions can somehow return to a level that would make this request unnecessary. Unfortunately, our assessment of the economic forecasts does not permit us the option of further waiting on this matter in the hope that the pressure might actually diminish.

I might point out a further problem that has arisen with respect to the 12 percent ceiling. This is in the area of real estate lending. Public Law 95-22 granted to Federal credit unions the new power to make long term real estate loans. Not only has the 12 percent ceiling seriously hampered Federal credit unions in making such loans, but, further, the statute actually reads: "1 percentum per month inclusive of all service charges" which does not readily lend itself to the traditional nature of a real estate loan and its associated charges.

Mr. Chairman, I thank you for the opportunity to comment on this legislation and I thank you for your indulgence in permitting me to expand the scope of the proposal to include this related and important matter pertaining to Federal credit unions.

The balance of my testimony addresses certain technical problems which are found in S. 1988 as it pertains to credit unions.

S. 1988

Sec. 104. As presently drafted, this does not clearly pertain to Federal credit unions. The section states that, "any State law notwithstanding," a federally in-

sured credit union may charge an interest rate on loans which is indexed at 1 percent above the local Federal Reserve discount rate. The section also specifically provides that state laws are preempted to the extent that they set a lower rate.

The specific mention of State laws would lead to a conclusion that this section affects only State loan interest rate ceilings and has no bearing on the 12 percent ceiling set for Federal credit unions in section 107(5)(A)(vi) of the Federal Credit Union Act (12 U.S.C. 1757).

We note, however, that there is nothing in section 104 of S. 1988 that expressly limits its effect to federally insured State chartered credit union. It provides that the rate prescribed may be changed if it exceeds the rate an insured credit union would otherwise be permitted to charge. Also, section 104 refers to the 90 day Federal Reserve discount rate in the district where the federally chartered financial institution is located. If, in fact, the intent is only to override State interest ceilings, I would suggest the following language:

"(f)(1) An insured state credit union may take, receive, reserve, and charge on any loan interest at a rate of not more than 1 percentum in excess of the discount rate on 90 day commercial paper at the Federal Reserve Bank in the Federal Reserve district where the credit union is located or at the rate allowed by the laws of the State, territory, or district where the credit union is located, whichever may be greater. Any contrary provision of a State constitution, statute or other law is hereby preempted for the purposes of this section.

If, however, it is the intent to include Federal credit unions, then I would suggest the following language: "(f)(1) An insured credit union may take, receive, reserve, and charge on any loan at a rate of not more than 1 percentum in excess of the discount rate on 90 day commercial paper at the Federal Reserve Bank in the Federal Reserve district where the credit union is located or at the rate allowed by section 107(5)(A)(vi), whichever may be greater, or, if an insured State credit union, the rate allowed by the laws of the State, territory, or district where the credit union is located, whichever may be greater. Any contrary provision of a State constitution, statute or other law is hereby preempted for the purposes of this section.

As a further comment, I would suggest that, in the event the Congress reaches a decision to amend the 12 percent ceiling provisions (sec. 107(5)(A)(vi)) for Federal credit unions, you might wish to consider granting the State credit unions whatever latitude is given to the Federals.

Sec. 204. It is my understanding that this section is primarily designed to clarify that when an insured credit union receives share or deposits, State usury laws will not have applicability to the rate of dividend or interest paid on those accounts. While the section applies to deposits and obligations of all insured credit unions, it has little practical effect on Federal credit unions as they are, by virtue of Federal preemption, presently not subject to State rate control laws. Also, it is important to note that the section applies to any "deposit or obligation" of an insured credit union. Thus, in addition to preempting State usury laws that might otherwise limit rates paid by insured credit unions on their shares or deposits, the section would preempt State usury laws applicable to all forms of borrowing by insured credit unions, including, for example, loans made by a credit union to another credit union that is federally insured, or certificates of indebtedness issued by an insured credit union.

Mr. Chairman, this concludes my prepared testimony. I will be pleased to answer any questions which you or the Committee members might have.

The CHAIRMAN. Thank you, Mr. Black. I might say, before we go to Mr. Janis, it's our view that the bill does apply to Federal credit unions. We could be wrong, however, and I'm delighted you called it to our attention. We will have clarifying language. After all, if you don't think it applies to credit unions, that's a reason for us to have a far clearer statute than we are proposing here.

Mr. Janis, go ahead.

STATEMENT OF JAY JANIS, CHAIRMAN, FEDERAL HOME LOAN BANK BOARD

Mr. JANIS. Mr. Chairman, I'm very pleased to appear before you today to testify on behalf of the Federal Home Loan Bank Board concerning S. 1988.

Mr. Chairman, I would like to submit the rest of my testimony for the record if I may.

The CHAIRMAN. Yes. Without objection, your testimony and all of the testimony of the panel will be submitted for the record. I apologize for this limitation, but we do want to have an opportunity to ask questions and we felt we could proceed more expeditiously this way.

[Complete statement of Mr. Janis follows:]

TESTIMONY OF JAY JANIS, CHAIRMAN, FEDERAL HOME LOAN BANK BOARD

Mr. Chairman, Members of the Committee, I am very pleased to appear before you today to testify on behalf of the Federal Home Loan Bank Board concerning S. 1988. We support strongly the objective of this legislation—to provide needed relief for borrowers and lenders living in states where artificial and unrealistic interest rate ceilings are imposed by law.

At the outset, I would like to summarize what the Bank Board regards as the adverse effects of mortgage usury laws. Our general findings are:

Usury ceilings discriminate.—Even when usury ceilings are close to the market-determined rate, they discriminate against people who do not qualify for prime mortgage loans, including those who seek lower downpayment mortgages. As the interest rate on prime mortgage loans approaches a State-imposed usury ceiling, only prime borrowers or those able to make high downpayments are able to obtain credit.

Usury ceilings make it harder to obtain housing.—As usury ceilings become generally binding, with all market mortgage interest rates above the usury ceilings, households seeking mortgages generally will be unable to obtain them, except to the extent that exemptions in the usury statutes permit such lending to be profitable. (Exemptions from the usury limit may include FHA and/or VA mortgage loans or mortgage loans sold in the secondary market.) With or without such exemptions, usury restrictions result in a decline in both housing construction and in the ability of households to buy or sell existing homes. The impact on housing construction is especially serious because of the Nation's unmet housing needs and the effect on unemployment in the construction industry. But it is also a matter of concern that, under a binding usury ceiling, even a sophisticated, knowledgeable person who believes that the prevailing interest rate is advantageous is prevented by law from obtaining a mortgage; and households that have to move because of job changes or other legitimate reasons are placed in a difficult situation.

Usury ceilings hurt depositories and threaten their Federal insurers.—Usury ceilings, when effective for prolonged periods, reduce the portfolio yield of depository institutions, adversely affecting the financial position of segments of the thrift industry. The result is to expose the Federal Government, through the FSLIC and the FDIC, to losses.

Usury ceilings hurt savers.—Usury restrictions, to the extent that they reduce portfolio yield and net worth, make it difficult for lending institutions to pay a market interest rate to savers except at serious risk to their safety and soundness.

Usury ceilings interfere with innovation.—Usury ceilings make it difficult for lending institutions to adopt mortgage innovations, such as variable rate mortgages and rollover mortgages, even though those innovations may be essential in an inflationary economy.

Usury ceilings shut off secondary market options.—Binding usury restrictions that lack the appropriate exemption prevent lending institutions from using the financial resources of two Federally chartered and sponsored secondary market corporations, namely FNMA and the Federal Home Loan Mortgage Corporation. These were set up specifically, as a matter of national policy, to channel funds into mortgage markets through the purchase of mortgages.

Before discussing these adverse effects in more detail, I would like to give a brief overview of usury restrictions. After the economic portion of my remarks, I will comment on specific provisions of the bill.

Overview of mortgage usury limits

The usual justification for usury limits is to prevent the charging of "exorbitant" rates of interest. This argument may have had some basis in the mortgage credit area when borrowers were poorly informed about mortgage interest rates available from different lenders and the number of lenders was limited. However, these conditions no longer hold. It is now an easy matter for borrowers to get quotations

on mortgage interest rates from different lenders by telephone. Borrowers can also usually obtain assistance on mortgage terms from the real estate brokers or builders with whom they are doing business. Furthermore, the number of competing sources of mortgage credit—S&Ls, banks, mortgage bankers—is enormous.

The fact is that usury ceilings on mortgage interest rates are an anachronism in a world in which mortgage lenders, including thrift institutions, are all affected by financial market forces and changes in open market interest rates. Usury ceilings are a futile attempt by states to protect mortgage borrowers from the impact of economic trends. Such an attempt is unrealistic. Mortgage interest rates are, of necessity, related to other interest rates. Lenders find it necessary to adjust mortgage interest rates in order to keep the demand for mortgages in line with the supply of such money and to maintain a balance between the cost of funds and portfolio yield. At the present time, the cost of obtaining new funds is extremely high. This is a fact which lenders and States are powerless to affect. Trends affecting mortgage rates are nationwide in their impact and are the result of changes in the economy, the inflation rate, and Federal Reserve policy—areas over which lenders and individual states have no control.

Usury restrictions are, in fact, illusory. They appear to promise mortgage loans at no more than a maximum rate. In fact, however, they have effects that are adverse to borrowers, lenders, construction workers, and all those who earn their livelihood in the housing and housing credit markets.

Effect of usury limits on borrower classes

Usury limits are most likely to discriminate against less affluent or riskier classes of borrowers. This discrimination occurs before the ceiling becomes binding for all borrowers. As market interest rates approach the usury ceiling, the market yield on non-prime or riskier loans exceeds the usury limit. When this occurs, lenders redirect their lending toward only prime loans and require high downpayments that only higher income households can pay. Our evidence in table 1 indicates the impact on downpayments.

Table 1 presents effective mortgage interest rates for differing loan-to-value ratios (which are the converse of downpayments) for selected months in 1977, 1978, and 1979. The data show a consistent pattern that lenders, on average, expect to receive significantly higher interest rates on low downpayment loans. In 1977, the rate on a 95 percent loan averaged 0.39 percent above the rate on a prime 80 percent loan. This premium averaged 0.36 percent in 1978, and 0.33 percent in 1979.

TABLE 1.—EFFECTIVE MORTGAGE INTEREST RATES FOR DIFFERING LOAN TO VALUE RATIOS, 25 YEAR MATURITY

	[Loan to value ratio]				
	50 percent	75 percent	80 percent	90 percent	95 percent
January 1977.....	8.80	8.88	8.93	9.16	9.31
April 1977.....	8.78	8.87	8.91	9.13	9.30
July 1977.....	8.93	9.02	9.05	9.28	9.44
October 1977.....	8.92	9.00	9.04	9.26	9.45
January 1978.....	9.03	9.11	9.14	9.38	9.56
April 1978.....	9.30	9.37	9.41	9.62	9.78
July 1978.....	9.76	9.83	9.87	10.08	10.19
October 1978.....	9.89	9.95	9.99	10.18	10.32
January 1979.....	10.44	10.51	10.55	10.74	10.84
April 1979.....	10.58	10.65	10.70	10.90	11.02
July 1979.....	11.13	11.20	11.26	11.48	11.59
October 1979.....	11.54	11.60	11.64	11.90	12.00

Source: Federal Home Loan Bank Board, Monthly Series on Commitment Rates and Lending Policy on Conventional Home Mortgages, National Average for All Major Types of Lenders.

TABLE 2.—DISTRIBUTION OF FIRST-TIME HOMEBUYERS BY AGE, INCOME, AND PERCENTAGE DOWNPAYMENT ON MORTGAGE LOANS ¹

(Downpayment as a percentage of home purchase price)

	5 percent	5.1 percent to 10 percent	10.1 percent to 19.9 percent	Total less than 20 percent	Percentage of first-time homebuyers in age group
Age of first-time homebuyers:					
18 to 29.....	5.5	26.2	20.0	51.7	62.9
30 to 39.....	5.9	19.6	17.0	42.5	26.2
40 to 49.....	4.3	16.8	13.0	34.1	7.0
50 and over.....	0.8	11.0	10.2	22.0	3.9
Annual income of first-time homebuyers:					
Less than \$15,000.....	5.6	23.2	15.9	44.7	22.0
\$15,000—\$24,999.....	6.4	27.4	20.7	54.1	49.3
\$25,000—\$34,999.....	4.6	18.8	54.1	40.7	18.3
\$35,000 or more.....	2.9	11.6	49.3	29.3	10.4

¹ Based upon a national survey of 8,500 purchasers of single-family homes who obtained conventional mortgages at savings and loan associations during 1977.

Source: Homeownership: Affording the Single-Family Home, U.S. League of Savings Associations, Economics Department.

As market rates approach usury ceilings, lenders stop making low downpayment loans. This primarily affects low and moderate income households and first-time homebuyers. This is brought out by table 2, which shows the greater dependence of these borrower classes on low downpayment loans.

Given the average magnitude of the risk premium on low downpayment loans and the normal dispersion of interest rates within a market, households seeking a low downpayment mortgage experience difficulty in obtaining a mortgage when the prime mortgage rate is below the usury ceiling. This is an important point to emphasize since it indicates that a usury ceiling has adverse effects even if it is still moderately above the average market interest rate.

Impact on lending volume and housing starts

Economic studies have found that usury limits have a significant depressing effect on both lending activity and housing construction in those States that have restrictive ceilings, even with the exemptions that some of the statutes provide for FHA and/or VA mortgage loans or secondary market sales. These studies may well understate the full restrictive impact of usury ceilings since most deal with only one type of lender, in particular, S&Ls. The studies would probably show an even greater falloff in lending if the lending data included diversified lenders, such as commercial banks, life insurance companies, and pension funds, which generally cease making mortgage loans in States with restrictive usury ceilings and channel additional funds into securities or commercial and industrial loans. The reduction in mortgage lending by savings and loan associations and other thrift institutions as a result of usury restrictions is proportionately less because of the asset restrictions placed on savings and loan associations. These restrictions arise principally through Section 593 of the Internal Revenue Code. However, those thrift institutions located in restrictive usury States will seek to purchase out-of-State loans or participations in such loans during periods when the usury constraints are effective; and, indeed, they are forced to do so because of the high cost of obtaining funds. Ironically, restrictive usury laws drive money out of the States which have such laws.

During the current economic period, some thrift institutions in restrictive usury States emphasize FHA and VA lending because these loans are in many cases exempt under State law from the usury ceiling; but FHA mortgages have restrictive limits on the mortgage amount, and the requirement that sellers must pay points charged above 1 percent often creates obstacles to the use of FHA-VA financing.

It is somewhat more difficult to project the impact of usury ceilings on housing starts, but most studies do suggest an adverse impact. Based on some estimates, usury limits could depress U.S. housing activity in 1980 by approximately 5 percent or about 85,000 units. Usury ceilings which are effective for a prolonged period undoubtedly result in a smaller housing stock. This occurs because new housing

construction is deferred. An older and lower quality housing stock results if substantial new construction is deferred for long periods of time. At present, 15 States have fixed usury limits at or below 12 percent. These States are: Washington, Oregon, Hawaii, Arizona, Louisiana, North Dakota, South Dakota, Texas, Kansas, Arkansas, New York, New Jersey, Mississippi, New Mexico, and Wisconsin. While there are a number of exemptions in some of the statutes in these States, especially with regard to FHA-VA loans and loan sales, these exceptions hardly eliminate the restrictiveness of the usury laws, although they dampen them somewhat. Indeed, the exemptions, to the extent they exist, are a recognition of the adverse effects of usury limits.

As a group, States with restrictive usury ceilings accounted for 30 percent of U.S. housing starts in 1978. Almost one-third of this total is attributable to Texas.

Let me turn briefly now to some of the specific studies on the effect of usury statutes. My description of the results will have to be cursory, but I will footnote each study.

Robins study

A study by Philip Robins¹ estimated that housing starts would be between 16 percent and 28 percent lower in SMSA's with "unduly" low usury ceilings. His study was based on a sample of 77 SMSA's for 1970.

France study

A study by Charles France² used a model based on the Philadelphia SMSA. His was a time series analysis, and he concluded that lending by S&L's declined by 23 percent when the usury limit was 100 basis point below market rates. France estimated his model over a period when the Pennsylvania usury law was particularly binding.

Ostas study

James Ostas³ arrived at similar conclusions regarding the effect of usury laws. He estimated that a 100 basis point differential between the unconstrained mortgage rate and the usury ceiling reduces housing permit activity by 14.4 percent. Ostas estimated his model using quarterly observations on fifteen large SMSA's over the 1965 to 1970 period.

McNulty study

McNulty⁴ has recently estimated a model of both lending volume and housing activity in Georgia. He used a time series model estimated over the 1966-1977 period. McNulty's conclusion was that usury limits 100 basis points below the unconstrained rate would decrease lending activity by 12.6 percent. McNulty did not find a significant relationship between the rate spread and building permit activity in Georgia over the sample period. He speculates that the reason for this is the fact that the Georgia usury limit was not severely binding at any point during the estimation period.

Floating ceilings

I would like to comment briefly now on one type of usury ceiling. A number of States have floating usury ceilings designed to cause the ceiling to change in tandem with the market. These limits have no long-term adverse effects on housing markets if the ceiling is sufficiently above a suitable index rate. Two states, Vermont and West Virginia, have floating ceilings at very narrow spreads over the index rate, thus resulting in maximum rates that are below the market rate. In some States, the index rate used does not appear appropriate. The mechanics of floating ceilings also cause temporarily binding usury limits in some States. This occurs where the limit is adjusted quarterly instead of monthly or if there are limits on the size of the periodic change in the ceiling rate.⁵ One might ask the question of what sense floating usury ceilings make, on economic grounds, as an alternative to the outright abolition of usury ceilings.

¹ Philip K. Robins, "The Effects of State Usury Ceilings on Single Family Homebuilding," *Journal of Finance*, March 1974.

² Charles L. France, "Pennsylvania's Floating Usury Ceiling: An Economic Evaluation," Working Paper No. 1, Federal Home Loan Bank of Pittsburgh, August 1975.

³ James R. Ostas, "Effects of Usury Ceilings in the Mortgage Market," *Journal of Finance*, June 1976.

⁴ James E. McNulty, "A Reexamination of the Problem of State Usury Ceilings: The Impact in the Mortgage Market" Federal Home Loan Bank Board, Invited Working Paper No. 21, March 1979.

⁵ For a complete discussion of such statutes see, Jean M. Lovati and R. Alton Gilbert, "Do Floating Ceilings Solve the Usury Rate Problem?" Review Federal Reserve Bank of St. Louis, April 1979.

Impediment to use of alternative mortgage instruments

In an inflationary economy, the traditional long-run fixed rate mortgage loses much of its appeal and poses significant risks to lenders restricted to such mortgages. Unfortunately, restrictive usury ceilings discourage lenders from offering alternative mortgages that require an adjustment in the interest rate periodically, even though such adjustment is symmetrical, i.e. both downwards as well as upwards. Lenders obviously will not offer a mortgage where meaningful upward adjustments in the interest rate are not permitted because of usury restrictions but where downward adjustments are subject to no limitation.

Realistically, we must expect that in an inflationary economy, with high and fluctuating interest rates, many lenders will be more willing to offer mortgages that provide some protection from the risks inherent in fixed rate long-term mortgages. Many institutions already offer variable rate mortgages or rollover mortgages, either with short maturities, such as 5 years, or renegotiation of the interest rate after 5 years or some similar period. The freedom to offer such mortgages contribute to safety and soundness in an inflationary economy. Borrowers also benefit because of the wider choice of mortgage instruments and the fact that interest rates fluctuate in both directions.

The continuation of restrictive usury ceilings will likely lead to a two-tier mortgage system in which alternative mortgage instruments will become increasingly more common in non-usury States but will be unavailable in most usury law States. Lending institutions in States with restrictive usury ceilings can even be expected to offer alternative mortgage instruments outside of their own State. The effect will be to provide a further incentive for lenders to avoid making mortgage loans in their own State where the usury statute poses a future as well as present threat to the ability to adjust mortgage interest rates on alternative mortgage instruments.

Usury ceilings and thrift viability

The legacy of restrictive usury laws has undesirable implications for the elimination or liberalization of deposit interest rate ceilings. Thrift associations located in States that have a long history of restrictive usury ceilings may not be able to afford the likely increased deposit costs and the more volatile cost of funds associated with a removal of rate control. In other words, the income on the mortgage portfolio may be insufficient to pay increased deposit costs without incurring significant losses for a large fraction of S&L's in the restrictive States.

There are two alternative results. The first is that this could prevent the elimination of rate control ceilings, with concerns about the solvency of a segment of the industry dictating policy for a much larger segment of the industry. The second is that it may result in insolvency of some thrift institutions if ceilings are liberalized or removed. Below-market mortgage loans constitute a large proportion of the portfolio in restrictive usury States, and this problem is aggravated as restrictive usury ceilings persist. The risk of insolvency poses a threat to the financial resources of the FSLIC and FDIC. We believe it is highly inequitable that Federal agencies drawing on the resources of all Americans must bear the risks engendered by usury laws imposed by individual States.

Access to secondary markets

As noted above, some usury laws exempt mortgage originations that are to be sold in the secondary market. These exemptions ease the restrictiveness of usury laws, although not entirely, since they do not permit depository institutions to originate mortgages at market rates in their own States for their own portfolios. Where these exemptions do not exist, the impact of usury ceilings is even more onerous because they prevent lending institutions from obtaining any funds from the two federally chartered or sponsored secondary market facilities: The FNMA and the FHLMC.

The practical impact is that these organizations, which were set up to provide a secondary market for mortgages, cannot purchase mortgages in States with binding usury restriction. The usury restrictions then have the perverse effect of shutting off these important sources of funds and offsetting national policy designed to cushion the flow of housing credit.

Comments on S. 1988

Turning to the specifics of S. 1988, the bill would do two basic things. First, it would allow Small Business Investment Corporations, and all depositories insured by the FDIC, FSLIC, or NCUA to charge interest on loans at rates equal to the greater of (1) whatever is permitted under State law, or (2) 1 percentage point above the local Federal Reserve Bank discount rate on 90-day commercial paper. This ability is at present enjoyed only by national banks. In Arkansas, however, business and commercial loans of \$25,000 or more could, until July 1, 1981, be made at a rate

up to 5 percentage points in excess of FRBank 90-day discount rate, since § 302 explicitly states that the provisions of S. 1988 would be in addition to, and not supersede, those of Public Law 96-104. Knowing violations of applicable Federal maximums would result in forfeiture of all interest, and the bill would create a civil remedy for recovery of double the amount of unlawful interest actually paid.

The second fundamental feature of the bill is that it would provide that Fed members and their affiliates, FDIC-insured Fed nonmembers and their affiliates, NCUA-insured credit unions and their affiliates, and FHLBank members (and nonmembers) and their affiliates, would be unable to claim the protection of State usury laws with respect to their deposits or other obligations. State civil and criminal penalties otherwise applicable in such instances would be of no effect.

The preemptions of State law mandated by the bill would be effective until such time as State legislatures adopted laws stating, in effect, that the Federal override was not wanted.

The bill is thus different in several important respects from the usury preemption provisions contained in H.R. 4986 (and H.R. 4998, which is virtually identical). To begin with, S. 1988 applies to all extensions of credit by affected lenders, while H.R. 4986 applies preemption only to loans secured by first liens on residential real property and to business and agricultural loans of \$25,000 or more. With respect to mortgages, however, the H.R. 4986 preemption could apply to a greater number of cases, including, in addition to loans made by the entities covered in S. 1988, loans eligible for purchase by the FNMA or the FHLMC, and loans made by creditors that make annually more than \$1 million in mortgage loans. We would like to see S. 1988 incorporate these particular provisions of H.R. 4986.

An important point on which the H.R. 4986 approach is preferable, is its refusal to impose any ceiling on first mortgage loan rates, in contrast to the S. 1988 ceiling of the 90-day discount rate plus 100 basis points. While we could live comfortably with the latter limitation, we strongly believe that a healthier economic environment would be generated by permitting the market place to dictate rates. It has been our experience that there are occasions when economic circumstances set the market rate for mortgages above the Federal ceiling that S. 1988 would impose. Over the last several months, the market rate for mortgages in some areas has been above 13 percent. In the Bank Board's view, the most desirable approach is to impose no mortgage interest ceilings, but, if ceilings are seen as necessary, to set a figure 500 basis points above the 90-day discount rate, instead of 100 basis points, in order to minimize the risk that unexpected economic developments will have unnecessarily harsh consequences for the mortgage markets and housing. We note that the 500 basis points approach is utilized with respect to business and agricultural loans of \$25,000 or more in H.R. 4986, H.R. 4998 and Public Law 96-104.

Another feature of H.R. 4986 we find more desirable than its S. 1988 counterpart is the provision permitting State override of mortgage usury preemption only if exercised within 2 years after the bill's enactment. S. 1988 would leave the override possibility open indefinitely. The Bank Board recognizes that considerations of comity weigh in favor of permitting States to reimpose interest ceilings if they choose. In our view, however, this choice should not be left open indefinitely, but should be foreclosed after a reasonable period of time. That usury ceilings sufficiently affect interstate commerce to justify Congressional action is to us clear; we believe that Congress should exercise in a permanent and unequivocal way its power to guarantee the American people a freely functioning national market place.

An aspect of the State override provisions we find undesirable in both bills is that such overrides would be allowed with respect to preemption of State ceilings pertaining to deposits of depositories. H.R. 4986, in Title VI, contains an expiration date for of this preemption, as well as for override in the interim; in a possible contradiction, however, it provides in Title II for absolute, permanent Federal preemption. In our view, the deposit interest area has long been preempted for Federal Home Loan Bank members by 12 U.S.C. 1425b, which provides, in pertinent part, that "the Board may * * * prescribe rules governing the payment and advertisement of interest * * * on deposits[.]" and pursuant to which the Bank Board has adopted a regulation (12 CFR 526.3) setting maximum limits that member institutions may pay on deposits. By passing a state override or Federal preemption termination provision covering deposits, Congress would not just be letting States reexercise a traditional prerogative, as would be the case with an override covering loans. Rather, it could be regarded as giving each State rate-control authority over deposits, not just of State-chartered institutions, but of national banks and Federal S&Ls as well. We regard this novel possibility as extremely undesirable. Few things could be more damaging to the smooth functioning of our national financial system than fragmenting responsibility for establishing deposit rate ceilings among the 50

State legislatures. Accordingly, we urge that the State override provisions in S. 1988 pertaining to deposit interest be eliminated.

In conclusion, we regard S. 1988 as a valuable initiative toward solving the problems of economic distortion and hardship—particularly in the mortgage credit and housing areas—engendered by State usury ceilings. Although the bill's preemption of State mortgage usury laws would not go quite as far as we might hope, we believe it would exercise a beneficial effect on credit availability under all but very unusual economic conditions. As I have indicated, our only major reservation regarding the bill concerns its potentially mischievous language on the subject of State override of Federal preemption in the area of deposit interest ceilings.

This concludes my remarks. I will be happy to answer any questions you might have.

The CHAIRMAN. Governor Schultz, go right ahead, sir.

**STATEMENT OF FREDERICK H. SCHULTZ, VICE CHAIRMAN,
FEDERAL RESERVE BOARD**

Mr. SCHULTZ. Mr. Chairman, I will just submit my written statement for the record and briefly synopsise it.

A majority of the Board supports the general thrust of Senate bill 1988. There are some members of the Board who have very serious concerns about the preemption problem. I think all of the members of the Board are concerned about the preemption aspect. Some feel that it is a serious enough situation for them not to favor the bill, but a majority of the Board does favor it.

LAWS USELESS OR COUNTERPRODUCTIVE

All of the members of the Board have very serious concerns about usury laws. Clearly, such laws tend to be either useless or counterproductive. So we very strongly support the general thrust of attempting to do away with usury laws. But there are certain members of the Board who feel that the issue is still, even under these circumstances, best left to the States. Others, a majority of the Board, feel that the situation is critical enough to support the general thrust of this legislation.

In addition, we do have very serious concerns about tying the ceiling rate to the Federal Reserve discount rate. We feel that it is important that the ceiling rate be tied to a market rate rather than to an administered rate. We recognize, of course, that the national banks are already tied to the discount rate. We would hope that that whole situation could be rethought, however. Not only is the discount rate a monetary policy tool that should not be constrained, it is also an administered rate that does not necessarily mirror conditions in the market. So we would very strongly urge that this particular aspect of the bill be thoroughly considered.

With those caveats, Mr. Chairman, a majority of the Board supports the general thrust of the bill.

The CHAIRMAN. Thank you very much, Governor Schultz.

[Complete statement follows.]

**STATEMENT BY FREDERICK H. SCHULTZ, VICE CHAIRMAN, BOARD OF GOVERNORS OF
THE FEDERAL RESERVE SYSTEM**

I am pleased to appear before the Senate Banking Committee today to present the views of the Federal Reserve Board on S. 1988. This bill would grant additional lender groups the authority, now limited to national banks, to set loan rates up to 1 percentage point above the Federal Reserve discount rate regardless of any State

law stipulating a lower ceiling. In addition, it would permit any State to reimpose its State usury limits by enacting overriding legislation. Another provision of the bill, also subject to State override, specifies that rates paid on deposits would be exempt from State usury regulation.

The Board has long been concerned about the adverse impact that usury ceilings can have on the availability of funds in local credit markets, and has frequently stated its opposition to such artificial constraints. In general, regulatory limits on loan charges tend either to have little or no effect (when market-determined rates are at or below the ceiling) or to be counterproductive (when market-determined rates are above the ceiling). When nominal market interest rates are high, as at present, usury ceilings typically distort credit flows by inducing lenders to channel funds into assets or geographic areas less affected by ceilings. Nonprice lending terms in restrained markets may be tightened severely to compensate for the relatively low nominal interest rates that can be charged, and credit may become totally unavailable except to the most highly qualified borrowers.

Because of the Board's view that credit markets function most effectively when allowed to operate as freely as possible, we support in principle the removal of impediments posed by usury laws. Nevertheless, serious concern has been expressed by some Board members about Federal preemption of State law. Also, the Board strongly recommends against tying ceiling rates to the Federal Reserve discount rate. The Board believes that a more effective long-range solution to rate ceilings should continue to be sought—for national as well as State banks and other institutions. While a majority of the Board feels that S. 1988 can be supported as a stop-gap measure, we urge that a more appropriate reference rate than the Federal Reserve discount rate be selected, and that a sufficient differential above that rate be specified to allow more adequate flexibility in various credit markets.

Many members of the Congress are understandably reluctant to preempt State laws or constitutional provisions. The Board also feels that corrective action at the State level would be the most desirable way to redress the counterproductive effects of State usury laws. Quite a few States, in fact, have already revised their usury or other lending statutes since the beginning of this year, although some revisions have been outdated by subsequent market developments. Further State action would await the next legislative sessions or, as in Arkansas, the process of constitutional amendment.

S. 1988 would immediately address the market dislocations due to rate ceilings in any State. As noted earlier, it also would honor State prerogatives by enabling legislatures to reject the rate flexibility provisions of this bill through passage of a new State law reaffirming existing regulations. In the view of the majority of the Board, this approach would provide adequate preservation of State authority to regulate lending practices. However, some members of the Board have strong reservations about endorsing legislation that would further encroach upon State powers.

The proposed bill would peg the maximum permissible lending rate at 1 percentage point above the discount rate on 90-day commercial paper prevailing in the Federal Reserve district in which a lending institution is located. The Board recognizes that this formulation has applied to national banks since 1933. Nevertheless, we have strong reservations about it, and I would like to invite your further reflection upon the advisability of indexing loan rate ceilings to the discount rate.

The Federal Reserve discount rate is a short-term rate; by comparison, many of the target credit markets of the proposed bill involve long-term lending, such as home mortgage loans, as well as shorter-term credit. It is unusual for interest rates across maturity categories to be patterned in such a way that a 1 percentage point markup over the discount rate would provide much practical relief from usury ceilings in all markets. Even now, with the discount rate a historically high 12 percent, a one percentage point markup would leave the ceiling lending rate below average home mortgage rates in many areas. Moreover, the discount rate is an administered rate, not a market rate, and may not always closely reflect levels or movements even of short-term market rates. In general, we feel it unwise to single out a tool of monetary policy for a purpose, such as indexing, not directly policy related.

As you know, other bills enacted or now under consideration by the Congress deal with restrictive state usury ceilings in somewhat different ways than S. 1988. The recently enacted Public Law 96-104, which in effect applies only to Arkansas, pegs permissible rates for business and agriculture loans of \$25,000 or more to the discount rate, but allows for a 5 percentage point differential. A provision in the proposed Financial Institutions Deregulation Act would remove usury ceilings on home mortgage loans altogether for a broad spectrum of lenders. In contrast to these approaches, the indexing formulation of S. 1988 provides relatively little relief

from State usury ceilings. We suggest as an alternative that outright removal of ceilings be considered, or if a ceiling is to be maintained, that a market rate of medium of long maturity be used as a reference rate, and that a markup be established to allow a wider degree of rate flexibility in the target credit markets.

In this connection, I would observe that experience with floating-rate usury ceilings in several States has shown that even a market rate of appropriate maturity may not always perform the pegging function in a fully satisfactory manner. Illinois, for instance, had employed a ceiling for residential mortgage loans that was 2½ percentage points above an index of long-term U.S. Government securities yields. However, yields required by lenders on home mortgage loans in unconstrained markets subsequently rose above this floating ceiling, and the volume of home mortgage lending in Illinois was curtailed. Consequently, in November of this year, the Illinois legislature suspended any ceilings on home mortgage rates through the end of 1981.

I would also note that the sponsors of S. 1988 have emphasized the goal of equalizing competition among national banks and other depository institutions. The Board shares the view that, in principle, similarly situated lenders should operate in similar regulatory environments. The bill would achieve partial competitive equality, inasmuch as the provisions now applicable to national banks would be extended to all federally insured State-chartered commercial and mutual savings banks, all federally insured savings and loan associations, certain federally insured credit unions, and all small business investment companies. However, various other lenders not covered by the proposal would remain without relief, including all life insurance companies, all mortgage bankers, and some credit unions.

In summary, because of the distortions in local credit markets that result from unreasonably low interest rate limitations, the Board strongly endorses efforts to remove the restraints of usury ceilings altogether. We would urge the States to reevaluate their usury laws in light of recent experience with historically high market rates, and are pleased to note that many States have been and are doing so. In view of the pressing need for some relaxation of usury ceilings and the time lapse before the scheduled opening of legislative sessions in several States, the majority of Board members supports S. 1988—subject to modification in order to incorporate a more appropriate reference rate than the Federal Reserve discount rate—as an interim measure until the States themselves or the Congress can provide a more satisfactory solution.

The CHAIRMAN. Chairman Sprague.

STATEMENT OF IRVINE H. SPRAGUE, CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

Mr. SPRAGUE. Thank you, Mr. Chairman. I will be brief.

We clearly have a serious disruption at this time. Telephone calls from our 14 regional directors last Thursday and Friday identified 23 States having varying degrees of problems. It's clear to us that something should be done. We have very serious reservations about writing permanent national policy to address what we hope will be a temporary aberration at this time.

We share the concerns that Governor Schultz expressed about the precedent for preemption of States rights. Our suggestion, I think the practical one, is to follow the line that the Senate has taken twice in the last few weeks, addressing the problem with some very definite time cutoffs in order to give the States, which clearly are aware that they have problems, an opportunity to act as they see fit. In that regard we would propose immediate enactment of the legislation with the July 1980 cutoff for those States that have the ability to act legislatively, and July 1981 cutoff for the States, that is, Arkansas, that have a constitutional problem.

The CHAIRMAN. Thank you, sir, and your statement will be printed in full in the record.

[Complete statement follows:]

STATEMENT OF IRVINE H. SPRAGUE, CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

Good morning Mr. Chairman, members of the Subcommittee.

We are here today to discuss legislation that would confer permanently on State-chartered banks the authority that national banks have enjoyed for 46 years to lend at a maximum interest rate of 1 percent above the discount rate, regardless of State law.

We support the thrust of this bill, S. 1988, but only as an emergency measure to meet a disruptive economic situation which some States themselves cannot deal with at this point.

We would note that at the time the national bank provision became part of the Banking Act of 1933, the Federal Government exercised no systematic supervisory or regulatory authority with regard to State-chartered banks unless such banks had voluntarily joined the Federal Reserve system. It was only with that landmark Banking Act of 1933, which established Federal deposit insurance for State-chartered as well as National banks, that Federal supervision and regulation of State non-member banks was also begun.

As a general principle, I am opposed to interfering in matters traditionally a State concern, such as usury laws. The present situation may be an exception, in a limited sense, because the current phenomenon of volatile, high market interest rates colliding with relatively low usury ceilings is causing severe distortion of fund flows.

After careful consideration, we have decided that the present circumstances justify our support of the bill with some limiting amendments. Specifically, any law should expire in July, 1981, to provide time for action by States with constitutional problems and by July, 1980, for States that can act by legislative means. We understand that several State legislatures and the District of Columbia already have taken action this year. More are in the process.

In short, it would be poor public policy to legislate permanently to address what we hope will be one of those temporary aberrations that unfortunately occur from time to time.

Without addressing the reasons for or the merits of usury ceilings, we all know the effects when market rates rise above usury limits.

Usury laws do work. The uncontested fact is they hold down rates. They also in some instances dry up the market. If usury ceilings apply only to certain classes of borrowers, lenders will tend to shift funds to loans not covered by the ceiling when market rates exceed the usury ceiling rates. In some cases, this could involve a shift from loans to other types of investments such as Treasury or Federal Agency obligations. In other cases it may mean making loans outside a normal trade territory in another State where the usury ceilings, if any, are higher. In extreme cases in some States where the ceilings apply broadly to most loans made by specific types of financial intermediaries, loanable funds in those institutions may dry up as savers and investors shift their money to market funds which can pay higher rates because their income is not inhibited by the lower usury ceilings.

However, it should be noted that usury ceilings are not the only State laws that restrict the flow of financial resources and discriminate against particular lending institutions. For example, New York, which also has a relatively restrictive usury ceiling, restricts the activities of savings banks in several important ways: New York savings banks may not make automobile and certain other consumer loans; they may not accept business deposits; they are subject to a more restrictive borrowing limitation and to more restrictive branching rules than other depository institutions in the State.

Provisions of S. 1988

S. 1988, as introduced, would permit State-chartered insured banks, Federal and State-chartered insured savings and loan associations, small business investment corporations, and Federal and State-chartered insured credit unions to charge 1 percent over the Federal Reserve discount rate (or the rate permitted by State law if that is higher) on all loans, notwithstanding State usury statutes. The bill would be permanent, but a State could at any time after its enactment make the Federal law inapplicable in that State by adopting legislation to that effect.

The purpose of S. 1988 is to achieve parity between the loan rates that may be charged by national banks and by State-chartered banks and other financial institutions.

Emergency relief

I would propose that the effective life of S. 1988 parallel that of Public Law 96-104, the Arkansas interim relief law, which provides for a temporary usury override on business and agricultural loans of \$25,000 or more until July 1, 1981, unless the voters act sooner on a constitutional proposition or the State legislature reimposes the ceiling.

The July, 1981, deadline—as well as a July, 1980, deadline for States with statutory ceilings—is also used in the nationwide counterpart to the Arkansas usury law that is contained in H.R. 4986 the omnibus banking bill now in conference.

Both deadlines occur again in another Senate passed measure, H.R. 4998, a stopgap extension bill, which also adopts certain provisions from the bill in conference, including the nationwide Arkansas usury law provision as modified to include the separate expiration dates for States with constitutional and statutory usury ceilings. H.R. 4998, as passed by the Senate, would also authorize remote service units for Federal savings and loan associations, automatic transfer services for commercial and mutual savings banks, and share drafts for Federal credit unions—all through March 31, 1980. Without this authority, all such services must cease at the beginning of next year under the terms of a Court of Appeals ruling last April.

There are two other provisions in the stopgap bill, both similar to language in the H.R. 4986 omnibus bill. One would preempt State usury ceilings for certain loans secured by residential mortgages, although States would be permitted to reimpose such ceilings within 2 years of the bill's enactment. Unlike H.R. 4986, the version in the stopgap bill, H.R. 4998, would give the Federal Home Loan Bank Board authority to make rules and issue interpretations concerning the usury provision, and H.R. 4998 would give institutions 6 months after enactment to make commitments to lend without regard to any reimposition of usury ceilings by State law, so long as the loan is made within 2 years of enactment. Finally, H.R. 4998 would require a 45-day study (instead of 90 days as in H.R. 4986) of difficulties faced by depository institutions with sizable portfolios of low-yielding mortgages.

The House counterpart to the Senate amended H.R. 4998 was introduced last Tuesday and was scheduled for Floor action today. H.R. 6100 would simply extend authority for remote service units, automatic transfer services and share drafts through March 31, 1980. I understand that the motion today under suspension will be to repass H.R. 4998 with the text of H.R. 6100 substituted for the Senate language.

The July, 1980, and July, 1981, usury preemption dates have been twice passed by the full Senate. It would seem appropriate in considering S. 1988 to follow precedent. Further, by the very act of incorporating an expiration date for the usury override authority, we would make it clear that the Federal intention in S. 1988 is to gain time for States to address the problems on their own. Perhaps this will force States to reconsider usury ceilings for whatever decision States wish to make.

It is true that a usury ceiling has the same effect whether it is imposed constitutionally or statutorily. It is also true that States with constitutional ceilings cannot change them without going through the lengthy, deliberate process that includes a vote by the people. States with constitutional ceilings do not have the option, for example, of calling a special session of the legislature to address the usury question. So it would seem fair to provide States with constitutional ceilings with an extra year in which to address their problem.

A bill revised as we have suggested would focus its relief primarily on one State in severe need. The new Arkansas usury law—Public Law 96-104—does offer relief with regard to business and agricultural loans of \$25,000 or more and H.R. 4986 and H.R. 4998 would make this nationwide, but the situation in Arkansas for other important loans—including mortgage and consumer—is nothing short of critical.

I have asked Arkansas State Bank Commissioner Beverly J. Lambert, Jr., to keep us provided with up-to-date information on the lending situation in Arkansas.

With the discount rate currently at 12 percent, the effect of Federal law is that, except for loans covered by Public Law 96-104, National banks can lend at 13 percent, but State banks are held to the 10 percent constitutional ceiling.

Mr. Lambert tells me that lending by State-chartered banks has come almost to a standstill in Arkansas. He says that such banks are making virtually no mortgage loans and very few consumer loans or small loans to the people who really need it most.

Mr. Lambert says that State banks have put much of their money into participations in large corporate loans with national banks. National banks, of course, were able to charge above the usury ceiling even before Public Law 96-104 provided interim relief for business and agricultural loans of \$25,000 or more.

Mr. Lambert says that a number of the 192 State-chartered banks in the State may convert to national charter next year if there is no remedy.

I also asked our Regional Director who supervises Arkansas banks to spot-check three different areas in Arkansas to determine what loan rates were being charged by competing National and State banks.

He reported that business and agricultural loans of \$25,000 or more, which are exempted by Public Law 96-104 from the State usury ceiling, are being made generally in the 15 percent interest range by both National and State-chartered banks in all three areas. Some State banks also were making other commercial loans at 10 percent in the three areas. National banks were making commercial and agricultural loans of less than \$25,000 for 13 percent in all three areas.

Personal loans in the three areas were being made at the respective limits—13 percent by National banks and 10 percent by State banks.

Real estate loans were not being made in any of the three areas by State banks. National banks were extending real estate credit in only two of the three areas and charging 13 percent.

Arkansas, in the spirit of Public Law 96-104, already has set about addressing the usury ceiling question on its own. The Arkansas legislature, which was not scheduled to meet again until January, 1981, did not adjourn this year and will continue the general session early in January to consider the drafting of a proposed usury amendment to the Arkansas Constitution. Legislators will consider four proposals to (1) remove the usury ceiling completely, (2) set the ceiling at five points over the discount rate, (3) set the ceiling three points over the discount rate, or (4) authorize the State Legislature to set the usury ceiling. Any amendment approved by the State legislature would have to be submitted to a referendum.

Another proposed amendment dealing with the usury issue already has been drafted by an Arkansas constitutional convention which met last summer. The convention is scheduled to review the draft and put it into a final version in June. The convention's proposal, which is scheduled to be submitted to a voter referendum in the November, 1980, election would give voters the choice between keeping the 10 percent limit or approving a ceiling that would float five points above the discount rate.

Other proposed amendments

Finally, I would propose three technical amendments to S. 1988. In the interest of equity, we recommend that the Committee modify S. 1988 to include insured foreign bank branches. And we recommend these other technical changes:

Section 101 proposes a new Section 26 to the Federal Deposit Insurance Act. Since our Act already contains a Section 26, the new section should be 27.

Section 202 of S. 1988 would add a new Subsection 18(2) to the Act. The proper sequence would be Section 18(m).

FDIC Regional survey

In order to obtain up-to-date information on the situation around the country, I had my staff conduct a telephone survey of our 14 Regional Offices last week. The following information was obtained from our Regional Directors. Listed by Region are those States which impose usury rates of less than 13 percent on one or more significant categories of loans. Comments contain an indication of the type of loan subject to the more stringent usury limit, but since State laws vary so with respect to definition of loan type and frequently include numerous exceptions, the comments are somewhat general.

The most severe problem appears to exist in Arkansas and is well publicized. Twenty-two other States have a restrictive usury rate on one or more types of loans but, in several of these States, there do exist enough exceptions or opportunities with respect to other types of loans to give State banks some flexibility by structuring loans properly. For instance, if the single payment rate is overly restrictive, the bank might be able to offer an installment loan.

Following are capsule summaries of the situation in the 23 States:

Note.—REM=Real Estate Mortgages; M=Thousands.

Region, State, and comments

Memphis:

Arkansas—10 percent maximum on all loans. Some relief recently obtained on business and agricultural loans over \$25,000.

Mississippi—Some smaller consumer loans limited to 10 percent.

Minneapolis:

Minnesota—Several rates more limited than 13 percent.
 Montana—Consumer loans generally limited to 12 percent.
 South Dakota—Consumer loans generally limited to 12 percent.
 North Dakota—Consumer loans generally limited to 12 percent.

New York:

New York—REM (single family) limited to 10¼ percent plus ¼ additional each 3 months.
 New Jersey—REM (single family) limited to 10½ percent.

Omaha:

Nebraska—Loans generally limited to 12½ percent.
 Iowa—Has floating rate keyed to U.S. Treasury securities—currently at 12¼ percent.

Richmond:

South Carolina—Loans to farmers limited to 9½ percent.
 North Carolina—Consumer loans under 25M limited to 12 percent.

San Francisco:

Arizona—Consumer loans (including mortgages) over 5,000—12 percent.
 Oregon—Owner occupied purchase money mortgages—12 percent.
 Washington—Consumer loans for personal property (includes mortgages) and commercial loans under 50M—12 percent.

Atlanta:

No States with usury limit problems.

Boston:

Vermont—12 percent on personal and mortgages—National banks thought to be holding at 12 percent also.

Chicago:

No States with usury limit problems.

Columbus:

Ohio—8 percent for mortgages, loans over 100M, and Corporations. Other exceptions also exist.
 West Virginia—11.5 percent on personal loans.

Dallas:

New Mexico—10 percent secured—12 percent unsecured.
 Texas—10 percent to individuals (personal and business)—12 percent on REM's.

Kansas City:

Missouri—Based on U.S. Treasury rate—currently 11.4 percent; goes to 12.8 percent in 1980.

Madison:

Wisconsin—12 percent basic ceiling rate.

Philadelphia:

Maryland—12 percent rate on single payment loans of over 3,500.
 As the above table shows, it is difficult to determine the precise impact of usury ceilings on the competitive position of State banks. One important reason for this is that we cannot know exactly how many National banks are able to use their rate-ceiling edge to advantage and to make loans which are uneconomical for State banks. In addition, interest rate-ceilings affect individual State banks differently, depending on the demand for particular kinds of loans and the availability of alternative methods by which State banks can meet these credit needs.

CONCLUSION

The FDIC regards S. 1988 as a needed form of relief during a time when economic conditions are placing many financial institutions, particularly the smaller ones, in a cost squeeze and are drying up funds for borrowers. We believe, however, that the usury override authority should be temporary giving States time to respond.

Thank you for this opportunity to testify.

The CHAIRMAN. Thank you, gentlemen. Mr. Janis, let me ask you first about a bill, H.R. 4986. We sent that to the House, not only extending the court decision for 3 months, but also providing temporary relief from restrictive home mortgage usury lending limits.

IMPORTANCE OF MORTGAGE USURY OVERRIDE

How important is the mortgage usury override to housing and thrifts and how strongly should the Senate insist on the usury provisions during this last week of the session—bearing in mind we have a very tough time constraint here?

Mr. JANIS. Senator, I don't think there's anything more important that can be done by the conferees and by the House and the Senate in this session in this whole area of housing and mortgage lending than to provide relief on usury ceilings.

It's clearly a way to help housing in a very difficult period: a way that doesn't cost one single cent of Federal expenditure, and will provide perhaps 85,000 more units than we would have had at a time going into 1980 when we are sure going to need it. In addition to providing housing units, it's going to do positive things, in terms of earnings and safety and soundness, for the institutions in the States that are affected by usury limits. And that, I would submit, Senator, is a crucial achievement.

The CHAIRMAN. Gentlemen, I apologize for this because I know it's in the middle of your testimony, but the distinguished senior Senator from Arkansas has arrived and I'm going to ask him to come forward and make his statement because I know he's very hurried this morning. Come up here. That's fine. Very good.

STATEMENT OF DALE BUMPERS, U.S. SENATOR FROM THE STATE OF ARKANSAS

Senator BUMPERS. Mr. Chairman, I just ask that my full statement be entered in the record.

The CHAIRMAN. It will be entered in full.

[Complete statement follows as though read:]

Senator BUMPERS. Mr. Chairman, I appreciate the courtesy of this committee in permitting me to testify in support of S. 1988, a bill Senator Pryor and I have introduced.

A provision in the National Bank Act, 12 U.S.C. 85, allows national banks to charge one percent over the Federal discount rate on its loans. This provision was passed in 1933 but has never been utilized until this year. Even in 1974, the Federal discount rate did not go over 8 percent and State usury ceilings were high enough that the provision was not triggered. The present Federal discount rate has gone from 9.5 percent in January to 12 percent in November and this provision has been used repeatedly this year.

The national banks in my State and other States with usury ceilings have been able to continue to operate during this time of tight money because of this provision. This privilege is not given to State banks, to savings and loans, to credit unions, or other financial institutions and the customers which they serve. In some towns, such as small towns in Arkansas, there is no national bank so that the only financial institutions serving these communities

were not able to offer them services that national banks in the community next door were offering their customers.

EQUALIZING THE MONETARY SITUATION

In order to equalize the monetary situation so that one type of financial institution would not have an unfair advantage over another, we have introduced S. 1988. S. 1988 would allow all federally insured institutions the same privilege that national banks have, the privilege of charging 1 percent over the Federal discount rate. This legislation will insure that neither financial institutions, nor customers of financial institutions will be penalized by inconsistent laws during time of high interest rates.

For example, in my own State of Arkansas, the difference in loan growth between State and national banks has been fairly substantial. There are 259 banks in my State, 191 State banks and 68 national banks. Using a random sampling of 14 Arkansas banks, 7 national banks and 7 State banks, and pairing each State bank with a national bank of approximately the same size, figures indicate that the national banks cumulative deposits grew at a rate of 4.47 percent from December 1978, to June 1979, while the State banks deposits only increased at the rate of 4.10 percent for that same period. An even more revealing figure for that same time frame is the comparison of growth in cumulative loans made. National banks loans grew 1.01 percent for that period, while State banks loans only grew 0.3 percent. During this period, the Federal discount rate was 9.5 percent or higher so that national banks could charge over 10 percent in interest while the State banks were limited to charging 10 percent by the Arkansas constitution. Although State banks deposits growth was equal to 91 percent of the national banks growth for that period, State banks loan growth only equaled 29.7 percent of the national banks loan growth. These figures are one example of the handicap State banks must operate under without the ability to charge the same rate of interest that national banks can charge.

HOME FINANCING SCARCE

This disadvantage is felt by other financial institutions. For example, the savings and loans in my home State, Arkansas, have made few housing loans this year. One S&L in eastern Arkansas has not made a home mortgage loan since December 1978. The fact that home financing has not been available has led the National Homebuilders Association to predict that housing starts in Arkansas will decline 50 percent in 1979 as compared to 1978. Our unemployment rate, usually higher than the national rate by one-tenth or two-tenths of 1 percent, is projected by the Arkansas Department of Labor to rise in November 1979, to nine-tenths of a percentage point above that of the Nation. The national unemployment rate for November was 5.8 percent and Arkansas rate is projected to be 6.7 percent. A large factor in this decline is layoffs in the construction industry caused by lack of financing. If these savings and loans had had the privileges of S. 1988, my State's economy would probably be in much better shape.

Mr. Chairman, I am sure that there are numerous other examples such as these indicating the inequality of allowing one financial institution an advantage the others do not have. I am in favor of our dual banking system. It allows different institutions to operate in ways which are best for different customers. In the small towns across the Nation there is often only one financial institution to serve the area. They provide a necessary service for their customers. However, it is not equitable to expect these financial institutions to serve their customers if other institutions are given such an advantage. S. 1988 will eliminate that advantage.

I understand Senator Pryor has already described the provision of S. 1988. I want to thank you, Mr. Chairman, for holding these hearings before the end of the year. You promised to hold these hearings during the Senate's consideration of the Depository Institution Deregulation bill, and you have kept your word. On behalf of all the people in my State, I thank you. I ran upstairs just now because I thought that would impress you, Mr. Chairman.

The CHAIRMAN. It would impress me even more if you would stop smoking those cigars, especially when we're sitting next to each other in the conference.

Senator BUMPERS. Well, my wife and daughter won't let me do it at home and I have to do it here or not at all.

A provision in the National Bank Act of 1933 allows national banks to charge 1 percent over the Federal discount rate on its loans. This provision was passed in 1933, but had never been utilized until this year. Even in 1974, the Federal discount rate did not go over 8 percent and State usury ceilings were high enough that the provision was not triggered. The present Federal discount rate has gone from 9.5 percent in January to 12 percent in November, and this provision has been used repeatedly this year.

Arkansas has a 10-percent usury rate. So even when the Federal discount rate is at 9 percent, national banks achieve no advantage over State banks. But now with the Fed discount rate at 12 percent, the national banks in my State are charging and have been entitled to charge 13 percent for sometime or 1 percent above the Federal discount rate. State banks are limited to 10 percent.

Arkansas received some relief in H.R. 2515, a bill we passed recently, but that bill only applies to business and agricultural loans in excess of \$25,000. However, we still have this disparity in lower denominational loans. A Federal bank, for example, could loan me \$20,000 and charge me 13 percent interest. A State bank could only charge 10 percent. Obviously, the effect of this is going to be a unitary banking system in my State, and I don't think that's healthy. We have prospered and done well in Arkansas under the dual banking system. On the other hand, if I had a State bank charter and I foresaw the Federal discount rate remaining at 12 percent for another year or two, I would be applying to the Comptroller General immediately for a national bank charter.

So this is simply a parity bill, and that's all it is. It's an equalization bill to put the two banks on equal footing, allow them to compete with each other. The bill also applies to savings and loans and credit unions. In relatively small communities of 10,000 or 15,000 people in my State, you will have a State bank and a

national bank. The national bank can charge 13 percent and the State bank can only charge 10 percent. Both of them competing fiercely for money. There isn't any question about who's going to win that fight.

So we think this is simple justice, simple equity, and while I'm testifying as a Senator from Arkansas on behalf of the financial institutions of my State it is my understanding that either 23 or 24 States would be affected by the legislation.

I have statistics here on the growth rates of banks in my State and some of the inequities and injustices that have occurred as a result of this, and I'll just simply submit that for the record.

The CHAIRMAN. Thank you very, very much. I think you and Senator Pryor have certainly given us a very clear understanding of what the problem is in Arkansas and how urgent this legislation is and how the temporary action that we provided before was useful but doesn't come anywhere near solving your real problem.

Senator BUMPERS. I thank you again, Mr. Chairman, for holding these hearings very promptly as you promised.

The CHAIRMAN. I might say while you're here, both of you, if you have any questions of any of the regulators before you, please—

Senator BUMPERS. Would you mind identifying the members of the panel, who were introduced before I arrived.

The CHAIRMAN. The panel consists of Mr. Black from the National Credit Union Administration; Mr. Janis from the Federal Home Loan Bank Board; Governor Schultz from the Federal Reserve Board; and Mr. Sprague from the FDIC.

Senator PRYOR. We may never get this chance again.

The CHAIRMAN. These are the top people. We can't do any better than that.

Senator BUMPERS. If the Federal Reserve Board would promise to lower the rate to 9 percent today, we wouldn't have to have this bill. Does anybody want to make such a commitment as that?

Mr. SCHULTZ. Not today, Senator.

The CHAIRMAN. I'm sure, as Senator Bumpers understands, if they reduce the discount rate to 9 percent or anything like it, you would have a complete reversal of Mr. Volcker's anti-inflation policy and you would have a terrific explosion of credit. The banks would be in there borrowing at 9 percent and lending at 14 or 15 percent and it would have an enormous effect. Senator, I'm sure you were being facetious.

Senator BUMPERS. I think they ought to follow Chase's example. Chase is down $\frac{3}{4}$ of a percent. You fellows ought to go down with them.

Mr. Chairman, I want to comment about some testimony that may be offered this morning which will call for a "sunset" or automatic termination provision in this legislation. Since 1934 this has been a meaningless piece of legislation until just recently. But in the unhappy event that these circumstances might occur again, I would be most reluctant to put a sunset provision in S.1988. I'm not sure what purpose that would serve.

The CHAIRMAN. We do provide, as you may know, that the States have the right to reverse what we have done. We simply put them in a position where they can do so. In other words, if the States want to reinstitute a usury law they are free to do it, but as we all

know, it's one thing to take the initiative to put it on the books when you're in these circumstances and it's quite something else to get it off if it is on the books.

INDEXING USURY LIMITS

Mr. Schultz, you say you don't favor indexing usury limits at the discount rate and I think you gave a very good reason for it. You heard Senator Bumpers give his very clear reason why it's important in that state as a matter of equity between State and national banks and, of course, the National Banking Act has provided for such indexing for 40 years as you know.

What index would you favor? Should there be any index at all? You say "the market rate." Which market rate?

Mr. SCHULTZ. The two that we have discussed, Senator, would be some margin above Treasury securities or the FNMA auction rate, and I think the Board would tend to favor some margin above Treasury securities under the circumstances.

The CHAIRMAN. Why should it be tied to anything? Why not just outright abolish it and have a free rate?

Mr. SCHULTZ. I think that would be ideal, but if you do tie it to something, then we would suggest the Treasury rate. But I think you're absolutely right, Senator. We prefer to see usury laws done away with entirely, and we would prefer to see no artificial constraints of this type at all.

The CHAIRMAN. How has the existing indexing under the National Banking Act worked out? Has it led to or had an adverse effect on inflation or monetary policy in your judgment?

Mr. SCHULTZ. Senator, no. I don't think so at this point in time. This consideration has not been a part of discussions about the discount rate. It really hasn't made very much difference, of course, up until very recently. We do have some concern, though, that at a future time, or even if the current very difficult period should continue, this aspect could have some impact on the discussion. We do not feel that the discount rate as a tool of monetary policy should be influenced by factors of this kind.

Senator BUMPERS. Would the Senator yield?

The CHAIRMAN. Yes, indeed.

Senator BUMPERS. Would you be in favor of taking this off the books totally?

Mr. SCHULTZ. Yes.

Senator BUMPERS. You would like to see the repeal of the legislation that now exists?

Mr. SCHULTZ. I would like to see the repeal of all usury statutes.

Senator BUMPERS. That's not the real world.

The CHAIRMAN. Why not?

Senator BUMPERS. All I'm saying is I'm not sure whether I agree or disagree with it. All I'm saying is it's not going to happen.

Mr. SCHULTZ. Before you came, Senator, I testified that we have very serious concerns about tying the ceiling rate to the Federal Reserve discount rate. I think that's the thrust of Senator Proxmire's question.

Senator BUMPERS. Yes, and I couldn't agree more. The only reason we're into this legislation is that people have begun to use

this to tie their interest rates to, as we obviously have done in my State, Senator.

The CHAIRMAN. I don't feel it's unrealistic or that it's impossible to abolish usury laws. I think there's been a tremendous improvement in public understanding of this in the last couple years, particularly in the last year or so. I think more and more people, not only bankers and savings and loan officials but borrowers—business people and others—have seen how counterproductive it is and how unrealistic it is. After all, we have never been associated, except in wartime, when we had other restrictions on borrowings or when we had this inflation rate before. With inflation as high as it is, you're bound to have interest rates that have to be higher than the inflation rate. Otherwise, you have a speculation which is a runaway. So with this kind of inflation we have—I think more and more people are understanding that the usury laws just don't work. You can't pass a law saying interest rates can't go any higher without also having laws on prices, wages, profits and interest and all kind of other things.

Senator BUMPERS. Obviously we are in a tremendous bind right now because our 1874 constitution in Arkansas established a usury rate of 10 percent. I'd just like to say we'll have our hands full in Arkansas. We have a constitutional amendment on the ballot next fall to tie our usury rate to the Fed discount rate. No. 1, it is something of a reflection of what we pay for money in the money markets and what we pay in interest because that's what they have to pay you when they borrow from you. So there is some relationship, but what I want to say is we're going to have a very difficult time repealing our old 10 percent interest rate and adopting the new one, not because bankers and sophisticated borrowers don't understand, but because a lot of other people don't understand. That's the reason I say, Senator, I just think you're going—I think there's a much wider understanding of the problems now than ever before in the history of this country, but whether it's enough to actually accomplish this is something else.

The CHAIRMAN. Well, you may be right, because with my next question I come to Mr. Sprague, who's a very able man, a man I highly respect. But he says, in the course of his statement, that usury laws do work. The uncontested fact is they hold down rates. You add, of course, they also in some instances dry up the market, and you go on to explain what seems to be a statement that contradicts the views of other witnesses at the table and the experience some of us feel we have been taught in the last year or so if we didn't understand it before.

Isn't it true, Mr. Sprague, that the usury laws simply cannot work when you have a usury law such as they had in Arkansas of 10 percent or even 12 percent when you have inflation which people anticipate to be at a higher level and therefore you expect interest rates to be substantially above usury laws? The reason I ask that is because if I were a lender, there's no way I'd lend money at a rate below the inflation rate because I'd be bound to lose on that basis. Instead of that, what I would do is take the money and invest it in commodities and other things. If I just have an average record of guessing and they rise as much as the inflation rate does, I'm better off than if I lend that money at less than

the inflation rate; and if the usury rate therefore is less than the inflation rate, then I'm not going to lend.

CUTOFF DATES NEEDED

Mr. SPRAGUE. Well, you're correct certainly, Senator. I have no dispute at all with that analysis. I'm trying to be practical at this point in time. We have a situation, as I stated in my testimony, where Arkansas has a very serious problem. Twenty-three other States have varying degrees of the same thing and it's hard to summarize them because they're so different, but 23 States do have a problem. It occurs to me that—and the Senator hinted at it—that enacting permanent legislation at a time of crisis, is not, I believe, good public policy. I think that we should attempt to address the immediate problem, give the States an opportunity to work their will. I would think legislation with that kind of a cut-off might have a chance of being enacted. I suspect that to rewrite permanent legislation probably wouldn't. And so I go back to my proposition that you do as the Senate has done twice already in the last month—to address the problem with some clear cut-off dates.

The CHAIRMAN. Chairman Janis, I'd like to ask you to comment on that. You give us exactly the opposite opinion. You say usury statutes discriminate even when usury ceilings are close to the market-determined rate, they discriminate against people who do not qualify for prime mortgage loans, among other matters.

What's your response to Mr. Sprague?

Mr. JANIS. Well, I'm usually in agreement with Mr. Sprague on most things, but I'm afraid on this one we probably have to part company a little bit.

My judgment, Senator, is that financial markets are really working in this country. People today are able to obtain good information on what rates are, and make appropriate judgments, and the market works for borrowers today in terms of keeping down rates. While usury limitations may have served a useful purpose years ago when the borrower was disadvantaged in the marketplace, especially in the mortgage market area, today there are so many different ways borrowers have an opportunity to get mortgage loans, at least to get quotes on them from different sources, that this tends to hold the rate down to what the market actually requires.

Therefore, it seems to me that we ought to do away with usury ceilings once and for all and we ought to do it on the basis of national housing policy. We need to house Americans and provide shelter without constraints of this kind.

The CHAIRMAN. That response leads me right into my next question. I'd like to ask Mr. Black to lead off and then have all of you comment.

SENSITIVE ISSUE OF STATES RIGHTS

Many of us are sensitive to the issue of States rights in our Federal system of Government. Governor Schultz was particularly specific on that. Senator Morgan on this committee has raised the issue many times.

Is our economy now so unified and national in scope, as Chairman Janis has indicated, that States rights could legitimately be preempted in the area of usury?

Mr. BLACK. I have testified to that effect, Senator. Yes, I do firmly believe that because money flows across State lines without regard to whatever artificial constraints that may perhaps be in place and because of those artificial constraints those flows are becoming even—well, let's say those flows are taking place quicker because there is a greater understanding in today's national market as to what alternate rates happen to be.

Senator BUMPERS. Would the Senator yield on that point?

The CHAIRMAN. Yes, indeed.

Senator BUMPERS. Mr. Black, let me take the opposite position from one I took a moment ago. Money flows in international markets across national lines with equal speed nowadays, does it not?

Mr. BLACK. Yes, sir. I have no disagreement with that at all.

The CHAIRMAN. Mr. Schultz?

STATES RIGHTS AND PREEMPTION

Mr. SCHULTZ. Mr. Chairman, the Board spent a considerable period of time discussing this preemption question. As I said, all members of the Board are concerned about the issue of States rights and preemption. We have a philosophical problem there. I think all of us tend to be federalists at least to some degree. The majority felt that the critical nature of the problem brought us down in favor of this kind of a bill which would preempt on the condition that the States could override if they decided to do so. There were certain members of the Board that felt very strongly about this issue and felt that even under these difficult situations we should not preempt. I might add that according to our figures, at least nine States do not meet in legislative session in 1980. So that means that you're involved with the problem of special sessions if you're going to do something in those States.

Let me just make a personal comment as a long-time former member of a State legislature. I came down on the side of preemption in the final analysis, even though I tend to be fairly strong philosophically on the question of States rights. I did so because this is a particularly difficult problem for State legislatures. It is really a no-win situation for State legislatures. It just seemed to me that under the circumstances, because of the critical nature of the problem, it was worthwhile giving them the opportunity to go at it from the other direction—to say that these usury laws will be preempted but you can reinstate them, you can override, if you wish to do so. This is a very hard problem for State legislatures to deal with.

The CHAIRMAN. We do exactly that, as you know.

Mr. SCHULTZ. Pardon?

The CHAIRMAN. In title III of the bill we do exactly that.

Mr. SCHULTZ. I know you do, and I'm favoring that.

The CHAIRMAN. We say that we provide this override unless and until such State legislatures adopt laws stating in substance that such State does not want such amendment or amendments made to

the statute with respect to this. So I don't know what we could do that would be effective beyond that.

Mr. SCHULTZ. I think you have done what needs to be done and I favor that provision in the bill. I'm just saying that there are members of the Board that have very serious philosophical problems here and would not favor the legislation on that basis.

The CHAIRMAN. Well, it's very helpful because you came here with a very strong background in State government. You were the head of the majority party in the Florida Senate; is that correct?

Mr. SCHULTZ. I was the speaker of the house.

The CHAIRMAN. I beg your pardon. Would you like to comment further, Mr. Sprague?

Mr. SPRAGUE. Well, very briefly, Senator, I don't think we serve a useful function by relieving the pressure on State legislatures. For example, in New York there are a great many problems in the savings bank industry and others that the legislature should address, and aside from other reasons, I would like to see the pressure kept on the States.

The CHAIRMAN. What if they have it in the constitution? That's what they have in Arkansas and California too, a constitutional statutory limit.

Mr. SPRAGUE. Well, California—my home State—exempts regulated financial institutions from the usury law and the constitution goes, as I understand it, individuals, which really isn't a factor in this picture.

The CHAIRMAN. You seem to dismiss then the fact that the other panelists put some stress on, that credit travels not only across State lines but, as Senator Bumpers has emphasized, across national lines. It wouldn't be devastating but you're going to put some States through a terrific trauma if—

Mr. SPRAGUE. Senator, I would never dismiss anything any of my colleagues have to say any time. Again, I'm trying to be practical. We have a bad problem. It needs to be addressed right now, not over the course of months and months of deliberation. I think you can move quickly if you have these cutoff dates. I think if you open up the whole philosophical question that both Governor Schultz and the Senator referred to, we won't have legislation. I'd like to see a bill passed.

The CHAIRMAN. Mr. Black, you appear to favor a change in the 12-percent lending limit imposed on Federal credit unions. That's one that I think many people who have used credit unions are familiar with, 1 percent a month. What new ceiling does NCUA recommend and will new credit union depositors and borrowers support a higher ceiling?

Mr. BLACK. Well, sir, the NCUA does not favor an imposition of another artificial ceiling. We would like to have some flexibility as far as the issue is concerned. Our concern with the bill currently before us is that it does not appear to us that—

The CHAIRMAN. Would you go to a market rate if you don't want a specific ceiling?

Mr. BLACK. Yes, but it doesn't appear to me that the current bill before us includes in its language the federally chartered credit unions but rather only the State chartered federally insured credit

unions, and that was the concern expressed in my earlier testimony.

As far as the credit union members are concerned, Senator, as I stated before and as you're perfectly aware, a ceiling rate, whatever that rate is, need not be the effective market rate. We have had testimony to that extent this morning. As far as the credit union members are concerned, I think it would depend upon the individual credit union and whatever rate existed in that individual credit union as to their response, sir.

The CHAIRMAN. Mr. Janis, one additional argument that can be made for lifting usury ceilings is that thrifts need to be able to charge market rates if they're to be able to pay market rates to savers. That's, of course, one reason why H.R. 4986 passed the Senate in the form it did. I note that the regulators permitted regulation Q rates. How much further can regulators go without some give on the usury ceiling?

Mr. JANIS. It makes it very difficult to go much further. Institutions obviously are constrained on what they can charge on the asset side, and usury restrictions make it very difficult on the liability side—which is where the deposits are—to be able to raise the rates paid to savers. It's very important that these institutions be competitive in the marketplace.

The CHAIRMAN. It's not only a matter of equity, but it's a matter of getting the wherewithal to sustain the housing industry.

Mr. JANIS. You're exactly right. There's a need not only to do something to provide an incentive for saving but, as well, a need to be able to obtain money in a very competitive marketplace: As you know, the thrifts are competing with money market funds and other types of relatively novel instruments. If they cannot charge market rates in mortgage lending, it makes it very difficult to be able to pay proper and appropriate deposit rates.

USURY LIMITS DEPRESS HOUSING INDUSTRY

The CHAIRMAN. You say the usury limits could depress the housing industry in the coming year by 85,000 housing starts. Now the usual rule of thumb is two jobs for every house constructed. That would be 170,000 jobs. How accurate are these estimates that you make, these 85,000 units, and what's the effect on the job market other than what I've indicated?

Mr. JANIS. I'm sorry, sir?

The CHAIRMAN. The first question is how accurate are the estimates?

Mr. JANIS. The 85,000 or the two jobs per—

The CHAIRMAN. Don't comment on those two jobs. I hope you will accept it, but if you don't, don't give me the bad news.

Mr. JANIS. Yes, I do accept it. On the 85,000, it's difficult to say. We have done a lot of studies. We have tried to do a lot of analyses.

Senator BUMPERS. What is that based on?

Mr. JANIS. The 85,000?

Senator BUMPERS. Yes.

Mr. JANIS. It's based on our best estimate.

Senator BUMPERS. Your best estimate of what? What's the figure for each 1 percent interest rate increase? Is that what you're saying or—

Mr. JANIS. We're saying that in 1980, given the x number of States in which usury rates are binding—and I say x number because there's a difference of opinion as to the number of States in which this is the case—and, given the interest rate levels that we anticipate in 1980 usury laws, would depress U.S. housing activity by approximately 85,000 units. This is based on four specific studies that I cite in my testimony—the Robins study, the France study, the Ostas study, and the McNulty study. Each of them examined in different markets a particular impact of usury ceilings. I could spell out the range they established, but it is in my testimony on pages 8 and 9. These studies have been published in the *Journal of Finance* and other publications.

Actually, the States with restrictive usury ceilings accounted for 30 percent of U.S. housing starts in 1980. Incidentally, almost one-third of this total was attributed to Texas. We think there are about 15 States now that are below 12 percent and this is where the number comes from.

The CHAIRMAN. It might be very helpful to have those States because I'd like to talk with the Senators from those States and maybe the people in the congressional districts who would be affected would be interested in this data since it would affect jobs and prosperity in their areas.

Mr. JANIS. I have a table right here and I can provide that to the staff after the hearings, Senator.

The CHAIRMAN. Fine. Now you say that there are adverse effects on secondary market operations of FNMA and the Federal Home Loan Mortgage Corporation of usury limits. Can you explain in a little more detail how usury limits affect FNMA and FHLMC? Are there any other restrictions besides usury limits that hamper efficient FNMA and FHLMC secondary markets?

Mr. JANIS. There can be other restrictions, but as far as usury goes, Fannie Mae and Freddie Mac just can't buy mortgages in States where there are binding usury laws, because they couldn't package those mortgages. What they do is put together packages of loans and sell the participation certificates to investors. An investor certainly isn't going to want to have in that portfolio a loan that someone could call usurious, because there could be penalties and a chance that some part of it would be at least partially invalid.

Obviously where VRM's are involved, the situation is even worse. Let's say you had a 12-percent usury ceiling and a VRM at 11 percent. No investor in the secondary market is going to want to buy a pool of VRM's at 11 percent where the variability of that instrument could not take it over 12 percent because the usury ceiling would be binding. In fact, in some case, income flow would stop entirely and this certificate that somebody purchased in the capital market would be useless. It's FNMA's and FHLMC's ability to tap the capital markets and go after nontraditional sources of lending that has made a tremendous difference in mitigating the effects of this particular crunch on housing. Were it not for their

ability to reach out to nontraditional capital markets, I think things would be a lot worse than they are right now.

The CHAIRMAN. The second part of my question is are there any other restrictions besides usury limits, any other restrictions that hamper efficient Fannie Mae and other secondary market operations?

Mr. JANIS. Well, yes, there are. I would like to submit a short reply for the record on that.

[Chairman Janis provided the following response for the record:]

There is no obstacle in the secondary market that is greater than below market state usury ceilings. As I stated in my testimony, more than twenty states cannot take advantage of the private secondary market or the programs of the Mortgage Corporation and the Federal National Mortgage Association because of below market usury ceilings.

However, there are a number of issues which if resolved would improve secondary market access in a number of areas of the country.

1. State tax and doing business statutes in some states have the effect of discouraging out-of-state investors from originating or buying loans secured by properties in such states. Many such statutes provide that the holding of an investment in real property in that state subject the investor to state doing business laws, including licensing fees, and state income tax laws. This can produce a double tax on the mortgage interest when the state where the property is located taxes on a situs basis and the state where the investor actually does business taxes on a residence basis.

While this is not a problem for mortgages sold to investors by FHLMC in the form of FHLMC securities, or for GNMA securities, it can be a real impediment to private secondary market investment mortgages.

Legislation to remedy this situation is pending before Congress.

2. There are increasing instances where existing state law or new state legislation is not compatible with the FHLMC uniform loan documents. The uniform documents are required not only for participation in the programs of the corporation, but increasingly by other private secondary market investors. The availability of uniform documents is the cornerstone of the dramatic growth in the secondary market from \$25 billion in 1974 to an estimated \$66 billion in 1978.

A prime example is the growing debate in some states over due-on-sale clauses. The Mortgage Corporation permits assumptions once a credit review of the new homebuyer by the lender certifies his creditworthiness. The original mortgagor is then released from liability. The Minnesota legislature passed a bill last year which requires lenders to consent to automatic transfers regardless of whether the new homebuyer is creditworthy. As a result, the Corporation's Board of Directors voted to cease purchases of loans from Minnesota until the law is changed to permit review of the new homebuyer's credit. If the Mortgage Corporation were to abandon its policy of uniform documents and accommodate such differences in state law as they are passed, sale of its securities would be hampered by the need to explain in the offering materials a myriad of differences. In the case of the credit underwriting-of-transferees issue, investors could also perceive a diminution of investment quality.

Other examples relate to state laws and regulations dealing with the holder-in-due-course doctrine, future advances, restrictions on loan terms, various lien priority issues, and enforcement of mortgages and deeds of trust. The great variety of provisions on these points is frequently a substantial factor in the size of transactional costs of primary market lenders and secondary market trading. These costs ultimately fall on the homebuyer.

We will continue to monitor this area and will advise you if it appears that a Federal solution is warranted.

The CHAIRMAN. And finally I have a question for Mr. Black. NAFCU states that the 12-percent limit threatens the continued viability of many member-owned Federal credit unions. Do you agree with that statement as the regulator of credit unions, and if so, how large is the problem?

Mr. BLACK. Yes, sir. I do agree, and I think the problem is considerable. We have had our Office of Policy Analysis look at

that issue, and they apparently are still involved in that study. However, I must admit that I receive—and I know that other members of the Board receive—communications daily from federally chartered credit unions, and usually the one word that stand out in all of those letters is “Help”.

The CHAIRMAN. Can you supply a little more specific data for the record?

Mr. BLACK. Yes, sir. We certainly can.

[The following information was received for the record:]

Documentation supporting the losses credit unions are expected to incur is shown on Table 3, 3a, and 3b of our December 14, 1979 letter to Chairman Proxmire.

Due to this and other supporting evidence, the NCUA Board in its December 6th meeting determined that the mandatory transfers to reserve for calendar year 1979 should be waived, since credit unions as a whole would experience substantial negative retained earnings. Without this waiver, credit unions would be unable to pay competitive dividends on members' savings, thereby increasing the potential outflow of savings. This would further restrict the ability of credit unions to meet members demands for consumer loans as well as further reducing liquidity.

With the waiver on mandatory reserve transfers, most credit unions are not likely to experience significant negative retained earnings in the near future. However, the retained earnings (excluding mandatory reserve transfers) to asset ratio continues to decline under the high and medium rate scenarios. If current interest rate conditions continue, it is likely that earnings will become negative unless some change in the current usury ceiling facing credit unions is implemented.

TABLE 3.—SUMMARY RESULTS OF CREDIT UNION SIMULATIONS BY CATEGORY OF FEDERAL CREDIT UNIONS, 1979 AND 1980

[Amounts in millions]

Low rate scenario FCU category and result	1979		1980	
	June	December	June	December
All FCU's:				
Net income after mandatory transfers to reserves during period.....	51.6	46.0	-24.06	.55
Total retained earnings, revocable reserves and other liability end of period..	2,733	2,861	2,926	3,019
Net income during period before transfers to reserves to assets (percent)...	0.7	0.67	0.33	0.46
Net income during period after transfers to reserves to assets (percent).....	.28	.24	-.12	0.00
Small FCU's:				
Net income after mandatory transfers to reserves during period.....	1.7	-.5	1.93	1.23
Total retained earnings, revocable reserves and other liability end of period..	468	484	504	521
Net income during period before transfers to reserves to assets (percent)...	.66	.59	.70	.58
Net income during period after transfers to reserves to assets (percent).....	.06	-.02	-.07	-.04
High loan-to-asset ratio FCU's:				
Net income after mandatory transfers to reserves during period.....	-7.97	-16.87	-47.29	-40.23
Total retained earnings, revocable reserves and other liability end of period..	833	848	835	831
Net income during period before transfers to reserves to assets (percent)...	.38	.26	-.22	-.07
Net income during period after transfers to reserves to assets (percent).....	-.14	-.29	-.78	-.64
Community FCU's:				
Net income after mandatory transfers to reserves during period.....	.68	-.17	-2.20	-2.55
Total retained earnings, revocable reserves and other liability end of period..	79	81	82	82
Net income during period before transfers to reserves to assets (percent)...	.56	.41	.06	.02
Net income during period after transfers to reserves to assets (percent).....	.13	-.03	-.40	-.44

Note.—Small FCU's represent all FCU's with assets less than \$2 million as of December 31, 1978. High loan-to-asset ratio FCU's represent all FCU's with a loan-to-asset ratio of 90 percent or more as of December 31, 1978.

TABLE 3A.—SUMMARY RESULTS OF CREDIT UNION SIMULATIONS BY CATEGORY OF FEDERAL CREDIT UNIONS, 1979 AND 1980

[Amounts in millions]

Medium rate scenario FCU category and result	1979		1980	
	June	December	June	December
All FCU's:				
Net income after mandatory transfers to reserves during period.....	51.6	46.0	-28.8	-24.3
Total retained earnings, revocable reserves and other liability end of period..	2,733	2,861	2,920	2,989
Net income during period before transfers to reserves to assets (percent)...	0.7	0.67	0.30	0.34
Net income during period after transfers to reserves to assets (percent)	.28	.24	-.15	-.12
Small FCU's:				
Net income after mandatory transfers to reserves during period.....	1.7	-.5	1.78	3.06
Total retained earnings, revocable reserves and other liability end of period..	68	484	504	525
Net income during period before transfers to reserves to assets (percent)...	.66	.59	.70	.75
Net income during period after transfers to reserves to assets (percent)	.06	-.02	.06	.11
High loan-to-asset ratio FCU's:				
Net income after mandatory transfers to reserves during period.....	-7.97	-16.91	-49.65	-51.10
Total retained earnings, revocable reserves and other liability end of period..	833	848	833	818
Net income during period before transfers to reserves to assets (percent)...	.38	.26	-.25	-.24
Net income during period after transfers to reserves to assets (percent)	-.14	-.29	-.82	-.82
Community FCU's:				
Net income after mandatory transfers to reserves during period.....	.68	-.17	-2.32	-3.21
Total retained earnings, revocable reserves and other liability end of period..	79	81	81	81
Net income during period before transfers to reserves to assets (percent)...	.56	.41	.04	-.09
Net income during period after transfers to reserves to assets (percent)	.13	-.03	-.42	-.56

Note.—Small FCU's represent all FCU's with assets less than \$2 million as of December 31, 1978. High loan-to-asset ratio FCU's represent all FCU's with a loan-to-asset ratio of 90 percent or more as of December 31, 1978.

TABLE 3B.—SUMMARY RESULTS OF CREDIT UNION SIMULATIONS BY CATEGORY OF FEDERAL CREDIT UNIONS, 1979 AND 1980

[Amounts in millions]

High rate scenario FCU category and result	1979		1980	
	June	December	June	December
All FCU's:				
Net income after mandatory transfers to reserves during period.....	51.6	46.0	-59.5	-164.5
Total retained earnings, revocable reserves and other liability end of period..	2,733	2,861	2,890	2,819
Net income during period before transfers to reserves to assets (percent)...	0.70	0.69	0.15	-0.37
Net income during period after transfers to reserves to assets (percent)	.28	.24	-.31	-.84
Small FCU's:				
Net income after mandatory transfers to reserves during period.....	1.7	-.5	-2.7	-5.9
Total retained earnings, revocable reserves and other liability end of period..	468	484	499	512
Net income during period before transfers to reserves to assets (percent)...	.66	.59	.55	.46
Net income during period after transfers to reserves to assets (percent)	.06	-.02	-.10	-.21
High loan-to-asset ratio FCU's:				
Net income after mandatory transfers to reserves during period.....	7.97	-16.91	-63.27	-98.57
Total retained earnings, revocable reserves and other liability end of period..	833	848	818	755
Net income during period before transfers to reserves to assets (percent)...	.38	.26	-.49	-1.05
Net income during period after transfers to reserves to assets (percent)	-.14	-.29	-1.06	-1.65
Community FCU's:				
Net income after mandatory transfers to reserves during period.....	.68	-.17	-3.37	7.37
Total retained earnings, revocable reserves and other liability end of period..	79	81	80	75
Net income during period before transfers to reserves to assets (percent)...	.56	.41	-.15	-.85
Net income during period after transfers to reserves to assets (percent)	.13	-.03	-.62	-1.34

Note.—Small FCU's represent all FCU's with assets less than \$2 million as of December 31, 1978. High loan-to-asset ratio FCU's represent all FCU's with a loan-to-asset ratio of 90 percent or more as of December 31, 1978.

The CHAIRMAN. Gentlemen, we have many other questions, but we have two other panels coming up, and unless Senator Bumpers has a question he would like to ask, I want to thank you very much for the fine record that you have made this morning. It has been very helpful to us.

Thank you.

Our next panel consists of Joseph Cugini, chairman-elect, Credit Union National Association; R. M. Duffey, president of the Texas Bankers Association; E. D. Dunn, commissioner of Banking and Finance of the State of Georgia, Conference of State Bank Supervisors; William H. Kennedy, chairman, Government Relations Counsel, American Bankers Association; and Vincent Lascara, legislative chairman, National Association of Federal Credit Unions.

Gentlemen, I apologize. We're going to have to be even a little more restrictive than we thought. If you could make your statements in 3 minutes, I understand you have been told that in advance. We would appreciate that.

We will run the clock so it will run 2 minutes on green and 1 minute on yellow, and then the stopwatch is on you.

Mr. Cugini?

STATEMENT OF JOSEPH N. CUGINI, CHAIRMAN-ELECT AND CHAIRMAN OF THE GOVERNMENTAL AFFAIRS COMMITTEE, CREDIT UNION NATIONAL ASSOCIATION

Mr. CUGINI. Thank you, Mr. Chairman. Being from Rhode Island and being quick of lip, I think I can probably accomplish this in 3 minutes.

Mr. Chairman, members of the committee, my name is Joseph N. Cugini, and I am the chairman-elect of the Credit Union National Association. The Federal credit union loan rate ceiling enacted in 1934 to help persons of average means meet their credit needs at normal rates of interest is now having the opposite effect.

The purposes of a credit union are: First, to promote thrift among its members and second, to create a source of credit for provident and productive purposes. These two purposes are inseparable, the members' pool of savings being the primary source for member loans.

Since members are both the suppliers and users of credit union funds, their interests as savers and borrowers must be evenly balanced. Thus, if members are to receive credit at a fair and reasonable rate of interest, members must be paid a fair and reasonable rate of interest for the savings to supply that credit.

DISCRIMINATION BETWEEN MEMBERS

Under current and foreseeable economic conditions, the 1934 loan rate ceiling causes, and will cause, discrimination between members.

The loan rate ceiling excludes certain members, primarily less advantaged persons, from credit union loans and denies credit union members as savers a real return of the money they make

available to other members in the form of credit. The ceiling was never intended to have this effect.

The Senate debate on the Financial Institutions Deregulation Act accurately concluded that in today's market the usury ceilings developed in response to yesterday's market no longer have a place.

At a time when the country had a deflation rate of 6.5 percent, when the banks prime rate was below 6 percent, when rates on money market instruments never rose above 5 percent, and savings account rates were 3 percent or less, then a 12 percent consumer loan rate was considered a normal rate. Under today's economic conditions, normal rates are much higher.

With an average U.S. inflation rate in the 1970's of 7.4 percent, the stated loan rate would have to be just over 20 percent to represent an adjusted-for-inflation rate of 12 percent. In fact, if we were to duplicate conditions of the early 1930's, when a 12-percent interest rate coupled with a 6.5-percent deflation rate actually represented a 19-percent real loan rate, the stated loan rate today would have to be about 28 percent, a rate for which we are not asking and which would not even be competitive.

For reasons of both equity and economics, the Federal credit union loan rate ceiling should be removed, increased, or adjusted to allow credit unions to meet their statutory objectives and to reestablish equity among their members.

Mr. Chairman, I have some letters that I would like to enter into the record, too, from credit unions.

The CHAIRMAN. Very good.

[Complete presentation of Mr. Cugini follows:]

STATEMENT OF JOSEPH N. CUGINI, CHAIRMAN-ELECT AND CHAIRMAN OF THE
GOVERNMENTAL AFFAIRS COMMITTEE, CREDIT UNION NATIONAL ASSOCIATION

(The Credit Union National Association, Inc. (CUNA) is an association of credit union leagues, representing each state and the District of Columbia. Through the leagues, CUNA represents more than 20,000 federally and state chartered credit unions which serve over 40 million members. Credit unions are cooperative, non-profit associations that offer various financial services to their members.)

Mr. Chairman, members of the Committee, my name is Joseph N. Cugini. I am chairman-elect of the Credit Union National Association, Inc. (CUNA), and president and general manager of the Westerly Community Credit Union, a state-chartered credit union, Westerly, Rhode Island. I am a director of the Rhode Island Credit Union League of which I am also past President and Chairman of the Board.

CUNA is pleased to have this opportunity to appear before you today on S. 1988, a bill "To Equalize Competition Between State and National Banks," introduced by Senators David H. Pryor (D-AR) and Dale L. Bumpers (D-AR). CUNA supports the purpose of this legislation but cannot endorse it in its present form because it does not address the needs of credit unions and their members.

Senators Pryor and Bumpers are to be commended for their courage and leadership in sponsoring S. 1988 as are you, Mr. Chairman, for scheduling hearings on it. While its purpose is not a popular one—to raise the legal ceiling on what financial institutions may charge for loans—the subject is of critical importance not only to credit unions but also to other financial institutions and borrowers as well.

As the attached press clippings clearly demonstrate (Appendix 1), credit unions across the nation are having increasing difficulty in today's economic environment in meeting the credit needs of their members. The primary obstacle is the 12 percent loan rate ceiling on credit union loans to members. The primary obstacle is the 12 percent loan rate ceiling on credit union loans to members. Under current economic conditions, this loan rate ceiling causes discrimination between various groups of members; for example, between members as savers and borrowers, and between groups of members as borrowers.

THE ANTI-CONSUMER ARGUMENT

Attempts to question the 12 percent credit union loan rate ceiling often are assailed on the grounds that increasing loan rates is contrary to the interests of consumers. Raising or eliminating the ceiling may well be to the disadvantage of some consumers, but only those credit union members who, under current conditions, have an advantage over other members through access to credit union loans. We shall demonstrate this discriminatory impact later.

Ceiling removal would provide substantial benefits to two other groups of credit union members: (1) savers who, as a result of current inflation rates, are being paid a negative real dividend rate; and (2) borrowers who are excluded from credit union loans because of the ceiling. The latter, as we also shall demonstrate, tend to come from less advantaged groups of consumers.

The loan rate ceiling, enacted at other times and for other reasons, was never intended to have a discriminatory effect among credit union members. Credit unions are member-owned credit cooperatives. A basic tenet of cooperative principles is equitable treatment of all members. The 12 percent loan rate ceiling is now having the opposite effect.

THE ORIGIN OF THE 12-PERCENT CEILING

When Congress enacted the Federal Credit Union Act in 1934, the country was emerging from a depression. From 1929 to 1933, the average inflation rate was minus 6.5 percent—deflation. Bank rates on short-term loans to the banks' most credit-worthy business customers were consistently below 6 percent, rates on money market instruments never rose above 5 percent, and savings account rates paid 3 percent or less.

In contrast, the cost of credit to the working people of the country was astronomical. In 1934, 22 states had laws on their books permitting charges of $3\frac{1}{2}$ percent a month, or 42 percent a year, on consumer loans of \$300 or less. These laws had been enacted to protect consumers from even higher rates on the theory that the alternative to a legal high rate is an illegal rate which is tremendously higher.

As high as it was, 42 percent was an "ordinary cost"; Congress heard cases cited where "as much as 600 percent interest had been charged." A much-repeated horror case involved a railroad employee who borrowed \$30 from a loan shark, paid back \$1,080 in interest, and then was sued for the original \$30.

With regard to the so-called "42 percent Loan Companies," Roy F. Bergengren, one of the founders of the American credit union movement, wrote: "There is no business, large or small, in the United States which could operate on 42 percent credit. . . . There is no worker in the United States who can afford . . . to pay 42 percent for credit."

It was in this environment that Congress placed the 1 percent per month, or 12 percent per year, ceiling on Federal credit union loan rates. Its purpose in doing so was to enable persons of average means to solve their credit problems "at normal rates" of interest—a term repeatedly used in Congressional debates at the time.

THE PRESENT

"Normal rates" are now quite different from those in effect in 1934 when the Federal Credit Union Act was passed. In the 1970s, inflation has averaged 7.5 percent and is once again in the double-digit range. Short-term business loans and money market rates are consistently at much higher levels, respectively 15.4 percent and 13 percent in December 1979. Interest rates available to savers at depository institutions have ranged from 5 percent to 12.6 percent, three to four times higher than 1934 savings account interest rates.

Despite a cumulative inflation rate of 457.9 percent since 1934, Federal credit unions have until recently been able to live within the 12 percent ceiling rate. They have been able to do so because of a set of economic, regulatory and competitive circumstances which are not likely to be repeated in the future.

The elimination of Regulation Q, for example, limiting what savers—and especially small savers—are paid for their funds, may be extended and painful but will not be stopped. Savers of average means are aware of the higher returns available to persons of greater affluence and are demanding equal treatment. This means continuing higher money costs for financial institutions, especially credit unions.

Despite the tendency of financial habits to change very slowly, and the loyalty of many credit union members, persistent inflation and the availability of higher rates elsewhere make it necessary for Federal credit unions to pay even higher dividend rates to remain viable. Though credit union borrowers may be willing to pay more,

the loan rate ceiling makes it impossible for Federal credit unions to earn more without shifting out of loans and into higher-earning investment assets.

Thus the Federal credit union loan rate ceiling, originally enacted to help persons of average means meet their credit needs at normal rates of interest, no longer permits normal rates to be charged for loans (or normal rates to be paid for savings). The ceiling itself has become an obstacle to Federal credit unions in achieving their congressionally mandated purposes of promoting thrift among their members and creating a source of credit for those members.

THE INEQUITIES BETWEEN SAVERS AND BORROWERS

Under current economic conditions, the Federal credit union loan rate ceiling creates a whole set of subsidies among credit union members. These subsidies may or may not be appropriate, but it is the right of the credit union members and their elected officials to make those equity decisions. They should not be determined by a statutory ceiling.

The most obvious question of equity associated with the loan rate ceiling is the transfer of income from some credit union members to others, i.e., from credit union members as savers to credit union members as borrowers. At current inflation and savings rates, saving members are subsidizing borrowing members with an actual loss of purchasing power.

Over the current decade, a 12-percent loan rate has had an average value adjusted for inflation of 4.4 percent. In comparison, with the 6.5 percent deflation rate of the early 1930s, the 12-percent loan rate adjusted for deflation represented a loan rate of over 19 percent. Thus, the adjusted loan rate actually has dropped from 19 percent to 4.4 percent.

In the 1970's, a 6-percent dividend rate adjusted for inflation has had an average value of minus 1.2 percent. In order for savers to have merely kept up with inflation over the past decade, effective dividend rates would have to have averaged 7.4 percent.

Thus, credit union rate structures over the past decade have resulted in a situation in which: (1) savers have actually paid for the privilege of maintaining a share account during six of the past ten years (negative real dividend rates), and (2) borrowers have actually been paid to take out loans during two of the last ten years (negative real loan rates). It is little wonder that such a rate structure has brought liquidity pressures and fueled inflation.

In short, the Federal credit union loan rate ceiling has resulted in the transfer of income from credit union members as savers to credit union members as borrowers. This is neither fair nor reasonable. Credit union members are entitled to receive a real return for the savings they make available to other members in the form of credit. These conditions also thwart the efforts of the Federal Reserve Board to deal with inflation.

THE INEQUITIES BETWEEN BORROWERS AND BORROWERS

Less obvious, but just as real, questions of equity involve transfers of benefits from members unable to borrow, because of the loan rate ceiling, to those members who are able to secure loans. Whenever a credit union, because of liquidity pressures, has to adopt measures that limit loan extensions, a group of disadvantaged borrowers will exist.

In periods such as the present when liquidity pressures are most intense, the 12 percent loan rate ceiling denies or severely limits Federal credit unions the option of raising loan rates. This restricts credit unions to the option of directly limiting member borrowing.

Directly limiting member borrowing denies the member the opportunity of choosing between loan postponement and an immediate loan at a higher rate. Raising loan rates certainly would not discourage all pending excess borrowing demands. However, those members who did wish to borrow at the higher rates would be providing additional income for the credit union to cover high funds costs.

All types of credit rationing require sets of rules to determine who will and will not have access to loanable funds. These rules must necessarily include some potential borrowers and exclude others. Any set of credit rationing rules is likely to have serious equity implications concerning who is and is not excluded.

The particular group of members to suffer as a result of the ceiling depends on the type of credit rationing steps taken. If a credit union allocates scarce loanable funds on the basis of first-come, first-served, the unfortunate members will be those who are simply unlucky enough to be at the end of the line.

If the credit union establishes a minimum loan amount, borrowers requesting smaller amounts will be excluded. If the credit union raises credit-worthiness standards, lower income borrowers tend to be left out. If the credit union raises downpayment requirements and/or lowers maturities, lower income borrowers will again be excluded. This is because lower income borrowers are less likely to be able to make higher downpayments or the larger monthly payments associated with decreased loan terms.

Thus, most non-price credit rationing plans likely to be adopted by credit unions in times of intense liquidity pressures are more apt to work against smaller, lower income borrowers. This is one of the most important groups of borrowers to whom credit unions provide an alternative to other, higher rate credit sources.

The disadvantage inflicted upon excluded groups can take essentially one of two forms: (1) the borrower will have to forego the use of the credit that was originally requested, or (2) the borrower may obtain credit elsewhere, but at much higher rates.

PRICE RATIONING IS MORE EQUITABLE

The raising of loan rates at a time of liquidity pressures is, of course, also a form of credit rationing. However, rationing scarce loanable funds by price is less likely to work against lower income borrowers than are the typical forms of non-price credit rationing mentioned above. Non-price credit rationing programs also conflict with the monetary policy goals of the nation's central bank.

In the first place, reducing loan demand by rate increases allows each potential borrower the choice of whether or not to seek a loan. It is likely that a rate higher than 12 percent will induce some members who would have been in the included category under nonprice rationing to postpone or forego borrowing. To the extent this happens, more loanable funds would be available to those who would have been in the excluded category under non-price rationing.

Second, removal of the 12 percent ceiling would tend to reduce liquidity pressures by allowing higher dividend rates. This also would tend to provide more loanable funds to borrowers who would otherwise be unable to borrow or be required to pay much higher rates elsewhere. A 12-percent rate which is below actual market rates encourages borrowing and adds to inflationary pressures.

Removal of the Federal credit union loan rate ceiling would not, of course, totally solve all liquidity problems of credit unions and replace all non-price rationing with price rationing. However, to the extent that price rationing is allowed to do the job more equitably, non-price rationing would be required to do less of the work.

THE EQUITY ISSUES IN SUMMARY

A recent paper by William C. Dunkelburg titled "The Transfer Implications of Consumer Credit Regulation," published as Working Paper No. 29 of the Credit Research Center at Purdue University, addresses many of the equity issues discussed above. The following is excerpted from the abstract to Dunkelburg's study:

"The author observes that consumers as savers are the ultimate source of funds to other consumers as well as to government and business. A credit union provides a simple example. In this context, it is easy to see that effective lending rate ceilings lower the return that lenders (consumers) can ultimately earn on their savings. Rate ceilings also determine which consumers can economically be served by the lending institution. Consumers who still qualify for credit at a low regulated price benefit, while those who cannot qualify are forced to find more expensive credit or do without credit services Loss of access to credit can impose significant economic losses on consumers, especially during periods of rapid inflation."

In summary, the search for relief from the 12 percent credit union loan rate ceiling is not an assault on credit union principles, but a defense of them. The intent of Congress in 1934 was to help persons of average means meet their credit needs at reasonable rates—not subsidized rates—of interest. Now it no longer permits reasonable rates of interest to be charged for loans or reasonable rates of interest to be paid for savings.

By protecting borrowers from rates slightly in excess of 12 percent at credit unions, the loan rate ceiling may well be driving many borrowers to loans at twice that rate. During the first 10 months of 1979, the credit union proportion of total consumer loans extended has fallen sharply, while that of finance companies has increased. Total extensions made by credit unions from January 1979 to October 1979 declined 4.4 percent compared to the same period in 1978, while finance company extensions increased nearly 22 percent over the same periods.

The clear decline in the credit union share of the consumer installment loan market relative to that of finance companies strongly suggests that credit union members are being forced to borrow from consumer finance companies at annual percentage rates generally in excess of 20 percent.

At a time when the country had a deflation rate of 6.5 percent, when the banks' prime rate was below 6 percent, when rates on money market instruments never rose above 5 percent, and savings account rates were 3 percent or less, then a 12 percent consumer loan rate was considered a "normal" rate. Under today's economic conditions, "normal" rates are much higher.

With an average U.S. inflation rate in the 1970s of 7.4 percent, the stated loan rate would have to be just over 20 percent to represent an adjusted-for-inflation rate of 12 percent. In fact, if we were to duplicate conditions of the early 1930s, when a 12 percent interest rate coupled with a 6.5-percent deflation rate actually represented a 19-percent real loan rate, the states loan rate today would have to be about 28 percent, a rate for which we are not asking and which would not even be competitive. However, it is illustrative of what has happened to the 12 percent rate ceiling as a result of economic conditions.

IMPACT ON SAVINGS FLOWS

The 12 percent loan rate ceiling is, in effect, a limit on earnings and therefore also a limit on dividends that can be paid for saving. The impact which the ceiling has had on savings flows into credit unions can be clearly demonstrated. As a result of the ceiling, credit union dividend rates have fallen behind rates of return paid to savers at other financial institutions. Loan rate relief is necessary to correct this situation.

Through the first six months of 1978, credit unions had the fastest savings growth rates of all U.S. financial institutions. Further, over the same period, Federal credit union consistently had higher savings growth rates than did state-chartered credit unions. During the first half of 1978, the Federal credit union savings growth rate of 11.8 percent was more than double the 5.2 percent rate experienced at other financial institutions.

However, during the second half of 1978, the growth rate at Federal credit unions plummeted to 1.5 percent while savings growth at other financial institutions dipped slightly to 4.3 percent. Then, during the first eight months of 1979, Federal credit union savings growth rebounded to 5.3 percent, but still below the 6.2 percent rate at other financial institutions. However, in October 1979, credit union savings declined by 2.6 percent or \$1.5 billion in just one month. That is the largest savings outflow for credit unions in any one month. We would also note that, since the middle of 1978, savings growth rates at state-chartered credit unions have exceeded those at Federal credit unions.

The reason for this dramatic slowdown in savings growth at Federal credit unions is not difficult to pinpoint. The time of the slowdown closely coincides with the advent of the Money Market Certificate (MMC). For most of the second half of 1978, Federal credit unions were legally unable to offer MMCs. By the time they were allowed to do so, maximum dividend rates had risen from about 7.3 percent in June to 9.5 percent in November.

Thus Federal credit unions were excluded from the MMC market when rates were relatively low and have been discouraged from active participation since November 1978 because the required dividend rate has been very close to the loan rate ceiling.

More recently, maximum rates on MMCs have risen above the 12 percent ceiling. The October savings outflow at credit unions testifies to this fact. The only way that a Federal credit union can currently break even on MMCs is to invest the proceeds on MMC sales in short-term investments paying more than 12 percent. That, of course, precludes the use of these member savings for member loans.

CREDIT UNIONS MUST RAISE DIVIDEND RATES

Credit union dividend rates will be facing substantial upward pressures in the coming months and years. Many Federal credit unions will require loan rate ceilings relief in order to make these dividend increases.

Ironically, a cost savings enjoyed by credit unions is one of the chief causes of the credit unions' sluggish savings growth. This irony is compounded by the fact that dividend rates on regular share accounts at credit unions typically exceed interest rates paid on passbook accounts at other financial institutions.

The proportion of Federal credit union savings held in the form of regular shares is about double the passbook proportions at other financial institutions. More than half the savings dollars at these other institutions is held in certificates paying

more than passbook rates. Thus the average cost of savings is lower at credit unions than it is at other institutions.

However, rather than this lower cost being a benefit to credit unions, it is the primary reason for their slow savings growth. Therefore, there is a need for credit union dividend rates to catch up with interest rates at other financial institutions in competition for savings.

Available data suggest that, not only have Federal credit unions not been active in the MMC market, but also that they have attracted a very small proportion of savings in the form of other share certificates. Probably the most important explanation of this phenomenon is that credit union loan rates, restricted by the 12 percent ceiling, have been stagnant while loan rates at other financial institutions have been rising dramatically. Since the advent of MMCs, the prime rate has moved from 8.5 percent to over 15 percent while mortgage rates have risen over 350 basis points. Thus many Federal credit unions have been squeezed out of offering certificate programs, which would have maintained their flow of savings to finance member loans.

DECLINING SAVINGS GROWTH

As has been demonstrated, much of the blame for the relative slowdown in savings growth at credit unions must be laid at the feet of the 12-percent loan rate ceiling. However, it should also be noted that total savings flows to other financial institutions have also slowed over the past few years. The problem has been exacerbated by the 12-percent loan rate ceiling.

Not only are aggregate savings rates declining but a dwindling proportion of savings is finding its way into traditional financial institutions. After several years of experience with zero or negative rates of return on savings in financial institutions, consumers are increasingly looking elsewhere for other ways to save.

The growth of close substitutes to traditional financial institutions, like money market funds, and activity in not-so-close substitutes, like housing, commodities and collectables, all attest to the consumers' attempts to beat inflation.

This sort of long-term "disintermediation" is troublesome not only to financial institutions but also to savers who, forced to find exotic ways to save, often sacrifice liquidity and security and undertake additional search costs. This current outflow from financial institutions is likely to grow into something more substantial unless net-of-inflation returns to savers at financial institutions are raised to a positive level.

As a result of these developments, it is likely that permissible returns to savers will continue to increase in an attempt to maintain the predominance of traditional financial institutions as savings vehicles. These increasing returns to savers will require additional dividend rate adjustments on the part of credit unions which will further add to the need for relief from the 12-percent loan rate ceiling.

THE IMPACT ON LIQUIDITY

The ability of credit unions to manage liquidity is severely limited by the 12-percent loan rate ceiling. The ceiling hampers credit union liquidity management in several ways.

In tight money periods, when liquidity pressures are most intense, credit unions are likely to be faced with disintermediation or a net loss of funds. As already noted, this disintermediation is primarily the result of the lid imposed by the loan rate ceiling on the ability of credit unions to pay sufficient dividends.

A case in point is provided by MMCs with a recent rate of 12.6 percent. In the absence of a reduction in loans outstanding to offset share withdrawals, a credit union faced with such withdrawals will be forced to borrow. The borrowing cost to the credit union in today's market will be close to 15 percent. Although a credit union faced with a savings outflow of this type will undoubtedly attempt to reduce loans outstanding, such a reduction in loans is not easily accomplished.

Using aggregate credit union data for September, assume, for example, that a Federal credit union has a loan-to-share ratio of 97 percent and a loan repayment ratio of 5.4 percent of outstanding loans per month. Assume further that this credit union is faced with an unexpected share withdrawal of 15 percent of total shares. This immediately increases the loan-to-share ratio to 114 percent. If the credit union were to absolutely shut off loans, it would take approximately two and a half months for its loan-to-share ratio to fall to 100 percent. The reason for this is not an increase in lending, but a savings outflow.

OPEN-END CREDIT

Liquidity management at all financial institutions is further complicated by the existence of open-end credit. In a recent small survey of Federal credit unions, about 70 percent offered some form of open-end credit. About 6 percent of these programs are credit card programs, the remainder probably being either lines of credit associated with share draft programs or simple pre-authorized signature lines.

With open-end credit, the option of directly shutting off previously granted lines of credit, although legally permissible, is more difficult. Further, it is precisely in tight money periods, when normal sources of consumer credit tend to dry up, that unused lines of credit are most likely to be drawn upon.

Such loan extensions, if excessive, could force the credit union to borrow at "tight money" rates. This forced borrowing, to the extent that it occurs at rates exceeding the net rate of return on line-of-credit loans, implies a subsidy from the general membership to line-of-credit borrowers.

In the absence of the 12 percent loan rate limit, line-of-credit loans could be charged at a rate sufficient to cover the average cost of funds. In this fashion, a special service availability of credit on demand could be provided to some members without requiring a subsidy from members who do not wish to use the service. We recognize, consistent with monetary policy goals, all financial institutions should curtail open-end credit programs in times of tight money. However, it must also be recognized that this is extremely difficult to do.

CREDIT UNION EXPENSES

The average expense-to-income ratio for Federal credit unions remained remarkably stable through 1978. In fact, net of cost of funds, the average operating expense-to-income ratio declined from 35.4 percent to 33.3 percent for 1970 to 1978. However, rising dividend pressures and the loan rate ceiling have caused a slowdown in savings growth at credit unions. In this context, there are undoubtedly many credit unions facing rising expense-to-income ratios because of slow growth.

These credit unions require rate relief, not so much to increase the spread between loan and dividend rates, but rather to raise both loan and dividend rates to encourage savings growth and thereby restore expense-to-income ratios to previous levels.

Some may argue that credit unions could raise dividend rates without raising loan rates as long as they maintain or improve efficiency. This criticism is answered by the fact that the average spread between stated loan rates and effective dividend rates at all Federal credit unions declined from 5.80 percent to 4.99 percent—a reduction of 14 percent—from 1972 to 1978.

Credit unions have been reducing the spread between loan rates and dividend rates. There is very little room left under the 12 percent loan rate ceiling to increase dividend rates. In fact, if all credit unions were to charge 12 percent on all loans, the maximum possible effective dividend rate would be roughly 7.25 percent, a rate that would not quite have matched the average rate of inflation over the past decade.

The fact that the average stated Federal credit union loan rate in 1978 was 11.15 percent reflects the fact that some auto loans and share-secured loans were made at rates less than the 12 percent maximum. Raising all credit union loan rates to the maximum under present conditions would have negative results. For example, the inability to offer share-secured loans at the typical 9 percent rate would lead to further disintermediation.

As noted, credit unions have had trouble attracting certificate funds. The main reason for this has been the loan rate ceiling. The inability to offer 9 percent or lower rate share-secured loans would compound credit union efforts in attracting certificate funds because, if a credit union were not able to offer a share-secured loan other financial institutions typically offer, it would make the credit unions certificates less liquid. Thus, credit union share certificates would be at a comparative disadvantage.

Elimination of the 12 percent ceiling would allow continued increases in dividend rates along with the ability to make various loans at different rates. Credit unions have done about all that can be done under the ceiling.

THE STATISTICAL CASE FOR RELIEF

We asked CUNA's Research Division to perform an analysis of recent credit union operations within the 12 percent ceiling to: (1) determine the extent to which Federal credit unions have needed rate relief during the past two years; and (2) the

extent to which Federal credit unions are likely to need rate relief in the context of market conditions existing during the latter part of 1979 and early 1980.

The model used for the analysis was an accounting model that calculates a credit union's "break even" loan rate. The data used were from year-end information collected by the National Credit Union Administration. A more complete description of the methodology of the analysis and the results are included with our testimony in Appendix 2. We would be happy to provide a complete technical derivation of the model used if the Committee would find it useful.

Basically, the investigation demonstrates that in 1977 and 1978, roughly 70 percent of Federal credit unions seemed to be breaking even under the 12 percent ceiling. Of the remaining 30 percent, slightly more than half were not breaking even under the ceiling and the remainder were too close to call.

When the 1978 data were adjusted to simulate recent and near-term future developments in financial markets, it was found that only 35 percent of Federal credit unions would break even, 46 percent would not break even, and the remaining 19 percent would be too close to call.

Those credit unions able to break even under the ceiling were found to be the larger, more efficient, faster-growing and somewhat more subsidized credit unions. Conversely, the credit unions that were found to have trouble breaking even tend to be smaller, less efficient, slower-growing and less subsidized. These smaller credit unions comprise more than 80 percent of all credit unions.

Since most of these characteristics are intertwined, it is possible that rate relief could work in the direction of alleviating some of the differences. To the extent that rate relief allowed greater dividends, growth would be encouraged. Accelerated growth would tend to lower expense-to-income ratios both by compensating for inflation and by allowing the realization of economies of size.

Any further upward pressures on dividend rates in the near future beyond the average 7.48 percent represented by the simulation would further deplete the ranks of breakeven credit unions and add to the list of credit unions having trouble under the 12 percent ceiling. If this were to happen, many borderline credit unions under the simulation would begin to have problems. These currently borderline credit unions have expense-to-income ratios below average, are slightly above average in asset size, and had 1978 growth rates that approximated the overall average.

In short, under these simulated conditions, only a little more than one-third of all Federal credit unions are breaking even under the 12 percent ceiling. A recent survey of Federal credit unions provides rough correlation for these figures. Of the survey respondents, 73 percent favored relief, 14 percent were opposed, and 12 percent said that relief was not yet necessary.

The survey, which was conducted prior to the Federal Reserve actions of October 6, provides valuable information on why Federal credit unions do or do not want rate relief. The primary reason for wanting relief is cost-of-funds pressure. Those who do not want relief either just do not need it or oppose ceiling removal on philosophical grounds. Those who favor relief, however, appear to be less subsidized than those opposing relief.

THE STATE EXPERIENCE

In 28 of the 46 states with state credit union laws, state-chartered credit unions are permitted to charge interest rates greater than 12 percent, at least on some loans. In one more state, state-chartered credit unions will have ceiling relief in the very near future. These laws have been on the books for periods ranging from two months to 25 years; most, however, have been enacted since 1975. A tabulation of these laws is included with our testimony as Appendix 3.

In spite of this authority, a league survey in early 1977 indicated that only 2.5 percent of all credit unions with the power to do so were then charging more than 12 percent. This undoubtedly was due to a number of factors, not the least being that credit unions are member-owned institutions. In the final analysis, the members themselves make the decisions as to what will be charged for loans and what will be paid for savings.

Under current financial and economic circumstances, more credit unions with the ability to do so are charging more than 12 percent on certain loans. During the week of October 22, 1979, credit union leagues in 22 states which allowed credit union loans in excess of 12 percent were contacted in an informal telephone survey. The leagues were asked to estimate the percentage of state-chartered credit unions in their states currently charging more than 12 percent on at least some loans, and if many such credit unions had begun to charge more than 12 percent in the recent past.

Twenty of the 22 leagues estimated the proportion of credit unions charging more than 12 percent. These estimates ranged from 1 percent to 80 percent and averaged 30 percent. When asked to assess whether many credit unions recently began to make loans in excess of 12 percent, 16 leagues responded yes and 4 answered no.

While no hard data on the practice are available, the recent league survey—given the close level of contact that most leagues have with credit unions in their own states—provides some valuable insight into the extent to which credit unions will charge more than 12 percent if permitted to do so.

A conservative estimate is that 20 percent or more of state-chartered credit unions with the power to do so are charging more than 12 percent on at least some loans. Further, the situation is very fluid. It is apparent that many state-chartered credit unions are at least seriously considering loan rates greater than 12 percent.

The data underscore the fact that removal or an increase in the loan rate ceiling is a permissive action and does not mean that all credit unions will charge the higher rate. Those which need the rate relief will use it, and those which do not need it will not use it. But as current financial pressures continue, more and more credit unions will need the additional latitude to achieve their statutory purposes of promoting thrift and providing a source of credit for their members.

THE DUAL CHARTERING SYSTEM

The Federal credit union loan rate ceiling also poses a potential problem for the dual Federal/state system of credit unions in those states which permit state-chartered credit unions to charge more than 12 percent on member loans.

During September and October, for example, 44 Federal credit unions contacted regional offices of the NCUA about converting to a state charter. During the same time, only one state-chartered credit union inquired about obtaining a Federal charter.

Current interest by Federal credit unions in changing charter status is greater than in previous years, according to NCUA. Moreover, of the 44 inquiring Federal credit unions, 37 acknowledged that the 12 percent ceiling is a major factor in seeking a state charter. In CUNA's recent credit union survey, several credit unions mentioned charter switching as an option in the absence of obtaining relief from the Federal credit union loan rate ceiling.

The dual chartering system will remain viable only as long as there is some parity between Federal and state-chartered credit unions. A major disparity in a critical area such as loan rates, especially under current economic conditions, could lead to a major exodus from the Federal system.

S. 1988—THE PRYOR-BUMPERS BILL

The bill by Senators Pryor and Bumpers (S. 1988) has the laudatory objective of helping credit unions and other financial institutions charge "normal" rates of interest for loans under current economic conditions. It would accomplish this by allowing state-chartered federally insured banks, federally insured savings and loans, small business investment companies and federally insured credit unions to charge the same interest rate as national banks. Section 85 of title 12 of the United States Code provides that national banks may charge 1 percent above the Federal discount rate, notwithstanding any State laws setting an interest rate ceiling.

At present, the discount rate is 12 percent; thus, under the bill federally-insured credit unions could charge 13 percent on loans to their members. While this may be sufficient on business and mortgage loans, it simply does not provide the added leeway which credit unions need in extending consumer credit to their members, given the earning capabilities of credit unions vis-a-vis other financial institutions.

In this regard, we would note that national banks, by an interpretive ruling of the Comptroller of the Currency and by case law, are also permitted to "charge interest at the maximum rate permitted by state law to any competing state-chartered or licensed lending institutions." That ruling continues:

"If state law permits a higher interest rate on a specified class of loans, a national bank making such loans at such higher rate is subject only to the provisions of state law relating to such class of loans that are material to the determination of the interest rate. For example, a national bank may lawfully charge the highest rate permitted to be charged by a state-licensed small loan company or morris plan bank, without being so licensed."

Thus national banks not only may lend at the discount rate plus 1 percent, as installment credit lenders they may charge the highest rate permitted to be charged by a state-licensed small loan company under a state's small loan law. Rates on such loans typically range from 18 percent to 36 percent per year.

Mr. Chairman, credit unions are not asking that they be permitted to charge the high rates charged by consumer finance companies. However, credit unions do need the right to charge rates which recognize the realities of consumer credit and permit payment of real rates of returns on the savings of their members.

At this point, it should be noted that the loan rate ceiling rate for Federal credit unions is 1 percentum per month on the unpaid balance inclusive of all service charges. Thus, under current conditions, a Federal credit union cannot meet some of its expenses in making the loan by adding service charges to the 12-percent rate. Those costs must be included in the loan rate ceiling.

As a result, today's double-digit interest rates have virtually nipped credit union mortgage lending authority, granted only last year, in the bud. Today, as a result, credit unions have for all practical purposes been priced out of the mortgage lending market just as they are being squeezed out of the consumer lending market.

THE ALTERNATIVES

There appear to be three basic alternatives to a fixed increase in the loan rate ceiling. The first would be removal of the ceiling entirely, leaving it up to each credit union to decide for itself what to charge for loans based on market conditions. This would be in the credit union tradition of self determination. In effect, it would be a return to 1934 conditions when the 12-percent ceiling was a normal rate.

A second approach would be to follow the pattern of S. 1988 by indexing the savings rate to some other monetary barometer. As in the Pryor-Bumpers bill, the Federal discount rate could be used but, to aid credit unions the spread would have to be greater than the 1 percent permitted national banks.

We would suggest that the Congress consider indexing the loan rate ceiling to some rate other than the Federal discount rate, some rate more reflective of market conditions. The discount rate may or may not be adjusted with market rates as the Fed has other means of affecting overall interest rates. Another index might be a periodic composite of the Federal funds rate or possibly even the rate charged credit unions by the Central Liquidity Facility of NCUA. Whatever rate is used, it should be as reflective as possible to actual market rates to insure that ceiling rate will decline as well as rise.

A variety of savings instruments are already indexed. For example, MMCs issued by financial institutions are tied to money market rates. Also, the credit union share certificate ceiling rate is now indexed to the average rate on 4-year U.S. Treasury Department securities. Thus, indexing the loan rate is a logical extension of the indexing of savings rates, balancing credit unions' earning ability with their cost of money.

A third alternative would be to grant the National Credit Union Administration authority to grant relief from the present ceiling on a broad or limited basis, i.e., credit union by credit union, region by region, or nationwide. We find this approach the least desirable of all. Such administrative power could raise the spectre of politicizing credit union loan rates which we are sure the NCUA Board as well as the credit union movement would not want. Also, the administrative burden of acting in a timely fashion on what could be literally thousands of applications could be extremely demanding and time-consuming on the resources of the agency.

Based on the history and dedication of the credit union movement, we urge your adoption of the index approach with a proper spread which recognizes the unique purposes and role of credit unions. We believe this approach, which holds out the promise of lower rates as the problem of inflation is brought under control, is clearly preferable to other approaches, such as a flat increase in the ceiling, which might require further action at a later date as economic conditions change.

CONCLUSION

The Federal credit union loan rate ceiling, enacted in 1934 to help persons of average means meet their credit needs at normal rates of interest, is now having the opposite effect.

The purposes of a credit union are: (1) to promote thrift among its members and (2) to create a source of credit for provident and productive purposes. These two purposes are inseparable, the members' pool of savings being the primary source for member loans.

Since members are both the suppliers and users of credit union funds, their interests as savers and borrowers must be evenly balanced. Thus, if members are to receive credit at a fair and reasonable rate of interest, members must be paid a fair and reasonable rate of interest for the savings to supply that credit.

Under current and foreseeable economic conditions, the 1934 loan rate ceiling causes, and will cause, discrimination between members.

The loan rate ceiling excludes certain members, primarily less advantaged persons, from credit union loans and denies credit union members as savers a real return on the money they make available to other members in the form of credit. The ceiling was never intended to have this effect.

CUNA does not believe that lifting the 12-percent ceiling represents a cure-all for credit unions faced with double-digit inflation and interest rates. Nor are we attempting to gain relief from our usury ceiling in order to embark upon lending policies that run counter to the efforts of the nation's central bank in its attempts to bring inflation under control.

Meeting the challenge presented by today's economic conditions and the recent expansion of credit union powers requires more than just relief from an anachronistic lending rate ceiling. It requires sound liquidity management, sound lending policies, sound investment policies, and a sound mix of savings programs—in short, sound management.

Yet even the best-managed credit union cannot survive the pressure of having to plow through the repeated waves of high inflation and interest rates we have experienced during this decade without the flexibility to adjust its lending and borrowing policies to market conditions.

It seems ironic that the debate on usury, which occurred on the Senate floor on the Financial Institutions Deregulation Act, centered almost exclusively around the need to lift State usury ceilings. Regardless of this fact, the debate accurately concluded that in today's market the usury ceilings developed in response to yesterday's market no longer have a place.

For reasons of both equity and economics, the Federal credit union loan rate ceiling should be removed, increased or adjusted to allow credit unions to meet their statutory objectives and to re-establish equity among their members.

Thank you. I shall be happy to answer your questions.

APPENDIX 1

[From the News Messenger, Fremont, Ohio]

LOAN WINDOWS CLOSED AT MANY CREDIT UNIONS

(By Thomas Rizzo)

Credit unions, traditionally a source of low-interest loans to members, are experiencing the same problems as banks and other lending institutions: expensive money.

The loan windows are closed at many Ohio credit unions because they can't charge borrowers enough interest. State and federally chartered credit unions are prohibited from lending money at more than 12 percent interest.

"We're losing money," explained Louise Herring, president of the Communicating Arts Credit Union of Cincinnati. "We can't charge borrowers more than 12 percent even though the prime interest rate is now 15 percent. In other words, the cost of money is too expensive."

She and other credit union officials are counting on a bill currently under consideration that would provide state chartered credit unions some relief.

House Bill 708 would allow credit unions to raise their lending rates from 12 percent to 18 percent.

"I'm opposed to raising it to 18 percent. That's too high," said Mrs. Herring. "We need an increase, but that puts us right up with all the other lenders. The idea of a credit union is to bring low cost credit to the average guy."

John Gouch, executive secretary of the Ohio Credit Union League in Columbus, said the 18 percent mandated in the legislation is a "permissive," emphasizing that "no one is obliged to charge that."

But too often, countered Mrs. Herring, the maximum becomes the minimum. In other words, she explained, some credit unions which have the option of charging between 12 percent and 18 percent will go with the highest rate—so the minimum becomes the maximum.

"What'll happen is the poor guy will be the one to pay 18 percent and credit unions will do what I think is an unpardonable thing by charging more for small loans than big loans; they'll charge 18 percent on a small loan and 13 percent or 14 percent on a car loan," she said.

Mrs. Herring favors a ceiling of 15 percent.

"There's a growing concern among our league members," Gouch admitted, "that 18 percent is a bit much."

Another provision of the bill opposed by Mrs. Herring is a section that would amend the current reserving structure of state chartered credit unions.

"This gives breaks to big credit unions and punishes smaller ones," she said. This, explained Mrs. Herring, would weaken the reserve structure of large credit unions while increasing the reserve rates of small credit unions—thus affecting the small credit union's ability to make loans and pay dividends.

A third provision also opposed by Mrs. Herring is one that would authorize the state superintendent to increase or decrease reserve requirements at his discretion.

"This is too much power to give one man; we should have the rule of law—not the rule of man," she said. "Reserves are too important to the safety of the members' money to be left to the judgment or political pressures of an appointed official."

[From the Oregon Journal, Portland, Oreg.]

CREDIT UNIONS FEELING MONEY PINCH

(By Charles Humble)

Credit unions haven't been left out of the current bind created by soaring interest rates and many are making adjustments, some almost weekly, to compensate.

Almost all are tightening up on credit to their members, most eliminating whole categories of loans.

"Money's tight and it's getting tighter," said Tom Augustine, president of the Oregon Credit Union League. "The bulk are reducing terms and requiring higher down payments . . . cutting out the unnecessary kinds of loans."

Federal credit unions are laboring under a 12 percent usury ceiling. State-chartered credit unions are in somewhat better shape with a usury ceiling of 15 percent. However, most have stayed at 12 percent and are resisting moving higher.

Richard M.M. McConnell, executive vice president of the National Association of Federal Credit Unions, has predicted that "a large number of our members will be out of the consumer loan market by the end of the year."

"Up to six weeks ago, we were in very good shape—our inflow was matching our loans," said Morris McElwee, manager of the 44,500-member Portland Teachers Credit Union. "But when the money market type certificates moved to 12 percent, it got some of our depositors' attention. And at the same time, people are saving less."

Consequently, McElwee finds his credit union, which has assets of \$72 million, having loaned out 97 percent of its deposits. That equalled the national average at the end of September and is up from 85 percent a year ago.

"Normally, we would prefer more liquidity," he said. "Somewhere in the 90 to 95 percent range."

As of Nov. 15, Portland Teachers put restrictions on certain lending categories—those sometimes referred to as luxury items. The credit union presently is not making loans on such items as recreational vehicles, mobile homes, furniture, boats, vacations, stock secured loans, campers, any kind of business loans and loans for investments.

"Right now, we're holding our interest at 12 percent, but that could change in two weeks," he said.

Wood Products Credit Union, with nine statewide branches and more than 30,000 members, curtailed some kinds of lending several months ago, but just this week took further steps to cut back on new loans.

Both its latest moves were in the areas of requiring bigger down payments and shorter terms, according to Leo Hasse, manager of the Portland office.

"We are offering money market certificates," he said, "but we're trying to hold our interest rate at 12 percent. We're considering possibly going higher, but we're trying to avoid that."

Wood Products Credit Union has raised its minimum, down payment on new car loans from 10 to 20 percent and on used cars from 30 to 40 percent. It also has shortened the repayment period from 48 to 42 months maximum on new cars.

"These are big changes," Hasse said, "So far we haven't been hurt by any layoffs in the industry, but we know that might be coming."

Several federal credit unions which got into money market certificates have backed off from issuing them on weeks when the rates paid on Treasury Bills have exceeded 12 percent.

"We're offering them this week because the interest rate is 11.9 percent," said the manager of a Portland credit union. "But next week, the rate will be over 12 percent so we won't."

Meanwhile, credit union groups, including NAFCU and the Credit Union National Association, are pressing federal regulators to lift the 12 percent lending limit which was set in 1934.

[From the Evening Independent, St. Petersburg, Fla.]

HIGH-INTEREST PLANS PUT PINCH ON CREDIT UNIONS

(By Rick Rutan)

A national life insurance official and the president of a Florida credit union association say policyholders and members are taking their low-interest money and buying high-interest certificates of deposit (CD) and money market certificates (MMC).

Persons who borrow against their insurance policies pay between 6 and 8 percent interest. State credit unions are allowed to pay 7.5 percent on savings accounts; federal credit unions may pay 7 percent. The six-month certificates have been paying as much as 12.6 percent.

In a "quick survey" of 15 major insurance companies, the American Council of Life Insurance in Washington, D.C. showed policy loans up 21 percent in September, according to press information director Walter Bussewitz. The latest industrywide report, he said, was compiled at the end of August when policy loans stood at \$32.713-billion.

"That is 8 percent of the industry's assets," said Bussewitz, citing peak years in 1973 and 1974 when policy loans stood at 8.6 and 8.7 percent of the industry's assets.

"It (borrowing on life insurance policies) definitely increased in October after the certificate interest rates went up," he said, "but those figures are not available yet."

Credit unions, meanwhile, are operating under two sets of rules. State-chartered employees' credit unions can charge more than 12 percent interest on loans, raising rates as the state makes adjustments. Their higher loan charges allow them to offer higher interest on savings accounts. Some also have offered "certificate" programs of their own.

Credit unions under federal charter, however, may not go higher than 12 percent interest, making it impossible for them to pay higher dividends.

Federally chartered credit unions were told in October they must maintain a cash reserve of 5 percent of their assets. Prior to that, some credit unions had loaned out all the money from members' savings accounts plus accrued interest.

On Oct. 18 interest rates on CDs and MMCs rose to 11.7 percent. In another week, it was up to 12.6. Credit unions, already overextended, faced the prospect of larger shareholders pulling out their accounts to buy the certificates.

"It has been happening," said Tom Burchnell, president of the Florida Credit Union League Inc., Tallahassee. "Most of the accounts are larger ones—\$5,000 or more."

Burchnell said no credit unions had gone out of business because "we had advised them earlier to be careful." He said some organizations which lend money only to credit unions have certificates available at 12 to 13 percent.

One such group is Southeast Corporate Credit Union. Its daily notes, in denominations of \$25,000 or more, pay as much as 13 percent on certain types of certificates. The rates change daily, he said.

[From the Daily Mail, Charleston, W. Va.]

CREDIT UNIONS APPLY SQUEEZE

(By Johanna Maurice)

Credit unions, because they are owned by the people they serve, have always been the friendliest lenders in town. But even the credit unions, slightly alarmed by the drain on their funds and the rising cost of borrowed funds, have perceptibly tightened their credit policies in recent weeks.

As a result, most are charging higher interest rates—many federal credit unions are charging the legal maximum of 12 percent—in an effort to discourage loans. Others have stopped making car loans entirely, or are requiring larger down payments and shorter terms for loans.

And most credit unions are no longer making loans for non-essentials like vacations and the purchase of recreational vehicles or boats.

The swift policy changes have no doubt surprised many credit union members. Little over a week ago, for example, members of a federal credit union at one Charleston company could still get a new car loan requiring only 9½ percent interest—friendlier terms than at any bank in town.

This week, following a policy committee session, things changed.

That credit union, hoping to discourage borrowing, is requiring larger down payments. And it will make no new car loan for longer than 36 months, a departure from past policy.

In addition, the credit union's policy committee agreed to set weekly limits on lending. Employees who want to borrow money will be dealt with on a first-come first-served basis.

And everybody, regardless of the purpose of the loan, will pay 12 percent. "We increased the interest on ALL loans to 12 percent," a spokesman for the policy committee said sadly. "We had been lending in a range of 9 to 12 percent."

Jose Alonzo, president of the West Virginia Credit Union League, said two relatively recent trends are nagging at credit union managers—the cost of borrowed money and the flight of "smart money" to investments that pay a higher interest rate.

"They [credit unions] are borrowing at the prime rates, which is anywhere from 12½ to 15 percent," he said. "I was hoping that it would top out at 15 percent, but now we'll shoot for 16 percent and hope it will blow over."

On the outflow side, credit union managers have been alarmed by the competition from money market certificates.

One credit union has maintained an average interest of 6 percent on deposits over the past several years, which had been enough to entice employees to desert 5½ percent passbook savings accounts at banks.

But then came money market certificates, which have been paying more than 12.6 percent interest. They have exerted a powerful pull on deposits.

"The biggest thing that's happened is money market certificates," said a member of one credit union's managing committee. "They really crushed us."

When his credit union declared it's semi-annual dividend a few months ago, important depositors stayed just long enough to collect. Then they exited, en route to MMCs.

"After the June dividend, we had a tremendous run on share withdrawals," the manager said. "I know one week alone, we lost people to a total of about 30,000-some dollars."

Until last week, credit unions which suddenly faced that kind of demand for cash to pay depositors could borrow it at 9½ percent interest from the organization that serves all federal credit unions. But no more.

"We had to raise our rate to 12 percent," Alonzo said. "And I don't know of any credit union that's borrowing at 12 to lend at 12. If they borrow, they're using it to meet share withdrawals."

The association that serves the 235 federal credit unions in West Virginia recently warned members that it will make loans only for the purpose of meeting share withdrawals. It will not lend money so that a credit union can expand its portfolio of loans.

"Credit unions are urged to implement drastic steps to insure some means of liquidity for the months ahead," the association warned in an Oct. 29th letter. "The outflow of member's savings is expected to reach record levels in November and through the first quarter of 1980. Your credit union must take steps NOW to avoid serious liquidity problems."

The association told member credit unions to make sure they have enough cash to cover share withdrawals, to stop issuing loans except those secured by shares (if the union is having to borrow money,) to consider not making loans for big-ticket purchases, to reduce loan limits, or to reduce the terms of loans.

In addition, Alonzo said, many credit unions are trying to "jawbone" big depositors into staying instead of pulling out in favor of purchasing an MMC. Credit union managers argue that investors' money, left in the credit union, helps make it possible for the credit union to help fellow employees.

But Alonzo admits that persuading depositors to leave their money in a credit union, where it makes no more than 7 percent, is a hard sell. "It takes an awful lot of philosophy," he said.

[From the Star Gazette, Elmira, N.Y.]

CREDIT MAY BE TIGHTER THIS YEAR

(By Kay Blough)

This year, you think, it's your year to have a super Christmas.

Then, a few months before serious shopping starts, credit tightens. Loans become harder to get.

Money seems less available. Money experts seem to be saying you shouldn't charge many gifts if you want to do your part to help the economy.

Unless you've strictly budgeted for the holidays, it appears Christmas will be leaner than usual.

Right or wrong?

Either, depending on who you talk to and how you do business.

Finance companies say their Christmas lending business doesn't show much of a change so far, although it's still too early to tell since borrowing for Christmas doesn't really pick up until after Thanksgiving.

Richard F. Churchill, manager of Associates Financial Services, said the majority of their business isn't Christmas loans, although some customers increase their loan overhead to have Christmas shopping money.

Since his customers have already budgeted their monthly payment to his company, Churchill said, what they're doing is extending their line of credit.

They may borrow up to the company's \$2,500 limit, Churchill said, but still will have the same monthly payment they have already budgeted.

"If customers had to increase their monthly output, then they probably wouldn't borrow more," Churchill said. "But if they don't have to raise the amount paid out, then they'll still probably borrow."

Credit unions are facing tighter Christmases. Most are discouraging members from borrowing for the holidays. Some have stopped making loans until credit terms loosen.

Mrs. Marilyn White, manager of the Ann Page Federal Credit Union, said they stopped giving loans in the first part of October when the prime interest rate rose.

"People aren't saving like they did before," Mrs. White said. "When people stop saving, we have no money to loan."

"I think people are beginning to realize the situation is difficult. A lot of our members are wondering what is happening in the financial world and agree we shouldn't be borrowing for Christmas."

"We're programmed for borrowing, not for saving. My personal feeling and my advice to the credit union members is not to charge gifts, to buy only what you can afford to pay for."

Matthew Lutomski, manager of the Oak Federal Credit Union, said his firm is discouraging borrowing.

"We're at a stalemate," Lutomski said. "We can't charge any more than 12 percent interest, but we borrow money at a higher rate than that."

"Although people seem to be borrowing as much as they can, we're trying to discourage that because of our stalemate."

William Ramsdell, a vice president at Chemung Canal Trust Co., said credit is generally tighter but that shouldn't affect Christmas shopping money.

People have gotten used to using credit cards over the past 8-10 years, Ramsdell said, and he thinks consumers will gear spending accordingly.

Since the American consumer makes the market, Ramsdell said, people will be shopping and money will be available.

However, Ramsdell said he thinks shopping will be geared to less expensive items.

One reason money will be available is because people have been relying on Christmas saving clubs, Ramsdell said.

This year's amount saved at Chemung Canal was a record \$1,838,846, Ramsdell said. From this he sees that people have enough money to invest in savings, as these clubs are a form of savings.

Ramsdell said charge card use is up this year, showing an increasing tendency to buy now and pay later.

Some Christmas shoppers showed a tendency to pay cash for gifts and a trend toward more practical, less extravagant gifts.

"This year will be about the same for us because it's not the first year I've tried to economize on Christmas," said Mrs. Maud Morse of Corning.

"I normally pay cash so I don't have huge bills. I hunt and hunt until I find something neat for between \$10 to \$20 for people on my list."

"I won't borrow money to have a nice Christmas," said Mrs. Nancy Fulkerson of Dundee. "I normally have enough saved so that I don't have to worry—because I budget for Christmas beforehand."

"It always seems we say Christmas will be smaller each year, but each year it turns out bigger. And each year the prices are up. I like to watch myself, but . . ."

[From the Idaho Statesman, Boise, Idaho]

SMALL BUSINESSES FORESEE BORROWING SQUEEZE

Small businesses that borrow money as a matter of course will be squeezed by the Federal Reserve Board's actions on Oct. 6 to restrict credit growth, businessmen say.

If the result of the action is a recession and reduced demand, prices could go up, and one businessman said he thought the government was simply passing the blame for inflation to consumers.

"They instigated inflation," said Mike Goffin, owner of Mike's Americana, a Boise furniture store. "I wish the government were up from about what they're trying to do."

Consumers who buy appliances on contracts may have to pay more for their goods than before if high interest rates and credit tightening slow business for a long time, said Mike Madison, president of the Idaho Home Furnishings Association.

Appliance and automobile dealers often work out financing plans for their inventories with the manufacturers. The financing, called flooring plans, is essentially a line of credit with an interest rate generally 1 or 2 percent more than the prevailing prime lending rate.

Furniture dealers, however, will borrow some money from banks to finance the cost of furniture inventories, Madison said.

But because the Treasure Valley has an extremely competitive market (with 26 furniture stores in Boise, Nampa and Caldwell), appliance dealers and furniture store dealers try to cut costs to maintain a decent profit margin, he said.

If sales slump and high interest rates continue, stores will be forced to pass on at least some of the interest costs to the consumer, Madison said.

Banks haven't decided yet what to do about interest rates on consumer loans. Retail businesses that grant credit, such as auto or appliance dealers, say they can't make any decisions until they know what the banks will do and what the marketplace will allow them to do.

Interest rates probably will go up on installment loans, said W. Brent Robinson, president of Citizens National Bank, but he couldn't say how much yet.

"The cost of money is getting out of hand," said Dennis Dillon, president of Dennis Dillon Oldsmobile, South Orchard Street and Interstate 80N.

"The only way we can react is to work on what we control," he said. "If we have an item that doesn't sell very well, we may have to stop the line and special-order it later."

Dillon said he had had more repossessions this year than ever before.

"Some of these are with people with solid jobs," he said.

Robinson of Citizens said mortgage foreclosures had increased this year. Until this year, he said, he had seen about 3 foreclosures in 9 years of working at the bank. This year, the bank has had to start 2 foreclosure proceedings.

Idaho's bankers are only starting to study the ramifications of the Federal Reserve Board's Oct. 6 action to raise to 12 percent its discount rate, the interest rate it charges banks for borrowing money. More important to the consumer, the board voted to increase credit reserves to try to control the U.S. money supply. Interest rates will be permitted to find their own level under the action.

"It's just too early to say what will happen to interest rates," said a senior officer for one bank. He asked not to be identified.

Partly, that is due to the banks' not having analyzed the situation completely yet. At the same time, the banks face competition from credit unions and finance companies, such as Ford Credit Corp or General Motors Acceptance Corp., who aren't directly affected by the Fed's decision. All those institutions tend to generate most of their money from their existing loans.

Demand for loans from credit unions has increased because their loans are cheaper than consumer loans from banks right now, said Gordon Bixler, executive director of the Idaho Credit Union League.

But the increased demand has caused some problems for credit unions. Some credit union members have to put their names on waiting lists until the cash for a loan is available. Other credit unions have borrowed money to meet the demand from the Idaho Corporate Credit Union, whose members are other credit unions

only. The corporate credit union's rates now are about 9.75 percent for member credit unions and 10.5 percent for non-member credit unions.

Meanwhile, federal law allows federally chartered credit unions to charge a maximum of 12 percent interest on loans and a maximum of 7.5 percent a year in dividends on savings. One credit union manager said the credit unions had had problems holding onto money because savers of \$1,000 or more could buy money market certificates, which pay more than 10 percent a year.

The Idaho Code does not set maximum interest rates for state-chartered credit unions.

The prime rate charged by commercial banks to their best customers on a short-term basis has risen to 14.5 percent. The U.S. Treasury Department had to agree this week to pay between 11.7 percent and 11.8 percent interest on Treasury bills, short-term securities sold to raise the cash to pay to the government's bills.

[From the Post Intelligence, Seattle, Wash.]

EVERYBODY'S CAUGHT IN THE CREDIT SQUEEZE

"I'm a credit card junkie. I always go over the limit. The bank used to send me a friendly letter telling me I was over. I'd send them a check to keep them happy and go back to charging. This time they took my card—told me I could reapply when I paid the balance. I tore the letter up. I've got plenty of other cards."

"I checked with the credit union to make sure I could get a signature loan. They said, 'Yeah, sure,' so I went ahead and ordered my new furniture. So now, when I want the money, they tell me they don't have any money to loan."

Such are the tales of woe emerging as the state's usury ceiling collides with the Federal Reserve Bank's squeeze on credit supply and the subsequent forcing up of interest rates.

Banks, credit unions, retailers—anyone covered by the state's 12 percent interest rate ceiling—are either restricting credit or swallowing losses. There's little profit incentive when money borrowed at 15.75 percent must be loaned at 12 percent.

The picture is further clouded by the ravages of inflation. The response of the battered consumer ranges from the inflation mentality of "buy now, quick, before prices go up again," to belt-tightening conservatism as the consumer becomes more and more apprehensive about the state of the economy.

Banks have moved forcefully to restrict credit. They are limiting loans to people who already have deposits at the bank, requiring higher down payments, cutting loans to new businesses and other "risky" ventures, shortening repayment terms and restricting bank credit card applications.

Robert F. Buck, executive vice president of Rainier National Bank, said the bank was "looking at our Visa and Mastercharge applications very closely, and we certainly aren't soliciting them." On installment loans, Buck said, "We're sticking very close to our policies. The kinds of things that in better times you might make some exceptions for, we don't now."

Seattle-First National Bank reports similar steps. It hasn't limited repayment terms. But on car loans, for example, it recently raised the down payment requirement from 20 to 34 percent.

Doug Shaw, vice president and manager of marketing for Peoples National Bank, said loan officers are taking a closer look at the purpose of the loan.

"If it's a guy who has to buy a car to get to work, we'll try to help him," Shaw said. "But we aren't particularly interested in luxury items. We want to take care of the needs of our customers and we can't do that if we make every loan that comes in the door."

The tougher attitude has already slowed the growth of debt in the last month. Rainier, for example, said net new loans (the money lent out minus the money paid back) slowed to \$2 million in October, about one-fifth the rate earlier in the year.

Credit unions have been badly hurt. Many have seen their reserves drastically reduced as members withdrew savings. Some members wanted to reinvest their money for a higher return—for example in mutual funds or money market certificates. But others were forced to spend the money because of inflation. Again, because of inflation, they can't afford to save as much.

The withdrawal of savings has forced some credit unions into a borrowing position. Since they must abide by the usury ceiling, they can charge only 12 percent on money that cost them 15.75 percent. Most have elected to sharply restrict loans instead.

Bud Jewell, executive director of the Boeing Credit Union, said loans have been "cut back drastically. We're up against the usury ceiling and the money's not available to loan."

Wilma Robinson, Seattle branch manager for the Washington State Employees Credit Union, said the union stopped loaning last week, "except in dire emergencies." Robinson said the union would have to borrow because of loss of savings—over \$2 million was withdrawn from savings in the month of October alone.

The reductions come at what would normally be the busiest time of the year for credit unions—members borrowing for the Christmas season.

"We make lots of small loans at Christmas," Robinson said. "Normally we would do more loans in the next six weeks than any other time of the year—at least in terms of number of loans, not dollarwise."

"We usually have a Christmas rush," Jewell said, "but we won't be loaning this year."

Retailers who do a large percentage of credit sales are caught in the same bind—they can charge only 12 percent for money that cost them more. But they are exceedingly reluctant to tighten credit for fear of losing sales.

Downtown department stores say there is no change in credit practices and their spokesmen issue cautious statements such as "we're watching the situation and seeing what develops."

But one credit manager admitted the situation was "getting really terrible." Despite the losses already swallowed, however, he said he didn't anticipate any restrictions on retail credit until the first of the year. "My gut attitude is that I don't think anybody is willing to do anything before Christmas," he said.

Mike Waller, controller of Continental Furniture, said the store "will absorb the (credit) loss."

"We have to continue to make retail sales," Waller said "We're looking beyond this time. We can't turn things off without doing a heck of a lot of damage. And the customer will remember. So it's better to take some loss than to lose a good customer."

"But this increases cost," Waller added. "Ultimately the customer will pay in the form of higher prices."

While retailers are willing to take some losses for the sake of Christmas sales, they are unenthusiastic about prolonged losses. Their hopes are presently pinned on the state Legislature which, when it convenes in January, will be asked to do something about the 12 percent ceiling—probably to raise it, at least temporarily. Businessmen agree the ceiling is set at an unrealistically low level.

The Association of Washington Businesses is at work drafting proposed legislation, but association president Doug Bohlke said the group had not yet settled on a specific recommendation.

But "There's got to be some relief," Bohlke said. "If there isn't, we're going to see a rise in prices or the cutting off of credit and eventually layoffs and the demise of smaller businesses."

[From the Sun, Baltimore, Md.]

CREDIT UNIONS CURTAIL AUTO LOANS, OTHERS

(By Ted Shelsby)

Credit unions, which traditionally have done a big part of their business in automobile financing, are cutting back sharply on the number of loan applications they are approving.

Mr. J. Domenick, managing director of the Maryland Credit Union League, Inc., says most of these financial cooperatives in Maryland are caught in a "liquidity squeeze" stemming from the Federal Reserve Board's credit-tightening measures and as a result, most have quit making big ticket item" loans for such things as boats and recreational vehicles. Even some home-improvement loans are being rejected.

In addition, Mr. Domenick noted that about one-fourth of the smaller credit unions (those with assets under \$500,000) have gotten out of the car loan business, except in cases of emergencies. He said 94 of the 221 cooperatives in Maryland would be termed small.

The problem is not confined to Maryland. James R. Wilson, president of the National Credit Union Association, says inflation is the paramount problem facing credit unions today.

"It is making it impossible for us to keep up our basic purpose of low-cost loans because we are no longer able to provide them."

As a result of these conditions, Mr. Domenick added that it is not uncommon at this time for some members of these same credit unions to have to wait to withdraw funds from their savings accounts.

The problem, he explained, is that during the present period of high interest rates the cost of borrowing money is between 13 and 16 percent. This compares with the 12 percent limit credit unions can charge for a loan.

Compounding the problem is the decline in saving activity on the part of members, due in part to credit unions dragging their feet on offering money-market certificates, which pay interest based on six-month Treasury bills.

Mr. Domenick noted that while savings are running about 9.5 percent ahead of last year's pace, this is not enough to keep up with loan demands. He said that during the same 12-month period ended September, 1978, savings were up about 18 percent, "We need 18 percent for normal growth," he added.

Mr. Domenick was quick to point out that the current rate of savings deposits in credit unions compares favorably with commercial banks, savings and loans and mutual savings banks.

To stimulate savings activity, more credit unions are moving into money-market certificates. And at least one credit union in the state has made a personal appeal to its members to build up their savings, saying that by doing so everyone will benefit eventually.

Mr. Domenick acknowledges that some credit unions were burned by their slowness to offer the money-market certificates.

He noted that a number of credit unions began noticing some sizeable savings withdrawals shortly after commercial banks added the savings plan. "The only reason these people were withdrawing was that credit unions didn't offer the [money-market] service."

Recognizing their mistake, between 20 and 25 credit unions made T-bill certificates available to their customers during the third quarter alone, according to Mr. Domenick. He expects this trend to continue.

With its appeal for increased savings, the Central Credit Union of Maryland sent letters to its members explaining that it had experienced a substantial increase in requests for loans over the past few months.

[From the Express, Newport, Vt.]

RAISE CEILING

MONTPELIER, Vt. (UPI).—Banking and Insurance Commissioner Stewart Ledbetter is expected this week to raise from 12 to 15 percent the ceiling on interest rates credit unions can charge.

The credit unions maintain they have to charge higher interest on loans so they can pay higher interest on savings accounts, thereby attracting more depositors.

Ledbetter said the shortage of deposits has forced some credit unions to require larger down payments on loans and to issue shorter term loans, while some have stopped making loans altogether.

There are 65 state-chartered credit unions in Vermont, with 60,000 members who have invested \$60 million.

Ledbetter said the interest rate hike won't effect the state's five federally chartered credit unions.

[From the Arizona Daily Star, Tucson, Ariz.]

SOME CREDIT UNIONS LIMIT LOANS IN MONEY SQUEEZE

(By Bill Bank)

Some local credit unions are feeling the pinch of dearer money and curtailing loans, but so far it seems to be business as usual for most commercial banks.

The Tucson Teachers Federal Credit Union loan maximum ounce was \$100,000, but "not it's \$12,500 per member," except for any additional vehicle loans, said Dick Avery, the union's assistant manager.

At the Hughes Federal Credit Union, real property loans were curtailed about six months ago, said loan manager Ken Rogers. "Because of our liquidity position, we

stopped making those 12-year home-improvement and second mortgage-type loans. We haven't made any since May 30."

The Hughes credit union also decreased the maximum allowed on unsecured loans from \$1,500 to \$1,000. "But we don't anticipate any future curtailments and are still making all other types (of loans)," Rogers said.

The Davis-Monthan Credit Union, one of the largest in the state with 38,000 members, is "limiting certain types of loans—for recreation vehicles and things of that nature—but we are looking at each individual case," said Dick Dickens, assistant to the general manager.

Also, mortgage loans have been temporarily suspended, and the ceiling on unsecured loans has dipped in general cases from \$5,000 to \$2,500, Dickens said.

The Tucson Newspapers Inc. credit union, which clamped some limitations on borrowing two weeks ago, has now stopped granting loans automatically in almost all cases. Only 100 percent share-secured loans are assured now, while other applications will be reviewed bi-weekly.

Commercial banks, while a bit more cautious in lending practices than a year ago, still are meeting most requests for loans, spokesmen said yesterday.

Jack Davis, executive vice president at United Bank, said his outfit still has not had to curtail loan activity. "We keep expecting to have to, but so far it just hasn't been necessary," he said.

Bob Pennington, senior vice president at First National Bank, said his bank is still making loans in all categories.

But several savings and loan companies have begun limiting their loans to existing customers.

"Our priority is to our present customers with savings accounts," said Ron Swager, a spokesman for Home Federal Savings & Loan Association.

[From the New Hampshire News, Manchester, N.H.]

NEW HAMPSHIRE CREDIT UNIONS IN A SQUEEZE

(By Peter Harrigan)

CONCORD, Oct. 20.—State Banking Commissioner Roland Roberge says credit unions in New Hampshire are suffering due to a 12 percent "cap" on loans they may write, and that he hopes to repeal the provision if there is a special legislative session next year.

There is no usury law in New Hampshire, but the legislature years ago directed that credit union loans "shall not in any case exceed one percent per month on unpaid loan balances." Roberge said the provision was once considered meaningless because no one thought interest rates would ever meet current levels.

"Credit unions are now in a tough bind. They've had to shut off some loans, because how can they lend money out at 12 percent if it costs them 11.6 for certificate accounts? They should have a point and one-half spread to stay healthy," Roberge said.

Roberge said some credit unions have borrowings of their own of up to 20 percent of their assets. A \$10 million credit union, for example, might be paying 15 percent interest, or \$300,000 a year on \$2 million, and only be able to lend the same amount out at 12 percent, or a \$60,000 loss, he explained.

"Add operating costs and the loss may be close to \$100,000 per year on loans . . . If this continues without legislative relief there could be problems," Roberge said.

There are 38 state-chartered and 32 federally-chartered credit unions in New Hampshire, with total assets of \$200 million and 185,000 members. Credit unions are tax-exempt nonprofit cooperatives which pay dividends on savings accounts.

Credit unions specialize in short-term consumer loans, and as a result of the 12 percent loan cap some have had to send customers to commercial banks or finance companies where interest rates run from 17 to 18 percent, Roberge said.

The state banking commissioner said he told the N.H. Credit Union league during the last legislative session that it should seek removal of the provision but that "the industry stood still."

"They see themselves as the 'credit union movement.' Their philosophy is that they are true cooperatives, and they've had some opposition within their own ranks to lifting the 12 percent cap," Roberge said.

A LAST RESORT

Roberge said he has discussed the problem with the office of Gov. Hugh Gallen, and that he expects to lead the effort to remove the provision. As a last resort Roberge is even prepared to seek review of the statute by the N.H. Supreme Court, he said.

Richard Reed, managing director of the N.H. Credit Union League, agreed with Roberge that "credit unions are now in an economic bind." He said the league plans to take some form of action in the 1981 legislative session to change the law.

Reed said that about a year ago he sent out five different releases to league members asking their reaction to seeking a repeal of the interest ceiling, but that he received no response. He said the impact of the ceiling "has come all at once" with record high interest rates throughout the banking industry.

Some credit unions have stopped making recreational loans for such things as skimobiles and minibikes, and have also been advised to tighten up on loan policies, Reed said. There is also a trend toward requiring them to keep more money on hand, he added.

"Credit unions have traditionally made loans that other institutions wouldn't touch. Our philosophy is to lend on character, but now we are having to make sure our loans are adequately secured . . . We're a unique breed in that we bend over backwards to serve our members, but at the larger levels we've had to become less personal," Reed said.

[From the Waterbury American, Waterbury, Conn.]

CREDIT UNION LENDING HIT

Many of the 611,000 credit-union members in Connecticut are suddenly finding they can't borrow money as easily or as cheaply as they once did.

Of the 171 state-chartered credit unions, 26 have raised their loan rates from 12 to 15 percent now that they are permitted to do so, said Jerry LeMay of the Connecticut Credit Union League in Wallingford.

Moreover, many of the remaining 404 credit unions in the state have had to tighten restrictions on borrowing because of difficulty in finding money at rates cheap enough to lend it out again at 12 percent he said.

"Many smaller credit unions are tightening their belt," he said.

[From the St. Paul Dispatch, St. Paul, Minn.]

AMERICANS OWE MORE THAN \$300 BILLION

(By Mike Bulger)

Consumer credit is increasing in this region, but maybe not as fast as record national figures would suggest.

The Federal Reserve Board reported Tuesday that Americans now owe more than \$300 billion for credit card and other installment loan purchases as they increased their debt by a record \$4.45 billion in September.

William Dalin, vice president of Bloomington-based Shopper's Charge Service, said there has not been a significant jump in consumers' use of credit.

"We have seen no real change in the pattern of consistent growth. Business just keeps increasing year after year," he said.

Richard Kothe, director of research for the Minnesota League of Credit Unions, said there has been an increase in loan demand, but many credit unions in the state are having a hard time meeting it.

"I would say loans are growing at a lesser rate than the general trend," he said, listing several reasons. Among them:

Minnesota law limits interest on consumer loans to 12 percent, which today is low compared to other interest rates.

Federal regulators have increased the amount that credit unions must keep in liquid reserves effective Dec. 31, forcing some to hold back funds to meet the requirement.

Credit unions, like other savings institutions, have seen "large sums" leave the normal savings account in favor of high-interest money market certificates.

"We generally have a seasonally adjusted inflow (in savings) at this time of year," Kothe said. "That seems to have slowed down."

"Right now I would have to say we're having a real sluggish inflow. At the same time, we're sluggishly putting money out."

At First National Bank of St. Paul, the use of bank credit cards and checking overdraft loans "have not increased in the same relationships that are indicated by the national trend," said Richard B. Jude, senior vice president for consumer banking. He said that use of credit cards is up about 10 percent this year, a rate lower than the national figures, and that use of overdraft checking is virtually unchanged.

Jude said First National "is open to our customers for credit for legitimate needs," but it is not making loans for investments or speculation.

He said there has not been an increase in demand for loans to consolidate debts, "which is a good sign."

The Federal Reserve said at the end of September Americans owed \$303.9 billion on their bank, retail store and gasoline credit cards and for loans written on automobiles and mobile homes. The statistics do not include more than \$750 billion owed on home mortgages.

Installment loans passed the \$200 billion mark in May 1977, government records show. They topped \$100 billion for the first time in December 1969.

Economists have been watching the debt figures closely because some fear Americans are taking on more loans than they can handle. Others fear that heavy borrowing now will force retrenchment in future months, just the opposite of what would be needed to spur the economy should it fall into recession.

"There's nothing to indicate there's a problem," Dalin said. Shopper's Charge has had no increase in delinquencies or charge-offs from bad accounts.

The new debt total resulted from record borrowing in September of \$28.6 billion, up 3.8 percent from August. At the same time, Americans paid off \$24.2 billion, down from the record \$25.1 billion in installment loan payments in August.

In other economic news Tuesday, the prices consumers pay for petroleum products have risen between 50 percent and 60 percent this year in the wake of higher prices charged for crude oil by the Organization of Petroleum Exporting Countries, according to Council on Wage and Price Stability.

And the Federal Home Loan Bank Board reported that the effective interest rate on mortgages for new homes jumped to a record 11.18 percent in early October. The increase from 11.02 in September marked the 24th consecutive month in which mortgage rates have risen, according to the bank board. Interest rates on mortgages for previously occupied homes rose from 11.2 percent in September to 11.3 percent in October.

And rates could go still higher in coming months because of action taken in October by the Federal Reserve to tighten credit.

[From the Courier, Waterloo, Iowa]

CONSUMERS FINDING COST OF BORROWING IS GOING UP

(By Steve Salato)

Getting money to buy a new car, to make home improvements or to purchase whatever one may want or need is becoming more expensive as financial institutions increase their interest rates.

Several lenders are increasing their interest rates on consumer loans because the costs they must pay to borrow money have also gone up, as evidenced this month in increases in the "discount" and "prime" rates.

The discount rate, increased from 11 to 12 percent, is the rate the Federal Reserve Board's member banks are charged when they borrow from the federal government.

The prime rate, which had been 13.5 percent in early October, increased to 14.5 percent, then to 15 percent earlier this week and to 15.25 percent Friday at Citibank, the nation's second biggest bank. The prime rate is the rate charged a bank's most credit-worthy customers.

The purpose of the increased rates is to discourage borrowing, hopefully resulting in a tightening of the money supply and a slowing of inflation.

"The cost of money is high. It's anybody's guess as to how long the high money market situation might last," said Larry Nuss, manager of the Muni-Fac Credit Union in Cedar Falls.

Traditionally, credit unions have loaned at 12 percent interest, but some are now having to increase their rates.

"It's something we've always been proud of, maintaining low interest rates for our membership," Nuss said.

But pride has now taken a back seat to economic wisdom at the Muni-Fac Credit Union. "The board of directors on Nov. 5 has elected to go to a 15 annual percentage rate on all new loans," Nuss said. "Anybody that has existing loans on that date will stay at 12 percent."

At least one other credit union in the area has already increased its rate from 12 to 15 percent. Beginning Oct. 15, the Chamberlain Manufacturing Corp. Employees Credit Union began charging its members 15 percent on borrowed money.

"When we have to borrow money, we have to borrow money at 11.75 percent and therefore we were not making anything by loaning at 12 percent," said Carolyn Bird, an employee of the credit union.

Officials at the John Deere and Rath employees credit unions said their institutions are still charging 12 percent and do not intend to increase the rates.

LeRoy Letney, executive vice president and manager of the Rath Employees Credit Union, said, "We've been there (at 12 percent) since we were organized in 1934. We have no intention of raising our rates."

Layton Stump, manager of the John Deere Employees Credit Union, said loans are still being made there for 12 percent.

"We have adequate funds, and we're not being forced into the borrowing market," said Stump, explaining why the John Deere credit union has not found it necessary to increase its interest rates.

Asked if the credit union might have to increase the rates at some point, Stump said, "We don't see it in the immediate future. I don't know what the immediate future is. I can honestly tell you we have not discussed going higher than 12 percent. But I can't guarantee they'll never go higher."

Stump said that interest rates generally will be lower at credit unions than at banks.

"In my opinion, the facts will bear out most credit unions are 12 percent or below and banks are 12 percent or higher," Stump said.

Dave Sasse, head of the installment loan department at the National Bank of Waterloo, said Stump's comment "would be a correct statement" because credit unions, unlike banks, are non-profit organizations that can operate while breaking even.

But Sasse said that even credit unions will have to increase their rates if they start borrowing from outside sources.

The increasing costs that financial institutions must pay to borrow money are causing lends to boost the rates they charge consumers.

"We are considering moving our rates again because of the extreme expense of money cost," Sasse said. "I am sure in the next week to two weeks we'll be increasing again. I would look for at least a percent in some areas, maybe as much as 2 percent."

For example, Sasse said the bank is currently making 36-month loans on new cars at 12 percent, but is thinking about increasing the rate to 13.5 percent or 14 percent.

So that it can make a profit, the bank must think about increasing its rates because the bank borrows money from the Federal Reserve at 12 percent while paying its customers a high rate, currently 12.65 percent, on six-month money market certificates, Sasse said.

Under Iowa law, the maximum rate a bank can charge on installment loans is 15 percent. If money costs would continue to increase and the ceiling rate wasn't lifted, Sasse said financial institutions could find themselves in the same position with installment loans as they are it with home mortgage financing.

In many cases, home mortgage funds have dried up because financial institutions, under Iowa's usury law, can make conventional loans for only 11 percent, although the firms must pay higher interest rates when they borrow from the Federal Reserve.

"Our volume is down some," said Sasse, noting the effect the higher interest rates are having. "I think there is public awareness that money has become more expensive, and I would think people are curtailing their borrowing, but I don't know how much that curtails their actual spending."

Dick Hansen, an officer in the consumer loan department at the Peoples Bank and Trust Co., said "We've steadily increased our rates because our money costs have gone up. Our last rate increase was from 13 to 13.5 percent on the bottom end. It's went up in the last year and a halftime from 10 percent to 13.5 percent. Profit wise, I'm not sure if we're making any more than we did a year ago just because of costs."

Hansen said logic indicates the higher interest rates will slow down consumer spending, "which is what the government is trying to do."

[From the Richmond News Leader, Richmond, Va.]

CREDIT UNIONS FORCED TO RESTRICT LOANS

(By Allen McCreary)

Rising interest rates have prompted heavy withdrawals of savings from some Virginia credit unions and forced them to restrict or eliminate some types of loans.

Virginia's State Employees Credit Union Inc. began notifying members today that no money is available for new car loans. Other loans are being restricted to a maximum of \$1,500.

Mrs. Dorothy J. Hall, general manager and treasurer of the State Employees Credit Union, said some \$750,000 in member savings have been withdrawn in recent months.

"They don't tell us exactly, where they're putting the money, but we know many of them are investing it for higher yields elsewhere," Mrs. Hall said.

In an attempt to stem the savings out-flow, the state credit union plans to offer higher-yield savings certificates beginning Dec. 1, Mrs. Hall said.

Savers who put in larger amounts of money for six to 24 months would get a higher return through the new certificates, she added.

Bill Stark, vice president of the Virginia Credit Union League in Lynchburg, said some credit unions have cut out car loans and are restricting other loans.

"I can't tell you right now which ones have cut out car loans, but many of them are cutting back on the percentage of financing on car loans—offering only 80 percent of the cost instead of 100 percent for instance—and others are reducing the length of the loans," Stark said.

"We've been telling them all for several years to plan for the problems we have now, and most are pretty well managed," he added.

"Some have begun to pay higher rates on savings to hold on to the savings they have; they can't borrow at 15 to 16 percent and lend money at 12 percent," Stark explained.

The State Employees Credit Union has assets of \$18.1 million, Mrs. Hall said. She said the persons who are saving smaller amounts have not abandoned the credit union, where the annual yield on savings amounts to 6.39 percent.

Some persons with substantial savings in the state credit union have found it more profitable to invest in money market securities and other higher-yielding plans, however.

Thomas Andrews, treasurer-manager of the Du Pont Fibers Employees Credit Union in Chesterfield County, said loan applications for large cars have been scrutinized more carefully during the past six months.

Thus far, however, the Du Pont credit union has not placed an across-the-board restrictions on car loans, he added.

"We hope we don't have to cut out such loans, but we're monitoring the situation every day," Andrews said.

John Skelton, president of Richmond Newspapers Employees Federal Credit Union, said "We're on about a two-week delay right now, but we haven't eliminated car loans or restricted the amounts of personal loans."

A spokesman for the employees credit union at the Defense General Supply Center at Bellwood said loans are being scrutinized more closely to avoid potential bad loans. Other lending restrictions were put into effect last May.

The Bellwood credit union has not restricted car loans, however.

The state credit union restriction limiting loans to \$1,500 enables the organization to continue to provide smaller loans for emergency purposes, Mrs. Hall said.

Stark said the Virginia Credit Union League has been urging member credit unions for several years to make preparations to ensure that they will be on sound footing to be able to continue small loans and emergency loans.

"We think we've planned well for the problems we're now facing. Every credit union carries depositor's insurance, so the members' savings aren't in any jeopardy at all," Stark said.

[From the Hawkeye, Burlington, Iowa]

LOCAL CREDIT UNIONS MANAGE STEADY INTEREST RATES

While credit union loan rates creep steadily upward across the state, most Burlington and West Burlington organizations are holding steady at 12%.

A telephone survey of local credit unions Thursday showed that with only one exception, members can borrow money at 1% per month on the unpaid balance.

Statewide, 11 credit unions are charging 15%. One of those is the Burlington Municipal Employees credit union, which charges 12% annually on share loans and 15% on other secured loans.

According to Dick White, BMECU president, share loans are granted to persons who borrow against their savings with the credit union. Other loans use some item of property as security.

All of the credit unions contacted stressed that although the rate is listed at 12% annually, the actual amount charged decreases as the balance of the loan decreases.

Fred Downey, director of field services for the Iowa Credit Union League, said the differing rates were approved in 1974 when the credit union by-laws were revised.

Under the revision, credit unions were given an option to charge up to 15% on closed-end loans. Closed-end loans require that whenever additional money is borrowed, a new set of documents is drawn up.

Open-end loans may be refinanced before completely paid, and interest on those loans is set by law at 12% annually.

The rationale behind lower rates for share-secured loans is that "the individual is putting up his savings for collateral." And the best collateral for money is more money," Downey said.

The largest credit union in the two-city area is the Iowa Ordnance Plant Federal credit union, whose assets at the end of 1978 were \$2.7 million, according to ICUL records. The IOP serves employees of the Iowa Army Ammunition plant at Middletown and other government employees.

Casebine credit union ranked second, with 1978 assets reported at \$1.5 million, representing J. I. Case employees. Three I, representing Iowa Industries Inc., reported \$1.4 million assets.

Also contacted were Zephyr Credit Union, representing the Burlington Northern railroad, and the Hawk Eye Employees credit union. Both reported charging the 12% annual rate.

Most reported interest rates have been steady for several years. Carolyn Balzer, Zephyr, said she has worked for the credit union for 10 years, and "it hasn't changed in all the time I've been here," but added, "it's getting to be more of a battle all the time," to keep interest rates down as inflation pushes rates up elsewhere.

Jerry Harvey, IOP, said their 12% rate "has been the same since we opened the doors in 1949."

At Casebine, Betty Duncan said their rates haven't fluctuated in some time, adding "we've never had any problems loaning out money" to employees.

According to Downey, credit unions have the option of charging 18% on the first \$500 of any loan and 15% on any amount above that amount. No one has requested permission to use that provision in loaning money, Downey said.

[From the Milwaukee Sentinel, Milwaukee, Wis.]

FOUR MAJOR BANKS RAISE PRIME RATES TO 15 PERCENT IN STATE

(By Lennox Samuels and John Tracy)

Wisconsin's major banks, like others in the nation, raised their prime lending rates to 15% Tuesday, and there were predictions the rate would climb even higher.

The First Wisconsin National Bank of Milwaukee, M&I Marshall & Ilsley Bank, Marine National Exchange Bank and First Bank—Midland added another one-half of 1% to the current 14½% rate in a continuing reaction to the Federal Reserve Board's tight money policy. The policy was designed to reduce inflationary borrowing.

Gordon H. Gunnlaugsson, an M&I vice president, said he did not think the lending rate has peaked. "It may very well go up some more," he said.

James Dolister, executive vice president of Continental Bank & Trust, agreed. "I think the rate will go up a little more yet," he said. "I wouldn't be at all surprised if it went to 16% before it levels off and begins to drop."

The prime rate is what banks charge their most credit-worthy customers.

Bank officials said that since the Federal Reserve Board started the tight money policy about two weeks ago, the cost of funds (certificates of deposit) has gone up about four points, from 11½% to about 15½%.

At the same time, the prime rate has moved less than two points, from 13½% to 15%.

Larry Elton, senior vice president for First Bank, said he did not expect the increase from 14½% would have much impact on people interested in home mortgages, because they are already finding it difficult to get such loans.

He said a higher down payment will "absolutely" be required now, but "that might become moot because the real estate lenders may not want to lend, regardless of the down payment."

"We're already at the level where the rate has almost pre-empted (the average home loan borrower) from the market," Gunnlaugsson agreed.

There has been some reduction in new loan applications, according to James C. LaVelle, senior Marine Bank vice president.

"You can say we continue to be in the mortgage market, but on a more selective basis," he said.

The recent rate hikes have also forced some of the state's 642 cooperative credit unions to raise their loan rates to the maximum allowed under state law in order to preserve diminished reserves.

The credit unions, whose low interest rates have made them perennial favorites for consumer loans, are "scrambling along with other financial institutions for money," said Robert Neek, president of State Central Credit Union, 10015 W. Greenfield Ave., West Allis.

John Hill, president of the Wisconsin Credit Union League, explained, "When the banks go out of consumer lending, that puts a great deal of pressure on credit unions. People aren't asking what the rate is. They're just borrowing."

Hill said the increased demand for credit union money has caused some larger credit unions to stop making second mortgage loans and reduce from 48 months to 36 months the repayment period on new car loans.

Hill said, however, that credit unions "are in better shape than most financial institutions. Because most have payroll deductions, the money keeps coming in."

State Central has tightened up its loan requirements, Neek said.

"Prior to this period, we had various rates for different types of loans," he said. "Now we have no preferential rates."

As an example, he said that six months ago new car loans carried a 9% interest rate. Then the rate moved to 10.8%, then to a flat 12%.

Today, auto loans, like all loans made at State Central, carry the maximum legal rates of 18% for the first \$500 and 12% for everything over that.

And where the credit union once extended new car loans over four years, and sometimes five, all loans are restricted to 36 months.

"This has cut down on the real large loans," Neek said, "because the payments would be prohibitive."

[From the Unterrified Democrat, Linn, Mo.]

CREDIT UNIONS RELEASED

The Missouri Supreme Court has struck down a state law which restricts the amount of interest credit unions can charge.

The court, in a unanimous ruling, struck down the statute which restricted credit unions to charging no more than 12 per cent interest per year. That statute, the court said, is invalid because the state constitution says interest rates shall be applicable to all lenders without regard to the type of business they operate.

The case involved the St. Louis Teachers' Credit Union which sought to have the statute relating to what interest it can charge declared unconstitutional.

In a concurring opinion, Judge Warren Welliver said it was "with reluctance" that he agreed the statute was unconstitutional.

The court's decision now means credit unions can charge higher rates of interest than 12 per cent.

[From the Minneapolis Star, Minneapolis, Minn.]

SEEKING A CREDIT UNION LOAN? DON'T BANK ON IT

(By Frank Allen)

To buy a new car this week, he tried to borrow \$7,000 from his company credit union in Minneapolis. As a reliable, 25-year employee, he qualified easily. But the loan officer turned him down.

"I told him I was sorry," the loan officer said, "but as of last Friday, we've set a limit. Nobody can borrow more than \$500 until we get our reserves built up to 5 percent of our assets. That's probably going to take us at least until the first of the year.

"He looked stunned. He just shoved his hands in his pockets and said he probably wouldn't buy the car at all."

In recent days, credit unions all over the Twin Cities have felt the financial pinch as the anxieties of savers grow, deposits shrink, loan demand refuses to subside and federal policy-makers allow underlying interest rates to punch through the roof. The pattern appears to be national, affecting hundreds of credit unions of every size and stripe.

To comply with new national rules that govern credit unions having assets of more than \$2 million, many are setting limits on how much their members can borrow. Some already have long waiting lists of loan applicants. Others have stiffened their down-payment requirements on new-car loans and have stopped making large FHA-backed loans for home improvements. Still others say they expect to take similar steps soon.

Credit union officials stress that these measures don't mean their organizations are insolvent or in trouble. The steps, they say, are simply a response to the high demand for credit that has helped fuel the nation's inflation problems.

"A lot of people are starting to realize that money is really getting tight," said a loan officer for a local 3,800-member credit union who has turned away about a dozen applicants this week. "They are getting scared. For many of them, the credit union is the only place they've ever borrowed money. They don't know where else to turn."

A random survey Wednesday by The Star of 15 local credit unions found that five have declared a moratorium on loans or set low borrowing limits. Another five predicted have to take similar steps within a few weeks.

Four others said they were having no trouble meeting the 5 percent reserve requirement at the moment but declined to forecast whether that would change. Only City-County Credit Union in Minneapolis reported having a significant "surplus" of deposits and hoping more loan applicants would walk through the door.

At Consolidated Freightways Credit Union in Minneapolis manager Marlene Skeate said, "We are topping everybody at \$1,000. And you can't do much with \$1,000. Maybe you can buy a new TV or stereo or get some car repairs done, but that's about it."

The 423-member credit union has discontinued new car loans indefinitely. After three months, new employees of the company can borrow up to \$350 without collateral and up to \$500 after a year.

"We are not making any loans until we get our cash flow built back up," said Ann Hart, manager of the 4,000-member Minnesota State Federation of Teachers Credit Union. "We have had a very high withdrawal rate this summer. I think that's probably because of the nature of our membership."

But Hart said teachers seem willing to wait for loans. After they try applying at their banks, she said, they come back to ask the credit union to keep their names on the waiting list. Today the list has more than 50 names.

"As far as we are concerned, the recession has been here for six months," said Steve Schanback, manager of South Minneapolis Community Federal Credit Union. "Our members have been saving less and less and dipping into their savings more and more. Before long, we will have to curtail lending."

The 1½-year-old, 830-member credit union has about \$300,000 in assets. Schanback said members, who generally don't have access to credit from banks but who are "smart enough to avoid the loan companies," borrow an average of less than \$1,000 at a time for medical bills, debt consolidation, refrigerators and used cars.

"We don't have a lot of members who are well off enough to look at buying new cars. We also have demand that we can't meet for home improvement loans because we can't afford to tie up large amounts of money for long periods of time."

The Minnesota Teamsters Credit Union has lowered its lending limit to \$2,000, compared with \$3,500 earlier this fall and \$10,000 in June.

"We have been borrowing money from Minnestoa Central Credit Union" to meet loan demand, said manager Dennis M. Anderson, Minnesota Central charges its member $\frac{1}{2}$ -percent more than the prime interest rate.

"As a result of the prime rate soaring, we would have to pay 15 percent right now for money," Anderson explained. "But under the state usury laws, the most we can charge when we turn around and lend it to our members is 12 percent. That's what you call a losing proposition."

The industry has at least two schools of thought on the extent of a credit union's obligation to meet its members' demand for loans. The more conservative organizations tend to operate as tidy, self-contained systems that put members' deposits to work as loans to other members and that cover overhead costs and pay interest on savings from the loan interest.

When loan demand outpaces the flow of deposits and the cost of borrowing money from outside sources exceeds what these credit unions can charge their own customers, they curtail lending. The more liberal organizations, however, adopt a different strategy.

"We believe a credit union should borrow, if necessary, to meet its loan demand—even if it costs them money," said Paul Horgen, treasurer-manager of the 14,000-member Teacher Federations Credit Union. "It's just good public relations. If you don't do it, people get the false impression that credit unions are not solvent."

To characterize City-County Credit Union, a 16,000-member organization that serves municipal and Hennepin County employees, as "solvent" would be an understatement.

"We happen to have \$3 million in surplus funds," said treasurer manager Jack Boursell. "We've got a lot more coming in than going out. If you've got a bundle of it sitting there, then you don't have to pay today's high rates to go out and borrow."

"We haven't had to change our normal ceilings (on Loans)—\$25,000 is still the maximum. We hope this situation will bring more loan business to us."

[From the Washington Post, Washington, D.C.]

RIISING INTEREST RATES LIMIT LENDING AT CREDIT UNIONS

(By Molly Sinclair)

The availability of money from private credit unions has dropped dramatically in recent months because of escalating interest rates.

In normal times, the 801 credit unions in the District of Columbia, Maryland and Virginia serve as primary savings-and-borrowing banks for members who have banded together at a company or a federal agency. Credit unions accept deposits and then loan the money to members at comparatively low rates.

But with the increase in interest rates, credit union deposits have fallen in many instances, officials said yesterday, because they can't pay more than 7 percent on regular deposits. Money market investments and other certificates now pay more than 10 percent.

At the Transportation Department Federal Credit Union, deposits in the last six months have plummeted 32 percent from about \$38 million to \$26 million.

Other credit unions in the metropolitan area where withdrawals this month have been heavier than expected include the U.S. Navy credit union. "Deposits are not growing as they would normally," a spokesman said.

The League Central Federal Credit Union, a corporate group serving about 300 area credit unions, reported a \$5 million drop in October deposits.

Deposits at the Washington Post Credit Union also are down, from \$6.7 million 10 months ago to \$6.1 million now.

"Young people don't have the money to deposit—it takes everything they have to live," said William G. Derry, the manager of the Transportation Department credit union.

Other depositors, he said, are putting their money into investments that yield more than credit union regular accounts.

To stem withdrawals and to attract new depositors, the Transportation Department credit union last month began offering higher-paying money market certificates to depositors, officials said. Each day Derry and his staff study the credit union cash flow to determine how much can be loaned.

The organization also has initiated a series of credit-rationing steps to spread around the limited funds. "We have priority loan applications—when a member's number comes up, he gets a loan," Derry said.

For a few months last spring, the credit union stopped making car loans, he said. Some are being extended now, but the car loans may be halted again on Dec. 1 if credit conditions deteriorate, he said.

The credit union's plight represents one aspect of the tightening money scene for credit unions in the metropolitan area.

Borrowing money from the Internal Revenue Service Federal Credit Union also is more difficult than it was once, but for slightly different reasons.

The IRS agency, began months ago to curb loan activity in anticipation that credit would tighten. Steps taken by the IRS union included raising rates on signature loans from 9 percent to 12 percent. The organization also lowered the loan pay-back period from 60 months to 36 months in some cases.

The IRS credit union also was among the few to offer money market certificates to members from the beginning, enabling depositors to earn higher rates without removing their money from their accounts.

"There is no question that we would have lost deposits without the money market program," said IRS credit union manager Floyd E. Schlueter.

Instead, the credit union is "holding steady," he said.

Officials will decide today if loan requirements should be curtailed again to maintain the union's balance. "We have to keep in touch with reality," said Gerald F. Bynan, the loan manager.

Loans from credit unions are in high demand, because their interest rates typically are lower than other financial institutions.

Currently, interest rates are running as high as 15 percent at regular financial institutions.

In contrast, a credit union is normally allowed by law to charge only 12 percent.

At a time of shrinking deposits and soaring demand for its loans, credit unions are using a variety of tools to apportion out the loan money that is available.

At the Agriculture Department Federal Credit Union, an applicant seeking a signature loan qualifies only if his other debts are minimal. If he already owes 25 percent or more of his take home pay to charge accounts and installment notes, he probably won't qualify for a credit union loan, an official there said.

The Navy's credit union also is "a little more persnickety" about who will receive a loan, a spokesman conceded.

The loan disapproval rate was 20 percent six months ago, he said. But now it is closer to 30 percent.

[From the Houston Chronicle, Houston, Tex.]

CREDIT UNIONS HERE ARE BETTER OFF THAN MOST

(By Leslie Loddeke)

In contrast to national declines in credit unions' coffers, Houston and the rest of Texas are recording gains in both credit union membership and assets, primarily due to their timely adoption of money market certificates.

Money market certificates are six-month notes based on the current 26-week Treasury Bill rate, which changes weekly.

Last month, Americans withdrew \$800 million more than they deposited in U.S. savings and loan institutions, putting the money in markets where it can earn higher interest.

Dr. Robert Von der Ohe, chief economist of the Credit Union National Association based in Madison, Wis., said the nation's 22,500 credit unions' growth rate "slowed dramatically over the past year.

"When the credit unions lost sums in January and in April, the response for many was to develop their own money market certificates," he said.

"The larger states, such as Texas, got into the use of certificates much more rapidly."

The 38-million-odd members of the nation's credit unions, which have about \$64 billion in assets, began making sizable withdrawals earlier this year when money became even tighter, putting their cash where they could get higher returns.

Loan money became harder to get because of the sudden drop in funds. Credit unions with quick reactions and sufficient assets turned to money market certificates to become more competitive with other financial institutions.

Von der Ohe said the national trend now is for the public to turn back to credit unions for consumer loans. "We're seeing a repeat of what happened in 1974, and in any period of tight money," he said.

"The banks were on the verge of closing their consumer credit windows," Von der Ohe said. "We saw a dramatic upswing in credit unions then because consumer lending in general was off.

"Now, more people are coming back to credit unions as a source of credit."

Texas' 1,417 credit unions have about 3 million members, equally divided between the northern and southern regions of the state.

Steve Gerishe, of the Houston headquarters office for the southern region of the Texas Credit Union League, said some credit unions still are experiencing belt-tightening, due to disintermediation, withdrawals from one financial institution to another which generates more revenue.

The Houston Area Teachers Credit Union, largest in the metropolitan area with 72,000 teacher and student members, was one of the city's first to jump into money market certificates. Credit union manager Gerald Maxwell said "We went in as soon as the S&Ls (savings and loan institutions), about July of last year. We had to compete with them.

"This definitely isn't a banner year for us, but we aren't hurting as much as a bank or savings and loan. We try to educate our members in certain respects, Maxwell said.

"For example, our members realize they participate in setting policy within our credit union, as they would be unable to do if they pulled their money out and put it into an S&L.

"We've had to cut back on our marginal-type loans, and we've raised the down payment on car loans, which are our bread and butter, really. We've quit using the word 'loan' in our marketing campaigns."

Texaco credit union Manager R. F. Gaudin said his 5,800 members "can get a better deal here than anywhere else. We are totally competitive with other financial institutions on our savings program."

On loans, Texaco charges the average credit union rate—the ceiling of 12 percent allowed by law—except for share-secured loans, which are charged 10.6 percent. About 75 percent of Texaco's employees belong to the credit union, which has assets topping \$13 million.

Money market certificates made a big difference to Tenneco Inc.'s Federal Credit Union, said Manager Bryan Burk.

"We adopted them in July of this year, and within the first three months we had issued more than \$2 million worth of the certificates," he said.

At the U.S.E. (United States Employees) Credit Union, Manager Gary Base oversees funds for about 9,000 federal employees in Houston's nine surrounding counties. His union's funds, like most in Texas, are moving "from one hand to the other," from fluid day-in-day-out deposits to money market certificates.

"We're looking at ways of creating alternate sources for funds, such as share drafts," he noted. Share drafts, instituted about two years ago at U.S.E., provide a new way for credit unions to save operating costs by issuing simple monthly statements with no returned checks. The book of drafts is used just like a checkbook.

[From the Times, Anchorage, Alaska]

CREDIT UNIONS IN ALASKA REDUCE NUMBER, SIZE OF LOANS

(By Andy Faletto)

Credit unions in Alaska are experiencing the crunch caused by inflation and other factors, forcing them to cut back on the size and number of loans they can make to members.

"Alaska was already in a recession, and recent government policies have only served to make it a depression here," said Dave Chatfield, president of the Alaska Credit Union League.

With more than half the state's population members of credit unions, a significant number of people are beginning to feel the crunch, too. Waiting lists for loans are commonplace, and it appears there are more rejections than loan approvals.

As of June 1979, there were 212,000 credit union members in Alaska. Their total deposits add up to \$457 million in assets, yet it is becoming increasingly difficult for members to get loans.

A credit union is a non-profit membership organization set up to serve a specified group of people.

Chatfield said there are two problems credit unions face. He offered a possible remedy to both.

But first the problems.

Chatfield said credit unions, with 61 offices statewide, are having difficulty attracting savings, which he said is the only practical source of money for credit unions. In the first six months of this year, credit union assets fell 3.2 percent—a total of more than \$15 million.

Part of that problem stems from laws dating back to 1934 which bind credit unions to a maximum ceiling of 12 percent interest on loans. At the time the law was passed, the prime interest rate was around 3½ percent. Today, the prime interest rate—that which banks charge to their best customers—is 15 percent.

Along with the higher prime rate, there are investment opportunities which promise greater earnings than a passbook savings account. Six month treasury bills for example return 12.65 percent. In contrast, credit unions pay 7 percent on passbook savings.

Chatfield said that although there is a certain amount of loyalty among credit union members, "there are an awful lot who want to take advantage when they see interest rates on other investments and earnings approaching 11 or 12 percent."

The result is savings are withdrawn from credit union passbook accounts and placed in investments that pay higher dividends.

The passbook withdrawals only compound the credit unions' problem, because the loan pools shrink and more restrictions are placed on loans, which in some cases causes more withdrawals and restrictions.

"When we can't make loans, some members become disappointed and withdraw their money to make their purchases," Chatfield said.

And when the credit union can't lend money, it is not doing what it was set up to do.

The survey showed real estate loans by credit unions dropped from more than \$60 million a year ago to \$11 million as of this September. Consumer loans dropped from \$314 million last year to \$159 million as of this September.

"This was due strictly to a lack of funds," Chatfield said, "not due to the lack of demand."

Now the possible remedy.

First, Chatfield said credit unions would like to attract state government deposits, if the interest rates are not too high, a maximum of 9½ percent.

"Otherwise, anything over 10 percent, our credit unions couldn't afford to take the funds," Chatfield said. It generally takes about 2 percent interest, or 200 basis points, to cover the cost of overhead.

Gov. Jay Hammond and Revenue Commissioner Tom Williams announced last week that \$50 million would be made available for deposit in Alaska banks and savings and loans. They did not mention credit unions, but Chatfield said meetings with Williams are scheduled to discuss possible state deposits in credit unions.

The second possible remedy Chatfield sees is allowing credit unions to charge higher interest rates for loans, although there has been some opposition voiced in Washington, D.C., to allowing this to happen.

Chatfield said it might be possible to index the interest rate to the cost of acquiring money. For example, the state usury law indexes the maximum amount of interest banks may charge to the quarterly federal funds discount—the quarterly interest rate the Federal Reserve Board charges for loaning money to banks.

Nationwide, credit unions have financed 17 percent of all consumer loans and 23 percent of all new car loans.

But not now, and not in Alaska.

"We have credit unions around the state that have had their loan departments shut down for months because there is no money to loan," Chatfield said.

A recent survey of the state's major credit unions shows their level of activity has dropped significantly, Chatfield said. And, in the case of at least one credit union, the level of activity dropped completely off the graph.

[From the Ledger-Star, Norfolk, Va.]

CREDIT UNIONS TIGHTEN UP ON LOANS

(By John Levin)

Most Tidewater credit unions today began limiting loans to members who can prove they need cash for emergencies.

People just aren't saving, they're spending and we're getting more conservative about lending," said Sharon Musich, assistant comptroller of the Naval Air Norfolk Federal Credit Union.

Credit unions across Virginia have begun looking more closely at how members will spend money they borrow, according to Bill Stark, vice president of the Virginia Credit Union League in Lynchburg.

The Naval Air Norfolk Federal Credit Union, the largest in South Hampton Roads announced the emergency cash loan restrictions for new members and a \$15,000 maximum on loans to all members. The restrictions will be in effect for at least three months.

Other credit unions either temporarily canceled all lending or severely tightened the amount of money available to members.

"They're not out of the lending business, but they have restricted their lending to items of necessity and short-term loans," according to Stark.

About 379 of the state's nearly 400 credit unions are members of the state league. Together they have nearly two million members and about \$2.5 billion in assets, Stark said.

"Before you could get a loan for a vacation or 100 percent of the cost of a new car. Now loans are being limited to necessities like refrigerators and used cars if they're necessary to members. That four-year loan for a new car is being looked at with more and more scrutiny," he said.

The crux of the problem is that credit unions are limited to charging 12 percent on loans. The limits can be changed only by Congress, for federal credit unions, or by the Virginia General Assembly, for state-chartered organizations.

Yet to compete with interest paid by savings and loan associations and banks, the credit unions last week began paying 12.651 percent to investors with \$10,000 or more.

Stark predicted the interest rate on loans will be raised by the middle of next year to match economic conditions.

But "we will be extremely conservative for the next six months," according to Mrs. Musich, of the Naval Air Norfolk credit union.

The 43,000-member organization is open to all active and retired military personnel and civilian workers at the Naval Air Station in Norfolk.

"On Friday we heard other military credit unions were going to cut off loans entirely. And our money was going out so rapidly we had to do something," Mrs. Musich said.

Money has flowed out of the credit union's savings accounts twice as fast this month as last October. Through Oct. 26, the Naval credit union's members withdrew nearly \$2 million from their accounts. Last October the savings withdrawals totaled \$923,000.

Smaller unions, such as the 2,700-member Tidewater Telephone Employees Credit Union, have put a ceiling on how much a member can borrow.

Margaret Ferris, the union's manager and treasurer, refused to disclose the ceiling, but noted that the organization's directors have the authority to limit loans to \$1,000 each.

"Our people will understand. After all credit unions are composed of people with a common bond. They realize it's a tight money time," she said.

Despite the higher interest rates offered by commercial lenders, the officers of credit unions say regular payroll deductions for credit union accounts have not declined.

"It surprises me people haven't reduced their savings," Mrs. Ferris said.

[From the Los Angeles Times, Los Angeles, Calif.]

LOW CEILING PUTS FEDERAL CREDIT UNIONS IN A BIND

Dr. Uzi Bodman wasn't hunting for a loan because he had fallen on hard times. The Los Angeles gynecologist just wanted \$4,000 to boost his investment in energy stocks and gold.

Bank of America, he says, quoted him a rate of about 20% interest. Then he heard about the credit union at Kaiser-Permanente Medical Center, where he works. Bodman joined and a few days later applied for and got \$4,000 at 12%.

Bodman is one among thousands who are flooding federal credit unions with requests for loans at bargain rates. But the gynecologist was lucky. While his request slipped through, thousands are being turned away.

With federal credit unions restricted to a federally mandated loan interest ceiling of 12%, there has been a deluge of people seeking auto, vacation and personal loans at rates unavailable at other financial institutions. But the cost to credit unions of obtaining new money is exceeding their interest ceiling. While they are limited to

paying no more than 7% on regular share accounts, the amount of money flowing into such accounts has dropped sharply and withdrawals have increased.

As a result, many of the nation's 12,715 federal credit unions, faced with finding costlier ways to raise money, are cutting back sharply on loans to their 23 million members.

Federal credit unions say interest rates are creating the most painful squeeze on their industry since it was established in 1934.

At the Rocky Mountain Credit Union in Boulder, Colo., one of 26 credit unions for IBM employees, new loans secured by shares of stock shrank from \$286,000 in July to \$70,000 in September. The credit union, with 10,000 members and \$22 million in assets, a year ago provided 100% financing on four-year car loans. By July of this year, down payments that had been set at 25% were raised to 30%, and a \$7,500 loan ceiling was established. Since July, new car loans have fallen off more than 20%.

At the Wright Patman Congressional Federal Credit Union, with 15,000 House employees as members and assets of \$25 million, general manager Bob Hess says required down payments for automobiles may soon be increased from 25% to 35% or 40%.

And at the NASA Federal Credit Union in Riverdale, Md., with 18,000 members and \$34 million in assets, the loan stream is looking more like a dried-up creek. General manager Don Beall says loans are being made only for necessities—"something that affects the health, welfare and security of the family." Even then, the loan cannot exceed \$1,000.

"The Federal Reserve is telling us that's the only way to go, and they're doing it with some action," Beall says. "They cut out our sources of money for the most part. They've taken away our ability to borrow by forcing rates to 15.5% or 16%. And if I hear one more time that the prime rate has nothing to do with consumer lending, I think I'll scream."

Banks and savings institutions in California and many other states have been free to respond to Federal Reserve credit-tightening by raising loan rates. Many of the nation's 9,500 state-chartered credit unions, with 18.2 million members, have received relief from their states. The California Legislature, for example, raised the ceiling on rates charged by State chartered credit unions in January, 1978, to 15% from 12%. (California also sets no limit on interest paid to depositors at state-chartered credit unions, but few pay any more than 8%.)

Growth in savings at federal credit unions has been retarded as members invest in so-called money-market certificates and money-market mutual funds that offer rates well above what credit unions were providing in interest on regular savings and share certificates.

As credit unions started issuing their own money-market certificates, they found themselves offering rates above what they can charge on loans. This week's rate on money-market certificates is more than 12%.

If credit unions borrow from banks to finance member loan demands, they find themselves paying at least the current prime rate of 15.25%.

"You can't run a deficit operation for very long. Eventually, the well runs dry," J. Alvin George of San Diego, chairman of the Credit Union National Assn., says.

The Kaiser-Permanente credit union, with 16,500 members and \$25 million in assets, cut out loans for "frills" like boats and campers. It no longer makes home-equity loans. Down payments on automobiles eligible for 12% loans have been increased to 15% from 10%. It used to be that a member could get a signature loan for two months gross pay after a year of employment. Today, only five-year employees can get that much.

Loan requirements at Kaiser-Permanente are being stiffened more than originally planned because of a surge in loans since last April. As members sought out the credit union's favorable interest rates, loans grew so fast that they're now 13% more than the credit union has in shares (the equivalent of bank deposits), share certificates (the equivalent of certificates of deposit) and certificates of indebtedness (promissory notes). At the same time, Kaiser-Permanente estimates that members withdrew \$1.56 million so far this year in pursuit of higher savings rates elsewhere.

"We have to tighten up even further because everybody is coming to us for loans," manager Jo MacClelland says.

More than anything else, MacClelland and credit union managers throughout the country want Congress to lift the interest rate ceiling on federal credit unions. Tie the ceiling to the prime or discount rate, they suggest.

"Unless that changes, it will mean serious liquidity problems for credit unions," MacClelland says.

At the very least, credit unions say, it's about time for a change in the ceiling.

"It was set in 1934 at a time when the prime rate was 1%. The 12%—or less—was fine enough for secured loans up until maybe a year ago," says Stephen Barden, who manages the Los Angeles County Employees No. 11 Federal Credit Union, among the nation's largest with 37,000 members and assets of \$100 million.

Lifting the interest rate lid would require congressional approval. Because Congress is to adjourn soon for its winter break, however, any relief bill is months away. Credit unions want an immediate rescue through emergency administrative action by their government regulator, the National Credit Union Administration.

Chairman Lawrence Connell says the credit union agency is "undertaking a very intensive study of this now and will be dealing with in the next couple of weeks." He says he is not unsympathetic to the problem.

As credit unions became more aggressive lenders, loans on average jumped to 97% of their shares compared with about 88% in the recent past. By borrowing from other financial institutions and re-lending to their own members, many credit unions have made loans in excess of their shares.

The trend has so disturbed Connell that NCUA for the first time has imposed a 5% liquidity reserve requirement on most federal credit unions that took effect Oct. 31. Credit unions have 60 days to comply. But some are so over-extended in lending that they may have to close the loan window to meet the deadline.

"We believe in a certain minimum discipline, and that means not giving loans in excess of shares on a regular basis," Connell says.

Connell may have a point, some credit union managers acknowledge, but they fault his timing.

"You should do these kinds of things when you have the ability to do them," says Beall of the NASA credit union. "It's hard at the height of the biggest liquidity crunch I think the world has ever seen to say, 'Hey, you've got to start putting some money away.'"

NCUA has set up a central liquidity fund, much like the Federal Reserve for banks and the Federal Home Loan Bank Board for savings institutions, to make loans so that credit unions can meet the liquidity requirement. But many credit unions have resisted the move, claiming rules on cash reserves only make their liquidity problem worse.

California credit unions claim Connell has made their situation more difficult in still other ways, and they have sued him because of it. In July, 1979, he imposed tough restrictions limiting the use of so-called "certificates of indebtedness," uninsured promissory notes with no maximum interest ceiling that were issued by credit unions to compete with other financial institutions. Connell decreed that rates could not exceed those on share certificates and could not be offered to non-members.

In July, the Los Angeles County Employees No. 11 Credit Union, along with the California Credit Union League and the Costa Mesa Municipal Employees Credit Union, sued Connell claiming the ruling burdened them with unfair competitive shackles.

However, in November of last year, Connell authorized federal credit unions to tap another source of funds. They were permitted to issue \$10,000 six-month money-market certificates tied to the 26-week Treasury bill rate, which fluctuates weekly. Already, credit unions have issued \$3.2 billion in money-market certificates, representing 5.7% of total savings.

The interest-sensitive certificates have helped credit unions hold on to the money of their members. "But look at the rate we're paying," says MacClelland of Kaiser-Permanente, which began offering them Oct. 1.

Much of the credit unions' current problem, some managers concede, came because they did not heed Connell's advice soon enough. At the end of 1977, credit unions were authorized to issue share certificates, their version of certificates of deposit, with maturities of up to six years. Connell urged credit unions to promote them tying up member savings for longer terms. But credit unions, unhappy with the higher rates they would have to pay, avoided them. Now, many have been forced to issue certificates at even higher rates to keep their funds.

APPENDIX 2

A STATISTICAL INVESTIGATION OF THE NEED FOR RATE RELIEF

This final section of the paper provides an analysis of recent credit union operations under the 12 percent ceiling. The extent to which federal credit unions have needed rate relief during the past two years will be investigated. Further, the extent to which federal credit unions are likely to need rate relief in the contest of market conditions existing during the later part of 1979 and early 1980 will be analyzed.

METHOD¹

The model used for the analysis is an accounting model that calculates a credit union's break-even loan rate. The model takes information describing all income sources to the credit union (excluding loan income) and all expense and net income distribution items. With this information, the model calculates the average loan interest rate at which the credit union would have "broken-even". For purposes of this paper, breakeven is defined as the ability to pay a 6 percent nominal dividend on regular shares² and transfer 6 percent of gross income to regular reserves without having to draw on undivided earnings. Thus, if the model computes a break-even loan rate for a credit union in excess of 12 percent, that credit union made some combination of the following adjustments in order to exist under the 12 percent ceiling: Paid dividends at less than a 6 percent nominal rate; transferred less than 6 percent of gross income to regular reserves; and drew down undivided earnings.

The data used in the analysis is from year-end information collected by NCUA. In order to perform the analysis for the years 1977 and 1978, data was required for the years 1976, 1977 and 1979. A total of 11,211 federal credit unions reported to NCUA in each of these three years. Because of certain data omissions, the analysis was performed on 11,110 credit unions in 1977 and 11,128 credit unions in 1978. The break-even loan rates computed for each credit union are necessarily approximations because year-end values for balance sheet items had to be used to estimate annual averages.

RESULTS

Summaries of the results of computing break-even loan rates are provided in Table IV-1 through IV-3. Break-even loan rates are divided into three categories and results are reported for three time periods. The three break-even loan rate categories are: (1) less than 11.5 percent. Credit unions in this category are interpreted as being able to operate under the 12 percent loan rate ceiling. (2) Between 11.5 percent and 12.5 percent. Credit unions in the category are interpreted as being on the borderline between being able and not being able to operate under the 12 percent loan rate ceiling. (3) Over 12.5 percent. Credit unions in this category are interpreted as being unable to operate in the long run under the 12 percent loan rate ceiling. It should be noted that even though a credit union may break-even under the ceiling, some such credit unions may encounter longrun capital adequacy difficulties. This is because our definition of break-even requires no transfers to undivided earnings.

In addition to results for the years 1977 and 1978, information is also reported for a category called "1978 Simulation". This category represents an attempt to simulate financial market conditions as they exist toward the end of 1978. The 1978 Simulation was derived using 1978 data with the following adjustments:

The rate paid on borrowed funds at each credit union was increased by 3 percent from the rate paid in 1978.

The rate earned on investments at each credit union was increased by 3 percent from the rate earned in 1978.

Interest refunds were discontinued.

Each credit union's total shares were redistributed in the following proportions: 40 percent in regular shares, 30 percent in Money Market Certificates, and 40 percent in other certificates.

The dividend rate on MMCs was set at 12.5 percent. The dividend rate on other certificates was set at 7.5 percent. The nominal dividend rate on regular shares was lowered from 6 percent to 5.5 percent.

The methods used to simulate current conditions with the category "1978 Simulation" are not intended to imply that credit unions would follow exactly these practices in the absence of the 12 percent loan rate ceiling. Rather, the attempt was made to evaluate the impact on credit unions of paying a return on savings approximately equal to rates paid by other financial institutions. The average cost of savings implied by the data used in the simulation is 7.48 percent. This average dividend rate is to be compared with a current inflation rate of 13 percent and an average inflation rate of 7.4 during the entire decade of the 1970s. Finally, the model assumes that the dividend rates used in the simulation are maintained for a full year. It may be argued that a 12.5 percent rate on MMCs is unlikely to prevail for an entire year. However, over the course of the next few years, if inflation does

¹ A complete technical derivation of the model used in this analysis is available on request.

² The ratio of the effective dividend rate to the nominal dividend rate was assumed to be 0.9. Thus a 6 percent nominal dividend rate represents an effective rate of 5.4 percent.

not evaporate and the demise of Regulation Q continues, an average rate of return to savers of 7.48 percent is not unreasonable.

The breakdown of credit unions falling into the three break-even loan rate categories is shown in Table IV-1. Because the results in 1977 and 1978 are so similar, these two years will together be compared to the data shown for "1978 Simulation". Over the past two years, about 70 percent of federal credit unions have been able to break-even with loan rates of less than 12 percent. Slightly more than 15 percent of federal credit unions have been having trouble with loan rates at or below the ceiling. This trouble has taken the form of transferring less than 6 percent of gross income to regular reserves, paying dividends in an amount less than a nominal rate or 6 percent, and/or drawing on undivided earnings. If we allow the assumptions that make up the simulation we find very different results. In this case, only 35 percent of federal credit unions would be able to break-even under the 12 percent ceiling and 46.3 percent would not break-even. The remaining 18.7 percent would be on the borderline.

Tables IV-2 and IV-3 contain descriptive information on credit unions falling into the trouble, no trouble, and borderline categories. The following observations generally apply to credit unions with break-even loan rates less than 11.5 percent.

These credit unions tend to have expense-to-income ratios less than the average. In 1977 and 1978, these credit unions had loan-to-share ratios slightly above the average. The reverse was true using the simulation.

These credit unions tend to be larger than average.

These credit unions tend to have ratios of expenses for space occupied to total expenses that are slightly below average. This is mild evidence that these credit unions tend to be subsidized.

These credit unions tend to be growing faster than average.

These credit unions are slightly more likely to have paid an interest refund than average.

These credit unions tend to pay higher than average dividends.

These credit unions represent a higher proportion of occupational bonds of association than the overall distribution.

The following observations generally apply to credit unions with break-even loan rates in excess of 12.5 percent.

They tend to have expense-to-income ratios higher than the average.

In 1977 and 1978, these credit unions had loan-to-share ratios well below the average. Using the simulation, these credit unions tend to have loan-to-share ratios slightly above the average.

These credit unions tend to be smaller than average.

These credit unions tend to have ratios of expenses for space occupied to total expenses that are slightly above the average. This is fairly mild evidence of lower than average subsidies.

These credit unions tend to be growing less rapidly than average. This factor might account in part for the higher expense-to-income ratios.

These credit unions are less likely to pay an interest refund than average.

These credit unions tend to pay lower than average dividends.

These credit unions represent a higher proportion of associational and residential credit unions than average. This is further evidence of the absence of subsidy.

The information presented thus far provides a fairly consistent comparison of credit unions that are and are not likely to be having trouble with the 12 percent ceiling. Credit unions that can break-even under the ceiling tend to be larger, more efficient, faster growing and somewhat more subsidized. Conversely, credit unions that have trouble breaking even under the ceiling tend to be smaller, less efficient, slower growing and less subsidized. Since most of these characteristics are intertwined. It is possible that rate relief could work in the direction of alleviating some of the differences. To the extent that rate relief allowed greater dividends, growth would be encouraged. Accelerated growth would tend to lower expense-to-income ratios both by compensating for inflation and by allowing the realization of economies of size.

Although elimination of the 12 percent ceiling may be a necessary part of the solution for credit unions with high expense-to-income ratios, many other steps would need to be undertaken to reduce costs in individual credit unions. Further, comparison of credit unions that were and were not breaking even under the ceiling in 1977 and 1978 produces a rather mild case for rate relief. However, a comparison of credit unions that would or would not have trouble breaking even under the simulation provides a strong case for relief. Credit unions that could break even under the ceiling given the simulated conditions have much lower expense-to-income ratios than average and are substantially larger than average and faster

growing than average. On the other hand, credit unions that would have trouble under the ceiling given the simulation conditions have expense-to-income ratios, asset sizes and asset growth rates that are substantially closer to overall averages than is the case using 1978 data.

Further, the relationship between a credit union's ability to break even under the ceiling and its expense-to-income ratio is not as simple as it might at first appear. Appendix B provides more detailed information on the relationships between break-even ability and the several variables shown in Table IV-2

Finally, any further upward pressures on dividend rates in the near future beyond the average 7.48 percent represented by the simulation would further deplete the ranks of break-even credit unions and add to the list of credit unions having trouble under the 12 percent ceiling. If this were to happen, many borderline credit unions under the simulation would begin to have problems. These currently borderline credit unions have expense-to-income ratios that are below average, are slightly above average in asset size, and had 1978 growth rates that approximated the overall average.

TABLE IV-1.—NUMBER AND PERCENT OF FEDERAL CREDIT UNIONS FALLING INTO 3 BREAK-EVEN RATE CATEGORIES

Year	Break-even loan rate			Total
	Less than 11.5 percent	11.5 to 12.5 percent	Over 12.5 percent	
1977	7,555	1,655	1,900	11,110
Percent	68.0	14.9	17.1	
1978	7,810	1,491	1,827	11,128
Percent	70.2	13.4	16.4	
1978 (simulation)	3,891	2,083	5,154	11,128
Percent	35.0	18.7	46.3	

TABLE IV-2.—COMPARISON OF AVERAGES

Break-even loan rate	In percent			Asset size (thousand)	In percent		
	Office occ. exp./total expenses	Expenses/ income	Loan/share		Asset growth	Interest ref./loan inc.	Effective div. rate
Less than 11.5 percent:							
1977	2.77	36.3	95.2	\$2,989	20.8	1.99	5.64
1978	2.74	36.2	94.8	3,280	21.0	2.04	5.99
1978 (simulation)	2.64	30.1	89.3	3,769	24.7	4.02	6.22
11.5 to 12.5 percent:							
1977	3.01	49.0	95.5	1,490	15.9	2.59	4.99
1978	3.19	50.9	97.9	1,778	12.1	1.93	5.25
1978 (simulation)	2.69	39.3	97.8	2,994	17.3	1.51	5.91
Over 12.5 percent:							
1977	3.35	63.7	84.6	675	12.5	1.18	3.98
1978	3.09	67.9	89.6	893	7.7	1.18	4.08
1978 (simulation)	3.09	55.0	96.8	1,749	12.5	0.40	4.97
Overall average 1977	2.91	42.9	93.5	2,364	18.7	1.94	5.28
Overall average 1978	2.86	43.4	94.4	2,686	17.6	1.88	5.57

TABLE IV-3.—COMMON BOND COMPARISONS

[In percent]			
Break-Even loan rate	Associational	Occupational	Residential
Less than 11.5 percent:			
1977.....	11.5	85.5	3.1
1978.....	12.7	84.2	3.0
1978 (simulation).....	11.6	86.5	1.9
11.5 to 12.5 percent:			
1977.....	15.5	79.5	5.1
1978.....	13.5	81.0	5.5
1978 (simulation).....	13.3	83.4	3.3
Over 12.5 percent:			
1977.....	23.8	69.7	6.5
1978.....	20.7	71.8	7.7
1978 (simulation).....	16.5	77.4	6.2
Overall Average 1977.....	14.3	81.7	4.0
Overall Average 1978.....	14.2	81.7	4.1

APPENDIX 3

STATES WITH CREDIT UNION INTEREST RATE CEILINGS IN EXCESS OF 12 PERCENT PER ANNUM

(DECEMBER 1979)

Credit union interest rate not to exceed 1¼ percent per month (15 percent per annum) on unpaid balance

California, Sec. 1500.

Connecticut, Sec. 36-206.

Georgia, Sec. 41A-3109.

Illinois, Sec. 492.46.

Louisiana, Sec. 6:654.

Michigan, Sec. 490.14.

Montana, Sec. 14-648.

North Dakota, Sec. 6-06-18.

Oregon, Sec. 723.502.

Credit union interest rate not to exceed indicated percentage on unpaid balance

Nebraska, 14 percent per year, Sec. 21-1773(6).

West Virginia, 1½ percent per month, Sec. 31-10-16.

Florida, 1½ percent per month, Sec. 657.14.

Credit union interest rate maximum is 12 percent per annum unless a higher rate is approved by regulatory authority.

Nevada, Sec. 678.710(1).

North Carolina¹ —Authorized rate cannot exceed 18 percent. Sec. 54-109.65.Vermont,¹ Sec. 2078(a).*Credit union interest rate subject to indicated maximum in State's consumer credit code*

Alabama—For closed-end credit, the rate limit is the greater of:

(a) \$15 per \$100 for the first \$500, \$10 per \$100 of the loan exceeding \$500 up to \$1,000, and \$8 per \$100 of the loan over \$1,000 up to \$2,000; or

(b) if the loan exceeds \$2,000, \$8 per \$100 of the loan.

For open-end credit, 1½ percent per month. Sec. 5-19-2.

Idaho—For closed-end credit, either 36 percent on part of unpaid balance up to \$300, 21 percent of unpaid balance over \$300 up to \$1,000, and 15 percent on part of unpaid balance over \$1,000, or 18 percent on the entire unpaid balance, whichever is greater. For open-end credit, 18 percent of unpaid balance. Sec. 3.508, 3.201.

¹ Credit union supervisor has set rate at 15 percent.

Indiana—For both open and closed-end credit, either 36 percent on part of unpaid balance up to \$300, 21 percent on part of unpaid balance over \$300 up to \$1,000, and 15 percent on part of unpaid balance over \$1,000 or 18 percent on entire unpaid balance, whichever is greater. Sec. 3.508.

Iowa—For closed-end credit, the rate is 15 percent per year on unpaid balance. For open-end credit, 18 percent on that part of unpaid balance up to \$500, 15 percent on that part of unpaid balance over \$500. Sec. 537.2401, 537.2402.

Kansas—For both open and closed-end credit, either 36 percent on part of unpaid balance up to \$300; 21 percent on part of unpaid balance over \$300 up to \$1,000; and 14.45 percent on part of unpaid balance over \$1,000, or 18 percent of unpaid balance, whichever is greater. Sec. 16a-2-401.

Maine—For both open and closed-end credit, either 30 percent on part of unpaid balance up to \$300, 21 percent on part of unpaid balance over \$300 up to \$1,000, and 15 percent on part of unpaid balance over \$1,000, or 18 percent on the unpaid balance, whichever is greater. Sec. 2.401(2).

Oklahoma—For both open and closed-end credit, either 30 percent on part of unpaid balance up to \$300, 21 percent on part of unpaid balance over \$300 up to \$1,000, and 15 percent on part of unpaid balance over \$1,000, or 18 percent of unpaid balance, whichever is greater. For loans involving a cash advance of \$100 or less, a lender may charge in lieu of the above rates:

(a) On an advance up to \$29.99 a charge of \$1.00 for every \$5.00 advanced;

(b) On an advance over \$29.99 up to \$35.00, a charge of one-tenth the amount advanced plus a handling charge of \$3.00 per month;

(c) On an advance of more than \$35.00 up to \$70.00, a charge of one-tenth the advance plus a handling charge of \$3.50 per month.

(d) On an advance of more than \$70.00 up to \$100.00, a charge of one-tenth the advance, plus a handling charge of \$4.00. Sec. 3.508A, 3.508B.

Utah—For both open and closed-end credit, either 36 percent on part of unpaid balance up to \$540, 21 percent on part of unpaid balance over \$300 up to \$1,800, and 15 percent on unpaid balance over \$1,800, or 18 percent on unpaid balance, whichever is greater. Sec. 3.508.

Wisconsin—For both open and closed-end credit, 18 percent on part of balance up to \$500 and 12 percent on part of unpaid balance over \$500.00. Sec. 422.201.

Credit union interest rate subject to State's usury law

Massachusetts—The rate on closed-end loans of \$3,000 or less cannot exceed the limit established by the small loans regulatory board pursuant to Ch. 140, Sec. 100. For open-end credit 18 percent on part of unpaid balance up to \$500, 12 percent on part of unpaid balance over \$500. Ch. 140, Sec. 100, 114A, 114B.

Missouri—On "small loans" (i.e., loans of \$2,500 or less, not made as permitted by other statutes and not secured by a lien on real estate, non-processed farm products, livestock, farm machinery or crops) the maximum interest rate is: 26.6 percent per annum on first \$800; 15 percent per annum on next \$1,700. The maximum rate is 10 percent per annum on the balance over \$2,500. (Sec. 408.100, 408.190.)

Rhode Island—21 percent maximum per year. Sec. 6-26-2.

Other act

Tennessee—Interest rate not to exceed either the applicable formula rate, which shall not exceed 18 percent, or the rate federal credit unions are permitted to charge, whichever is greater. The applicable formula rate is a rate 5 percentage points above the Federal Reserve discount rate in effect in the Federal Reserve District which includes the largest geographical area in this state. Sec. 45-1820.

THE CASE FOR

LOAN RATE CEILING RELIEF

By

Bill Hampel
Economist II
Research & Payment Systems
Credit Union National Assoc.
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I EXECUTIVE SUMMARY

This paper presents the case for relief from the 12% loan rate ceiling for federal credit unions. Section II presents the basic arguments for rate relief, Section III provides information from a recent survey of federal credit unions, and the extent to which individual credit unions need relief is discussed in Section IV. It is our firm conviction that some form of relief from the 12% loan rate ceiling should be sought.

The primary arguments for rate relief detailed in Section II include:

- When adjusted for inflation, a 6% dividend rate has represented a return to the saver of minus 1.2% during the 1970's. Adjusted for inflation, a 12% loan rate has actually represented a cost of 4.4% during the 1970's. Loan rate relief is necessary to correct this imbalance.
- Credit union dividend rates have fallen behind rates of return paid to savers at other financial institutions during the past year. Loan rate relief is necessary to correct this situation.
- The ability of credit unions to manage liquidity is severely limited by the 12% ceiling.
- The loan rate ceiling creates or maintains a set of subsidies from some credit union members to others. These subsidies include not only the transfer of income from savers to borrowers, but also the transfer of benefits from some borrowers to other borrowers. Any subsidy transfers within a credit union should be determined by the credit union rather than by a rate ceiling.

Information is also provided in Section II demonstrating that federal credit unions have been reducing the spread between loan rates and dividend rates. There is very little room left under the ceiling to increase dividend rates.

In Section III, a recent survey of federal credit unions indicates that 73% of the survey respondents favor rate relief, 14% are opposed to ceiling relief and 12% say that relief is not yet necessary. The survey was conducted prior to the recent Federal Reserve actions of the 6th of October. The survey responses probably overstate the desire for relief on the part of all federal credit unions because of the expense of replying to the survey. The survey does, however, provide useful information on why federal credit unions do or do not want rate relief. The primary reason for wanting relief is cost of funds pressures. Those who do not want relief either just do not need it or oppose ceiling removal on philosophical grounds. Those credit unions favoring relief appear to be less subsidized than those opposing relief.

Section III also reports on a recent survey of credit union leagues in states allowing state-chartered credit unions to charge more than 12% on loans. This survey indicates that a rapidly rising proportion of credit unions with the power to do so are beginning to charge more than 12% on at least some loans.

Section IV provides data showing that in 1977 and 1978, roughly 70% of federal credit unions seemed to be breaking even under the 12% ceiling. Of the remaining 30%, slightly more than half were not breaking even under the ceiling and the remainder was too close to call. When 1978 data was adjusted to simulate recent and near-term future developments in financial markets, it was found that only 35% of federal credit unions would break even, 46% would not break even, and the remaining 19% would be too close to call. Those credit unions that are able to break even under the ceiling tend to be large, rapidly growing, and have low expense-to-income ratios. The opposite is true for credit unions that have trouble breaking even. However, credit unions that would have trouble breaking even under the simulated conditions are neither unusually small nor do they have unusually high expense-to-income ratios.

II. THE CASE FOR RATE RELIEF

Federal credit unions have operated under a 12% loan rate ceiling since 1934. At the time of the passage of the Federal Credit Union Act, a 12% loan rate was indeed substantial as inflation rates were negligible. However, in the 1970's the U.S. inflation rate has in no sense been negligible. In freely functioning financial markets, nominal or stated interest rates typically adjust to expected inflation rates. This adjustment has of course not occurred with credit union loan rates. The result has been that while the stated interest rate on most credit union loans has remained stable, the real or adjusted for inflation rate has at times been substantially reduced. Table II-1 below shows the effect of inflation on interest and dividend rates at credit unions during the 1970s. The loan rate assumes a loan made for one year with a single payment of principle and interest with a stated interest rate of 12%. The dividend rate assumes a share balance held for one year with an effective annual dividend rate of 6%.

TABLE II-1

Year	Rate of Inflation (CPI, Dec to Dec %)	12% Loan Rate (Adjusted for Inf.)	6% Dividend Rate (Adjusted for Inf.)
1970	5.5%	6.2%	0.5%
1971	3.4	8.3	2.5
1972	3.4	8.3	2.5
1973	8.8	2.9	- 2.6
1974	12.2	- 0.2	- 5.5
1975	7.0	4.7	- 0.9
1976	4.8	6.9	1.1
1977	6.8	4.9	- 0.7
1978	9.0	2.8	- 2.8
1979*	<u>13.0</u>	<u>- 0.9</u>	<u>- 6.2</u>
10 year average	7.4%	4.4%	- 1.2%

*Assumed inflation rate.

1. The real rate of interest on any financial arrangement actually refers to the nominal or stated rate adjusted by the rate of inflation expected to prevail over the life of the arrangement. The "adjusted for inflation" rates shown in the table represent loan and dividend rates actually realized after accounting for the inflation that took place during each year.

The data in Table II-1 allows the following rather startling observations:

- During the entire decade of the 1970s, a nominal 12% credit union loan actually represented an average interest rate of 4.4%. During two years of the decade, the inflation adjusted loan rate has actually been negative.
- During the entire decade of the 1970s, a nominal dividend of 6% represented an inflation adjusted average dividend rate of minus 1.2%. During six years of the decade, the real dividend rate was negative.

It cannot be argued that interest rates at most other financial institutions have been much more rational over the past decade than has been the case at credit unions. These other financial institutions are also limited by legislation and regulation as to ways in which they can adjust rate structures. However, during the past year and a half, regulatory changes have begun to allow financial institutions to provide greater returns to at least some savers. In order to provide substantially improved returns to savers, rates of return on assets have to increase. Since June 1978 (the month that Money Market Certificates became available to banks, savings and loan associations, and mutual savings banks), the bank prime rate has almost doubled from 8 1/2% to 15% and mortgage rates have risen by about 350 basis points. Over the same period, the federal credit union loan rate has remained fairly stable at slightly less than 12%.

Thus, the primary argument against the 12% loan rate limit for federal credit unions is that the ceiling is an anachronism in the context of inflation rates experienced in the 1970s. It is to be hoped that recent actions taken by the Federal Reserve System will eventually wring out much of our current inflation. However, even optimists realize that several years will be required to undo inflationary pressures that have been almost fifteen years in the making. Federal credit unions need the ability to operate in an inflationary environment in the interim. The remainder of this section of the paper will explore some of the effects of inflation on credit union operations and will also provide some additional arguments for rate relief.

Savings Flows

Table II-2 provides information on recent savings flows to U.S. financial institutions from 1976 to August of this year. Through the first six months of 1978, credit unions had the fastest savings growth rates of all U.S. financial institutions. Further, over that same period, federal credit unions consistently had higher saving growth rates than did state-chartered credit unions. During the first half of 1978, the federal credit union savings growth rate of 11.8% was more than double the 5.2% rate experienced at other financial institutions. However, during the second half of 1978 the rate at federal credit unions plummeted to 1.5% while savings growth at other financial institutions dipped slightly to 4.3%. Then, during the first eight months of 1979, federal credit union savings growth rebounded to 5.3%, still slightly below the 6.2% rate at other financial institutions. It is also interesting to note that since the middle of 1978, savings growth rates at state-chartered credit unions have exceeded those at federal credit unions.

TABLE II-2

Percentage Growth Rates for Savings at
Various Financial Institutions

	<u>1976</u>	<u>1977</u>	<u>1978</u>	1st 6 mos. <u>1978</u>	2nd 6 mos. <u>1978</u>	1st 8 mos. <u>1979</u>
Comm. Banks	15.8%	10.1%	9.3%	5.5%	3.7%	7.4%
S&Ls	17.6%	15.2%	11.4%	5.6%	5.5%	6.2%
MSBs	11.6%	8.8%	6.3%	3.3%	2.9%	1.8%
Sub Total	15.9%	11.8%	9.7%	5.2%	4.3%	6.2%
Federal CUs	19.8%	23.2%	13.5%	11.8%	1.5%	5.3%
State CUs	15.8%	16.6%	13.1%	10.4%	2.4%	8.8%
All CUs	17.9%	20.2%	13.3%	11.2%	1.7%	6.9%

The reason for this rather dramatic slowdown in savings growth at federal credit union is of course not difficult to pinpoint. The timing of the slowdown just about exactly coincides with the advent of Money Market Certificates (MMCs). For most of the second half of 1978 federal credit unions were legally unable to offer MMCs. By the time they were allowed into the market, maximum dividend rates had risen from about 7.3% in June to 9.5% in November. Thus, federal credit unions were excluded from the MMC market while rates were relatively low, and have been discouraged from active participation since November because the required dividend rate has been very close to the loan rate ceiling. Of course, more recently, maximum rates on MMCs have risen above the 12% ceiling. The only way that a federal credit union can currently break even on MMCs is to invest the proceeds of MMC sales in short term investments paying more than 12%. This of course precludes the use of these member savings for member loans.

Table II-3 provides some insight into the distribution of savings at federal credit unions compared to practices at other financial institutions. The data in the table suggests that not only have federal credit unions been fairly inactive in the MMC market, but also that federal credit unions have attracted a very small proportion of savings in the form of other share certificates. The fact that the proportion of federal credit union savings held in the form of regular shares is about double the passbook proportions at other financial institutions has three likely explanations. The first and probably most important explanation has already been mentioned. It is namely that credit union loan rates have been stagnant while loan rates at other financial institutions have been rising dramatically. Thus, many credit unions have been squeezed out of offering certificate programs. The second explanation is that federal credit unions have only been empowered to issue share certificates since late in 1977. Credit unions have had to undergo a learning process and many were probably not geared up for certificates by the time rates began rising in mid-1978. Finally, there is a philosophical position maintained by some credit unions that it is inequitable to offer higher dividend rates to only some members. These credit unions feel that the very essence of a certificate program involves implicit discrimination.

Many of these credit unions have raised regular share dividend rates across the board rather than instituting certificate programs. Of course, a general dividend rate increase has a much greater impact on the credit union's average cost of funds than would be the case if only certain member's dividend rates were increased by means of a certificate program.

TABLE II-3

Savings Distributions at Various Financial Institutions

	<u>Regular Share</u> <u>(Passbook)</u>	<u>MMC</u>	<u>Other Certificates</u>
Commercial Banks	40.7%	11.6%	47.6%
S&Ls	30.5%	21.1%	48.3%
MSBs	47.2%	17.8%	35.0%
FCUs	87.7%	4.9%	7.4%

One further point needs to be made before leaving the topic of savings flows. It has been mentioned that credit union savings flows have slowed considerably compared to savings growth rates at other financial institutions in the past year. Much of the blame for this relative slowdown must be laid at the feet of the 12% loan rate ceiling. However, it should also be noted that total savings flows to other financial institutions have also slowed over the past few years. Savings growth rates in banks, S&Ls and MSBs fell from 15.9% in 1976 to 11.8% in 1977 to 9.7% in 1978. If the experience of the first eight months of 1979 is a reasonable barometer, savings flows to these institutions for the full year will be approximately 9.3%. In fact, recently released information from the Commerce Department reveals that the third quarter of 1979 saw the lowest rate of savings out of disposable income since the first quarter of 1951.

Declining savings growth rates at financial institutions represent the fact that not only are aggregate savings rates declining, but also that a dwindling proportion of savings is finding its way into traditional financial institutions. After several years of experience with zero or negative rates of return on savings in financial institutions, consumers are increasingly looking for other ways to store value or save. The growth of close substitutes to traditional financial institutions, like money market funds, and activity in not so close substitutes, like housing, commodities, and collectables, all attest to the consumer's attempts to beat inflation. This sort of long term "disintermediation" is troublesome not only to financial institutions. Savers who are forced to find exotic ways to save often sacrifice liquidity and security and must undertake additional search costs. This current trickle from financial institutions is likely to grow into something more substantial unless net-of-inflation returns to savers at financial institutions are raised to some small positive level. The best long run solution is of course a reduction of inflation rates. In the short run, however, it appears highly likely that Regulation Q will continue to crumble.

It would seem that credit union dividend rates will be facing substantial upward pressures in the coming months and years. Dividend rates on regular share accounts at credit unions typically exceed interest rates paid on passbook accounts at other financial institutions. However, more than half of the savings dollars at these other institutions is held in certificates paying more than passbook rates. Thus, the average cost of savings is lower at credit unions than it is at other institutions. Rather than this lower cost being a benefit to credit unions, it is one of the chief causes of sluggish savings growth. Therefore, there is a need for credit union dividend rates to catch up with interest rates at other financial institutions in the competition for savings. As will be discussed in Section IV, many federal credit unions will require loan rate ceiling relief in order to make these dividend increases. Furthermore, there are ample reasons to believe that permissible returns to savers will increase in the near future in an attempt to maintain the predominance of traditional financial institutions as savings vehicles. These increasing returns to savers will require additional dividend rate adjustments which further contribute to the need for relief.

Liquidity

The current loan rate ceiling hampers credit union liquidity management in several ways. In tight money periods, when liquidity pressures are most intense, credit unions are likely to be faced with cross- and/or dis-intermediation. As has been discussed in the previous section, the cross- and dis-intermediation is primarily the result of the lid imposed on the ability to pay sufficient dividends by the loan rate ceiling. A case in point is that the current rate on MMCs is 12.6%. In the absence of a reduction in loans outstanding to offset the share withdrawal, a credit union in this situation will be forced to borrow. The borrowing cost to the credit union in today's market will be close to 15%. Although a credit union faced with a savings outflow of the type envisioned here will undoubtedly attempt to reduce loans outstanding, such as reduction in loans is not easily accomplished. Assume for example that a federal credit union has a loan-to-share ratio of 97% and a loan repayment ratio of 6.4% of outstanding per month¹. Assume further that this credit union is faced with an unexpected share withdrawal of 15% of total shares. Although this is a rather extreme savings outflow, it is certainly possible given current rates on MMCs and the size of MMCs². If the credit union were to absolutely shut off loans, it would take approximately two months for its loan-to-share ratio to fall to 100%.

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1. These numbers approximate actual federal credit union averages in August 1979.
 2. At the end of 1977, 36% of the dollar amount of federal credit union shares was held in accounts greater than \$10,000.

Credit union liquidity problems are further exacerbated by the existence of open-end credit. In a recent small survey of federal credit unions,¹ about 70% offered some form of open-end credit. About 6% of these open-end credit programs reported in the survey are credit card programs. The remainder were probably either lines of credit associated with share draft programs or simple preauthorized signature lines. With open-end credit, the option of directly shutting off previously granted lines of credit, although legally permissible, is more difficult. Further, it is precisely in tight money periods, when normal sources of consumer credit tend to dry up, that unused lines of credit are most likely to be drawn upon. Such "uncontrollable" loan extensions often force the credit union to borrow at "tight money" rates. This forced borrowing, to the extent that it occurs at rates exceeding the net rate of return on line-of-credit loans, implies a subsidy from general membership to line-of-credit borrowers. In the absence of the 12% loan rate limit, line of credit loans could be charged at a rate sufficient to cover the average cost of funds. In this fashion a special service-availability of credit on demand-could be provided to some members without requiring a subsidy from members who do not wish to use the service.

Finally, in very tight money situations, a loaned-up credit union has in principle two options available to avoid the high costs of acquiring additional funds. The credit union can either directly limit member borrowing or raise loan rates. Directly limiting member borrowing denies the member the opportunity of choosing between loan postponement and an immediate loan at a higher rate. Raising loan rates would certainly not discourage all pending excess borrowing demands. However, those members who did wish to borrow at the higher rates would be providing additional income for the credit union to cover high funds costs. This option of raising loan rates is unavailable or severely limited with the 12% ceiling.

In situations where a credit union is not fully loaned-up, liquidity pressures might induce the credit union to attempt to slow loan extensions without completely shutting off loans. Some credit unions attempt to do this by offering loans on a first come-first served basis. This process is quite arbitrary and faces problems due to the varying sizes of loan requests. Another method of slowing loan demand is to establish a minimum loan amount. In this way, smaller, more costly loans can be excluded. This is particularly attractive when rising funds costs are straining income. A third method of restricting loan extensions is to raise credit worthiness standards. This option is appealing in tight money periods when a recession and rising delinquencies are expected. Finally, loan extensions may be trimmed by raising downpayment requirements on secured loans (reducing loan to value limits) and/or reducing loan terms. These steps tend to reduce cash outflows, and, in the case of shorter loan terms, increase the cash inflow associated with loan repayments.

1. See Section III.

All of these methods to limit loan extensions without increasing interest rates fall under the general heading of "non-price credit rationing". It must be recognized that all types of credit rationing require a set of rules to determine who will and will not have access to loanable funds. These rules must necessarily include some potential borrowers and exclude others. Any set of credit-rationing rules is likely to have serious equity implications concerning who is and is not excluded. Because of the importance of the equity implications of the 12% loan rate ceiling, the following subsection is devoted to those implications.

The "Equity" of the Loan Rate Ceiling - The Consumer Issue

The existence of the 12% loan rate ceiling implies a whole set of subsidies from some credit union members to others. Some of these subsidies might be considered equitable, others might not. In any case, it is properly the responsibility and privilege of a credit union board or the general membership to decide which subsidies are appropriate. Furthermore, some of the subsidies implicit in the 12% loan rate ceiling are less obvious than others. It is important that all involved are aware of these less obvious but no less real subsidies.

The most obvious subsidy associated with the loan rate ceiling is of course the transfer of income from savers to borrowers. Whereas a 12% loan rate ceiling does not necessarily imply such a subsidy in the absence of inflation, the data in Table II-1 indicates the extent of this subsidy in the context of inflation rates experienced in the 1970s. Over the current decade, a 12% loan rate has had an average value adjusted for inflation of 4.4%. Over the same period, a 6% dividend rate adjusted for inflation has had an average value of minus 1.2%. In order for savers to have merely kept up with inflation over the past decade, effective dividend rates would have to have averaged 7.4%. Thus, credit union rate structures over the past decade have resulted in a situation in which: (a) savers have actually paid for the privilege of maintaining a share account during six of the past ten years (negative real dividend rates), and (b) borrowers have actually been paid to take out loans during two of the last ten years (negative real loan rates). It is little wonder that such a rate structure has brought liquidity pressures.

It is not altogether certain that credit unions would have established loan rates exceeding 12% during much of the past decade in the absence of the 12% limit. In fact it is very doubtful that rates would have been raised early in the decade. This is because habits like the 12% APR take a long time to break. Also, because in any year during the past ten it is likely that the rate of inflation may have been underestimated, the actual extent of the subsidy from savers to borrowers may not have been fully realized. However, more recently consumers have become more accustomed to inflation, and pressures have been building to raise both loan and dividend rates to redress the imbalance between actual loan costs and returns to savings. Unfortunately, these pressures have run afoul of the 12% loan rate ceiling.

A second set of subsidies implicit in the 12% rate ceiling involves transfers of benefits from members unable to borrow under the ceiling to those members fortunate enough to secure loans. The existence of the 12% ceiling insures that those members who borrow from credit unions can do so at rates that are less than or equal to the rates that would prevail without the ceiling. These members clearly benefit from the rate ceiling. However, a group of would-be borrowers is likely to suffer as a result of the rate limit. These are the borrowers that are excluded from borrowing by whatever means of credit rationing is employed. Whenever a credit union has to adopt measures that limit loan demand in the face of liquidity pressures, such a group of disadvantaged borrowers will exist. The very existence of the ceiling is likely to exacerbate any liquidity pressures that the credit union might face by limiting the ability of the credit union to attract funds either in the form of savings or borrowing.

The particular group of members to suffer as a result of the ceiling depends on the type of credit rationing steps taken. If a credit union allocates scarce loanable funds on the basis of first come-first served, the unfortunate members will be those who are simply unlucky enough to be toward the end of the line and/or those who are far removed from information dissemination systems and hence do not anticipate the loan restricting steps. If the credit union establishes a minimum loan amount, borrowers requesting smaller amounts will of course be excluded. If the credit union raises credit worthiness standards, lower-income borrowers will tend to be left out. If the credit union raises downpayment requirements and/or lowers maturities, lower-income borrowers will again be excluded. This is because lower income borrowers are less likely to be able to make higher downpayments or the larger monthly payments associated with decreased loan terms.

It is apparent that most non-price credit rationing schemes likely to be adopted by credit unions attempting to restrict loan extensions are likely to work against smaller, lower-income borrowers. This is specifically the type of borrower to whom credit unions are supposed to provide an alternative to other higher rate credit sources. The disadvantage inflicted upon excluded groups can take essentially one of two forms: (a) the borrower will have to forgo the use of the credit that was originally requested, or (b) the borrower may obtain credit elsewhere, but this is likely to be at much higher rates. Because the excluded borrower is likely to have a lower than average income or credit rating, the only other source of credit to such a borrower is likely to be a firm that may charge between 18% and 30%. Thus, by protecting borrowers from rates slightly in excess of 12% at credit unions, the loan rate ceiling may well drive many borrowers to loans at twice that rate.

It is of course true that the raising of loan rates in a time of liquidity pressures is itself a form of credit rationing. However, rationing scarce loanable funds by price is less likely to work against lower-income borrowers than are the typical forms of non-price credit rationing. In the first place, reducing loan demand by rate increases allows each potential borrower the choice of whether or not to pursue a loan application. It is likely that raising loan rates beyond 12% will induce some members who would have been in the included category under non-price credit rationing to postpone or forgo borrowing. To the extent that this happens, more loanable funds will be available to those who would have been in the excluded category under non-price rationing. Secondly, the removal of the 12% ceiling would tend to reduce liquidity pressures by allowing higher dividend rates. This would also tend to provide more loanable funds to borrowers who would otherwise be excluded.

An example comparing price-rationing and non-price credit rationing may be instructive. A few disclaimers must be mentioned at the outset. First of all, there is no way to estimate precisely the extent to which credit union loan rates would rise in the absence of the 12% ceiling. This would of course depend on the extent of liquidity pressures, the extent of member demands for increased dividends, and the level of money market interest rates. However, on the basis of spread information provided at the end of this section of the paper, the following example is probably quite reasonable. We begin with the following assumptions: (a) a member requests a \$3,000 loan for 48 months, (b) in the absence of loan rate relief, the credit union would restrict loan extensions by lowering maximum maturities to 36 months, (c) freed from the 12% ceiling, the credit union would raise loan rates to 15% to counter liquidity pressures, and (d) a similar loan could be obtained from some other financial institution at 18%. The member is thus faced with the following:

<u>Type of Loan</u>	<u>Loan Amount</u>	<u>Interest Rate</u>	<u>Length</u>	<u>Monthly Payment</u>	<u>Total Finance Charge</u>
Initial request 12% ceiling	\$3,000	12%	48 mos.	\$79.00	\$ 792.00
Included member 12% ceiling	\$3,000	12%	36 mos.	\$99.64	\$ 587.04
Previously excluded member, no ceiling	\$3,000	15%	48 mos.	\$83.49	\$1,007.52
Alternate loan	\$3,000	18%	48 mos.	\$88.12	\$1,229.99

Under the 12% ceiling, the member's income may be sufficient to qualify for the loan at 36 months. This member can accept or reject the loan depending on the importance of the extra \$20 monthly payment compared to the reduced total finance charge. On the other hand, while the member may have been able to afford a monthly payment of \$79 per month, a payment of \$99 per month may not be acceptable to the member or allowable in terms of credit standards. This member is thereby excluded under non-price credit rationing and faces the choice of an 18% loan at \$88 per month or not borrowing. Finally, if the credit union had the freedom to charge 15% for the loan, the member would have the choice of not borrowing, or a 15% loan at \$83.50 per month. In terms of most common credit rating systems, a low income borrower is more likely to be able to qualify for the 48 month, 15% loan at \$83.50 per month than the 36 month, 12% loan at \$99.64 per month.

Again, the validity of the above example rests on the assumption that credit unions unfettered with the 12% ceiling will: (a) continue to charge lower loan rates than consumer finance companies, and (b) be able to alleviate some liquidity pressures by raising loan and dividend rates. Evidence presented elsewhere in the paper indicates that these two requirements are likely to be met at least to a substantial degree. Of course, removal of the 12% loan rate ceiling would not totally solve all liquidity problems and replace all non-price rationing with price rationing. However, to the extent that price rationing is allowed to do some of the work more equitably, non-price rationing would be required to do less of the work.

A recent paper by William C. Dunkelburg titled "The Transfer Implications of Consumer Credit Regulation" and published as Working Paper No. 29 of the Credit Research Center at Purdue University addresses many of the equity issues discussed in this subsection of the paper. The following is excerpted from the abstract to Dunkelburg's study (p.1):

The author observes that consumers as savers are the ultimate source of funds to other consumers as well as to government and business. A credit union provides a simple example. In this context, it is easy to see that effective lending rate ceilings lower the return that lenders (consumers) can ultimately earn on their savings. Rate ceilings also determine which consumers can economically be served by the lending institution. Consumers who still qualify for credit at a low regulated price benefit, while those who cannot qualify are forced to find more expensive credit or do without credit services. That denial of credit can cost the consumer money is documented by an example of the value of financing a washer and dryer, even at rates as high as 40 percent. Loss of access to credit can impose significant economic losses on consumers, especially during periods of rapid inflation.

One final point needs to be made concerning the subsidization of some credit union members by costs imposed on other members that occurs in large measure because of the 12% loan rate ceiling. Attempts to question the 12% limit have often been assailed on the grounds that increasing loan rates is contrary to the interests of consumers. Hopefully, this subsection of the paper has demonstrated that raising or eliminating the 12% ceiling may well be to the disadvantage of some consumers - but only to borrowers fortunate enough to have access to credit union loans under current conditions. On the other hand, ceiling removal would provide substantial benefits to two groups of consumers: (a) savers, and (b) borrowers who are excluded from credit union loans because of the ceiling. These currently excluded borrowers tend to come from less advantaged groups of consumers.

Expenses

There is one further aspect of the impact of inflation on credit unions that needs discussion here. Some may argue that increases in operating expenses due to inflation have necessitated a greater spread between dividend and loan rates. This position is highly questionable. If the assets of a credit union grow at roughly the same rate as the inflation that is fueling expenses, then net income will grow at the same rate without a change in spread. For example, assume that prices this year are 10% higher than last year. The expenses associated with putting a loan on the books are likely to have also risen by 10%. However, the average size of a loan is also likely to have increased by 10% therefore, average income from a loan will also have increased by 10% with no increase in loan rates.

There are available no price indices that gauge the rate of inflation on that specific set of goods and services whose purchase makes up a typical credit union's expenses. In fact, as information provided in the next subsection indicates, the average expense-to-income ratio for federal credit unions has remained remarkably stable through 1978. However, rising dividend pressures and the loan rate ceiling have caused a recent slowdown in savings growth at federal credit unions. In this context, there are undoubtedly many federal credit unions facing rising expense-to-income ratios because of slow growth. These credit unions require rate relief not so much to increase the spread between loan and dividend rates, but rather to raise both loan and dividend rates to encourage savings growth and thereby restore expense-to-income ratios to previous levels.

Recent Credit Union Spreads

Thus far, several arguments have been presented in favor of relief from the 12% loan rate ceiling for federal credit unions. These arguments maintain that loan rates must be able to rise so that:

- dividend rates can rise at least to the point that savers can match inflation with credit union share accounts.
- dividend rates can rise to match rates paid on savings at other financial institutions whose loan rates are not under binding legal limitations. This would help to restore the flow of savings to credit unions.
- loan and dividend rate structures can be established that determine only those inter-member subsidies that individual credit unions expressly want.
- credit unions will be better able to manage liquidity.

Those arguments that relate ceiling relief to rising dividend payments may be questioned on the following grounds: credit unions could raise dividend rates without raising loan rates so long as they maintain or improve efficiency. The information presented in Table II-4 addresses this criticism.

The figures reported in Table II-4 are derived from aggregate data on federal credit unions published in Annual Reports of NCUA¹. The effective loan rate is computed by dividing loan income (net of refunds) by average loans outstanding. The cost of delinquency is the difference between the effective loan rate and the result of dividing loan income by average nondelinquent loan balances. Interest refunds are derived by dividing interest refunds paid by average loans outstanding. The stated loan rate is the sum of the first three columns. The effective dividend rate is the result of dividing total dividends paid or payable for the year by average shares. Member spread is the difference between the stated loan rate and the effective dividend rate. Finally, operating expenses are defined as total expenses less interest on borrowed money.

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1. Average values for loans outstanding and shares had to be estimated on the basis of year-end totals. As such, the rates reported in the table are approximations. However, any monthly patterns which might cause an average of year-end values to provide a very biased estimate of the actual average are likely to be repeated each year. Thus, year to year comparisons of the rates shown in the table are reasonably valid.

The information reported in Table II-4 reveals that from 1972 to 1978, the average spread between stated loan rates and effective dividend rates at all federal credit unions declined from 5.80% to 4.99%. This reduction in member spread was achieved by a slight increase from 10.92% to 11.15% in the average stated loan rate and a increase from 5.12% to 6.16% in the average effective dividend rate. This reduction in spread was accomodated by:

- maintaining a stable level of delinquency costs.
- lowering interest refunds from 0.43% of loans outstanding to 0.23%.
- reducing operating expenses from 35.4% of gross income to 33.32% of gross income. This increase in operating efficiency allowed for an increase in borrowing costs from 1.38% to 4.60% of gross income. The net result was an increase in total expenses from 36.79% of gross income to 37.92%.

One other factor not shown in the table has worked to reduce member spread. This is the fact that rising loan-to-share ratios have raised the average rate of return on assets at credit unions.

TABLE II-4
Federal Credit Union Member Spreads

Year	Effective Loan Rate	Cost of Delin- quency	Interest Refund	Stated Loan Rate	Effective Dividend Rate	Member Spread	Operating Expense/ Income	Interest on Borrowed Funds/Income	Total Expense/ Income
1972	10.24%	0.26%	0.42%	10.92%	5.12%	5.80%	35.40%	1.38%	36.79%
1973	10.25	0.24	0.37	10.86	5.39	5.47	34.46	1.79	36.25
1974	10.33	0.24	0.31	10.88	5.65	5.23	33.78	2.59	36.37
1975	10.34	0.26	0.28	10.88	5.80	5.08	34.60	2.88	37.48
1976	10.52	0.25	0.26	11.03	5.84	5.19	34.27	2.96	37.22
1977	10.45	0.23	0.27	10.95	5.94	5.01	34.00	3.52	37.51
1978	10.67	0.25	0.23	11.15	6.16	4.99	33.32	4.60	37.92

On the basis of the data in Table II-4, it can be very plausibly argued that federal credit unions are not placing downward pressure on dividend rates by becoming less efficient. In fact, just the opposite is the case. Although effective dividend rates at credit unions have risen from 5.12% to 6.16% over the past six years, federal credit unions are approaching the limit of what can be done under the 12% ceiling. If federal credit unions were to charge 12% on all loans, the maximum possible effective dividend rate would be roughly 7.25%. This assumes no interest refund and a continued cost of delinquency of 0.25% of loans outstanding. This 7.25% dividend rate would not quite have matched the average rate of inflation over the past decade. Further, the fact that the average stated federal credit union loan rate in 1978 was 11.15% represents the fact that some auto loans and share secured loans were made at rates less than the 12% maximum. Raising all credit union loan rates to the maximum would have two effects: (a) bad debt losses would rise as less loans would be secured, and (b) the inability to offer share-secured loans at the typical 9% rate would lead to further dis- and cross-intermediation. Elimination of the 12% ceiling would allow continued increases in dividend rates along with the ability to make various loans at different rates. Federal credit unions have done about all that can be done under the ceiling.

III. RECENT SURVEYS

An investigation of the 12% loan rate ceiling must necessarily consult the views of federal credit unions. In an attempt to collect these views, questionnaires were sent to all leagues for distribution to credit unions. The leagues were asked to direct the questionnaires to federal credit unions that seemed to be squarely on either side of the issue, i.e., credit unions either in favor of or opposed to removal of the 12% loan rate ceiling. A copy of the questionnaire sent to credit unions as well as a questionnaire for the leagues to complete are provided in Appendix A. This section discusses responses that have been received from 182 federal credit unions.

Basic Credit Union Results

The first question on the credit union survey asks for a yes/no response to the question of whether or not the credit union needs rate relief. Several credit unions added a third response, i.e., not yet. Allowing for this third option, the responses to the first question are:

Does your credit union need relief from the 12% rate ceiling on loans? Yes _____ No _____

Total Responses	-	182	(100%)
Yes	-	133	(73.1%)
No	-	26	(14.3%)
Not Yet	-	23	(12.6%)

Respondents were next asked why they did or did not want relief. Because this was an open-ended question, multiple responses were possible. Thus, percentages add to more than 100%.

Reasons given by those responding yes:

<u>Reason</u>	<u>% of Yes Responses</u>
Cost of funds - savings	51.9%
General expenses	36.8%
Cost of funds - borrowing	29.3%
Liquidity	15.0%
Cost of funds - unspecified	12.8%
Lack of subsidy	9.0%
Want ability to charge different rates for different loans	6.8%
Want the flexibility to decide rates	6.1%
To maintain or augment services	4.5%
Cost of regulation	3.8%
Other	5.3%

Reasons given by those responding no or not yet:

<u>Reason</u>	<u>% of No or Not Yet Responses</u>
Do not need relief	69.4%
Contrary to credit union philosophy	24.5%
Rate relief would bring further regulation	8.2%
Local competition for loans	6.1%

The next question asked which of five different services were offered to members during the years 1977 and 1978. It is in no sense implied that these five services represent a service package that all credit unions should provide. Nor is it intended that these services constitute a sufficient service mix. Of these five services, credit unions responding "Yes" offered an average of 2.7 in 1977 and 2.8 in 1978. Credit unions responding "No/Not Yet" offered an average of 2.4 of the services in 1977 and 2.6 in 1978.

Services offered by those responding yes

	<u>1977 % of Yes Responses</u>	<u>1978 % of Yes Responses</u>
a) Life savings insurance	82.7%	81.2%
b) Loan protection insurance	88.0%	85.7%
c) Open-end credit	61.7%	68.4%
d) Share drafts	37.6%	48.1%
e) Credit cards	0	3.8%
f) None or left blank	0.8%	2.3%

Services offered by those responding No/Not Yet

	<u>1977 % of No/Not Yet Responses</u>	<u>1978 % of No/Not Yet Responses</u>
a) Life savings insurance	69.4%	71.4%
b) Loan protection insurance	91.8%	91.8%
c) Open-end credit	61.2%	71.4%
d) Share drafts	12.2%	22.4%
e) Credit cards	2.0%	6.1%
f) None or left blank	4.1%	2.0%

Finally, respondents were asked to submit copies of Financial and Statistical reports for the twenty-five months from December 1976 through December 1978. One of the uses of the F&S statements was to measure the amount of sponsor subsidy. Sponsor subsidies to credit unions often involve the provision of office space and/or some office operation services. On the basis of financial statements alone, it is not possible to gauge the extent of sponsor provided office operations services. However, some estimate can be made of sponsor provision of office space. Credit unions that incur space occupied expenses of less than \$50.00 per month were considered to be substantially subsidized with respect to office occupancy. Credit unions incurring space occupied costs exceeding \$50.00 per month may well be partially subsidized for office occupancy. However, any attempt to create categories of "partially subsidized" and "not subsidized" based on income/expense statements alone is impossible. Thus, although we report data only for those credit unions that definitely appear to be subsidized, many other respondents are probably partially subsidized.

Credit unions paying less than \$50.00 per month for space occupied.

Percent of Yes responses	12.0%
Percent of No/Not Yet responses	48.9%

Interpretation of Credit Union Survey Results

Responses to the first question in the credit union survey (do you need rate relief?) are not to be taken as an indication of the extent of desire for rate relief on the part of all federal credit unions. There are two reasons why responses to the first question cannot be considered representative. In the first place, the questionnaires were distributed to credit unions through leagues with specific instructions to target the questionnaires to credit unions that feel strongly either one way or the other on the 12% issue. Representatives from many leagues have indicated that they are aware of few credit unions that are specifically opposed to relief. Secondly, and more importantly, respondents to the survey were asked to submit twenty-five months of financial statements with the completed questionnaire. This data requirement undoubtedly creates a strong bias in favor of responses advocating rate relief. For a credit union feeling a need for rate relief, the return of the questionnaire and financial statements is likely to be perceived as an action that will make rate relief more likely. On the other hand, a credit union that is having no difficulty operating under the 12% ceiling has less of a stake in the 12% issue. No harm is done to that individual credit union if the loan rate ceiling is raised or removed because the credit union can simply operate below the new ceiling. Such a credit union is understandably less likely to go to the trouble and expense of responding. However, although the survey does not provide an indication of overall federal credit union opinion on the 12% issue, the survey responses provide a great deal of valuable information on why credit unions either favor or oppose rate relief.

Of those credit unions indicating a need for relief, the primary reason given had to do with the cost of funds. The most common response was that income must be increased to provide for rising dividend costs - 51.9% of yes responses. Another 29.3% of these credit unions mentioned the high cost of borrowed funds while 12.8% referred to high funds costs without specifying borrowing or savings. A few credit unions indicated that borrowing costs are a problem primarily because of regulatory constraints on dividend or interest rates payable to members. Because of limits on rates payable to members, the credit unions feel compelled to borrow from other sources at rates that are higher than those that would be necessary to obtain member funds. It should also be noted that virtually all of the questionnaires were completed and returned prior to the recent Federal Reserve actions that have raised short term rates by about 2% in the space of only three weeks.

The second most common reason for wanting relief is the pressure of rising expenses in general (36.8%). It has been argued that credit union growth can offset the effects of inflation on expenses. However, the effects of dis- and cross- intermediation have probably made rising expense-to-income ratios a problem in many credit unions. Further, many of the credit unions citing rising expenses as the reason for needing relief may well have had funds acquisition expenses in mind.

One further reason for wanting relief requires some comment. Some 6.8% of credit unions responding yes indicated a desire to be able to charge different rates for different loans. These credit unions would like to charge lower rates for secured loans (eg. share secured loans, auto loans) than for unsecured loans (eg. personal loans, line-of-credit loans). However, the loan rate ceiling on all loans has required raising rates on secured loans in order to generate income. These credit unions feel that if some loans could be made at rates exceeding 12%, then rates could be lowered on secured loans.

Finally, not all of the reasons given by credit unions fit neatly into categories. Below are excerpts from a few of the responses:

"We strongly urge that the 12% limit be increased in order that we may be able to obtain funds to prevent our members from borrowing at other sources where rates could be 18 to 24%. As a result of the high cost of money, this Credit Union has had to severely restrict its loan limits, bringing hardships to many of our members."

"The answer is very clear. Members who constitute 10% in number have 90% of the money in shares. They are not satisfied with 7 3/4% dividends any more. 10% or more on 6 months certificates is what they demand. If you are paying for your own building and trying to keep up with inflation it is very difficult when your income is restricted."

"The cost of doing business does not have a rate ceiling. More of our members are going into C.D.'s which command a higher earning rate. Our loan demand is heavy since 12% is "cheap" money right now. The affluent member is drawing money from his share account to the Money Market Certificate. To replace this money going out is costing us at present 14%. This will have to stop somewhere, which means that services in some areas will have to be reduced. When services and benefits are cut, your troubles will then begin. The 12% rate might have been acceptable years ago, but it does not fit into modern credit union operations. I don't like it, but I'm afraid the present rate structure must be adjusted."

"In order to be able to offer our savers a reasonable dividend. To be able to continue to make loans that are not 'bankable' because of a higher risk factor. This relates especially to young people, poor people, and people who become "over extended". With laws and regulations making it more difficult to collect from slow payers, if we can't pass on a higher interest rate, then we will force these marginal borrowers to go the loan and finance companies where the rates are exorbitant and concern non-existent."

"The rapidly rising cost of money (dividends) will eventually force us to raise the interest rate maximum. Lets not wait until we have lost savings before we start worrying."

"In summary, the cost of obtaining funds for lending will increase in the future, inflation rate will remain high and increase our operating costs. Our low ceiling is creating excessive loan demand and encouraging borrowing because of the expectation of high costs in the future. Our restrictive loan policies as a result of an eroded share base are causing our low income people to seek loans at Finance Companies at excessive rates - thus, causing financial problems for our members. The only way we can equitably restrict loans (since we have an interest rate ceiling) is by requiring larger down payments, shorter terms, etc. These restrictions force low-income people, who have hardest time meeting restrictions to seek funds elsewhere at much higher rates. The higher income people, able to meet down payment and shorter term requirements, are ENCOURAGED to borrow because of a low interest ceiling. The Federal Reserve is attempting to fight inflation through high interest rates to discourage excessive consumption. The Credit Unions are being counter-productive to this intent by keeping low interest rates."

Of those credit unions responding No/Not Yet to the need for relief question, the primary reason given was that relief was not needed (69.4%). The next most common response was that charging loan rates in excess of 12% is against the philosophy of credit unions. Some credit unions expressed the fear that rate relief would only be achieved at the risk of further regulation and that the trade-off is unacceptable. Finally, 6.1% of the No/Not Yet respondents indicated that loan rates at other financial institutions in their areas require that loan rates remain below 12% anyway.

A very small number (3) of the credit unions opposed to rate relief cited impressive statistics on dividend, loan interest and refund rates. These respondents indicated that comparably effective management at other credit unions would eliminate any need for rate relief. Interestingly, the income/expense statements of two of these credit unions indicate considerable sponsor subsidy.

Two excerpts from credit unions in the No/Not Yet categories are provided below. The first is fairly representative of those credit unions opposed to rate relief on philosophical grounds. The second quote is from the Not Yet group.

"Credit Unions were organized and designed to help small borrowers at the lowest possible interest rate to keep their members from the loan sharks. It is my sincere belief that we should lead the parade and hold the line at 12%. Let's not go into long term loans for homes, motels, airplanes and yachts. Let's confine our lending to help the working men and women. It would be very easy to raise our rates and follow the inflation that is going on in our country today."

"At this point we are able to pay a good dividend (6 3/8%) with the 12% maximum. Our facilities are at present provided free. We can foresee, however, the need to build our own quarters in the future. At that time, we may need such relief."

The remaining information from the questionnaires allows some comparison of the characteristics of credit unions favoring or opposed to relief. Because of the small number of responses, any such comparison must be regarded as highly probably only and subject to considerable statistical error. The following tentative observations can be made:

- Both groups of credit unions increased the number of services offered from 1977 to 1978. The greatest increases came in share draft and credit card programs.
- Credit unions responding Yes are more likely to offer share draft programs than are credit unions responding No/Not Yet. In fact, some of the credit unions opposing rate relief on philosophical grounds were also opposed to share drafts and credit cards for philosophical reasons.
- There seems to be very little difference between the two groups in terms of the provision of loan protection insurance and open-end credit. However, credit unions favoring relief are probably more likely to offer life-savings insurance than are credit unions responding No/Not Yet.
- Credit unions indicating a need for relief are less likely to be receiving substantial subsidies for space occupied than are credit unions responding No/Not Yet. The data does not allow any reasonable inferences on the degree of partial subsidies.

State-Chartered Credit Unions Without a 12% Ceiling

In twenty-two states, state-chartered credit unions are permitted to charge interest rates greater than 12% on at least some loans. In a few more states, state-chartered credit unions will have ceiling relief in the very near future. Credit union leagues in the twenty-two states permitting credit union loans at rates in excess of 12% were contacted in an informal telephone survey during the week of October 22, 1979. League representatives were asked to estimate the percentage of state-chartered credit union in the state that currently charge more than 12% on at least some loans. They were also asked if many state-chartered credit unions had begun to charge more than 12% in the recent past.

Any accurate estimation of the extent to which state-chartered credit unions with the power to do so are charging more than 12% on loans would require a rather extensive survey of individual credit unions. The results of this league survey are not likely to accurately reflect the data that might be obtained from a large credit union survey. However, given the level of contact that most leagues have with credit unions in their respective states, the results of the survey provide a valuable overview.

Of the twenty-two leagues in which state-chartered credit unions can charge more than 12% on loans, twenty leagues were willing to hazard a guess on this proportion of credit unions charging more than 12%. These estimates ranged from 1% to 80% and averaged 30%. State-chartered credit unions in these twenty states have had the ability to charge more than 12% for periods ranging from two months to over 45 years. However, most of these twenty states have switched to allowing credit unions to charge rates in excess of 12% since 1975. When asked to assess whether many state-chartered credit unions have recently begun to make loans at more than 12%, sixteen leagues responded yes, four answered no, and two did not know.

While no hard data on the practices of state-chartered credit unions in states allowing credit union loan rates in excess of 12% is available, the recent league survey provides at least some insight. A fairly reasonable estimate is that 20% or more of state-chartered credit unions with the power to do so are charging more than 12% on at least some loans. Further, the situation is very fluid. It is apparent that many state-chartered credit unions are at least seriously considering loan rates greater than 12%. In comparison, it may be noted that a similar league survey in early 1977 indicated that only 2.5% of credit unions with the power to do so were charging more than 12%.

IV A STATISTICAL INVESTIGATION OF THE NEED FOR RATE RELIEF

This final section of the paper provides an analysis of recent credit union operations under the 12% ceiling. The extent to which federal credit unions have needed rate relief during the past two years will be investigated. Further, the extent to which federal credit unions are likely to need rate relief in the context of market conditions existing during the later part of 1979 and early 1980 will be analyzed.

Method¹

The model used for the analysis is an accounting model that calculates a credit union's break-even loan rate. The model takes information describing all income sources to the credit union (excluding loan income) and all expense and net income distribution items. With this information, the model calculates the average loan interest rate at which the credit union would have "broken-even". For purposes of this paper, break-even is defined as the ability to pay a 6% nominal dividend on regular shares² and transfer 6% of gross income to regular reserves without having to draw on undivided earnings. Thus, if the model computes a break-even loan rate for a credit union in excess of 12%, that credit union made some combination of the following adjustments in order to exist under the 12% ceiling.

- paid dividends at less than a 6% nominal rate.
- transferred less than 6% of gross income to regular reserves.
- drew down undivided earnings.

The data used in the analysis is from year-end information collected by NCUA. In order to perform the analysis for the years 1977 and 1978, data was required for the years 1976, 1977 and 1978. A total of 11,211 federal credit unions reported to NCUA in each of these three years. Because of certain data omissions, the analysis was performed on 11,110 credit unions in 1977 and 11,128 credit unions in 1978. The break-even loan rates computed for each credit union are necessarily approximations because year-end values for balance sheet items had to be used to estimate annual averages.

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1. A complete technical derivation of the model used in this analysis is available on request.
 2. The ratio of the effective dividend rate to the nominal dividend rate was assumed to be 0.9. Thus a 6% nominal dividend rate represents an effective rate of 5.4%.

Results

Summaries of the results of computing break-even loan rates are provided in Tables IV-1 through IV-3. Break-even loan rates are divided into three categories and results are reported for three time periods. The three break-even loan rate categories are: (1) less than 11.5%. Credit unions in this category are interpreted as being able to operate under the 12% loan rate ceiling. (2) Between 11.5% and 12.5%. Credit unions in the category are interpreted as being on the borderline between being able and not being able to operate under the 12% loan rate ceiling. (3) Over 12.5%. Credit unions in this category are interpreted as being unable to operate in the long run under the 12% loan rate ceiling. It should be noted that even though a credit union may break-even under the ceiling, some such credit unions may encounter long run capital adequacy difficulties. This is because our definition of break-even requires no transfers to undivided earnings.

In addition to results for the years 1977 and 1978, information is also reported for a category called "1978 Simulation". This category represents an attempt to simulate financial market conditions as they exist toward the end of 1979. The 1978 Simulation was derived using 1978 data with the following adjustments:

- The rate paid on borrowed funds at each credit union was increased by 3% from the rate paid in 1978.
- The rate earned on investments at each credit union was increased by 3% from the rate earned in 1978.
- Interest refunds were discontinued.
- Each credit union's total shares were redistributed in the following proportions: 40% in regular shares, 20% in Money Market Certificates, and 40% in other certificates.
- The dividend rate on MMCs was set at 12.5%. The dividend rate on other certificates was set at 7.5%. The nominal dividend rate on regular shares was lowered from 6% to 5.5%.

The methods used to simulate current conditions with the category "1978 Simulation" are not intended to imply that credit unions would follow exactly these practices in the absence of the 12% loan rate ceiling. Rather, the attempt was made to evaluate the impact on credit unions of paying a return on savings approximately equal to rates paid by other financial institutions. The average cost of savings implied by the data used in the simulation is 7.48%. This average dividend rate is to be compared with a current inflation rate of 13% and an average inflation rate of 7.4% during the entire decade of the 1970s. Finally, the model assumes that the dividend rates used in the simulation are maintained for a full year. It may be argued that a 12.5% rate on MMCs is unlikely to prevail for an entire year. However, over the course of the next few years, if inflation does not evaporate and the demise of Regulation Q continues, an average rate of return to savers of 7.48% is not unreasonable.

The breakdown of credit unions falling into the three break-even loan rate categories is shown in Table IV-1. Because the results in 1977 and 1978 are so similar, these two years will together be compared to the data shown for "1978 Simulation". Over the past two years, about 70% of federal credit unions have been able to break-even with loan rates of less than 12%. Slightly more than 15% of federal credit unions have been having trouble with loan rates at or below the ceiling. This trouble has taken the form of transferring less than 6% of gross income to regular reserves, paying dividends in an amount less than a nominal rate or 6%, and/or drawing on undivided earnings. If we allow the assumptions that make up the simulation we find very different results. In this case, only 35% of federal credit unions would be able to break-even under the 12% ceiling and 46.3% would not break-even. The remaining 18.7% would be on the borderline.

Tables IV-2 and IV-3 contain descriptive information on credit unions falling into the trouble, no trouble, and borderline categories. The following observations generally apply to credit unions with break-even loan rates less than 11.5%:

- These credit unions tend to have expense-to-income ratios less than the average.
- In 1977 and 1978, these credit unions had loan-to-share ratios slightly above the average. The reverse was true using the simulation.
- These credit unions tend to be larger than average.
- These credit unions tend to have ratios of expenses for space occupied to total expenses that are slightly below average. This is mild evidence that these credit unions tend to be subsidized.
- These credit unions tend to be growing faster than average.
- These credit unions are slightly more likely to have paid an interest refund than average.
- These credit unions tend to pay higher than average dividends.
- These credit unions represent a higher proportion of occupational bonds of association than the overall distribution.

The following observations generally apply to credit unions with break-even loan rates in excess of 12.5%.

- They tend to have expense-to-income ratios higher than the average.
- In 1977 and 1978, these credit unions had loan-to-share ratios well below the average. Using the simulation, these credit unions tend to have loan-to-share ratios slightly above the average.
- These credit unions tend to be smaller than average.
- These credit unions tend to have ratios of expenses for space occupied to total expenses that are slightly above the average. This is fairly mild evidence of lower than average subsidies.
- These credit unions tend to be growing less rapidly than average. This factor might account in part for the higher expense-to-income ratios.
- These credit unions are less likely to pay an interest refund than average.
- These credit unions tend to pay lower than average dividends.
- These credit unions represent a higher proportion of associational and residential credit unions than average. This is further evidence of the absence of subsidy.

The information presented thus far provides a fairly consistent comparison of credit unions that are and are not likely to be having trouble with the 12% ceiling. Credit unions that can break-even under the ceiling tend to be larger, more efficient, faster growing and somewhat more subsidized. Conversely, credit unions that have trouble breaking even under the ceiling tend to be smaller, less efficient, slower growing and less subsidized. Since most of these characteristics are intertwined, it is possible that rate relief could work in the direction of alleviating some of the differences. To the extent that rate relief allowed greater dividends, growth would be encouraged. Accelerated growth would tend to lower expense-to-income ratios both by compensating for inflation and by allowing the realization of economies of size.

Although elimination of the 12% ceiling may be a necessary part of the solution for credit unions with high expense-to-income ratios, many other steps would need to be undertaken to reduce costs in individual credit unions. Further, a comparison of credit unions that were and were not breaking even under the ceiling in 1977 and 1978 produces a rather mild case for rate relief. However, a comparison of credit unions that would or would not have trouble breaking even under the simulation provides a strong case for relief. Credit unions that could break even under the ceiling given the simulated conditions have much lower expense-to-income ratios than average and are substantially larger than average and faster growing than average. On the other hand, credit unions that would have trouble under the ceiling given the simulation conditions have expense-to-income ratios, asset sizes and asset growth rates that are substantially closer to overall averages than is the case using 1978 data.

Further, the relationship between a credit union's ability to break even under the ceiling and its expense-to-income ratio is not as simple as it might at first appear. Appendix B provides more detailed information on the relationships between break-even ability and the several variables shown in Table IV-2.

Finally, any further upward pressures on dividend rates in the near future beyond the average 7.48% represented by the simulation would further deplete the ranks of break-even credit unions and add to the list of credit unions having trouble under the 12% ceiling. If this were to happen, many borderline credit unions under the simulation would begin to have problems. These currently borderline credit unions have expense-to-income ratios that are below average, are slightly above average in asset size, and had 1978 growth rates that approximated the overall average.

TABLE IV-1

Number and Percent of Federal Credit
Unions Falling Into Three
Break-Even Rate Categories

<u>Year</u>	<u>Break-Even Loan Rate</u>			<u>Total</u>
	<u>Less than 11.5%</u>	<u>11.5% - 12.5%</u>	<u>Over 12.5%</u>	
1977	7,555 (68.0%)	1,655 (14.9%)	1,900 (17.1%)	11,110
1978	7,810 (70.2%)	1,491 (13.4%)	1,827 (16.4%)	11,128
1978 Simulation	3,891 (35.0%)	2,083 (18.7%)	5,154 (46.3%)	11,128

TABLE IV-2
Comparison of Averages

Break-Even Loan Rate	Year	Office Occ Exp/ Total Expenses		Expenses/ Income	Loan/ Share	Asset Size (thousand)		Asset Growth	Interest Ref/ Loan Inc.	Effective Div Rate
		Year	Total Expenses							
Less than 11.5%	1977		2.77%	36.3%	95.2%	\$2,989	20.8%	1.99%	5.64%	
	1978		2.74	36.2	94.8	\$3,280	21.0	2.04	5.99	
	1978		2.64	30.1	89.3	\$3,769	24.7	4.02	6.22	
	Simulation									
11.5%-12.5%	1977		3.01	49.0	95.5	\$1,490	15.9	2.59	4.99	
	1978		3.19	50.9	97.9	\$1,778	12.1	1.93	5.25	
	1978		2.69	39.3	97.8	\$2,994	17.3	1.51	5.91	
	Simulation									
Over 12.5%	1977		3.35	63.7	84.6	\$ 675	12.5	1.18	3.98	
	1978		3.09	67.9	89.6	\$ 893	7.7	1.18	4.08	
	1978		3.09	55.0	96.8	\$1,749	12.5	0.40	4.97	
	Simulation									
Overall Ave	1977		2.91%	42.9%	93.5%	\$2,364	18.7%	1.94%	5.28%	
Overall Ave	1978		2.86%	43.4%	94.4%	\$2,686	17.6%	1.88%	5.57%	

TABLE IV-3

Common Bond Comparisons

<u>Break-Even Loan Rate</u>	<u>Year</u>	<u>Associational</u>	<u>Occupational</u>	<u>Residential</u>
Less than 11.5%	1977	11.5%	85.5%	3.1%
	1978	12.7%	84.2%	3.0%
	1978	11.6%	86.5%	1.9%
	Simulation			
11.5%-12.5%	1977	15.5%	79.5%	5.1%
	1978	13.5%	81.0%	5.5%
	1978	13.3%	83.4%	3.3%
	Simulation			
Over 12.5%	1977	23.8%	69.7%	6.5%
	1978	20.7%	71.8%	7.7%
	1978	16.5%	77.4%	6.2%
	Simulation			
Overall Ave	1977	14.3%	81.7%	4.0%
Overall Ave	1978	14.2%	81.7%	4.1%

APPENDIX A

FEDERAL CREDIT UNION

12% QUESTIONNAIRE

Name of Credit Union _____

Address _____

Phone No. _____ NCUA Charter No. _____

1. Does your credit union need relief from the 12% rate ceiling
on loans? Yes _____ No _____

Why?/Why not? _____

2. Which of the following services did you offer your members in
each year? (Check space if service was offered)

	1977	1978
a) life savings insurance	_____	_____
b) loan protection insurance	_____	_____
c) open-end credit	_____	_____
d) share drafts	_____	_____
e) credit cards	_____	_____

3. Please attach copies of your BALANCE SHEET, INCOME/EXPENSE STATEMENT,
STATISTICAL INFORMATION for each month from December 1976 to December
1978. (i.e., 25 statements)

LEAGUE QUESTIONNAIRE

Federal Credit Union 12% Study

League _____

Who may be contacted regarding this
questionnaire (person completing questionnaire) _____

- I Very briefly assess the general mood among federal credit unions in your league regarding the 12% loan rate ceiling. (i.e., Do many seem to be specifically in favor of or opposed to relief from the 12% ceiling? Why?)

II Please list any federal credit unions that to your knowledge are specifically in favor of relief from the 12% ceiling. Please provide what information you can even if all columns cannot be completed.

[illegible]

III Please list any federal credit unions that to your knowledge are specifically opposed to raising the 12% ceiling. Please provide what information you can even if all columns cannot be completed.

[illegible]

APPENDIX B

In Section IV, data is provided on the extent to which credit unions need relief from the 12% ceiling. It was noted that 16.4% of federal credit unions needed relief in 1978 and that 46.3% would need relief if credit unions are to pay current market rates to savers. Information comparing credit unions that do and do not need relief is also discussed in Section IV. Basically, credit unions unable to break even under the 12% ceiling tend to be small, with slow growth rates and relatively high expense-to-income ratios. Opposite tendencies were found in credit unions that break even under the ceiling.

There is a danger in relying simply on comparisons of averages to analyze differences in credit unions that do and do not need ceiling relief. Since an average is just a single number summarizing information about a large group, it necessarily leaves out a great deal of information, e.g., how far above and below the average members of the group lie. This appendix provides comparative information beyond simple averages on credit unions that do and do not need ceiling relief. Tables B-1 to B-7 show detailed distribution information for the seven variables for which average data is presented in Table IV-2 of the main paper.

The information in Tables B-1 to B-7 provides the following more detailed picture of credit unions with break-even loan rates exceeding 12.5%:

- Although these credit unions tend to have higher than average expense-to-income ratios, many of them have "respectable" expense-to-income ratios. In 1977, roughly 29% of these credit unions had E/I ratios of less than 50%. The proportions of these credit unions with E/I ratios of less than 50% were about 22% in 1978 and 42% with the simulation.
- These credit unions tend to be smaller than average. In 1978, 71.9% had assets of less than \$500,000. The corresponding proportion with the simulation is 57%. Of all federal credit unions in the U.S., 47.4% had 1978 assets of less than \$500,000. Further, when the simulation was used, a few larger credit unions joined the needing relief category. In 1978, only 26 federal credit unions with assets of more than \$10 million needed relief. Using the simulation, this number rose to 187.
- These credit unions tend to have lower asset growth rates than average. However, many of these credit unions had rather high growth rates. In 1978, 16.1% had asset growth rates over 20%, and, using the simulation, 24% fell into this growth category.
- Although these credit unions tend to pay lower dividends than average, 17.5% paid effective dividend rates exceeding 6% under the simulation. It should be noted that an effective dividend rate of 6% represents a nominal rate of approximately 6 2/3%.

The data in Tables B-1 to B-7 shows that not all credit unions needing relief follow the tendencies shown by averages. However, the fact remains that credit unions needing relief do have higher expense-to-income ratios than those not needing relief. There is a possibility that this fact could be misconstrued into maintaining that only "inefficient" and therefore "undeserving" credit unions need ceiling relief. However, the information in Table B-4 suggests that such an interpretation would be false. Table B-4 tells us that credit unions needing relief tend to be much smaller than average. In 1978, fully 71.9% of credit unions needing relief had assets of less than \$500,000 while only 40.8% of credit unions not needing relief fell into this asset category. With the simulation, 57% of those credit unions needing relief had 1978 assets of less than \$500,000 while 36.9% of those not needing relief had less than half a million dollars in assets. The importance of this asset size comparison is that it accounts for much of the difference in expense-to-income ratios found between credit unions that do and do not need ceiling relief. In other words, while it is true that credit unions needing relief have higher expense-to-income ratios than those not needing relief, a major reason that these credit unions have higher expense-to-income ratios is that they tend to be smaller.

Information from NCUA's 1978 Annual Report indicates that federal credit unions of less than \$500,000 in assets had an average expense-to-income ratio of 48.5% in 1978 while credit unions with assets exceeding \$500,000 had an average expense-to-income ratio of 41%. Although these asset size differences do not fully account for the higher expense-to-income ratios of credit unions needing relief, the information counters the charge that only "inefficient" credit unions need rate relief.

Many of the credit unions needing ceiling relief have high expense-to-income ratios because they are small and thus do not enjoy economies of size. A public policy opposed to ceiling relief thus maintains that these smaller credit unions should not survive. However, ceiling relief would allow the survival and stimulate the growth of these smaller credit unions. Growth would allow many of these credit unions to achieve some of the efficiencies of larger size. Finally, even though most smaller credit unions do not have the low expense-to-income ratios that larger credit unions do, with ceiling relief these credit unions will continue to provide substantial benefits to consumers. With ceiling relief these credit unions will be able to pay savings rates similar to those at other financial institutions while offering consumer loans at rates still substantially below those at most other typical sources of consumer credit. The relevant comparison is not always that between more and less efficient credit unions, but rather between less efficient credit unions and other consumer options.

TABLE B-1
Distribution of Credit Unions by Ratio of
Office Occupancy Expenses to Total Expenses (%)

Breakeven Loan Rate	Year	0-.5%	.5-1%	1-3%	3-5%	5-10%	10-20%	20-30%	Over 30%	Average	
										Ofc. Occ. Exp./	Tot. Exp.
Less than 11.5%	1977	57.1%	3.2%	11.7%	11.5%	10.5%	3.5%	1.1%	1.5%	2.77%	2.77%
	1978	55.6%	3.5%	12.3%	11.8%	11.2%	3.2%	1.1%	1.3%	2.74%	2.74%
	1978	59.0	3.9	11.3	10.3	9.7	3.2	1.0	1.6	2.64	2.64
	Simulation										
11.5%-12.5%	1977	53.7	2.4	11.8	12.0	13.2	4.7	1.1	1.2	3.01	3.01
	1978	52.5	2.6	11.6	14.4	11.7	4.4	1.1	1.7	3.19	3.19
	1978	54.4	3.6	13.4	11.7	12.1	2.6	1.0	1.3	2.69	2.69
	Simulation										
Over 12.5%	1977	61.5	1.6	8.3	8.8	10.7	5.6	1.5	2.1	3.35	3.35
	1978	59.7	2.2	9.4	8.8	11.8	5.2	1.2	1.7	3.09	3.09
	1978	54.0	2.5	11.4	12.7	12.3	4.4	1.3	1.4	3.09	3.09
	Simulation										
Overall Distribution	1977	57.3	2.8	11.1	11.1	11.0	4.0	1.2	1.5	2.91	2.91
Overall Distribution	1978 & 1978 Simulation	55.8	3.2	11.7	11.7	11.3	3.7	1.1	1.4	2.86	2.86

TABLE B-2
Distribution of Credit Unions by Ratio of
Total Expenses to Gross Income (%)

Break-even Loan Rate	Year	0-20%	20-40%	40-60%	60-80%	80-100%	100-120%	Over 120%	Average Expense/ Income
Less than 11.5%	1977	4.1%	61.2%	33.9%	0.7%	0.1%	-	-	36.3%
	1978	4.2	60.7	34.7	0.4	-	-	-	36.2
	1978	8.5	84.2	7.0	0.3	-	-	-	30.1
	Simulation								
11.5%-12.5%	1977	0.1	11.6	81.5	6.8	0.1	-	-	49.0
	1978	-	7.0	83.8	9.0	0.3	-	-	50.9
	1978	-	58.0	41.7	0.2	0.1	-	-	39.3
	Simulation								
Over 12.5%	1977	0.1	6.8	44.8	35.5	7.8	2.5	2.4	63.7
	1978	0.1	3.3	38.5	42.2	10.1	2.6	3.2	67.9
	1978	-	8.3	68.2	17.8	3.7	0.9	1.1	55.0
	Simulation								
Overall Distribution	1977	2.8	44.5	42.9	7.6	1.4	0.5	0.4	42.9
Overall Distribution	1978 & 1978 Simulation	3.0	44.1	41.9	8.4	1.7	0.4	0.5	43.4

TABLE B-3
Distribution of Credit Unions by
Loan/Share Ratios (%)

Break-even Loan Rate	Year	0-40%	40-60%	60-80%	80-100%	100-120%	Over 120%	Average Loan/ Share
Less than 11.5%	1977	1.5%	5.8%	15.0%	35.1%	33.5%	9.2%	95.2%
	1978	1.6%	5.6%	13.8%	35.7%	35.9%	7.4%	94.8%
	1978	3.0%	9.3%	19.0%	35.3%	28.5%	4.9%	89.3%
	Simulation							
11.5%-12.5%	1977	1.0%	5.3%	15.2%	34.3%	33.1%	11.1%	95.5%
	1978	0.9%	3.7%	12.2%	34.3%	37.8%	11.1%	97.9%
	1978	0.7%	2.7%	10.2%	38.5%	39.8%	8.1%	97.8%
	Simulation							
Over 12.5%	1977	7.3%	12.1%	19.4%	31.1%	23.0%	7.2%	84.6%
	1978	4.5%	9.5%	15.6%	32.8%	29.0%	8.7%	89.6%
	1978	1.7%	4.7%	11.5%	33.6%	38.0%	10.5%	96.8%
	Simulation							
Overall Distribution	1977	2.4%	6.8%	15.8%	34.3%	31.6%	9.1%	93.5%
Overall Distribution	1978 & 1978	2.0%	6.0%	13.9%	35.1%	35.0%	8.1%	94.4%
	Simulation							

TABLE B-4
Distribution of Credit Unions
by Asset Size (\$Millions)

Breakeven Loan Rate	Year	\$0-0.2	\$0.2-0.5	\$0.5-1.0	\$1-2	\$2-5	\$5-10	\$10-20	\$20-50	\$50-100	Over \$100	Average Assets
Less than 11.5%	1977	21.1%	22.0%	17.7%	14.2%	13.4%	5.8%	3.2%	2.0%	0.5%	0.2%	\$2,989
	1978	19.6	21.2	18.0	14.9	13.8	6.1	3.7	2.1	0.5	0.2	3,280
	1978	17.7	19.2	17.4	14.9	16.0	7.3	4.2	2.2	0.8	0.3	3,769
	Simulation											
11.5%-12.5%	1977	27.4	25.3	20.1	12.4	8.7	4.1	1.3	0.5	-	0.1	1,490
	1978	26.1	25.2	17.8	14.5	9.4	3.6	2.4	0.8	0.2	0.1	1,778
	1978	18.7	23.8	19.4	16.4	12.2	4.1	3.2	1.6	0.2	0.3	2,994
	Simulation											
Over 12.5%	1977	51.8	23.0	12.3	7.2	4.0	1.2	0.3	0.2	-	0.1	0,675
	1978	47.2	24.7	13.2	7.2	4.7	1.6	0.8	0.6	0.1	-	0,893
	1978	33.1	23.9	16.1	11.4	8.3	3.7	2.1	1.3	0.2	-	1,749
	Simulation											
Overall Distribution	1977	27.3	22.6	17.1	12.7	11.1	4.8	2.4	1.5	0.3	0.2	2,364
Overall Distribution	1978 & 1978 Simulation	25.1	22.3	17.2	13.5	11.7	5.0	3.0	1.7	0.4	0.2	2,686

TABLE B-5
Distribution of Credit Unions by
Annual Asset Growth (%)

Break-even Loan Rate	Year	Less Than -20%	Average Asset Growth							
			-20 - -10%	-10-0%	0-10%	10-20%	20-30%	30-40%	Over 40%	
Less than 11.5%	1977	0.2%	0.6%	3.8%	18.7%	35.4%	21.7%	9.6%	10.2%	20.8%
	1978	0.4	0.8	5.2	24.6	36.1	19.1	7.9	5.8	21.0
	1978	0.3	0.9	4.8	24.8	37.5	19.1	7.5	5.1	24.7
	Simulation									
11.5%-12.5%	1977	0.7	1.5	7.6	30.9	32.2	13.6	6.4	7.2	15.9
	1978	0.7	2.4	11.8	34.1	29.3	12.6	5.2	3.9	12.1
	1978	0.5	0.7	4.6	25.1	35.0	19.3	8.7	6.2	17.3
	Simulation									
Over 12.5%	1977	2.3	5.1	16.9	30.9	22.8	10.3	4.8	6.8	12.5
	1978	4.5	7.4	18.5	30.7	22.9	8.3	3.5	4.3	7.7
	1978	2.0	3.6	12.4	29.2	28.9	13.4	5.6	5.0	12.5
	Simulation									
Overall Distribution	1977	0.6	1.5	6.6	22.6	32.7	18.6	8.2	9.1	18.7
Overall Distribution	1978 & 1978 Simulation	1.1	2.1	8.3	26.9	33.0	16.5	6.8	5.3	17.6

TABLE B-6
Distribution of Credit Unions by Ratio of
Interest Refunds to Loan Income (%)

Breakeven Loan Rate	Year	0-0.5%	0.5-1%	1-3%	3-5%	5-10%	10-20%	Over 20%	Average Refund Rate
Less than 11.5%	1977	80.5%	0.2%	1.1%	3.0%	9.0%	5.2%	1.0%	1.9%
	1978	80.3	0.2	1.1	3.1	8.5	5.6	1.2	2.04
	1978	67.1	0.2	1.3	3.6	13.2	11.3	3.3	4.02
	Simulation								
11.5%-12.5%	1977	77.8	0.1	0.9	3.0	9.4	7.2	1.8	2.59
	1978	83.7	-	0.6	2.5	6.2	5.4	1.7	1.93
	1978	82.6	0.2	1.2	3.7	8.3	3.7	0.2	1.51
	Simulation								
Over 12.5%	1977	90.2	0.1	0.3	1.1	4.3	3.0	1.1	1.18
	1978	92.6	-	0.3	1.2	2.3	2.5	1.3	1.18
	1978	94.7	0.1	0.5	1.5	2.2	0.9	-	0.40
	Simulation								
Overall Distribution	1977	81.8	0.1	0.9	2.7	8.2	5.1	1.1	1.94
Overall Distribution	1978 & 1978								
	Simulation								
		82.8	0.1	0.9	2.7	7.2	5.1	1.2	1.88

TABLE B-7
Distribution of Credit Unions by Effective
Dividend Rate on Regular Shares

Breakeven Loan Rate	Year	0-1%	1-2%	2-3%	3-4%	4-5%	5-6%	6-7%	7-8%	Over 8%	Average Dividend Rate
Less than 11.5%	1977	0.5%	0.1%	0.5%	2.1%	12.4%	52.7%	30.5%	1.0%	0.3%	5.64%
	1978	0.7	0.1	0.4	1.3	7.3	35.9	44.3	9.5	0.5	5.99
	1978 Simulation	0.8	-	0.4	1.0	4.6	25.9	51.7	14.9	0.7	6.22
11.5%-12.5%	1977	0.6	0.2	1.5	5.7	36.1	51.1	4.8	-	0.1	4.99
	1978	0.7	0.4	0.8	3.8	26.0	54.9	12.7	0.5	0.2	5.25
	1978 Simulation	0.4	-	0.4	1.3	6.9	42.4	42.9	5.6	0.1	5.91
Over 12.5%	1977	9.2	2.8	7.0	18.2	38.0	22.6	2.1	0.2	-	3.93
	1978	9.7	2.3	6.3	15.5	33.2	27.8	4.6	0.4	0.1	4.08
	1978 Simulation	4.0	1.0	2.6	7.3	24.2	43.4	16.1	1.2	0.2	4.97
Overall Distribution	1977	2.0	0.6	1.8	5.4	20.3	47.3	21.8	0.7	0.2	5.28
Overall Distribution	1978 & 1978 Simulation	2.2	0.5	1.4	4.0	14.1	37.2	33.5	6.8	0.4	5.57

CREDIT UNION NATIONAL ASSOCIATION, INC.,
Washington, D.C., January 2, 1980.

Hon. HENRY S. REUSS,
Rayburn House Office Bldg., Washington, D.C.

DEAR MR. CHAIRMAN: During the first meeting of Senate and House conferees on H.R. 4986, the House made it clear that it did not consider an amendment offered by the Senate with regard to CLF capital stock a technical amendment.

Discussion with staff indicates that a brief hearing on the need for this amendment, which would allow corporate central credit unions to purchase CLF stock for those members utilizing the CLF, would suffice to satisfy House conferees' questions about the need for the amendment.

Passage of H.R. 4998 extending the share draft and certain usury exemptions to March 31, 1980, allows time for hearings on certain sections of H.R. 4986 in both House and Senate. CUNA would appreciate it if hearings on the CLF stock subscription might also be scheduled as early as practicable during this period.

I would also like to personally take this opportunity, Mr. Chairman, to thank you for your interest and belief in the goals of the organized credit union movement. Your efforts in expanding the services credit unions can offer their members have benefited millions of low and moderate income Americans.

Thank you for your consideration. I look forward to continuing our relationship in the new decade we are entering.

Sincerely,

JAMES C. BARR, CAE.

RESOLUTION

Whereas Credit unions were created to promote thrift and provide loans to credit union members; and,

Whereas the rising cost of money has made loans to members of Arizona's Federal and State credit unions virtually impossible because of the 12 percent interest rate ceiling in the Federal Credit Union Act and the Arizona Credit Union law; and,

Whereas the laws of some 27 states have been amended to permit state chartered credit unions in those states to make loans to members in excess of 12 percent; and,

Whereas there seems to be a growing recognition within the Congress of the United States and the Arizona Legislature that a 12 percent statutory loan ceiling is not feasible when interest rates of savings and investment alternatives continue to soar to levels never before seen in history: Therefore, be it

Resolved That the Arizona Credit Union League support legislation to amend the Federal Credit Union Act and the Arizona Credit Union Law as soon as humanly possible to seek relief from the 12 percent limit on loans contained in both statutes; be it further

Resolved, That copies of this Resolution be sent to: 2 U.S. Senators, 4 U.S. Representatives, Members of State Legislature, NCUA Board, State Banking Superintendent, CUNA, Inc., U.S. Leagues, All Arizona Credit Unions.

Adopted at the Arizona Credit Union League Annual Meeting, Yuma, Arizona, November 17, 1979.

BECKMAN EMPLOYEES CREDIT UNION,
Fullerton, Calif., October 22, 1979.

Hon. WILLIAM E. DANNEMEYER,
Longworth Office Building, Washington, D.C.

DEAR CONGRESSMAN DANNEMEYER: You and the members of the House of Representatives have shown that you support the ideas and principles of credit unions. I wish to thank you again for your part in the share draft issue.

It is indeed unfortunate that I need to ask for your help again. The skyrocketing interest rates have caught the Federally Chartered Credit Unions in literally a strangle hold. The 12 percent APR maximum that these credit unions may charge does not allow them to attract money to loan. It will be only a matter of time before the larger accounts in these credit unions will be going where the yield is higher and with today's high costs you can't blame these members.

Credit unions are made up with a large percentage of the members with small share accounts. (Beckman Employees Credit Union has 76 percent of the membership with less than \$1000 in their accounts. The same 76 percent hold only 12 percent of the total shares invested in the credit union.) Credit unions must depend on the relatively small percentage of their membership to support the loan needs of

the total membership. These members are loyal to their credit union as long as the credit union is paying a competitive, or better return on their investment.

The rising cost of operations due to compliance with more and more regulations and labor cost, combined with competitive cost of funds, leaves the credit unions no where to go when the rate charged on loans may not exceed twelve percent (12 percent APR). There are some credit unions that have already had to stop making loans which forces the credit union members to go finance companies that charge thirty percent (30 percent APR). This results in a much deeper cut into the purchasing power of the member's dollar.

The problem of the credit unions is now and growing larger each day. Your support for immediate emergency relief by raising the annual percentage rate that Federally Chartered Credit Unions may charge would be most appreciated.

Sincerely,

L. L. SIDFRID,

Manager, Beckman Employees Credit Union.

BILLINGS HEALTH AFFILIATED FEDERAL CREDIT UNION,
Billings, Mont., December 3, 1979.

Hon. MAX BAUCUS,
*U.S. Senate,
Dirksen Senate Office Building, Washington, D.C.*

DEAR MR. BAUCUS: Our credit union is writing to ask your help in securing a new law that would permit Federal Credit Unions to increase their loan rate beyond 12 percent APR should that be necessary for them.

The Federal Credit Union law enacted in 1934 could not possibly foresee and therefore did not take into account the tremendous cost of funds resulting from today's economic turmoil.

In our own case, we are now having members wait for loans to be made only as funds become available through share deposits, as it is impossible to pay the interest to borrow the money as we need it. It is also difficult to secure share deposits when we are unable to increase our dividend rate so as to attract this money.

During the past several years, our credit union has been growing at a rate of 12 percent per year. At the close of 1978, our assets were \$693,351; assets as of 10-31-79 were \$722,969, an increase of only 4.1 percent and we don't expect a big change by the end of 1979.

Not only does this obsolete law stifle a credit union's growth, but it causes consumers to wait for (or not get at all) goods and services that they need now.

Thank you for your consideration on behalf of Federal Credit Unions.

Sincerely,

MYRTLE A. FLADLAND, *Manager.*

CALIFORNIA CREDIT UNION LEAGUE,
Pomona, Calif., December 17, 1979.

Hon. ALAN CRANSTON,
Senate Office Building, Washington, D.C.

Senator, you are probably well aware of the bind federal credit unions are experiencing due to a restrictive annual percentage rate ceiling on loans to members. Because of the high cost of money and disintermediation, a significant number of California's federally-chartered organizations are temporarily out of the lending business. Their inability to compete with other financials offering high yields on investments has ground them to a halt.

The attached resolution was passed unanimously during our League's annual meeting last month. We believe it is urgent to recognize the plight of our federal credit unions and support our request for relief which will surely be before you early next year. Incidentally, California's 525 state-licensed credit unions are weathering this economic storm, helped by an annual percentage rate of 15 percent, which has been in the state law for a couple years. Our state's 1,200 federal credit unions are hurting.

Respectfully,

JACK REIDY,
*Vice President,
Governmental and Public Affairs.*

California Credit Union League



Resolution

INTEREST RATE RELIEF

WHEREAS: One year ago, recognizing the severe impact of economic conditions on federal credit unions, conditions which have seriously deteriorated since then, this body petitioned for relief from the interest ceiling imposed by the Federal Credit Union Act; and

WHEREAS: This interest limitation has now forced federal credit unions to cut services to members; and

WHEREAS: Sound national economic policy uses price incentives to control credit, not artificial restraints, and federal credit unions, the only institutions subject to a federal usury ceiling, are excluded from participation in such policy.

NOW THEREFORE BE IT RESOLVED by the California Credit Union League: That the Credit Union National Association, the National Credit Union Administration and the Congress of the United States act immediately to remove the 12% interest ceiling; and

BE IT FURTHER RESOLVED: That California Credit Union League management, at its discretion, take any necessary action to secure such relief including but not limited to personal lobbying efforts in Washington, D.C. and if no legislation is introduced by April 30, 1980 the California Credit Union League should proceed with legislative proposals of its own.



Adopted this seventeenth day of November, Nineteen Hundred and Seventy Nine, by the authority vested in me by the Board of Directors, California Credit Union League, I hereby set my hand and corporate seal.

Evelyn E. Keller
 Evelyn E. Keller
 Chairman of the Board

[Telegram]

ALVIN GEORGE,
Chairman of Board, CUNA Headquarters,
Madison, Wis.

Urgent: Continuous double digit inflation with no reversal in sight, continuous rise in prime rate with no solution in sight, continuous cost of living increases being granted by both public and private sector, renders current regulatory maximum of 12 percent on Federal credit union loans to members unrealistic. Request your immediate attention to support increase in interest ceiling on loans of Federal credit union.

ROGER LANCE,
Treasurer, DOD Federal Credit Union.

Great Falls, Mont., November 19, 1979.

Hon. MAX BAUCUS,
U. S. Senate,
Dirksen Senate Office Building, Washington, D.C.

DEAR SENATOR BAUCUS: I'm writing this letter to acquaint you with the extraordinary predicament in which the Great Falls U.S. Employees Federal Credit Union finds itself because of the Federally-imposed 12 percent interest rate ceiling.

Money market certificates over 12 percent, massive disintermediation, heavy loan demand because the 12 percent ceiling rate is the lowest available, all of this leads to no money available to service members needs! If we can't service members needs for loans we have less income; less income leads us to less money for dividends; less money to pay for dividends means a lower dividend rate, thus there is more outflow of funds from the Credit Union to other financial institutions.

Loss of funds to other financial institutions during October 1979 was \$120,000.00 which amounted to 70 percent of available funds for loan service. This extraordinary drain on Credit Union resources has hampered our ability to service members needs. We would be committing financial suicide if we chose to borrow money at 15 percent to meet members needs and have it paid back to us at 12 percent. We can't even make money market certificates available so long as they hover over 12 percent.

Credit unions need rate relief if we are to remain functioning financial institutions! Rate relief must come from the Congress. The current 12 percent ceiling was enacted in 1934 when rates were much lower and far stabler than today's volatile money market.

Rate relief must come soon if we are to maintain any semblance of plasticity when the money market.

On behalf of the Board of Directors, the members and staff, I would urge you to consider the matter of rate relief.

Sincerely Yours,

STEVE EGGERICHS, *Manager.*

SHELBY COMMUNITY FEDERAL CREDIT UNION,
November 13, 1979.

Hon. JOHN MELCHER,
U. S. Senate,
Dirksen Senate Office Building, Washington, D.C.

DEAR SIR: I wish to take this opportunity to thank you for voting for the passage of the share draft legislation.

I would also like to ask that you use all your influence to get the 12 percent rate ceiling for Federal Credit Unions raised to a rate that will allow the Credit Unions to compete with the other lending agencies.

It is very unrealistic to think that the Credit Unions will be able to continue to operate when the highest rate they can charge is 12 percent and money costs them 14.50 or 15 percent. Credit Unions are an important asset to the community and at present are badly in need of help from Congress.

Thank you for your consideration of this matter.

Yours truly,

MARILYN A. HUNT,
Assistant Treasurer,
Shelby Community Federal Credit Union.

TUCOEMAS FEDERAL CREDIT UNION,
Visalia, Calif., October 23, 1979.

FRANK ANNUNZIO,
Chairman, House Consumer Affairs Subcommittee,
House Office Building, Washington, D.C.

I have read with much concern your remarks that have appeared in various trade publications about your opposition to the initial proposals to lift the 12 percent loan interest limit for Federal Credit Unions.

Statements which appear to have been made by you indicate that you may be unaware that Federal Credit Unions no longer just have their regular 7 percent share accounts. Most credit unions now have a full range of certificates on which higher rates may be paid, including the 26 week money certificates. Our credit union has several certificate programs for our members including the money market certificates. We were forced into these programs to keep the funds in our credit union. Just paying 7 percent would never have kept the large depositors in our credit and we would have been forced to curtail lending activity. Today the rate on these 26 week certificates is being quoted at 12.651 percent which means that we will be paying more on new certificates than we can charge for loan interest rates. This does not make sense. Our own astute, concerned members are very worried. We are getting calls everyday wanting to know what are we going to do? When will we raise our interest rates? When we reply that we cannot raise our rates, they really do not understand why. To them it only makes sense that you run a credit union so that you at least charge enough in income to cover expenses, dividends and mandatory reserve requirements. You also indicated that credit unions should not be "middlemen" borrowing at 14 percent someplace and then loaning it back to members at 12 percent. I am not sure where you obtained your figures, but to state that this is what credit unions have been doing is an unfair distortion of the true facts. In my area, I have never heard of any Federal Credit Union doing any such thing. For some reason, you have also thrown in a comment about our tax exempt status. We have long since ceased to tremble at the threat of being taxed. Since we are a cooperative, taxation would only hurt those members that we serve and could result in the loss of some of the services that we now provide.

I sincerely urge you to re-examine your position regarding the lifting the 12 percent rate ceiling. Please give consideration to the hard fact that we must pay our savers at least equal to what they could get elsewhere in order to retain our funds for lending. To not pay the current rates of money market certificates would see several hundred thousand dollars leave our credit union and could cause liquidity problems and we certainly would not have funds for further lending purposes. Also please give consideration to the fact that in addition to the higher cost of funds, credit unions must pay higher costs for labor (we are NOT all volunteers), utilities and all the usual costs of just getting the office open each day. Federal Credit Unions are facing a crisis of cost of funds versus income which must be resolved immediately. I urge you to lend your support to the efforts of raising the 12 percent loan interest rate ceiling so that Federal Credit Unions can continue to serve their members in spite of the inflationary times we all seem to face. Thank you for your interest in credit unions.

ANNA BELLE BROWN, *Manager.*

WESLA FEDERAL CREDIT UNION,
Shreveport, La., November 5, 1979.

FRANK ANNUNZIO,
U.S. House of Representatives,
Rayburn House Office Bldg., Washington, D.C.

DEAR SIR: I read in the October issue of CapCom that you made the following statement and I quote, "There is no reason why an increase is needed. In most cases, a credit union pays a maximum of seven percent to its regular savers and lends that money at a maximum of twelve percent which provides for a five percentage point spread."

I would like to point out the following facts:

1. Our credit union, and I assume many others, have lost hundreds of thousands of dollars of that 7 percent money to Money Market Certificates at 12.1 percent or better. This money loss has forced us to either stop loaning money to our members to recover the loss or borrow money at much higher rates which we can not afford to do for very long.

2. Even the small saver is putting money into Merrill-Lynch "Ready Asset Trust" or similar funds causing us even further loss of our 7 percent money.

The reality of this situation is that if the above trends continue, it is not a matter of our members getting 12 percent money on loans, we won't be able to service them at all.

In the present tight money situation, we can no longer attract funds at 7 percent. Our savings deposits have dropped from \$9,500,000 to \$8,800,000 in the last five months. If this trend continues we will gradually go out of business. Our members are being forced to go out to finance companies and pay extremely high interest rates. This is certainly not helping the common working man. I hope and pray that you will look further into this problem.

Sincerely,

W.G. McWILLIAMS,
President,
WESLA FCU Board of Directors.

FINANCE CENTER FEDERAL CREDIT UNION,
Indianapolis, Ind., September 20, 1979.

Mr. JIM WILLIAMS,
CUNA Washington Office, Washington, D.C.

DEAR JIM: Our Board of Directors has directed that I write to you about our concerns on the 12-percent ceiling rate on loans made by Federal credit unions.

The rapidly rising cost of borrowed money, and the inability of federal credit unions to pay the 10 to 11 percent that is now required to attract "certificate" money, is forcing us out of the loan business. We can still survive for a short time; however, the handwriting is on the wall, and it will soon be impossible to obtain the funds to make loans.

We urge you to take as much pressure as possible on legislative sources, in seeking emergency legislation to lift the 12 percent ceiling on loans made by federal credit unions. Next summer is going to be too late for many credit unions.

So, please, place maximum effort towards the most critical problem facing credit unions today.

Thanks.

Sincerely yours,

R. F. BENJAMIN, Treasurer.

INDIANA CREDIT UNION LEAGUE, INC.,
Indianapolis, Ind., November 28, 1979.

Mr. JIM WILLIAMS,
President, Credit Union National Association,
Madison, Wis.

DEAR JIM: As we are all aware, economic conditions over the past year have steadily declined with respect to credit unions. Increased demands for higher rates on savings and substantially more expensive borrowed funds, coupled with inflation, have put a considerable strain on credit union earnings. This problem is magnified even more by the fact that, on the average, credit unions' loan portfolios are equal to 97 percent of shares, and yet, federal credit unions are limited to a usury ceiling of 12 percent.

It should be noted further that all other state and federally chartered financial institutions in Indiana, including state credit unions, have had the authority to charge a much higher rate of interest on loans since 1971. During periods of high rates, this has put federal credit unions in Indiana at a disadvantage in their earnings ability.

For these reasons, the board of directors of the Indiana Credit Union League, in their recent meeting of November 16, 1979, adopted the enclosed resolution explaining the plight of federal credit unions operating in Indiana and urging Congress to understand their concern and to give consideration to legislation granting federal credit unions relief from their present usury ceiling. The resolution also urges CUNA, NCUA, and all other state and national credit union trade associations to actively work toward some form of relief from the 12 percent loan rate ceiling.

While we realize that any rate relief now or within the next year would have little if any affect on federal credit unions under their present circumstances, we believe that federal credit unions need the flexibility presently afforded other Indiana financial institutions in order to better cope with similar economic crises in the

future. We would further note that the authority to charge higher rates by state credit unions in Indiana since 1971 has neither been abused nor caused any adverse effects with regard to credit union philosophy, but on the contrary, has allowed state credit unions to more effectively compete with other types of financial institutions in both the savings and the lending functions. We would also like to point out the state credit unions rarely exceed a rate of 12 percent on loans except during times of higher rates, as we are presently experiencing, and when the Federal Reserve Board is attempting to tighten credit. In this regard, such flexibility fulfills a two-fold purpose by giving credit unions the ability to maintain strong earnings and by effectively tightening credit through increased costs to members for borrowings.

With these thoughts in mind, we would ask your favorable consideration of the action urged by the enclosed resolution.

Sincerely,

MORTON E. JESTER, *President.*

INDIANA CREDIT UNION LEAGUE, INC., BOARD OF DIRECTORS MEETING, NOVEMBER
16-17, 1979

RESOLUTIONS

Whereas Section 107(5)(A)(vi) of the Federal Credit Union Act provides that the rate of interest on loans to members of a federal credit union shall not exceed one percent (1 percent) per month on the unpaid balance inclusive of all service charges; and

Whereas all other financial institutions in Indiana, including state credit unions, may by law charge a rate of interest on loans much in excess of that allowed for federal credit unions; and

Whereas lending to and receiving savings from members in a self-help atmosphere are the two primary services offered by credit unions to their members; and

Whereas savers in financial institutions and more particularly in credit unions, are demanding higher returns on their investments; and

Whereas money market funds are available at higher rates to savers from sources outside the heavily regulated financial institution sector of the marketplace; and

Whereas credit unions, because of competition from other financial institutions, from financial intermediaries, and from the federal government itself, are forced to increase the rate of return they pay their member/savers in order to prevent withdrawal of their funds; and

Whereas the prime lending rate, which is the rate the largest financial institutions establish for their best customers, has steadily increased to record heights; and

Whereas the funds received from member/savers and through borrowings, both of which sources are extremely costly because of higher rates demanded on them, are the only funds available to make loans at the statutory maximum of 1 percent per month; and

Whereas this high cost on liabilities and low yield on assets in the loan portfolio are creating an extremely adverse effect on net income margins in credit unions: Now therefore be it

Resolved, That the Board of Directors of the Indiana Credit Union League, Inc., acting in the best interest of affiliated federal credit unions in Indiana, believes that federal credit unions must have relief from the maximum lending rate established in the Federal Credit Union Act; and be it further

Resolved, That the Board of Directors of the Indiana Credit Union League, Inc., strongly urges Congress to understand the plight of federal credit unions, which stand firm in their philosophical intent but which presently are struggling for survival in order to retain that self-help philosophy in the future, and to give serious consideration to federal legislation that will better enable federal credit unions to continue serving their members' borrowing needs during periods of economic upheaval as well as during periods of economic stability; and be it further

Resolved, That the Board of Directors of the Indiana Credit Union League, Inc., exhorts the Credit Union National Association, the National Credit Union Administration, and all other state and national credit union trade groups to pursue all available avenues toward promoting an equitable relief from the statutory maximum loan rate that federal credit unions may charge; and be it further

Resolved, That in an attempt to accomplish the foregoing, copies of this resolution be distributed to the Credit Union National Association, the National Credit Union Administration and to all United States Credit Union Leagues with encouragement for them to affect similar action on this most concerning issue.

Adopted this 16th day of November 1979.

The CHAIRMAN. Thank you for a good terse statement. The letters will be entered in full into the record.

Mr. Duffey?

STATEMENT OF ROBERT M. DUFFEY, JR., PRESIDENT AND CHIEF EXECUTIVE OFFICER, PAN AMERICAN BANK, BROWNSVILLE, TEX., AND PRESIDENT, TEXAS BANKERS ASSOCIATION

Mr. DUFFEY. Mr. Chairman, I'm Robert M. Duffey, president and chief executive officer of the Pan American Bank of Brownsville, Tex., a State-chartered bank, and president of the Texas Bankers Association, a trade association whose membership includes 1,394 of the 1,428 banks in our State. Of the banks in Texas, 621 are national and 807 are State banks. More than 100 towns in rural Texas have only two banks, one operating under State charter and the other under national charter.

INTEREST RATES AT RECORD LEVEL

The Texas Constitution of 1876 as amended provides the maximum rate banks may charge on single maturity loans to non-preferred borrowers at 10 percent. Until recently that 10 percent ceiling had not been a competitive rate. Now with interest rates at record levels, national banks are authorized by Federal statute to charge 1 percent over the discount rate, now 13 percent, on any loan regardless of State usury provisions, creating a situation of serious inequity and disintermediation between State and national banks in Texas.

State banks are being discriminated against and in particular, smaller rural agricultural banks. In its laudatory efforts to control inflation, the Federal Reserve has sent interest rates to historic highs. The discount rate has been increased to 12 percent. Six month money market certificates are over 11½ percent and large CD's of over \$100,000 are over 12 percent.

A national bank in a Texas community can bid for these high rate deposits and maintain a profitable spread, while a State bank is preempted from these funds for lending purposes by the constraints of the 10 percent usury limit.

Most rural banks in Texas deal with individuals and nonincorporated businesses. Many of their loans are a line of credit for a fixed amount with a single maturity payable when a farmer is paid for his crop. National banks in Texas can charge 13 percent on a crop loan, while a State bank is limited to 10 percent for the same loan.

The inequity is in funding because national banks can profitably bid money market rates for their funds and State banks cannot, or at least cannot and operate at a profit. Funds at State banks are necessarily being withheld from borrowers because of the 10 percent lending limit and are being invested in higher yielding Fed funds, large CD's, or corporate loan participations purchased from city bank correspondents.

RURAL AGRICULTURE BANKS AFFECTED

Texas has an 18 percent usury ceiling for corporations and thus urban banks and in particular large urban banks dealing mainly with corporate customers are not similarly constrained by the State usury ceilings. Banks most affected are banks Congress should most want to support—small rural agricultural banks.

Texas has a rather unique situation in that our State legislature meets biennially. Our next regular session is scheduled to meet in 1981. Our Governor is unlikely to call a special session before 1981 due to the cost and also due to the fact that regardless of the State/national competitive inequity, national banks are positioned to fund community credit needs.

We are not inconsistent in asking for this relief from this inequitable situation in Washington because present State usury override for national banks is authorized by Federal statute in Washington, or in Texas. National banks in Texas until recently and State banks have traditionally competed equitably under present law.

I want to thank the chairman of the committee for allowing us to testify in favor of S. 1988. I want to say also that we have attached to our testimony a survey of banks in Texas showing the distribution by charter for your information, Senator, and also I would like to include written testimony from one of our smaller State and rural agricultural bankers, Kenneth Irwin, president and CEO of the Grover State Bank in Grover, Tex.

The CHAIRMAN. Without objection, that will be done.

[Complete Statement with attachments follow:]

STATEMENT OF R. M. DUFFEY, JR. ON BEHALF OF THE TEXAS BANKERS
ASSOCIATION

Mr. Chairman, I am Robert M. Duffey, Jr., Chairman, President and Chief Executive Officer of the Pan American Bank, Brownsville, Texas, a State chartered bank, and President of the Texas Bankers Association, a trade association whose membership includes 1,394 of the 1,428 banks in our State.

I am here to testify in favor of S. 1988, a bill introduced by Senators Pryor and Bumpers of Arkansas to equalize competition between State and national banks. Of the banks in Texas, 621 are national banks and 807 are State banks. More than 100 towns in rural Texas have only two banks, one operating under State charter and the other under national charter.

The Texas Constitution of 1876, as amended, provided the maximum rate of interest State banks may charge on single maturity loans to non-corporate borrowers at 10 percent. Until very recently the 10 percent ceiling has not been a competitive constraint. Now with interest rates at record levels, national banks are authorized by Federal statute to charge 1 percent over the Discount Rate, now 13 percent on any loan regardless of State usury provisions creating a situation of serious inequity and disintermediation between State and national banks in Texas.

State banks are being discriminated against and in particular smaller rural agricultural banks. In its laudatory efforts to control inflation the Federal Reserve has sent interest rates to historic highs. The Discount Rate has been increased to 12 percent, 6 month money market certificates are over 11½ percent and large C.D.'s of over \$100,000 are above 12 percent. A national bank in a Texas community can bid for these high rate deposits and maintain a profitable spread while a State bank is preempted from these funds for lending purposes by the constraints of the 10 percent usury limit.

Most rural banks in Texas deal with individuals and non-incorporated businesses. Many of their loans are a line of credit for a fixed amount with a single maturity payable when a farmer is paid for his crop. A national bank in Texas can charge 13 percent on a crop loan while a State bank is limited to 10 percent for the same loan. The inequity is in funding because national banks can profitably bid money market rates for their funds and State banks cannot, or at least cannot and operate at a

profit. Funds at State banks are necessarily being withheld from borrowers because of the 10 percent lending limit and are being invested in higher yielding Fed Funds, large C.D.'s or corporate loan participations purchased from city bank correspondents.

Texas has an 18 percent usury ceiling for corporations and thus urban banks, and in particular large urban banks, dealing mainly with corporate customers are not similarly constrained by the State usury ceilings. Banks most affected are banks Congress should most want to support—small rural agricultural banks.

Texas has a rather unique situation in that our State Legislature meets biennially; our next regular session is scheduled to commence in 1981. Our Governor is unlikely to call a special legislature session before 1981 due to costs involved and also due to the fact that regardless of the State—national competitive inequity, national banks are positioned to fund community credit needs.

We earnestly solicit your favorable consideration of S. 1988 as an appropriate response to maintaining the historic competitive balance between national banks and State chartered (but Federally insured and thus Federally regulated) banks. The present imbalance was created by the Federal actions of: (1) Congressional authorization for national banks to charge 1 percent above the Discount Rate notwithstanding State law, and (2) Federal Reserve action in raising the Discount Rate to historic highs. As to the latter, we suggest that our State Legislature could not have reasonably been expected to anticipate this occurrence in the last Session since the Discount Rate had never, prior to mid-1979, been up to 10 percent in its 64 year history.

The Texas Constitution has been construed by our Attorney General to prohibit a floating rate ceiling tied to an outside index such as the Discount Rate. So, if the provisions for 1 percent over the Discount Rate is economically sound for national banks—from a public policy viewpoint—it likewise should be economically sound for Federally insured and regulated State banks and, in Texas at least, S. 1988 is about the only practical way to confer the necessary authority to achieve that end.

We are not inconsistent in asking for relief from this inequitable situation in Washington because present State usury override for national banks is authorized by Federal statute in Washington—not in Texas. National and State banks in Texas, until the recent financial crisis, have traditionally competed equitable under present State law.

I want to thank the chairman and the committee for allowing us to testify today in favor of S. 1988.

NUMBER OF BANKS, BY TYPE OF CHARTER, IN VARIOUS TEXAS CITIES AND TOWNS

Town	Type of charter	
	State	National
Abilene.....	4	3
Alice.....	2	1
Alvin.....	1	1
Amarillo.....	3	5
Anahuac.....	1	1
Andrews.....	1	1
Angleton.....	1	1
Arlington.....	4	4
Athens.....	1	1
Austin.....	7	11
Ballinger.....	1	1
Bandera.....	1	1
Bastrop.....	1	1
Bay City.....	1	1
Baytown.....	4	1
Beaumont.....	6	4
Beeville.....	1	2
Bellaire.....	2	2
Bellville.....	1	1
Big Spring.....	1	2
Bonham.....	1	1
Borger.....	1	1
Brenham.....	1	2
Brownfield.....	1	1

NUMBER OF BANKS, BY TYPE OF CHARTER, IN VARIOUS TEXAS CITIES AND TOWNS—Continued

Town	Type of charter	
	State	National
Brownsville.....	2	3
Brownwood.....	1	2
Bryan.....	2	2
Burkburnett.....	1	1
Caldwell.....	1	1
Canadian.....	1	1
Canyon.....	1	1
Carrizo Springs.....	1	1
Carrollton.....	2	1
Carthage.....	1	1
Center.....	1	1
Childress.....	1	1
Clute.....	1	1
Coleman.....	1	1
College Station.....	1	1
Comanche.....	1	1
Commerce.....	1	1
Conroe.....	3	1
Cooper.....	1	1
Copperas Cove.....	1	1
Corpus Christi.....	7	6
Crockett.....	1	1
Dalhart.....	1	1
Del Rio.....	1	1
Denison.....	1	2
Denton.....	2	2
Dumas.....	1	1
Duncanville.....	1	1
Eagle Pass.....	1	1
Edinburg.....	1	2
El Paso.....	9	11
Ennis.....	1	1
Fairfield.....	1	1
Farmers Branch.....	1	1
Forney.....	1	1
Fort Stockton.....	1	1
Fredericksburg.....	1	1
Freeport.....	1	1
Friendswood.....	1	1
Gainesville.....	1	1
Galveston.....	2	5
Garland.....	3	3
Gatesville.....	1	1
Georgetown.....	1	1
Giddings.....	1	1
Gonzales.....	1	1
Grand Prairie.....	1	3
Granger.....	1	1
Grapevine.....	1	1
Greenville.....	1	2
Hallettsville.....	1	1
Harlingen.....	1	3
Herford.....	1	1
Hillsboro.....	2	1
Humble.....	1	2
Huntsville.....	1	2
Hurst.....	1	1
Irving.....	4	2
Jacksonville.....	1	1
Jasper.....	1	1
Junction.....	1	1

NUMBER OF BANKS, BY TYPE OF CHARTER, IN VARIOUS TEXAS CITIES AND TOWNS—Continued

Town	Type of charter	
	State	National
Kermit	1	1
Kerrville	2	2
Kilgore	2	1
Killeen	1	1
Kingsville	1	2
La Grange	1	1
Lake Jackson	1	1
La Marque	1	1
Lancaster	1	1
La Porte	1	1
Laredo	1	4
League City	1	1
Levelland	1	1
Lewisville	2	1
Liberty	1	1
Littlefield	1	1
Livingston	1	1
Lockhart	1	1
Longview	4	3
Lubbock	4	6
Lufkin	2	2
Luling	1	1
Madisonville	1	1
Marlin	1	1
Marshall	1	2
Mason	1	1
McAllen	1	3
McKinney	1	2
Memphis	1	1
Menard	1	1
Mercedes	1	1
Mesquite	2	1
Mexia	1	1
Midland	2	3
Mission	1	1
Monahans	1	1
Mt. Pleasant	1	1
Muleshoe	1	1
Nacogdoches	1	2
Navasota	1	1
New Braunfels	1	2
Odessa	2	4
Orange	1	2
Pampa	1	1
Paris	1	2
Pasadena	4	1
Pearland	1	1
Pecos	1	1
Pittsburg	1	1
Plainview	1	2
Plano	1	2
Port Arthur	2	1
Port Lavaca	1	1
Port Neches	1	1
Richardson	3	4
Robstown	1	1
Rockwall	1	2
Rosenberg	1	1
Round Rock	1	1
San Angelo	2	4
San Augustine	1	1

NUMBER OF BANKS, BY TYPE OF CHARTER, IN VARIOUS TEXAS CITIES AND TOWNS—Continued

Town	Type of charter	
	State	National
San Marcos.....	1	2
Schulenburg.....	1	1
Seguin.....	1	2
Sherman.....	1	2
Silsbee.....	1	1
Snyder.....	1	1
Spring.....	1	1
Stafford.....	1	1
Stephenville.....	2	1
Sugar Land.....	1	1
Sulphur Springs.....	1	2
Sweetwater.....	1	1
Taft.....	1	1
Temple.....	1	3
Terrell.....	1	1
Texarkana.....	3	2
Texas City.....	1	1
Tyler.....	3	4
Vernon.....	1	2
Victoria.....	3	1
Waco.....	2	6
Waxahachie.....	1	2
Weatherford.....	1	2
Weslaco.....	1	1
West.....	1	1
West Columbia.....	1	1
Wichita Falls.....	2	4
Winnsboro.....	1	1
Yoakum.....	1	1
Yorktown.....	1	1

¹ Excluded are towns with banks of the same type of charter, towns with just one bank, and the major metropolitan cities of Dallas, Fort Worth, Houston, and San Antonio.

STATEMENT OF KENNETH IRWIN, PRESIDENT, GRUVER STATE BANK, GRUVER, TEX.

Mr. Chairman, my name is Kenneth Irwin. I am President and Chief Executive Officer of the Gruver State Bank in Gruver, Texas, a state nonmember bank located in Hansford County, in the top of the Texas Panhandle. I am also President of the North Canadian Bankers Association representing a group of banks approximately twenty one in number and encompassing the top ten counties in the State of Texas. These banks are almost equally divided between those with state charters and those with national charters.

The purpose of my testimony this morning is to point out and to discuss some aspects of the discrimination and inequities that exist between the state and national banks operating in our great State of Texas. At the present time, national banks operating in Texas are permitted under a Federal Statute, being 12 U.S.C. 85, to charge an interest rate at one percent above the discount rate in effect at their respective Federal Reserve Bank.

To my knowledge, most all national banks in Texas are at this time utilizing this statute which does enable them under present conditions and with the discount rate presently at 12 percent to charge 13 percent on a normal term loan. However, as a state chartered bank in Texas, the laws of our great state still permit us to charge only the 10 percent rate on a term loan.

Our state legislature in the last session did offer a limited amount of relief which became effective on August 27, 1979, by amending some parts of the Texas Consumer Credit Code. However, under these amendments and using Chapter 4 of the Code, we are forced to use means and mechanics to structure a loan in a rather unorthodox manner in order to charge a rate greater than 10 percent for any loan under

\$250,000. In other words what has heretofore been a single payment loan must now be drawn to have two or more payments in order to charge a rate in excess of 10 percent.

Relief was also granted at this time on loans in excess of \$250,000. But I ask you, how many country banks or banks twenty, thirty, or forty million dollars in resources have any significant number of customers whose borrowing needs are in excess of this amount.

Today, we are paying almost 12 percent for money market certificates of deposit. Prime rate is somewhere between 15 and 15½ percent. Therefore, you can quickly comprehend that charging 10 percent and operating a bank at increased costs in an almost impossible task. I want to make it very clear that we do not favor high interest rates, but we simply need to be in a competitive position with our peers who operate under national charters when it comes to pricing our loans in order to maintain an interest spread with some degree of profitability.

I would like to quickly point out the profit picture in my own shop. As of November 30, 1979 opposed to November 30, 1978. My interest expense on C.D.'s shows a 57 percent increase. Those expenses which we are able to control being what we term "occupancy expenses" such as utilities, supplies, advertising, postage, etc. have remained the same as they were a year ago. We have been able to maintain a 15 percent increase in gross income on loans. However, the meaningful figure is net operating profit and this is a minus 12 percent as opposed to a year ago. In 1978 our bank earned 1.7 percent on average assets which is a respectable figure.

It is going to be difficult for us to achieve a 1.25 percent return on average assets for 1979.

The supplementary Index to notes under Article 12 U.S.C. 85 specifically quotes the following: "Purpose of this section (12 U.S.C. 85) authorizing National Banks to charge interest at the rate allowed by the laws of the state where the bank is located is to put National Banks on an equal footing with the most favored lenders in the state without giving them an unconscionable and destructive advantage over all state lenders; whether the state banks will enjoy parity and interest regulation with National Banks is for the states since the Federal statute merely prevents State Legislation which purports to give State Banks or possibly any state lender advantages over National Banks. This section is enabling, rather than restraining in nature, and was intended solely to place National Banks in a position to compete with all other banks in the country."

As you can quickly comprehend, banks in those states still operating under a constitutional usury ceiling are placed in the same position that the above statute achieved for national banks.

Competitive equality is the sole objective we are seeking with our national bank peers.

Gentlemen, we are proud to be a state chartered bank in our great State of Texas, but feel that the discrimination set forth puts our dual banking system in jeopardy.

The CHAIRMAN. I'm sure you're interested in Chairman Janis' observation that 30 percent of the housing losses because of the usury statutes will be in Texas.

Mr. DUFFEY. Yes, sir.

The CHAIRMAN. Mr. Dunn?

STATEMENT OF E. D. "JACK" DUNN, COMMISSIONER OF BANKING, STATE OF GEORGIA, ON BEHALF OF THE CONFERENCE OF STATE BANK SUPERVISORS

Mr. DUNN. Thank you, Mr. Chairman.

I'm Jack Dunn, commissioner of banking in the State of Georgia, immediate past president of the Conference of State Bank Supervisors.

Mr. Chairman, the Conference of State Bank Supervisors is supportive of the basic relief provision of this bill as an emergency measure. We believe that the States are in a better position to more responsively reflect the needs of their citizens in connection with usury matters than is the Federal Government. However, we have recently seen usury ceilings in a number of States become

anachronistic in part because of underlying inflation pressure and interest rate extremes over which States have no direct control.

BANKS UNABLE TO SERVE CUSTOMERS

This has caused serious problems. In some areas, State chartered banks have been unable to get enough funds to serve their customers. Furthermore, State banks are at a competitive disadvantage regarding national banks in the usury area because Congress many years ago in 12 U.S.C. 85 bestowed on national banks a preferential lending status that has no validity today.

We urge Congress to correct this inequity. It should be pointed out that States as a whole have been responsive in adjusting usury provisions to meet changing economic needs and are doing so at a somewhat more encouraging pace than is the Federal Government's efforts to correct underlying inflationary problems and resulting high interest rates.

However, both State and Federal corrective efforts take time to work through the normal democratic processes.

CSBS believes that the emergency relief provisions of S. 1988 as amended should be enacted as soon as feasible and should take effect immediately upon passage.

SUGGESTED AMENDMENTS

We believe, however, the bill should be amended to, No. 1, provide a sunset provision that would take effect no later than 2 years after enactment of this bill. This would be consistent with the emergency nature of the bill and would reflect congressional intent that State statutes not be permanently preempted.

No. 2, the sunset provisions should also be applicable to 12 U.S.C. 85 so that when they take effect 2 years after enactment of S. 1988, section 85 will provide for equal treatment of State and National banks alike with respect to the usury ceiling, and the States shall determine the usury ceilings to be applied consistently and equitably within their borders.

This would be consistent with the "policy of equalization" embodied in the other sections of the National Banking Act, whereby State law is a standard for both State and National banks.

No. 3, legislative language accompanying 1988 should spell out in unmistakable terms that this bill is of an emergency nature; That it is not intended to reflect a continued pattern of extending Federal regulation into areas such as interest rates on loans which should be the prerogatives of the States to determine.

Mr. Chairman, I made a pledge to the superintendent of banks in Arkansas to help them in any way that I could personally. As past president of the Conference of State Bank Supervisors, I hope this committee will accept our report. We have done a survey. We show that some 32 States are affected during this time of emergency.

I will have to admit that I concur completely with the statements you made earlier. I think it is time that our country looks at usury laws that are probably archaic and out of date.

Mr. Chairman, I will be glad to submit this information to you.
[The complete statement of Mr. Dunn follows.]

STATEMENT OF E. D. "JACK" DUNN ON BEHALF OF THE CONFERENCE OF STATE
BANK SUPERVISORS

Mr. Chairman, I am E. D. "Jack" Dunn, Commissioner of Banking and Finance for the State of Georgia and Immediate Past President of the Conference of State Bank Supervisors (CSBS) on whose behalf I am testifying today. CSBS is composed of officials of the states responsible for the supervision of approximately 10,500 state-chartered commercial and mutual savings banks in the fifty states and their counterparts in Guam, Puerto Rico and Virgin Islands.

The Conference is pleased to testify regarding S. 1988 because the underlying conditions which have given rise to this proposed emergency legislation are of deep concern not only to federal and state bank regulators and the banking industry but to the public which they serve.

BASIC CAUSE OF THE PROBLEM

Usury ceilings, no matter how well intentioned and regardless of whether imposed by state or federal authorities, represent artificial restraints on otherwise free credit flows when prevailing market rates exceed such ceilings. Distortions in credit flows caused by unrealistic usury ceilings typically have grave and adverse consequences for economic activity.

It has been the consistent view of the Conference that in setting usury ceilings the states are in a better position to more responsively reflect the needs of their citizens than is the federal government. And while the Conference still adheres to the position that this is the decidedly preferable manner in which to determine usury rates throughout the country, we recently have seen usury ceilings in a number of states become anachronistic, in part because of underlying situations over which states have no direct control. Specifically, inflationary monetary policies of the Federal Reserve System, coupled with periods of high budgetary deficits of the federal government, have contributed to this dilemma for several states. As a result, what otherwise might have been reasonable usury provisions, have become onerous constraints in a number of states.

The situation has been further exacerbated because Congress nearly 50 years ago gave national banks what has come to be an undeserved competitive advantage over their state-chartered counterparts by permitting national banks to charge 1 percent above the discount rate irrespective of state law.

While some states have not acted as promptly as some people might desire in adjusting usury provisions to changing economic needs, states generally are acting responsively in this area. For example, during the period from December 1975 to November 1979, 38 states either liberalized usury ceilings or exempted federally insured mortgage loans of FHA and VA programs. Nine of the above states liberalized their usury ceilings and exempted federally insured mortgages; 21 liberalized usury ceilings; and eight exempted federally insured mortgages. States, despite any shortcomings with respect to achieving desirable flexibility in their usury statutes or constitutional provisions, are achieving necessary changes; and the federal government, despite past inflationary extremes in monetary and fiscal policies, is trying to come to grips with the basic problem of inflation-laden high interest rates that make usury provisions of such concern at this time. Action by the states, however, is progressing at a somewhat more encouraging pace than is the federal government's effort to correct the underlying inflationary problem. But both take time: State constitutional and legislative revisions and federal monetary and fiscal policy corrections all must accommodate to realities of democratic political and economic processes.

The best of all solutions would be for the federal government to reduce significantly the continuing inflation rate. This would obviate the need for action of the sort being contemplated in S. 1988. However, in view of the massive monetary and fiscal excesses which started to accumulate nearly 15 years ago, an immediate solution to inflationary pressures on interest rates is unrealistic.

THE INEQUITABLE SITUATION CAUSED BY 12 U.S.C. 85

Senator Dale Bumpers in discussing the objective of this legislative proposal with his Senate colleagues on November 1, 1979, stated that the question of permitting state banks to charge 1 percent above the discount rate—as national banks can do irrespective of state law—was not a "usury issue" in the strictest sense but a matter of "competitive equity." CSBS subscribes to the position that national banks do enjoy an unfair competitive advantage over state banks by virtue of the 1 percent differential, and that Congress is the proper body to address this inequity which

becomes of real significance when the discount rate is higher than state usury limits governing state-chartered banks.

When Title 12 U.S.C., Sec. 85 dealing with usury matters was originally enacted as Section 30 of the National Bank Act of 1864, it was clear from the Congressional debates at that time that Congress intended to give national banks a preferential lending status vis-a-vis state-chartered banks. The U.S. Supreme Court in the *Tiffany* case in 1973¹ declared that the provisions of the National Bank Act were designed to protect national banks from "Unfriendly legislation by the states" and "ruinous competition with state banks." This preferential treatment for national banks was reaffirmed by the U.S. Supreme Court in 1978 in applying the *Tiffany* decision to interstate lending transactions by a national bank. At that time the Supreme Court stated that " * * * the protection of state usury laws is an issue of legislative policy, and any plea to alter Sec. 85 to further that end is better addressed to the wisdom of Congress than to the judgment of this Court."

Mr. Chairman, whatever reasons might have existed in the past for granting national banks preferential status with regard to state banks in the usury area are no longer valid. Both classes of banks are privately owned and perform essentially the same functions for the public. Congress should end this competitive inequity now embodied in 12 U.S.C., Sec. 85.

CSBS POSITION ON S. 1988

Reflecting the emergency nature of the interest rate situation in some states, CSBS is supportive of the thrust of S. 1988 with amendments noted below and urges relief without delay. The Conference recommends the following amendments to S. 1988:

(a) S. 1988 should be amended to include not only the exemptive provisions for states as contained in Sec. 301 but also to contain "sunset" provisions that would take effect no later than two years after enactment of the bill. It is believed desirable to have the "sunset" provisions to reflect Congressional intent that state statutes not be permanently preempted, and to be consistent with the emergency nature of this proposed legislation. The two-year period, it is believed, would have the desirable effect of giving states with constitutional provisions an adequate opportunity to address their particular usury problems and legislatures in states with statutory provisions more time to achieve desirable flexibility in this area;

(b) The "sunset" provisions should also be applicable to 12 U.S.C., Sec. 85, so that when they take effect, Sec. 85, as amended, will provide for equal treatment of both state and national banks alike with respect to usury ceilings. We have attached a proposed amendment to achieve this objective. Under the proposed amendment, national banks would be bound by state provisions governing state-chartered banks in the usury area;

(c) Legislative language accompanying any bill enacted as the result of S. 1988 should spell out in unmistakable terms that this legislation is not intended to further a pattern of extending federal regulation into areas such as interest ceilings on loans which should be the prerogative of the states to determine; and

(d) This legislation should be enacted as soon as feasible and take effect immediately upon enactment.

Thank you, Mr. Chairman.

PROPOSED AMENDMENT TO 12 U.S.C. SEC. 85

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 for banks organized under the laws of the State, Territory, or District where the association is located, or, in the case of an out-of-state association, by the laws of the State, Territory, or District where the borrower resides, and no more.

ANALYSIS OF STATE USURY LAW CHANGES FOR COMMERCIAL BANK LOANS COMPARING THE DATES OF DECEMBER 1975 AND NOVEMBER 1979

State—changes

Alabama.—usury laws have changed to allow 18 percent for home mortgage loans, permits loan exemptions for FHA and VA.

Alaska.—no change.

¹ *Tiffany v. National Bank of Missouri*, 85 U.S. (18 Wall.) 409 (1873).

Arizona.—maximum contract rate for individuals is 12 percent as compared to 10 percent in 1975, there is an 18 percent maximum on business, commercial and agricultural loans to unincorporated or corporate businesses over \$5,000; loan exemptions for FHA and VA.

Arkansas.—no change.

California.—loan exemptions for FHA and VA.

Colorado.—maximum contract rate for unincorporated and corporate businesses is 45 percent and opposed to UCCC maximum of 18 percent in 1975. Conventional Real Estate loans have a limit of 13 percent until July 1, 1981.

Connecticut.—no change.

Delaware.—no change.

Florida.—usury limit raised to 18 percent with no limit for loans over \$500,000. Loan exemptions for FHA and VA.

Georgia.—ceiling on contract rate for individuals and unincorporated businesses was raised from 8 to 10½ percent.

Hawaii.—loans exemptions for FHA and VA.

Idaho.—maximum contract rate for unincorporated businesses 13 percent, corporate businesses 12 percent over \$10,000 and N/L (no limit) over \$25,000 if not secured by a residential mortgage and not subject to UCCC; 13 percent maximum on realty loans. UCCC maximum was used across the board in 1975.

Illinois.—individual contract rate raised to 9 percent. No limit on real estate loans until Dec. 31, 1981.

Indiana.—loan exemptions for FHA-banks only and FHA and VA S. & L.'s only.

Iowa.—established a floating ceiling at 2 percentage points over index of 10 year constant maturity U.S. government notes and bonds, N/L over \$100,000; loan exemptions for FHA and VA.

Kansas.—no change.

Kentucky.—loan exemptions for FHA and VA.

Louisiana.—Real Estate mortgage loans increased to 12 percent and loan exemptions for FHA and VA.

Maine.—UCCC for individual contract rate is set at 12¼ percent instead of N/L.

Maryland.—maximum individual rate increased from 8 percent to 10 percent, a 12 percent maximum was set on loans secured by a certificate of deposit or if such loan is unsecured; the new law deletes the usury ceiling on residential realty loans.

Massachusetts.—no change.

Michigan.—State law now sets N/L on business loans, on loans for one family dwellings by regulated lenders and on loans of \$100,000 or more that are secured by real estate other than a one-family home until December 31, 1981.

Minnesota.—State law has set a floating ceiling for unincorporated businesses at 4½ percentage points over the FR discount rate and mortgage loans set by the Commissioner at monthly index of FNMA auction rate of the previous month rounded up to next higher ¼ percent. (11-30-82)

Mississippi.—loan exemptions for FHA and VA.

Missouri.—Director of Division of Finance sets rate quarterly at 3 percent over the monthly index of long-term U.S. Government (10 years) bond yields rounded to nearest one-tenth percent. No limit on loans to corporations and unincorporated business over \$5,000. Loan exemptions for FHA and VA.

Montana.—floating ceiling on contract rates of the greater of 10 percent, or 4 percentage points over the 9th FR district 90-day discount rate for loans up to \$150,000; from \$150,000 to \$300,000, the rate is the greater of 10 percent, or 5 points over the discount rate; there is N/L for loans over \$300,000.

Nebraska.—maximum individual contract rate increased from 12 to 12¼ percent.

Nevada.—state changed its usury law to provide for a fixed ceiling of 18 percent; loan exemption for FHA and VA.

New Hampshire.—no change.

New Jersey.—contract maximum for individual and unincorporated businesses is set at a rate not to exceed 2½ percent over long-term U.S. government bond index maximum non-residential loans set at 8 percent. N/L on \$50,000 more except loan secured by 1 to 6 family property which rate may not exceed 2½ percent over long-term U.S. government bond index (maximum 10%).

New Mexico.—no change.

New York.—10¼ percent contract rate for individuals may use ¼ percent every 3 months until it reaches ceiling of 2 percentage points over monthly index of U.S. government 10 year bond yield until December 15, 1980, N/L on \$250,000 or more except if secured by 1 to 2 family dwelling, previous ceiling was 8½ percent. Rate of unincorporated businesses set at 5 percent over 90 day discount rate set by N.Y. F.R. banks for \$25,000 or more.

North Carolina.—maximum contract rate for individuals and unincorporated businesses was raised from 9 percent to 12 percent with N/L over \$25,000.

North Dakota.—for individuals and unincorporated businesses the greater of 7 percent, or $5\frac{1}{2}$ percentage points over rate paid on 30-month CD's (previous maximum rate was $9\frac{1}{2}$ percent); N/L over \$35,000 instead of \$25,000. Loan exemptions for FHA and VA.

Ohio.—residential mortgages are set at a floating ceiling of 3 percentage points over the 4th FR district 90-day discount rate (previous rate 9 percent).

Oklahoma.—UCCC at 18 percent for individuals, 45 percent maximum for unincorporated businesses plus all other loans except consumer loans and consumer related loans; loan exemptions for FHA and VA.

Oregon.—conventional mortgage maximums—12 percent on residential real estate loans, N/L on all loans over \$50,000, in 1975 no maximums were listed for real estate loans.

Pennsylvania.—no change.

Rhode Island.—no change.

South Carolina.—maximum contract rate for consumer loans for individuals has been changed from 8 percent to UCCC with maximum of 18 percent percent. Until June 30, 1980, there will be no limit on mortgage loans; there is a limit of 9½ percent commercial agricultural loans up to \$50,000 until June 30, 1981.

South Dakota.—individual and unincorporated businesses increased from 10 percent to 12 percent (reverts back 7-1-81) an N/L on these loans over \$100,000, void after same date.

Tennessee.—State has adopted a floating ceiling of 5 percentage points over Federal Reserve discount rate (18 percent maximum) for consumer loans; residential loan rate is set at 2 percentage points over the FNMA monthly auction rate (not to exceed 18 percent).

Texas.—18 percent on loans over \$250,000 except real estate. Real estate mortgage loans on 1-4 family units the lesser of 12 percent or 2 percent over 10 year U.S. Government Bonds rounded to nearest $\frac{1}{4}$ percent (9-1-81).

Utah.—loan exemptions for FHA only.

Vermont.—individual contract rate increased from 8 percent for mortgages on 1 to 2 family residential property rate set at $1\frac{1}{4}$ percent over the average yield of 3 to 5 yr. U.S. government securities and seasoned corporate bonds to be set monthly (until June 30, 1981).

Virginia.—no change.

Washington.—loan exemptions on FHA and VA for MSB's only.

West Virginia.—N/L on individual business loans over \$20,000, for mortgage loans a floating ceiling rate of up to $1\frac{1}{2}$ percentage points over the average yield on long-term U.S. government bonds; this is an addition to the present statute.

Wisconsin.—loan exemption for FHA and VA.

Wyoming.—an 18 percent maximum on realty loans have been instituted.

STATES AND TYPES OF LOANS WITH USURY CEILINGS
THAT WOULD BE PREEMPTED BY A 13% FEDERAL CEILING
December 12, 1979

State	Maximum Contract Rate			Conventional Home Mtg. Loans %
	Individual %	Unincorporated %	Corporation %	
Alabama	8			
Arizona	12			
Arkansas	10	10	10	
California	Non-regulated lenders are limited to 10%			
Connecticut	12	12		
Georgia	12	12		12
Hawaii	12 (NL over 750,000)	12 (NL over 750,000)	12 (NL over 750,000)	
Illinois	9			
Iowa	12½	12½		
Kansas	10			11
Louisiana	8			12
Maryland	12			
Michigan	7			
Mississippi	10			

STATES AND TYPES OF LOANS WITH USURY CEILINGS THAT WOULD BE PREEMPTED BY A 13% FEDERAL CEILING

State	Maximum Contract Rate			Conventional Home Mortgage Loans %
	Individual %	Unincorporated %	Corporation %	
Missouri	12.8			
Nebraska	12½ (NL over 100,000)			
New Jersey				Maximum 10 3/4
New Mexico	10			
New York	10½ (under 250,000)			
North Carolina	12 (25,000 or less)			10½ (under 250,000)
Ohio	8% (under 100,000)			
Oklahoma	10			
Oregon	10 (NL over 50,000)	12 (NL over 50,000)	12 (NL over 50,000)	12% (on residential, NL over 50,000)
Pennsylvania	6% (under 50,000)	6% (under 10,000)		12½ (on residential mortgages of 50,000 or less)
South Carolina	12	8		
South Dakota	12 (NL over 100,000)			

STATES AND TYPES OF LOANS WITH USURY CEILINGS THAT WOULD BE PREEMPTED BY A 13% FEDERAL CEILING

State	Maximum Contract Rate	Conventional Home Mtg. Loans	
	Individual %	Unincorporated % Corporation %	
Texas	10% (under 250,000	10% (under 250,000	11½ to 12%
Vermont			12%
Virginia	8		
Washington	12	12 (NL over 50,000)	12 (NL over 50,000)
West Virginia	8		10½
Wisconsin	12 (NL over 150,000)	12	

December 12, 1979

The CHAIRMAN. Thank you very much.
Mr. Kennedy.

STATEMENT OF WILLIAM H. KENNEDY, JR., CHAIRMAN OF THE BOARD, NATIONAL BANK OF COMMERCE, PINE BLUFF, ARK., AND CHAIRMAN, GOVERNMENT RELATIONS COUNCIL OF THE AMERICAN BANKERS ASSOCIATION

Mr. KENNEDY. Thank you, Mr. Chairman.

I am William H. Kennedy, Jr., chairman of the board of the National Bank of Commerce in Pine Bluff, Ark. In addition, I also serve as chairman of the Government Relations Council of the American Bankers Association. Our association, which includes 13,107 full service banks, welcomes this opportunity to express its views concerning the current hardship borne by State chartered financial institutions in many States. Our concern is predicated upon the existent statutory disparity between the lending restrictions imposed upon national and State chartered depository institutions.

Under the National Banking Act, national banks may charge a rate of 1 percent in excess of the Federal Reserve discount rate on any credit transaction, notwithstanding any State laws setting an interest rate ceiling. Prevailing economic conditions have pushed interest rates to historically high levels. At this time, many States still have usury laws which are not responsive to current market conditions. The retention of such lending restrictions results in a debilitating hardship upon the citizens and economy of the States.

USURY LAW INEQUITIES

S. 1988 seeks to alleviate these usury law inequities. This legislation would merely allow all State chartered financial intermediaries to charge the same interest rate as national banks. The bill also would permit States not wishing to create such a condition to reinstate interest rate limitations. Based upon our resolve to maintain an economic environment of competitive equity among all competing depository institutions, the American Bankers Association supports S. 1988 as a necessary initiative to insure the independence and sustenance of our Nation's dual banking system.

The underlying intent of usury laws—that is, the protection of the unwary borrower from avaricious lenders—is not realized under today's market conditions. For within current market conditions, State chartered institutions operating under unrealistic lending constraints are unable to serve the legitimate credit demands of the community.

Our membership has long supported efforts to promote healthy and equitable competition within the financial community. Such competition promotes the efficient allocation of resources, advancement of innovative customer services, and sound management—all benefits to the customer.

It is the belief of the association that usury limits set below market rates have a pernicious impact upon credit flow and exert an adverse influence on the distribution of goods and services.

LENDERS MAKE INVESTMENTS IN OTHER STATES

This determination rests upon three precepts. First, when market interest rates exceed the usury ceiling on a certain type of loan, funds are diverted by lenders from that type of credit transaction to alternative loans or investments that carry higher rates and greater profits. Often these investments are made in another State.

Second, lenders will react to binding usury restrictions, particularly when the market rates exceed the ceiling, by attempting to reduce their costs of loans subject to the interest limit. As a result, lending ceilings below the existing market rate divert credit flows from those types of economic activity covered by the strictures of interest usury statutes.

Finally, the inability to change a market rate on loans precludes the ability to pay a going rate. In essence as new savings instruments are created such as the 6-month money market CD, the 4-year money market CD, and now the new 30-month money market CD, financial institutions in usury limited States cannot earn sufficient to pay their savers competitive prices. The result is a loss of funds with which to provide needed goods and services.

With a recognition and appreciation of each State's right to effectuate local economic policy responsive to the concerns of its citizens, the American Bankers Association believes that S. 1988 provides a reasonable means to alleviate severe credit distortions during periods of pungent economic conditions.

The legislation now before your committee attempts to maintain a milieu conducive to the preservation of fair competition between national and state chartered institutions. We believe that a competitive marketplace in which all providers of a financial service can compete free of discriminatory restrictions best furnishes an environment for economic growth, development, and stability.

In conclusion, let me commend the committee for holding these hearings and confronting this most important issue. The American Bankers Association stands ready to work with Congress and support all efforts to alleviate this pressing problem.

Mr. Chairman, I would like to submit for the record an analysis of State usury statutes which might be useful to you.

Mr. CHAIRMAN. Very good. We would like to have that. We appreciate that.

[Complete statement of Mr. Kennedy and the additional material referred to follows:]

STATEMENT OF WILLIAM H. KENNEDY, JR., ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION

Mr. Chairman and members of this Committee, I am William H. Kennedy, Jr., Chairman of the Board of the National Bank of Commerce in Pine Bluff, Arkansas. In addition, I serve as Chairman of the Government Relations Council of the American Bankers Association. Our Association, which includes 13,107 full-service banks, welcomes this opportunity to express its views concerning the current hardship borne by state-chartered financial institutions in many states. Our concern is predicated upon the existent statutory disparity between the lending restrictions imposed upon national and state-chartered depository institutions.

Under the National Banking Act, national banks may charge a rate of one percent in excess of the Federal Reserve discount rate on any credit transaction, notwithstanding any State laws setting an interest rate ceiling. When this compre-

hensive banking statute was enacted in 1933, it served to enhance and maintain the viability of our national banking system. This intent has been realized.

Prevailing economic conditions have pushed interest rates to historically high levels. At this same time, many states still have usury laws which are not responsive to current market conditions. The retention of such lending restrictions results in a dual-pronged debilitating hardship upon the citizens and economy of these states. First, when market interest rates rise above usury ceilings, low-income borrowers generally are unable to obtain loans from banks or other intermediaries. Secondly, state-chartered financial institutions are placed at a critical disadvantage, not only in granting loans, but also in attracting and retaining deposits which flow to markets not subject to artificially restrictive credit ceilings.

S. 1988 seeks to alleviate these usury law inequities. This legislation would merely allow all state-chartered financial intermediaries to charge the same interest rate as national banks. The bill also would permit states not wishing to create such a condition to reinstate interest rate limitations. Based upon our resolve to maintain an economic environment of competitive equity among all competing depository institutions, the American Bankers Association supports S. 1988 as a necessary initiative to insure the independence and sustenance of our nation's dual banking system.

The underlying intent of usury laws, that is, the protection of the unwary borrower from avaricious lenders, is not realized under today's market conditions. The enactment of statutory interest rate ceilings has occurred during periods of economic duress and social polarization. Following times of economic devastation created by war, drought, or monetary instability, many regions have experienced an explosion in capital demand as communities struggle to achieve a financial basis for economic development. During such periods, in the absence of legal restrictions on the amount of interest that could be charged, borrower demand propelled interest rates to exorbitant limits. For instance, following the Civil war, a reasonable interest rate in certain regions was considered to be about 24 percent per annum and 60 percent was not an unusual amount at the time.

During these periods of financial upheaval and uncertainty, the perceptions of the general populace focused on the perceived unconscionable interest rate profits reaped by lenders at the expense of the local citizenry. Many of these statutory provisions against usury, dating back 100 years in some cases, remain the basic laws regarding the legal and maximum rates of interest in certain states.

These antiquated statutes no longer serve their intended purpose. For within current market conditions, state-chartered institutions, operating under unrealistic lending constraints, are unable to serve the legitimate credit demands of the community. Our membership has long supported efforts to promote healthy and equitable competition within the financial community. Such competition promotes the efficient allocation of resources, advancement of innovative customer services, and sound management—all benefits to the consumer. It is the belief of the Association that usury limits set below market rates have a pernicious impact upon credit flow and exert an adverse influence on the distribution of goods and services.

This determination rests upon two precepts. First, when market interest rates exceed the usury ceiling on a certain type of loan, funds are diverted by lenders from that type of credit transaction to alternative loans or investments that carry higher rates and greater profits. The redirection of credit may be to other types of loans that are not subject to a binding ceiling or to loans in other states where no such lending restrictions exist. A corollary to this conclusion is that borrowers who are not inhibited by the market interest rate itself will seek other sources of available credit—whether it be different types of loans or from those institutions not subjected to the credit restriction.

Secondly, lenders will react to binding usury restrictions, particularly when the market rates exceed the ceiling, by attempting to reduce their costs of loans subject to the interest limit. As a result, lending ceilings below the existing market rate divert credit flows from those types of economic activity within the strictures of interest usury statutes. Empirical examination of this issue illustrates the deleterious impact of relatively low rate ceilings upon the availability of credit for low income and higher risk borrowers. In a recent study undertaken by the American Finance Association on the effect of usury ceilings upon credit distribution, Douglas F. Greer concludes that rejection of loan applications are significantly higher in those states where legal rate restrictions are relatively low. Extrapolating data gathered for the National Commission on Consumer Finance, Greer's analysis supports the thesis that the marginal credit risk, that is the low income, unestablished borrower, bears an inordinate burden of resultant credit reduction or reallocation during periods of high interest rates.

With a recognition and appreciation of each state's right to effectuate local economic policy responsive to the concerns of its citizens, the American Bankers Association believes that S. 1988 provides a reasonable means to alleviate severe credit distortions during periods of pungent economic conditions. Recently enacted legislation provides for the temporary preemption of state usury restrictions in Arkansas on business and agricultural loans of \$25,000 or more until January 1, 1981 and establishes a ceiling five percentage points above the discount rate in the Federal Reserve District in which a bank is located. All other loan transactions will continue to be negotiated under laws and regulations placing state-chartered banks at a severe competitive disadvantage. Such limited relief does not provide a permanent, comprehensive resolution to this existant crisis. The legislation now before your Committee attempts to maintain a milieu conducive to the preservation of fair competition between national and state-chartered institutions. We believe that a competitive marketplace in which all providers of a financial service can compete free of discriminatory restrictions best furnishes an environment for economic growth, development, and stability.

In conclusion, let me commend the Committee for holding these hearings and confronting this most important issue. The American Bankers Association stands ready to work with Congress and support all efforts to alleviate this pressing problem.

INTEREST RATE PARITY LAWS

Alabama—act 103 (1979)

Individuals, partnerships, banks or other corporations engaged in the business of lending money may charge the maximum rate permitted by other federal or state chartered or licensed lending institutions in the state.

Florida—stat. ann. (1977) sec. 687.12

All licensed lenders may charge the maximum rate of interest permitted on similar loans by any licensed lender.

Georgia—code ann. sec. 41A-1313 (1974)

Banks may charge the same special interest rate or fee authorized for other lenders for a designated type of loan.

Illinois—S.H.A. Ch. 74 sec. 4 (1979)

State banks may charge the same rate as national banks.

Kentucky—H.B. 40-X (1979)

Banks and trust companies may charge any rate allowed national banks on loans up to \$15,000.

Michigan—stat. ann. sec. 23.710(191)(d) (1974)

Banks may charge the maximum rate permitted for national banks on other than credit card or installment loans.

New Jersey—ch. 156 (1979)

Any person may charge the same rate allowed national banks when it exceeds 8 percent (not applicable to 1-6 family first real estate mortgage loans).

North Dakota—cent. code sec. 47-14-09 (1979)

State banks and the Bank of North Dakota may charge the maximum rate allowed for a particular type of loan by national banks or state or federal savings and loans within the state.

Pennsylvania—stat. ann. T. 41 sec. 604 (1978)

Banks and trust companies may charge the maximum rate permitted for national banks.

South Carolina—code ann. sec. 34-1-110 (1979)

State banks may charge the same rate allowed national banks.

Tennessee—code ann. sec. 45-435 (1979)

State banks may charge the maximum rate allowed national banks.

Virginia—code sec. 6.1-5.2 (1975)

The State Corporation Commission may, from time to time, confer upon state banks the power to charge the same rate as national banks.

ANALYSIS OF STATE USURY STATUTES

This chart is intended to present an overview of the law in each state and the District of Columbia placing an interest rate ceiling on mortgage loans. The format displays the maximum contract rate for individuals, unincorporated businesses, and corporations, respectively. EXCEPT AS NOTED UNDER THE FHA/VA OR CONVENTIONAL MORTGAGE COLUMNS, THE INDIVIDUAL CONTRACT RATE IS APPLICABLE TO HOME MORTGAGE LOANS. In addition to the rates noted herein, state chartered banks in a number of states are expressly authorized to charge rates permitted to national banks pursuant to 12 U.S.C. §85. The chart makes no attempt to detail the specific loan rates for the wide variety of personal loans such as bank installment loans, loans by licensed lenders, and the like.

The figures given are annual interest rates, with the entry NIL as an abbreviation for "No Limit." "UCCC" refers to the Uniform Consumer Credit Code. Individual contract rates in those states which have adopted the UCCC or a variant are those which are applicable only to consumer loans by non-supervised, non-regulated lenders. Citations listed under the name of each state are supplemented by a notation under a particular entry where appropriate.

Office of the State Legislative Counsel
American Bankers Association

THIS CHART IS INTENDED TO PROVIDE AN OVERVIEW AND NOT A DEFINITIVE ANALYSIS OF THE LAW IN EACH STATE.

STATE USURY STATUTES

STATE	MAXIMUM CONTRACT RATE			1/2-ME MORTGAGE EXCEPTIONS	
	INDIVIDUAL	UNINCORPORATED BUSINESS	CORPORATION	FHA & VA	CONVENTIONAL
ALABAMA Code §§ 6-6-1	6% ^a	N/L—\$100,000 or more § 6-6-5	15%—\$10,000 to \$100,000 N/L—\$100,000 or more § 6-6-3	X	18%—real estate loans § 5-15-3(f)
ALASKA Stat. §§ 45-010(b)	5 percentage points over the discount rate charged by the 12th F.R. district N/L—over \$100,000				
ARIZONA Rev. Stat. §§ 44-1201	12%	18%—over \$5,000 § 44-1208	18%—over \$5,000 § 102-150	X	
ARKANSAS Const. Art. 19 § 13 Rev. Stat. Ann. § 66-602	10%	10%	10%	§ 44-1208	
CALIFORNIA Const. Art. X § 1	10%—non-regulated lenders ^a N/L—regulated lenders			X	
COLORADO Rev. Stat. §§ 9-3-801	UCCC—12%	45% § 5-3-605	45% § 5-3-605	12 U.S.C. § 1709-1a	13%—realty loans (until 7/1/81)
CONNECTICUT Gen. Stat. § 37-4	12%	12%	18%—over \$10,000 § 37-9		N/L—any loan by bank or S&L N/L—realty loans over \$5,000 § 37-9
DELAWARE Code Ann. T. 6 § 2301	4 percentage points over the Federal Reserve discount rate N/L—over \$100,000		N/L	X	Residential mortgage loans—4 percentage points over the Federal Reserve discount rate
DISTRICT OF COLUMBIA Code Ann. §§ 28-3301 & 28-3309	8%	N/L—over \$5,000	N/L	X	11%—residential mortgage loans (until 8/1/81) 15% (until 1/1/80) Emergency Act 3-105
FLORIDA Const. Art. 10 § 689.02	18% N/L—over \$500,000 Interest at more than 25% is criminal usury	Reg. 74-27	§ 29-904(f)	Reg. 70-38 & § 39-3307	Reg. 74-27 D.C. Law 2-140 N/L—loans by S&Ls § 665.395 N/L—loans by other lenders § 667.12
GEORGIA Const. Art. 8 § 57-101	10 1/2%	10 1/2%	N/L—over \$3,000 § 57-118	§ 687.032(f)(a)	Residential loan rate set at 2 1/2 percentage points over the monthly index of long term U.S. gov't (20 yr.) bond yields N/L—any loan over \$100,000 § 67-107.7 § 57-119
HAWAII Rev. Stat. §§ 480-3 & 478-8	12% N/L—over \$750,000	12% N/L—over \$750,000	12% N/L—over \$750,000	X	N/L—mortgage loans secured by "alternative mortgage instruments"

^a But see, *Fletcher v. Tuscaloosa Federal Savings and Loan Assn.*, 254 Ala. 173, 314 So. 2d 51 (1975).

^b 10% limit on consumer loans by non-regulated lenders held unconstitutional. Committee Against Unfair Interest Limitations v. California, 46 U.S.L.W. 2319 (Cal. Super. 1977). Appeal pending.

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STATE USURY STATUTES

STATE	MAXIMUM CONTRACT RATE		HOME MORTGAGE EXCEPTIONS	
	INDIVIDUAL	UNINCORPORATED BUSINESS	CORPORATION	FHA & VA
IDAHO Code Ann. §28-22-105	UCC—18% §28-33-207	13% N/L—over \$25,000 if not secured by a residential mortgage and not subject to UCC	12%—over \$10,000	CONVENTIONAL 13%—residential realty loans §28-33-105
ILLINOIS SHA Ch. 74 §4(1)	8% §28-33-207	N/L	N/L	X Residential loan rate set monthly by the Governor's committee on interest rates on the basis of the index of long-term U.S. govt. bonds yielding 15%—realty loans effective Sept. 1, 1979 §24-4-3-105
INDIANA Code Ann. §24-4-5-3-201	UCC—18%	N/L	N/L	FHA—banks only §24-4-5-3-201 FHA & VA—SAs only §28-1-27-23(g)
IOWA Code Ann. §535.2	Sup'l sets rate monthly at 2 percentage points over the index of 10-year constant maturity U.S. govt. notes and bonds.	§244.5-3-605	§244.5-3-605	X
KANSAS Stat. Ann. §16a-2-401	UCC—18%	N/L—\$100,000 or more 10% §16-207	N/L §335-2(2)	§662.45 & 662.46
KENTUCKY Rev. Stat. §360.010(1)(a)	8½% N/L—over \$15,000	N/L—over \$15,000 N/L—to a limited partnership or business trust	N/L §17-705	X
LOUISIANA Civ. Code Ann. Art. 2924	8% §16-207	8% §16-207	§600-025	§386-030
MAINE Rev. Stat. T. 9-4 §2-401	UCC—12¼%	N/L	R.S. §12-703	X R.S. §9-3503
MARYLAND Commercial Law §12-103	12% §12-103(e)	N/L—over \$5,000 §12-103(e)	no provision N/L—over \$5,000 §12-103(e)	N/L—first mortgage loans by a supervised financial institution T. 8-6 §42.2 & T. 9-4 §1-202 N/L—residential realty loans §12-103(b)
MASSACHUSETTS Rev. Laws Ch. 107 §3	N/L	N/L	N/L	
MICHIGAN Stat. Ann. §19-15(1)	7% N/L—business loans §19-15(1)	N/L	N/L	X N/L—loans on one family dwellings by regulated lenders (until 12-31-81) 11%—Mortgage loans and land contracts by non-regulated lenders N/L—loans of \$100,000 or more, secured by real estate, made to a one family home (until 12-31-81) §19-15(1)(c)
MINNESOTA Stat. Ann. §334.01	Interest at more than 25% is criminal usury §19-15(5) 8% N/L—over \$100,000	4½ percentage points over F.R. discount rate §334.017	§19-200(2)(5) N/L	X Comm'r sets rate at monthly index of FHMA auction index for one month, rounded to next higher ¼% (until 11-30-82) §47-20

3 On loans under \$15,000 state banks may charge rates authorized to national banks

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STATE USURY STATUTES

STATE	MAXIMUM CONTRACT RATE			HOME MORTGAGE EXCEPTIONS	
	INDIVIDUAL	UNINCORPORATED BUSINESS	CORPORATION	FHA & VA	CONVENTIONAL
MISSISSIPPI Code Ann. § 7-1-1	10%	Partnerships—15% over \$250,000	15%—over \$2,500	X	
MISSOURI Ann. Stat. § 408.030	Director of Division of Finance sets rate quarterly at 3% over prime rate of long term U.S. gov't (10 yr.) bond yields rounded to nearest 1/8%	N/L—over \$5,000 N/L—over \$5,000 for residential real estate loans	N/L	\$43-33-207	
MONTANA Code Ann. § 31-1-107	Up to \$150,000—greater of 10% or 4 percentage points over the 9th F.R. district 90-day discount rate Over \$150,000—greater of 10%, or 5 points over the discount rate N/L—over \$300,000	\$4408.035(2) & 408.075(6)	\$448.035(1)	FHA only	
NEBRASKA Rev. Stat. § 45-101.03	12 1/2% N/L—over \$100,000	11% N/L—over \$100,000 N/L—loans to partnerships § 45-107.04	N/L	X	\$32-1-424
NEVADA Rev. Stat. § 99.150	18%			X	
NEW HAMPSHIRE Rev. Stat. § 336.1	N/L	N/L	N/L	\$62-285	
NEW JERSEY Rev. Stat. § 33-1-1	Comm'r may set a rate not to exceed 2 1/2% over long term U.S. gov't bond index (maximum non-residential loans-8%)* N/L—\$50,000 or more except 1 to 6 family first mortgage loans	N/L	N/L	X	Comm'r may set a rate not to exceed 2 1/2% over long term U.S. gov't bond index for loans secured by 1 to 6 family residential property (maximum 10 1/4%)
NEW MEXICO Stat. § 50-6-16	10% N/L—\$50,000 or more § 50-6-15(C)	N/L—\$50,000 or more § 50-6-15(C)	N/L § 37-1-6 § 50-6-15(B)	X	7% add-on for conventional real estate loans under the Bank Installment Loan Act—banks only. § 48-21-4
NEW YORK Banking Law § 5-501	10%—may rise 1/8% every 3 months until it reaches ceiling of 2 percentage points over monthly index of U.S. gov't (10 yr.) bond yields (until 12/15/80) N/L—\$250,000 or more secured by 1 to 2 family residential property 5% over 90-day discount rate set by N.Y. Fed. Res. Bank N/L—\$25,000 or more Banking § 108(9)		N/L Gen. Oblig. § 5-527	X	
NORTH CAROLINA Gen. Stat. § 24-1.1	Interest at 25% or more is criminal usury. Penal § 190.40		N/L	X	N/L—first mortgage on residential real property if lender is bank, S&L, credit union, or federally insured depository institution 10%—over \$100,000 N/L—\$10,000 or more } other lenders § 24-1.14

* 6% absent action by Comm'r fixing rate.

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STATE USURY STATUTES

STATE	MAXIMUM CONTRACT RATE			HOME MORTGAGE EXCEPTIONS	
	INDIVIDUAL	UNINCORPORATED BUSINESS	CORPORATION	FHA & VA	CONVENTIONAL
NORTH DAKOTA Gen. Code § 47-1403	Greater of 7%, or 5% percentage points over rate paid on 30-month CD; (current rate is 12%)	N/L—loans to partnerships N/L—over \$50,000	N/L	X	12%—loans by S&Ls
OHIO Gen. Code § 1343.01	8% N/L—over \$100,000 Interest at more than 25% a criminal usury	8% N/L—over \$100,000 T. 144 § 2-201	N/L \$170.68 T. 144 § 2-201	X	\$7.02-04 Residential mortgages—3 percentage points over the 4th F.A. district 30-day discount rate
OKLAHOMA Gen. Code T. 144 § 2-201	UCCC—10%	45% T. 144 § 2-605	N/L T. 18 § 1-26	X	13%—realty loans T. 144 § 2-105 45%—all loans other than consumer loans and consumer-related loans T. 144 § 2-605
OREGON Rev. Stat. § 82.010	10% ^a N/L—over \$50,000	12% N/L—over \$50,000	12% N/L—over \$50,000	X	12%—real estate loans N/L—all loans over \$50,000
PENNSYLVANIA Gen. Code § 8201 & 301	6% N/L—over \$50,000	6% N/L—over \$10,000	N/L T. 41 § 2	X	Mortgage rate set monthly at 2% percentage points over the rate set by the U.S. govt. bond yields N/L—all loans over \$50,000 N/L—loans secured by real estate lien other than 1 to 2 family residential mortgage
RHODE ISLAND Gen. Laws Ann. § 6-26-2	21%	21%	21%		
SOUTH CAROLINA Code Ann. § 34-31-30	UCCC—12% § 37-3-201 12% (reverts to 10% 7/1/81) N/L—over \$100,000 (void after 7/1/81)	8% 9½%—commercial agricultural loans up to \$50,000 (until 6/30/81) → → → § 54-3-71	N/L—corporations with \$40,000 capital § 54-3-40 N/L § 54-3-71	X	Until 6/30/81, first mortgage loans: N/L—over \$100,000 N/L—under \$100,000 if a fixed rate with no prepayment penalty
SOUTH DAKOTA Gen. Laws § 54-3-7				X	
TENNESSEE Ch. 203 § 9	5 percentage points above Federal Reserve discount rate (16% maximum)			X	Residential loan rate set at 2 percentage points above the FIMA monthly prime rate but not to 5 years or longer; rate may not exceed 18% Ch. 208 § 9
TEXAS Const. Art. 16 Code Art. 5069-1.04	18%—over \$250,000 (except loans secured by residences, agricultural or ranch land) Art. 5069-1.07(b)	10% N/L	18%—\$5,000 or more Art. 5062-2.09	X	For loans secured by 1-4 family residential property, the lesser of a) 12%, or b) 2% over the long term (10 yr.) U.S. govt. bond yields, rounded to the nearest 1/8% (effective 8/2/79, until 9/1/81) Art. 5069-1.07(c)
UTAH Code Ann. § 708-3-201	UCCC—18%	N/L	N/L \$708-3-605	FHA only § 33-3-7	
VERMONT Gen. Stat. T. 9 § 41	12%	N/L	N/L T. 9 § 46(1)	X	For mortgage on 1 to 2 family residential property, the lesser of a) 12% over the long term U.S. govt. securities and seasoned corporate bonds to be set monthly (until 6/30/81)

^a In addition to the rates shown, banks may charge an 8%, add-on or 15% on loans up to \$50,000.
§ 708-46(1)(a)

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STATE USURY STATUTES

STATE	MAXIMUM CONTRACT RATE			HOME MORTGAGE EXCEPTIONS	
	INDIVIDUAL	UNINCORPORATED BUSINESS	CORPORATION	FHA & VA	CONVENTIONAL
VIRGINIA Code §61-330.11	8%	N/L—\$5,000 or more §61-330.44	N/L §61-330.43	X §61-330.38	N/L—first mortgage loans §61-330.37
WASHINGTON Rev. Code §19.52.020	12%	12% N/L—over \$50,000 §19.52.080	12% N/L—over \$50,000 §19.52.080	MSBs only	
WEST VIRGINIA Code §47-6-5	8% N/L—business loans to individuals over \$20,000	N/L	N/L	§32.20.040	Comm'r sets rate for mortgage loans at up to 1½ percentage points over the average yield on long term U.S. govt. bonds §47-6-5(b)
WISCONSIN Stat. Ann. §138.05	12% N/L—\$150,000 or more except loan secured by 1 to 4 family residential property	12%	N/L §47-6-10	X §§374-4-27 & 374-4-29	
WYOMING Stat. §40-14-310	UCCC—10%	N/L §40-14-308	N/L §40-14-309	§719.03	18%—realty loans §40-14-305

ANALYSIS OF STATE USURY STATUTES

NOVEMBER 29, 1979 UPDATE OF OCTOBER 1979 CHART

California.—Proposition No. 2, passed by the voters in November, increased the rate permitted to nonregulated lenders to the higher of 10 percent or 5 percent over the Federal Reserve discount rate.

Distict of Columbia.—Law 3-38, makes permanent a 15 percent ceiling on the individual contractrate and the home mortgage rate.

Illinois.—P.A. 81-1097, increases the individual contract rate from 8 percent to 9 percent and lifts the interest rate ceiling on mortgage loans until December 31, 1981.

Nebraska.—Delete the 11 percent limit listed as the unincorporated business rate.

New York.—The individual contract rate is 10¼ percent, effective November 1.

Tennessee.—The statutory citation for Chapter 203 is sec. 47-14-102 and 47-14-103.

Vermont.—The rate on home mortgage loans is one-fourth percent over the average yield of 3-5 year (was cited as "long-term") U.S. government securities and seasoned corporate bonds, to be set monthly.

The CHAIRMAN. Mr. Lascara?

STATEMENT OF VINCENT A. LASCARA, PRESIDENT, NAVY FEDERAL CREDIT UNION, ON BEHALF OF THE NATIONAL ASSOCIATION OF FEDERAL CREDIT UNIONS

Mr. LASCARA. Mr. Chairman, I am Vincent A. Lascara, member of the board of directors of the National Association of Federal Credit Unions and chairman of the legislative committee of that association.

I am also president of the Navy Federal Credit Union. The National Association of Federal Credit Unions is the only national trade association exclusively representing the interests of federally chartered credit unions. We represent 5.6 million credit union members who hold deposits in their credit unions, totaling over \$11 billion.

Senators Pryor and Bumpers are to be commended for their efforts to correct inequities confronting our Nation's financial institutions. The interest rate formula proposed in S. 1988 is one method of addressing the interest rate ceiling crisis, now causing an unnecessary and unwarranted hardship on Federal credit unions.

As you know, Federal credit unions are, by statute, limited to charging a maximum of 1 percent per month on loans to their members. For over 45 years, we have proudly lived well below the 12-percent ceiling. At the time that ceiling was set, the prime interest rate was approximately 1½ percent.

Clearly the 12-percent ceiling now has become unduly repressive in today's marketplace. Last month, the National Association of Federal Credit Unions sent a letter to all federally chartered credit unions to determine what impact the 12-percent ceiling is having upon credit union operations and member services. Over 81.5 percent of the National Association of Federal Credit Union members responding stated that they now need or anticipate soon needing relief from the 12-percent ceiling.

The urgency of this situation is even more forcefully driven home by the fact that over 85.4 percent of the National Association of Federal Credit Union members responding state that they have already curtailed loans to their members or have cut back other services or they plan to do so before the end of 1979.

As a result, individual credit union members are often compelled to turn elsewhere to secure credit, often at excessive rates of interest, some approaching 21 percent or greater. The problem is all too real, and the need for legislative action to provide relief is urgent.

USURY CEILINGS STRANGLE LOCAL ECONOMY

The present situation, if left unchecked, would undoubtedly result in unnecessary economic injury to our Nation's consumers. Consequently, I wholeheartedly agree with the statement recently made on the Senate floor by Senator Pryor that:

In the golden days of low interest rates, this problem never came up. But as the discount rate has risen to 12 percent in our present, tight-money economy * * *. Once reasonable usury limits of, say, 12 percent now threaten to strangle the local economy.

The intolerable conditions cited by the Senator in his statement apply nationally to federally chartered credit unions. The remedy proposed by Senators Pryor and Bumpers is one way of addressing the immediate problems confronting a variety of financial institutions.

I would like to suggest two alternatives to that proposal. I suggest that rather than indexing the interest rate that Federal credit unions might charge on loans to the Federal Reserve discount rate, that this committee consider permitting Federal credit unions to charge 1 point above the rate being charged by the National Credit Union Administration's central liquidity facility when that rate is above 11 percent.

I urge this committee to expedite implementation of this constructive revision of the Federal Credit Union Act at the earliest possible time. Indexing the rate of interest Federal credit unions may charge on loans to the central liquidity facility rate would both recognize the uniqueness of Federal credit unions and emphasize the important role which the National Credit Union Administration and its central liquidity facility can and should play in the activities of those credit unions. It appears far more desirable to index credit union loan interest rates to the central liquidity facility rate than to the Federal Reserve discount rate since the latter was designed and intended to serve commercial banking systems and structures while the CLF was designed and intended to serve our Nation's credit unions.

Another method of dealing with the fixed 12-percent interest ceiling rate would be authorizing the National Credit Union Administration Board to establish by regulation the maximum interest rate which Federal credit unions may charge on loans. Such a delegation of authority by the Congress to the National Credit Union Administration Board would permit the agency to respond to fluctuations in the economy in a manner best assured to preserve the safety and soundness of the institutions they regulate while properly weighing the interests of the consumers they serve.

Mr. Chairman, I have submitted additional written comments for the hearing record. The National Association of Federal Credit Unions favors immediate relief from the 12-percent ceilings and suggests pegging that rate 100 basis points above the central liquidity facility rate.

[Complete statement of Mr. Lascara follows:]

PREPARED STATEMENT OF VINCENT A. LASCARA, PRESIDENT OF NAVY FEDERAL CREDIT UNION, ON BEHALF OF THE NATIONAL ASSOCIATION OF FEDERAL CREDIT UNIONS

Mr. Chairman, members of the Committee on Banking, Housing and Urban Affairs, I am Vincent A. Lascara, chairman of the Legislative Committee of the National Association of Federal Credit Unions and president of Navy Federal Credit Union. The National Association of Federal Credit Unions (NAFCU) is the only national trade association exclusively representing the interests of our nation's federally chartered credit unions. I appreciate the opportunity to appear before you today to comment upon S. 1988, a bill intended to equalize competition between state and national banks and for other purposes as well. Accompanying me this morning is Richard M. M. McConnell, the executive vice president of our association.

INTRODUCTION

Mr. Chairman and members of the committee, Senators Pryor and Bumpers are to be commended for their efforts to correct, through appropriate legislation, certain competitive inequities presently confronting our nation's financial institutions. Likewise, you and your staffs are to be commended for acting as promptly as you did in arranging public hearings on the bill introduced by Senators Pryor and Bumpers. According to Senator Pryor, S. 1988 "would merely allow State chartered, federally insured banks, federally insured savings and loans, small business investment companies, and Federal credit unions to charge the same interest rate as national banks." (125 Cong. Rec. 152, at S. 15684, November 1, 1979). The interest rate formula proposed in S. 1988 is one method of addressing the present interest rate ceiling crisis confronting many of our nation's financial institutions—a crisis whose impact is causing what many consider to be an unnecessary and unwarranted hardship for Federal credit unions throughout the nation. Since I am most familiar with the operations—and laws and regulations governing the operations—of Federal credit unions, I shall address my comments to their unique situation.

As you know, Federal credit unions are, by statute, limited to charging a maximum of 12 percent on loans to their members. The Federal Credit Union Act restricts credit union lending as follows: "The rate of interest [shall] not exceed 1 per centum per month on the unpaid balance inclusive of all service charges." (12 U.S.C. 1757 (5)(A)(vi)). This 12 percent ceiling was initially established over 45 years ago, on June 26, 1934, when the Federal Credit Union Act was passed into law. At the time the ceiling was set, the prime interest rate was approximately 1½ percent. One may assume the ceiling was set at 12 percent—then considered extraordinarily high—to assure that credit unions would not be adversely affected by the interest rate ceiling in meeting their members' demands for loans and other financial services. While it may have been considered high in 1934, the 12 percent ceiling has become unduly repressive in today's marketplace.

NAFCU'S SURVEY OF FEDERAL CREDIT UNIONS ON 12-PERCENT CEILING

In response to mounting concerns expressed by credit union leaders throughout the country, NAFCU last month sent a survey to all federally chartered credit unions in order to determine what impact the 12 percent ceiling is having upon their operations and member services. I would like to share with you the results of that informal survey, a summary of which is attached for your reference and review (Appendix I). You will also find attached (Appendix II) a random sampling of completed surveys which indicates that the severity of the present loan interest rate ceiling problem is not restricted to any one geographical area, but is indeed nationwide.

The NAFCU survey shows overwhelming support for removal of the 12 percent ceiling. Over 81.5 percent of NAFCU members responding state that they now need (or anticipate soon needing) relief from the 12 percent ceiling. The urgency of this situation is even more forcefully driven home by the fact that over 85.4 percent of the NAFCU members responding to our survey stated that they have already curtailed loans to their members or cutback other services, or that they plan to do so before year-end 1979.

Mr. Chairman and members of the committee, as you know, credit unions are member-owned and member-operated cooperatives. The Federal Credit Union Act states quite clearly that a Federal credit union is "a cooperative association orga-

nized * * * for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes * * *". (12 U.S.C. 1752 (1)). Unfortunately, an ever-growing number of Federal credit unions are today finding it more and more difficult to fulfill their statutory obligation to serve as a source of credit for their members while required to lend under the strictures imposed by the 12 percent interest rate ceiling. Institutional viability is currently being seriously threatened, while individual consumer-members of credit unions are being compelled to turn elsewhere to secure loans not from their credit unions but from other types of financial institutions or finance companies—where they may be forced to pay an excessive rate of return in order to secure a loan.

THE DILEMMA FACING FEDERAL CREDIT UNIONS IS ALL TOO REAL

The dilemma facing Federal credit unions is not, as some may contend, a mere fiction conjured up by economists, lobbyists or trade association executives. The problem is all too real, and the need for legislative action to provide relief is urgent. As the manager of a \$1.8 million credit union recently stated:

"Our biggest fear is disintermediation. We are already feeling the effect since we stopped offering money market certificates when the rate went above 12 percent. If our dividend rate drops * * * more and more of our regular share accounts will be invested elsewhere. Also, it is frustrating to see our members going to finance companies to borrow at 19 to 33 percent or even to banks which are charging 15 percent on new car loans now. We can't even make Federally Insured Loans anymore * * * This is definitely not the purpose of a Credit Union the way we see it."

The treasurer of a \$335,000 credit union states:

"A small credit union like this one is on a treadmill going nowhere. We cannot entice savers because of our low dividend rate. We cannot increase income because of the low interest rate charged."

Or consider the comments of the general manager of a \$52.4 million credit union:

"Relief from the 12 percent ceiling is urgently needed. We cannot operate when money costs are higher than our return. We foresee many small credit unions either merging or liquidating * * *".

With this background, Mr. Chairman and members of the committee, it becomes evident that immediate relief from the statutorily imposed 12 percent interest ceiling on loans secured at Federal credit unions can and must be granted if Federal credit unions are to continue functioning in today's marketplace as "a source of credit for provident or productive purposes" for their member-owners. The bill which is the subject of today's hearings, S. 1988, would allow Federal credit unions to "charge on any loan, interest at a rate of not more than 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 financial institution is located or at the rate allowed by the laws of the State * * * where the credit union is located, whichever may be greater."

Mr. Chairman and members of the committee, in the time that remains I would like to discuss with you the merits of that proposal, and also suggest some alternative plans which might be implemented by the Congress to alleviate a situation which—if left unchecked—will undoubtedly result in unnecessary economic injury to our nation's consumers.

THE PRYOR-BUMPERS PROPOSAL (S. 1988)

As I stated in my introductory comments, Senators Pryor and Bumpers deserve recognition for the leadership role they have taken in bringing to the attention of the Senate the immediate need for some type of corrective action in the area of financial institution lending rates, if consumer loan demands are to be met by our country's traditional lending institutions. I whole-heartedly agree with the statement recently made on the Senate floor by Senator Pryor during debate on H.R. 4986, the "Depository Institutions Deregulation Act of 1979", that:

"In the golden days of low interest rates, this problem never came up. But as the discount rate has risen to 12 percent in our present, tight-money economy, . . . Once-reasonable usury limits of, say, 12 percent, now threaten to strangle the local economy." (125 Cong. Rec. 152, at S. 15684, November 1, 1979).

I recognize that Senator Pryor's statement on the floor addressed itself directly to the plight of state chartered financial institutions in his home state of Arkansas. Nevertheless, the intolerable conditions cited by the Senator apply universally to federally chartered credit unions as well.

The remedy proposed by Senators Pryor and Bumpers is one way of addressing the immediate problems confronting a variety of financial institutions. These problems stem from antiquated usury ceilings which once effectively achieved their purpose but now are out-dated and repressive. I would like to comment upon that proposed remedy before suggesting to the committee alternative approaches.

Section 104 of S. 1988 would amend Section 205 of the Federal Credit Union Act by adding a new subsection dealing with the rate an insured credit union might charge on member loans. Section 205 of the Federal Credit Union Act sets forth, among other things, "requirements governing insured credit unions". Thus, the amendments to this section which would allow credit unions to charge "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 it is located would appear to apply to federally insured credit unions, regardless of the source of their charter. This formula, indexed to the Federal Reserve's discount rate, provides a floating ceiling or maximum interest rate which a credit union may impose on loans extended to borrowers.

The present language of S. 1988 leaves some doubt as to whether or not federally chartered credit unions would be assured the security of a fixed usury ceiling in the event that the floating rate falls below the present statutory 12 percent. Such a guarantee is clearly essential if Federal credit union managers are to administer their portfolios responsibly. NAFCU staff will be happy to work with the committee in drafting language to clarify this ambiguity.

In addition, if the committee should go forward with the general plan for relief outlined in S. 1988, I would suggest an additional technical amendment striking 12 U.S.C. 1757(5)(A)(vi) which currently prohibits Federal credit unions from charging in excess of 1 per centum per month on loans. This correction would merely reflect the intent of this committee and the Congress that Section 205 of the Federal Credit Union Act (12 U.S.C. 1785) be controlling in this area.

I would now like to suggest two alternatives to the proposal put forward by Senators Pryor and Bumpers.

THE "CLF INDEX" APPROACH

The floating interest rate ceiling formula contained in S. 1988 would, if enacted in its present form, index the rates which financial institutions might charge on consumer loans to the Federal Reserve discount rate. While such an index may be appropriate for certain types of financial institutions, I suggest that other readily available indexes might be more appropriate for federally chartered credit unions. To tie the interest rate which federally chartered credit unions may charge on loans to their member-owners to the Federal Reserve discount rate could tend toward the further homogenization of our nation's various types of financial institutions. Clearly, this is something which the National Association of Federal Credit Unions hopes to avoid, since we believe that credit unions have a unique structure among financial institutions, and provide a unique service to their member-owners which cannot and will not be duplicated by other types of financial institutions. I realize that you, Mr. Chairman, as well as the members of this committee, recognize the importance of retaining essential distinguishing characteristics among financial institutions.

With that though in mind, I would suggest to the committee that they consider endorsing a loan interest rate formula for federally chartered credit unions similar to that proposed by Senators Pryor and Bumpers, but one which incorporates one of the many functional characteristics which distinguish Federal credit unions from all other types of financial institutions. Quite simply, rather than indexing the interest rate Federal credit unions might charge on loans to their members to the Federal Reserve discount rate, I suggest that this committee consider indexing that interest rate to the corresponding rate being charged by the National Credit Union Administration's Central Liquidity Facility (CLF).

For the record of this hearing, I have attached to my written statement a copy of a letter from a member of our association, John F. Kinney, general manager of Electric Boat Federal Credit Union in Groton, Connecticut (Appendix III). Mr. Kinney's letter, addressed to Mr. Robert Dugger, director of policy analysis at the National Credit Union Administration, is dated October 25, 1979. Noting that Electric Boat Federal Credit Union and numerous others "urgently need relief from the 12 percent ceiling," Mr. Kinney suggests that "the NCUA seek authority * * * to allow Federal Credit Unions to charge 1 percent above the CLF lending rate." This morning, on behalf of the National Association of Federal Credit Unions (NAFCU), I urge this committee to expedite implementation of this constructive revision of the Federal Credit Union Act at the earliest possible time.

Mr. Chairman and members of the committee, as you know, the Central Liquidity Facility's relationship to Federal credit unions is not unlike the Federal Reserve System's relationship to our nation's commercial banks. Created by Title XVIII of Public Law 95-630, the Central Liquidity Facility is a corporation within the National Credit Union Administration (NCUA), and provides credit unions with a source of funds to meet their liquidity needs. Indexing the rate of interest Federal credit unions may charge on loans to the rate being charged by the CLF would both recognize the uniqueness of Federal credit unions and also emphasize the important role which the National Credit Union Administration and the CLF can and should play in the activities of Federal credit unions. It appears far more desirable to index credit union loan interest rates to the CLF rate than to the Federal Reserve discount rate, since the latter was designed and intended to serve commercial banking systems and structures.

In addition, indexing as we propose would guarantee the ability of Federal credit unions to charge a uniform maximum interest rate nationwide, thus reinforcing the uniqueness of each element of our nation's financial institution structure.

THE "NATIONAL CREDIT UNION ADMINISTRATION BOARD DISCRETION" APPROACH

Another method of dealing with the undue hardship imposed upon Federal credit unions by the statutorily imposed 12 percent interest rate ceiling would be to vest in the National Credit Union Administration Board, the independent agency charged with the regulation of our nation's Federal credit unions, the authority to establish by regulation the maximum interest rate which Federal credit unions may charge on funds extended to their members in the form of consumer loans. Such a delegation of authority by the Congress to the National Credit Union Administration Board would permit the agency to respond to fluctuations in the economy in a manner best assured to preserve the safety and soundness of the institutions they regulate, while properly weighing the interest of the consumers they serve.

The committee may wish to examine certain parameters which may be placed upon the Board's discretionary authority. You may wish to delegate to the NCUA Board the discretionary authority to increase the loan interest rate, if conditions in the marketplace indicate an increase is called for, up to a stated statutory maximum (for example, 18 percent). Or the committee may wish to give the National Credit Union Administration Board a temporary grant of such authority on an experimental basis (for example, until year-end 1981). Of course, it would be quite simple to consolidate these two options, and grant the NCUA Board temporary authority to increase Federal credit union loan interest rates up to a maximum of 18 percent if, in the judgement of the Board, economic conditions indicate such relief is appropriate. Attached in Appendix IV is a proposed draft of statutory language which could accomplish the various proposals mentioned above.

CONCLUSION

Mr. Chairman and members of the committee, the 12 percent ceiling on interest rates currently threatens the continued viability of many member-owned Federal credit unions. The attached survey recently conducted by the National Association of Federal Credit Unions (NAFCU) clearly reveals how serious and immediate the problem presently confronting us is. Relief from that ceiling is needed now. I repeat, over 81.5 percent of the NAFCU member credit unions responding to the NAFCU survey state that they now need (or anticipate soon needing) relief from the 12 percent ceiling. Even more troubling to us all should be the fact that over 85.4 percent of NAFCU member respondents state that they have already curtailed loans to their members or cutback services, or that they plan to do so before year-end 1979. We cannot delay acting on this urgent matter any longer. Delays will only further threaten the viability of Federal credit unions and cause additional economic injury to millions of American consumers.

Senators Pryor and Bumpers have presented the committee with one laudable proposal intended to deal with this problem. I have set forth two other options. In reviewing the various options available to the committee, it is my strong conviction that the most feasible and equitable manner of averting potentially disastrous consequences for a number of Federal credit unions and their consumer-members would be to provide the needed relief from the present 12 percent interest rate ceiling by indexing the rate a Federal credit union may charge on loans to members to the rate charged by the National Credit Union Administration's Central Liquidity Facility.

I thank the committee for the opportunity to appear before you today to present the views of the National Association of Federal Credit Unions (NAFCU) on the issues encompassed by S. 1988. The staff of our association remains available to assist you as you consider this and any other issue affecting the well-being of our nation's financial institutions.

I will be pleased to answer any questions which the committee might have at this time.

APPENDIX I

Summary of responses to NAFCU's November 1979 survey of all Federal credit unions regarding the impact the statutorily imposed 12% loan interest rate ceiling was having upon their operations and member services.

NAFCU 12% CEILING SURVEY - 1979

DO YOU NOW NEED, OR ANTICIPATE SOON NEEDING, RELIEF FROM THE 12% CEILING?

	<u>Members</u>	(%)	<u>NonMembers</u>	(%)	<u>TOTAL</u>	(%)
YES	190	(81%)	246	(74%)	436	(77%)
NO	34	(15%)	63	(19%)	97	(17%)
NO RESPONSE	<u>9</u>	(04%)	<u>24</u>	(07%)	<u>33</u>	(06%)
Total Responses	233		333		566	

HAVE YOU AND/OR DO YOU ANTICIPATE CURTAILING LOANS OR CUTTING BACK SERVICES (WITHIN THE LAST MONTH AND/OR BEFORE THE END OF THE YEAR)?

	<u>Members</u>	(%)	<u>NonMembers</u>	(%)	<u>TOTAL</u>	(%)
YES	199	(85%)	251	(75%)	450	(79%)
NO	30	(13%)	76	(23%)	106	(19%)
NO RESPONSE	<u>4</u>	(02%)	<u>6</u>	(02%)	<u>10</u>	(02%)
Total Responses	233		333		566	

APPENDIX II



National Association of
Federal Credit Unions

P.O. Box 3769
Washington, D.C. 20007

703/522-4770

In response to mounting concerns expressed by numerous credit union leaders from throughout the country, including both members and non-members of the National Association of Federal Credit Unions (NAFCU), during the month of November 1979 NAFCU mailed a survey to all Federally chartered credit unions in order to determine precisely how the 12% statutory loan interest rate ceiling was affecting their operations and member services. The information appearing on this page was provided by a Federally chartered credit union located in:

ALABAMA

1. WHAT RATES IS YOUR CREDIT UNION OFFERING ON THE FOLLOWING LOANS?
UNSECURED _____ % AUTO _____ % SECURED _____ % HOME IMPROVEMENT _____ %
At the present time, we have discontinued all loans.
2. a) DO YOU NOW NEED, OR ANTICIPATE SOON NEEDING, RELIEF FROM THE 12% CEILING? WHY OR WHY NOT Dire need of relief because
of the high interest rate on borrowed money. We have applied
for a state charter.
- b) WHAT RATE ARE STATE CHARTERED CREDIT UNIONS IN YOUR STATE
AUTHORIZED TO CHARGE ON LOANS? small loans - 36%, large loans-18%
3. HAVE YOU CURTAILED ANY LOAN PROGRAM WITHIN THE LAST MONTH? IF SO,
WHAT All loans have been discontinued.
4. DO YOU ANTICIPATE CURTAILING LOANS OR CUTTING BACK SERVICES BEFORE
THE END OF THE YEAR? IF SO, IN WHAT AREAS? _____
5. WHICH OF THE FOLLOWING SERVICES DO YOU OFFER?
SHARE DRAFTS X CREDIT CARDS X OPEN-END CREDIT X when possible
6. WILL THE 5% LIQUIDITY RESERVE REQUIREMENT, EFFECTIVE 10/31/79, HAVE
AN IMPACT ON YOUR LENDING? IF SO, WHAT WILL THAT IMPACT BE
Failed to meet the deadline for reserve requirement, would have to
borrow a million dollars to meet the requirement.

ADDITIONAL COMMENTS:

NCUA is too slow. More and more credit unions will probably have to
liquidate because of the 12% ceiling.



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CALIFORNIA

1. WHAT RATES IS YOUR CREDIT UNION OFFERING ON THE FOLLOWING LOANS?
UNSECURED 12 % AUTOMOBILE ~~12~~ % SECURED MOR. % HOME IMPROVEMENT MOR. %
2. a) DO YOU NOW NEED, OR ANTICIPATE SOON NEEDING, RELIEF FROM THE
12% CEILING? WHY OR WHY NOT? We definitely need to have the 12%
ceiling raised in order to give us more flexibility in times of tight money.
- b) WHAT RATE ARE STATE CHARTERED CREDIT UNIONS IN YOUR STATE
AUTHORIZED TO CHARGE ON LOANS? 15%
3. HAVE YOU CURTAILED ANY LOAN PROGRAM WITHIN THE LAST MONTH? IF SO,
WHAT? We have curtailed all loan activity for the past 5 months except share loans;
loan drafts and have reduced our personal loans to a max. of \$2500.
4. DO YOU ANTICIPATE CURTAILING LOANS OR CUTTING BACK SERVICES BEFORE
THE END OF THE YEAR? IF SO, IN WHAT AREAS? We have already checked with
our attorney on curtailing our open end loans if the need arises.
5. WHICH OF THE FOLLOWING SERVICES DO YOU OFFER?
SHARE DRAFTS x CREDIT CARDS OPEN-END CREDIT x
6. WILL THE 5% LIQUIDITY RESERVE REQUIREMENT, EFFECTIVE 10/31/79, HAVE
AN IMPACT ON YOUR LENDING? IF SO, WHAT WILL THAT IMPACT BE
What lending? We have already asked for an extension as we are presently in
a borrowed position that we have been working on to retire, then to be hit with
a 5% liquidity.

ADDITIONAL COMMENTS:

I believe that the administration is working against credit unions not for them.



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CALIFORNIA

1. WHAT RATES IS YOUR CREDIT UNION OFFERING ON THE FOLLOWING LOANS?
UNSECURED 12 % AUTO 12 % SECURED 12 % HOME IMPROVEMENT 12 %
2. a) DO YOU NOW NEED, OR ANTICIPATE SOON NEEDING, RELIEF FROM THE
12% CEILING? WHY OR WHY NOT Yes. All loans discontinued. Scaled down
since 12/1/78.
- b) WHAT RATE ARE STATE CHARTERED CREDIT UNIONS IN YOUR STATE
AUTHORIZED TO CHARGE ON LOANS? 15%
3. HAVE YOU CURTAILED ANY LOAN PROGRAM WITHIN THE LAST MONTH? IF SO,
WHAT See 2(a).
4. DO YOU ANTICIPATE CURTAILING LOANS OR CUTTING BACK SERVICES BEFORE
THE END OF THE YEAR? IF SO, IN WHAT AREAS? _____
5. WHICH OF THE FOLLOWING SERVICES DO YOU OFFER?
SHARE DRAFTS X CREDIT CARDS X OPEN-END CREDIT X
6. WILL THE 5% LIQUIDITY RESERVE REQUIREMENT, EFFECTIVE 10/31/79, HAVE
AN IMPACT ON YOUR LENDING? IF SO, WHAT WILL THAT IMPACT BE _____
Yes. Make conditions worse (if possible) if share withdrawals are heavy in January, 1980.

ADDITIONAL COMMENTS:

Board of Directors has appointed a committee to investigate a California charter and this
is an old time FCU stronghold.

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CALIFORNIA

1. WHAT RATES IS YOUR CREDIT UNION OFFERING ON THE FOLLOWING LOANS?
UNSECURED 12 % AUTO 12 % SECURED 12 % HOME IMPROVEMENT %
2. a) DO YOU NOW NEED, OR ANTICIPATE SOON NEEDING, RELIEF FROM THE
12% CEILING? WHY OR WHY NOT ABSOLUTELY NEED RELIEF
IN ORDER TO BORROW FUNDS FROM WESCORP AS NEEDED. WE FEEL
WE SHOULD BE ABLE TO CHARGE 15% ON UNSECURED LOANS & 12% SECURED
b) WHAT RATE ARE STATE CHARTERED CREDIT UNIONS IN YOUR STATE
AUTHORIZED TO CHARGE ON LOANS? 15%
3. HAVE YOU CURTAILED ANY LOAN PROGRAM WITHIN THE LAST MONTH? IF SO,
WHAT WE STOPPED MAKING ALL LOANS (EXCEPT SHARE LOANS) ON OCTOBER 19,
WHEN WESCORP STOPPED MAKING LOANS TO MEMBER CREDIT UNIONS
4. DO YOU ANTICIPATE CURTAILING LOANS OR CUTTING BACK SERVICES BEFORE
THE END OF THE YEAR? IF SO, IN WHAT AREAS? WE WILL NOT MAKE ANY
AUTO LOANS THE REST OF YEAR. WE HOPE TO MAKE SMALL XMAS CONSUMER
LOANS AFTER DECEMBER 11th, 1979.
5. WHICH OF THE FOLLOWING SERVICES DO YOU OFFER?
SHARE DRAFTS CREDIT CARDS OPEN-END CREDIT X
6. WILL THE 5% LIQUIDITY RESERVE REQUIREMENT, EFFECTIVE 10/31/79, HAVE
AN IMPACT ON YOUR LENDING? IF SO, WHAT WILL THAT IMPACT BE
We are under 2 million, so does not affect us

ADDITIONAL COMMENTS:

We feel Federal Credit Unions must allow the 15% limit, just as the
State Chartered credit unions do. This would allow a better dividend
for savers plus insure the availability of funds for borrowers. Our
Board is considering changing our Charter from Federal to State at present

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DISTRICT OF COLUMBIA

1. WHAT RATES IS YOUR CREDIT UNION OFFERING ON THE FOLLOWING LOANS?
UNSECURED 12 % AUTO - % SECURED 12 % ^{Share Secured} ~~HOME/IMPROVEMENT~~ 9 %
2. a) DO YOU NOW NEED, OR ANTICIPATE SOON NEEDING, RELIEF FROM THE 12% CEILING? WHY OR WHY NOT? If current high interest rates prevail for an extended period, we will need a higher ceiling to be able to compete for share dollars in the money market place.
b) WHAT RATE ARE STATE CHARTERED CREDIT UNIONS IN YOUR STATE AUTHORIZED TO CHARGE ON LOANS? not applicable
3. HAVE YOU CURTAILED ANY LOAN PROGRAM WITHIN THE LAST MONTH? IF SO, WHAT? Yes. Credit Union is making only share secured loans in the amount of share deposits and signature, comaker and line-of-credit loans in the maximum amount of \$1000.00, less other outstanding unsecured obligations.
4. DO YOU ANTICIPATE CURTAILING LOANS OR CUTTING BACK SERVICES BEFORE THE END OF THE YEAR? IF SO, IN WHAT AREAS? It may be necessary to curtail outstanding lines-of-credit; limiting new advances to \$1000.00 just as new applications are now limited.
5. WHICH OF THE FOLLOWING SERVICES DO YOU OFFER?
SHARE DRAFTS X CREDIT CARDS OPEN-END CREDIT X
6. WILL THE 5% LIQUIDITY RESERVE REQUIREMENT, EFFECTIVE 10/31/79, HAVE AN IMPACT ON YOUR LENDING? IF SO, WHAT WILL THAT IMPACT BE? We have advised NCUA that we will not be able to meet the liquidity reserve requirement.

ADDITIONAL COMMENTS:

NOV 26 1979



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FLORIDA

1. WHAT RATES IS YOUR CREDIT UNION OFFERING ON THE FOLLOWING LOANS?
UNSECURED 12 % AUTO ~~discontinued~~ SECURED ~~shares~~ 12 % HOME IMPROVEMENT ~~discontinued~~
2. a) DO YOU NOW NEED, OR ANTICIPATE SOON NEEDING, RELIEF FROM THE 12% CEILING? WHY OR WHY NOT IMMEDIATELY! We have had to curtail all loans;discontinue advances on open end loans.Discontinue new open end loans.
Maximum of \$1,000 for loans that are necessary--the emergency, and high-priority
b) ~~credits~~ WHAT RATE ARE STATE CHARTERED CREDIT UNIONS IN YOUR STATE AUTHORIZED TO CHARGE ON LOANS? 18%
3. HAVE YOU CURTAILED ANY LOAN PROGRAM WITHIN THE LAST MONTH? IF SO, WHAT Home improvement loans were discontinued last year, in July this year we had to discontinue auto, boat,etc.loans and cut back sig loans from 2500 to 1500. Last month we cut back sig loans to \$1000 dollars for emergency only.
4. DO YOU ANTICIPATE CURTAILING LOANS OR CUTTING BACK SERVICES BEFORE THE END OF THE YEAR? IF SO, IN WHAT AREAS? It is very possible that we will need to discontinue lending and invest in high rate Treasury Notes.
5. WHICH OF THE FOLLOWING SERVICES DO YOU OFFER?
SHARE DRAFTS xx CREDIT CARDS OPEN-END CREDIT has been discontinued
6. WILL THE 5% LIQUIDITY RESERVE REQUIREMENT, EFFECTIVE 10/31/79, HAVE AN IMPACT ON YOUR LENDING? IF SO, WHAT WILL THAT IMPACT BE We agree with the reserve requirement and meet it now with the above restrictions and limitations on loans...

ADDITIONAL COMMENTS:

IN THE EVENT WE HAVE TO WIND DOWN OUR SHARE DRAFT PROGRAM WE WILL NOT BE ABLE TO MEET THE RESERVE REQUIREMENT, OR HAVE FUNDS TO MEET OUR MEMBERS WITHDRAWAL REQUIREMENTS IN JANUARY, 1980.

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FLORIDA

1. WHAT RATES IS YOUR CREDIT UNION OFFERING ON THE FOLLOWING LOANS?
UNSECURED 12 % AUTO 12 % SECURED 12 % HOME IMPROVEMENT %
2. a) DO YOU NOW NEED, OR ANTICIPATE SOON NEEDING, RELIEF FROM THE 12% CEILING? WHY OR WHY NOT
Obviously yes if the prime rate and treasury bill rate maintain their current levels. Cost of funds should not exceed earnings for an extended period.
b) WHAT RATE ARE STATE CHARTERED CREDIT UNIONS IN YOUR STATE AUTHORIZED TO CHARGE ON LOANS? 18%
3. HAVE YOU CURTAILED ANY LOAN PROGRAM WITHIN THE LAST MONTH? IF SO, WHAT Yes. Auto loan per-cent paid down increased to 30%
Max. auto loan decreased to 7,000.
Further curtailments are being considered.
4. DO YOU ANTICIPATE CURTAILING LOANS OR CUTTING BACK SERVICES BEFORE THE END OF THE YEAR? IF SO, IN WHAT AREAS?
Yes. Most likely in the auto loans and the percent paid back prior to refinancing of unsecured and comaker loans.
5. WHICH OF THE FOLLOWING SERVICES DO YOU OFFER?
SHARE DRAFTS x CREDIT CARDS OPEN-END CREDIT x
6. WILL THE 5% LIQUIDITY RESERVE REQUIREMENT, EFFECTIVE 10/31/79, HAVE AN IMPACT ON YOUR LENDING? IF SO, WHAT WILL THAT IMPACT BE
The reserve will be met by reducing the funds available for loans.

ADDITIONAL COMMENTS:

If no action is taken in the very near future by Congress,
a change to state charter will be seriously considered.



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INDIANA

1. WHAT RATES IS YOUR CREDIT UNION OFFERING ON THE FOLLOWING LOANS?
UNSECURED 12 % AUTO 12 % SECURED 12 % HOME IMPROVEMENT 12 %
 2. a) DO YOU NOW NEED, OR ANTICIPATE SOON NEEDING, RELIEF FROM THE 12% CEILING? WHY OR WHY NOT Yes. We are not able to attract the shares needed to meet loan demand. With the ceiling at 12% we cannot afford MMC or bank loans in large enough blocks to fill this gap.
b) WHAT RATE ARE STATE CHARTERED CREDIT UNIONS IN YOUR STATE AUTHORIZED TO CHARGE ON LOANS? _____
 3. HAVE YOU CURTAILED ANY LOAN PROGRAM WITHIN THE LAST MONTH? IF SO, WHAT No mobile home loans, recreational vehicle or business loans. Restricted auto loans to one new loan per family and a maximum of \$9,000. Restricted total amount loaned to one family to \$10,000, excluding auto loans.
 4. DO YOU ANTICIPATE CURTAILING LOANS OR CUTTING BACK SERVICES BEFORE THE END OF THE YEAR? IF SO, IN WHAT AREAS? Consolidation loans, vacation loans, non essential loans and holding signature loans to \$2500.
 5. WHICH OF THE FOLLOWING SERVICES DO YOU OFFER?
SHARE DRAFTS Yes CREDIT CARDS Yes OPEN-END CREDIT Yes
 6. WILL THE 5% LIQUIDITY RESERVE REQUIREMENT, EFFECTIVE 10/31/79, HAVE AN IMPACT ON YOUR LENDING? IF SO, WHAT WILL THAT IMPACT BE Yes. See #2 above plus the fact that a 12% loan rate makes our loans even more attractive. We will have to cut back on loans to meet this 5% requirement.
- ADDITIONAL COMMENTS:
- If we are to restrict loans to the level of share deposits, we must be able to compete for these deposits in the market. As rates go above 7% money leaves and we are faced with shrinking assets. Most credit unions have the majority of their deposits in the hands of a minority. How can

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KANSAS

1. WHAT RATES IS YOUR CREDIT UNION OFFERING ON THE FOLLOWING LOANS?
UNSECURED 12 % AUTO 12 % SECURED 12 % HOME IMPROVEMENT 12 %
2. a) DO YOU NOW NEED, OR ANTICIPATE SOON NEEDING, RELIEF FROM THE 12% CEILING? WHY OR WHY NOT yes, because money is not available at rates we can pay and only charge 12% for our loans. The return is not enough to be competitive.
b) WHAT RATE ARE STATE CHARTERED CREDIT UNIONS IN YOUR STATE AUTHORIZED TO CHARGE ON LOANS? 18% for up to 1,000.00 and 14.5 over 1,000.0
3. HAVE YOU CURTAILED ANY LOAN PROGRAM WITHIN THE LAST MONTH? IF SO, WHAT yes, all loans have been curtailed do to lack of funds
4. DO YOU ANTICIPATE CURTAILING LOANS OR CUTTING BACK SERVICES BEFORE THE END OF THE YEAR? IF SO, IN WHAT AREAS? yes, all areas
5. WHICH OF THE FOLLOWING SERVICES DO YOU OFFER?
SHARE DRAFTS CREDIT CARDS OPEN-END CREDIT
6. WILL THE 5% LIQUIDITY RESERVE REQUIREMENT, EFFECTIVE 10/31/79, HAVE AN IMPACT ON YOUR LENDING? IF SO, WHAT WILL THAT IMPACT BE we have kept our own reserve but now do to regulation this will limit our resources even more

ADDITIONAL COMMENTS:

Common sense tells a person that you can not run a business lending

money at 12% and pay loan insurance and run in the red and pay interest to be competitive with other money markets in the area.

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MARYLAND

1. WHAT RATES IS YOUR CREDIT UNION OFFERING ON THE FOLLOWING LOANS?
UNSECURED 12 % AUTO 12 % SECURED 10 % HOME IMPROVEMENT 12 %
Share
2. a) DO YOU NOW NEED, OR ANTICIPATE SOON NEEDING, RELIEF FROM THE
12% CEILING? WHY OR WHY NOT Yes - Because of the escalating cost
of funds in today's market and the necessity of paying money market
rates on certificates just to retain funds.
b) WHAT RATE ARE STATE CHARTERED CREDIT UNIONS IN YOUR STATE
AUTHORIZED TO CHARGE ON LOANS? 12%
3. HAVE YOU CURTAILED ANY LOAN PROGRAM WITHIN THE LAST MONTH? IF SO,
WHAT Effective 26 Oct. '79 suspended all LOC associated with Prime Account
and Share Draft accounts. Reduced signature loan limit to \$2500 per account.
Reduced max auto loan to 75% or \$5,000 whichever is lower. Set a maximum loan
limit of \$10,000 per account exclusive of share loans.
4. DO YOU ANTICIPATE CURTAILING LOANS OR CUTTING BACK SERVICES BEFORE
THE END OF THE YEAR? IF SO, IN WHAT AREAS? If necessary will (1)
limit future loan disbursements to a maximum dollar amount per day (2) suspend
another class of loans.
5. WHICH OF THE FOLLOWING SERVICES DO YOU OFFER?
SHARE DRAFTS xxxx CREDIT CARDS OPEN-END CREDIT Suspended 10/26/79
6. WILL THE 5% LIQUIDITY RESERVE REQUIREMENT, EFFECTIVE 10/31/79, HAVE
AN IMPACT ON YOUR LENDING? IF SO, WHAT WILL THAT IMPACT BE _____
Yes - Our recent actions to limit loan activity was a direct result of the
Reserve requirements.

ADDITIONAL COMMENTS:

During 1978 the following classes of loans were suspended and remain suspended:
Short term, 1st and 2nd Trust Loans; recreational vehicle loans, boat loans.

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MINNESOTA

1. WHAT RATES IS YOUR CREDIT UNION OFFERING ON THE FOLLOWING LOANS?
UNSECURED 12 % AUTO 12 % SECURED 12 % HOME IMPROVEMENT 12 %
2. a) DO YOU NOW NEED, OR ANTICIPATE SOON NEEDING, RELIEF FROM THE 12% CEILING? WHY OR WHY NOT? Will need. The cost of attracting fund, either in the market, or in the forms of deposits is going to erode our spread. We have all ready eliminated our 10% Interest Refund in essence, raising our loan rates.
b) WHAT RATE ARE STATE CHARTERED CREDIT UNIONS IN YOUR STATE AUTHORIZED TO CHARGE ON LOANS? 12%
3. HAVE YOU CURTAILED ANY LOAN PROGRAM WITHIN THE LAST MONTH? IF SO, WHAT? Reduced maximum loan down to 7500.00, and lowering the maximum debt payments/net income percentage down from 50% to 40%, eliminating the higher risk loans. (not really serving the member who probably need help the most)
4. DO YOU ANTICIPATE CURTAILING LOANS OR CUTTING BACK SERVICES BEFORE THE END OF THE YEAR? IF SO, IN WHAT AREAS? Not any further than we already have, but I must qualify this by stating we will have to react to changing conditions, which are very chaotic.
5. WHICH OF THE FOLLOWING SERVICES DO YOU OFFER?
SHARE DRAFTS _____ CREDIT CARDS _____ OPEN-END CREDIT X NOV 19 1979
6. WILL THE 5% LIQUIDITY RESERVE REQUIREMENT, EFFECTIVE 10/31/79, HAVE AN IMPACT ON YOUR LENDING? IF SO, WHAT WILL THAT IMPACT BE? We will do only what we must. We intend on riding out the extension provision since nobody was given the opportunity of planning and budgeting for this regulation, we do not feel enforcement will be very stringent. If NCUA wishes us to cut services, they might as well lock the door up.
ADDITIONAL COMMENTS:
The NCUA has done much to hinder, restrict, and complicate the normal activity of our business. We will always have the normal business cycles to deal with. The present conditions are extremely difficult and challenging. It is about time the NCUA did something to help our industry cope. P S Thanks for asking.

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MINNESOTA

1. WHAT RATES IS YOUR CREDIT UNION OFFERING ON THE FOLLOWING LOANS?
UNSECURED 12 % AUTO 12 % SECURED 12 % HOME IMPROVEMENT 12 %
2. a) DO YOU NOW NEED, OR ANTICIPATE SOON NEEDING, RELIEF FROM THE 12% CEILING? WHY OR WHY NOT _____
We needed it 6 months ago. _____
- b) WHAT RATE ARE STATE CHARTERED CREDIT UNIONS IN YOUR STATE AUTHORIZED TO CHARGE ON LOANS? 12%
3. HAVE YOU CURTAILED ANY LOAN PROGRAM WITHIN THE LAST MONTH? IF SO, WHAT We have reduced all LOC loans to \$1,500.00. All loans have been cut off except for new and used cars, stock secured \$1,500.00 - share secured to limit of shares. For practical purposes, we are all but shut down on loans.
4. DO YOU ANTICIPATE CURTAILING LOANS OR CUTTING BACK SERVICES BEFORE THE END OF THE YEAR? IF SO, IN WHAT AREAS? _____
We probably will cut all loans off.
5. WHICH OF THE FOLLOWING SERVICES DO YOU OFFER?
SHARE DRAFTS X CREDIT CARDS _____ OPEN-END CREDIT X
6. WILL THE 5% LIQUIDITY RESERVE REQUIREMENT, EFFECTIVE 10/31/79, HAVE AN IMPACT ON YOUR LENDING? IF SO, WHAT WILL THAT IMPACT BE _____
It is going to probably be what will cause the final close off of loans.

ADDITIONAL COMMENTS:

We forsee the 12% limit and 5% liquidity requirement causing lay offs.

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P.O. Box 3769
Washington, D.C. 20007 703/522-4770

In response to mounting concerns expressed by numerous credit union leaders from throughout the country, including both members and non-members of the National Association of Federal Credit Unions (NAFCU), during the month of November 1979 NAFCU mailed a survey to all Federally chartered credit unions in order to determine precisely how the 12% statutory loan interest rate ceiling was affecting their operations and member services. The information appearing on this page was provided by a Federally chartered credit union located in:

MONTANA

1. WHAT RATES IS YOUR CREDIT UNION OFFERING ON THE FOLLOWING LOANS?
UNSECURED 12 % AUTO 12 % SECURED 12 % HOME IMPROVEMENT 12 %
2. a) DO YOU NOW NEED, OR ANTICIPATE SOON NEEDING, RELIEF FROM THE
12% CEILING? WHY OR WHY NOT IT COULD HAPPEN. IT SEEMS THAT ALL CREDIT
UNIONS ARE IN A SQUEEZE TO OBTAIN FUNDS.....HOWEVER MARKETS EXCEEDING 12% MAKES IT IMPOSS
IBLE TO SERVE MEMBERS AS WELL AS IN THE PAST
b) WHAT RATE ARE STATE CHARTERED CREDIT UNIONS IN YOUR STATE
AUTHORIZED TO CHARGE ON LOANS? 15%
3. HAVE YOU CURTAILED ANY LOAN PROGRAM WITHIN THE LAST MONTH? IF SO,
WHAT Yes - limited amount, and will not accept new member application for loan..
4. DO YOU ANTICIPATE CURTAILING LOANS OR CUTTING BACK SERVICES BEFORE
THE END OF THE YEAR? IF SO, IN WHAT AREAS?
Cloudy at this time - depends on the cost of money, if we should need to borrow
funds.. Our Tress State Central CU now charging 14.5%.....
5. WHICH OF THE FOLLOWING SERVICES DO YOU OFFER?
SHARE DRAFTS xx CREDIT CARDS xx OPEN-END CREDIT xx
6. WILL THE 5% LIQUIDITY RESERVE REQUIREMENT, EFFECTIVE 10/31/79, HAVE
AN IMPACT ON YOUR LENDING? IF SO, WHAT WILL THAT IMPACT BE xx
IT COULD FORCE US TO HAVE TO BORROW FUNDS TO BE IN COMPLIANCE.

ADDITIONAL COMMENTS:

HELP!!!!!!

NOV 19 1979



National Association of
Federal Credit Unions

P.O. Box 3769
Washington, D.C. 20007 703/522-4770

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NEBRASKA

1. WHAT RATES IS YOUR CREDIT UNION OFFERING ON THE FOLLOWING LOANS? 12%
We are making small emergency loans only:
UNSECURED _____ % AUTO _____ % SECURED _____ % HOME IMPROVEMENT _____ %
2. a) DO YOU NOW NEED, OR ANTICIPATE SOON NEEDING, RELIEF FROM THE 12% CEILING? WHY OR WHY NOT? YES! We are struggling to pay back \$350,000 of borrowed money at 12%. We have over \$350,000 in Federally insured student loans which we had anticipated selling to the Nebraska Higher Education Loan Program to reduce notes payable. However, the purchase of these loans, dependent on the sale of 7 1/2% tax free bonds, has been postponed until the bond market improves. This borrowed money, and \$500,000 in A's and B's money market certificates has raised the average cost of our money to be before any of the costs for b) WHAT RATE ARE STATE CHARTERED CREDIT UNIONS IN YOUR STATE (see # 3) AUTHORIZED TO CHARGE ON LOANS? 14%
→ Conversion to a State Chartered Credit Union has been considered.
3. HAVE YOU CURTAILED ANY LOAN PROGRAM WITHIN THE LAST MONTH? IF SO, YES! WHAT services or operations expense are added. Due to the lower loan rates in the past, our rate of earnings on loans averages 11% before any costs of servicing or losses are calculated. This is not enough margin because we had to dip into undivided earnings to pay the 6% dividend this quarter. At the present rates, we will have to reduce our dividend by the first quarter next year. In order to pay back our borrowed money, we are making nothing but small (\$100 or \$200) emergency loans and share backed loans.
4. DO YOU ANTICIPATE CURTAILING LOANS OR CUTTING BACK SERVICES BEFORE THE END OF THE YEAR? IF SO, IN WHAT AREAS? Since we have curtailed lending completely, all we can cut are services and expenses. We do not offer money market certificates when the rate is over 12%. Since salary and insurance are our biggest expenses, staff hours have been cut and there and loan protection from CUNA Mutual which we have always carried as a service to our members are under review.
5. WHICH OF THE FOLLOWING SERVICES DO YOU OFFER? NONE
SHARE DRAFTS _____ CREDIT CARDS _____ OPEN-END CREDIT _____
6. WILL THE 5% LIQUIDITY RESERVE REQUIREMENT, EFFECTIVE 10/31/79, HAVE AN IMPACT ON YOUR LENDING? IF SO, WHAT WILL THAT IMPACT BE _____
NONE. Because of our size, we do not have to meet this requirement.

ADDITIONAL COMMENTS: Our biggest fear is disintermediation. We are already feeling the effect since we stopped offering Money Market Certificates when the rate went above 12%. If our dividend rate drops to 6% or below, more and more of our regular share accounts will be invested at higher rates elsewhere. Also, it is frustrating to see our members come to finance companies to borrow at 19 to 33% or even to the banks which are charging 15% on new car loans. We can't even make Federally insured loans anymore and if we continue to cut services, in other areas we will become nothing more than a private investment club for a few of our members.
10/79 This is definitely not the purpose of a Credit Union the way we see it.



National Association of
Federal Credit Unions

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NEVADA

1. WHAT RATES IS YOUR CREDIT UNION OFFERING ON THE FOLLOWING LOANS?
UNSECURED 12 % AUTO 12 % SECURED 6.8 % HOME IMPROVEMENT 12 %
2. a) DO YOU NOW NEED, OR ANTICIPATE SOON NEEDING, RELIEF FROM THE 12% CEILING? WHY OR WHY NOT e.s. -
Money running out due to extreme demand & competition with interest rates on savings. Also high rates on all our lines of credit.
b) WHAT RATE ARE STATE CHARTERED CREDIT UNIONS IN YOUR STATE AUTHORIZED TO CHARGE ON LOANS? 15.75
3. HAVE YOU CURTAILED ANY LOAN PROGRAM WITHIN THE LAST MONTH? IF SO, WHAT yes. Aggregate loan limit per account is \$5000--we stopped EV loans & New car loans / require 1 yr. membership for loans.
4. DO YOU ANTICIPATE CURTAILING LOANS OR CUTTING BACK SERVICES BEFORE THE END OF THE YEAR? IF SO, IN WHAT AREAS?
Depends on money situation, but might have to stop used car loans & / or personal loans.
5. WHICH OF THE FOLLOWING SERVICES DO YOU OFFER?
SHARE DRAFTS _____ CREDIT CARDS _____ OPEN-END CREDIT x
6. WILL THE 5% LIQUIDITY RESERVE REQUIREMENT, EFFECTIVE 10/31/79, HAVE AN IMPACT ON YOUR LENDING? IF SO, WHAT WILL THAT IMPACT BE
Yes probably. Less loans out to members .

ADDITIONAL COMMENTS:

Board is seriously considering switching to State Charter due to better rates for loans & more liberal policies.



National Association of
Federal Credit Unions

P.O. Box 3769
Washington, D.C. 20007

703/522-4770

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NEW JERSEY

1. WHAT RATES IS YOUR CREDIT UNION OFFERING ON THE FOLLOWING LOANS?
UNSECURED 12 % AUTO 12 % SECURED 12 % HOME IMPROVEMENT 12 %
2. a) DO YOU NOW NEED, OR ANTICIPATE SOON NEEDING, RELIEF FROM THE
12% CEILING? WHY OR WHY NOT Yes! To offer 7% % Share Certifi-
cates to be competitive with S & L Associations. We lose
shares because of imposed limitations.
b) WHAT RATE ARE STATE CHARTERED CREDIT UNIONS IN YOUR STATE
AUTHORIZED TO CHARGE ON LOANS? Unknown
3. HAVE YOU CURTAILED ANY LOAN PROGRAM WITHIN THE LAST MONTH? IF SO,
WHAT We have placed a temporary moratorium on all loans until our
share to loan ratio comes in around 95 % .
4. DO YOU ANTICIPATE CURTAILING LOANS OR CUTTING BACK SERVICES BEFORE
THE END OF THE YEAR? IF SO, IN WHAT AREAS? All loans have been
curtailed for the past two months
5. WHICH OF THE FOLLOWING SERVICES DO YOU OFFER?
SHARE DRAFTS NA CREDIT CARDS NA OPEN-END CREDIT NA
6. WILL THE 5% LIQUIDITY RESERVE REQUIREMENT, EFFECTIVE 10/31/79, HAVE
AN IMPACT ON YOUR LENDING? IF SO, WHAT WILL THAT IMPACT BE With
a curtailment of loans coupled with heavy withdrawals of shares,
our liquidity stands around 7%. Loans would affect our liquidity,
but I don't know to what extent.

ADDITIONAL COMMENTS:

If we are to remain a viable organization, we should be placed on a
par with other institutions as for interest charged on loans, enabling
us to compete with commercial institutions with higher interest on
shares.



National Association of
Federal Credit Unions

P.O. Box 3769
Washington, D.C. 20007 703/522-4770

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PENNSYLVANIA

1. WHAT RATES IS YOUR CREDIT UNION OFFERING ON THE FOLLOWING LOANS?
UNSECURED 12 % AUTO 12 % SECURED 12 % HOME IMPROVEMENT 12 %
2. a) DO YOU NOW NEED, OR ANTICIPATE SOON NEEDING, RELIEF FROM THE
12% CEILING? WHY OR WHY NOT Yes. We have been forced into Money
Market Certificates, to hold our deposits. It is costing us more for money
than we can make on the loans.
b) WHAT RATE ARE STATE CHARTERED CREDIT UNIONS IN YOUR STATE
AUTHORIZED TO CHARGE ON LOANS? 12%
3. HAVE YOU CURTAILED ANY LOAN PROGRAM WITHIN THE LAST MONTH? IF SO,
WHAT We have stopped all Mortgages, long term home improvement loans. Also
we have lowered all loans limits to \$5,000.00
4. DO YOU ANTICIPATE CURTAILING LOANS OR CUTTING BACK SERVICES BEFORE
THE END OF THE YEAR? IF SO, IN WHAT AREAS? Board is meeting every
two weeks to review loan policies.
5. WHICH OF THE FOLLOWING SERVICES DO YOU OFFER?
SHARE DRAFTS CREDIT CARDS OPEN-END CREDIT
6. WILL THE 5% LIQUIDITY RESERVE REQUIREMENT, EFFECTIVE 10/31/79, HAVE
AN IMPACT ON YOUR LENDING? IF SO, WHAT WILL THAT IMPACT BE
We will have to keep \$640,000.00 in reserves at all times.

ADDITIONAL COMMENTS:

We would appreciate any relief that we can get from the 12% loan ceiling.

10/79



National Association of
Federal Credit Unions

P.O. Box 3769
Washington, D.C. 20007 703/522-4770

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SOUTH CAROLINA

1. WHAT RATES IS YOUR CREDIT UNION OFFERING ON THE FOLLOWING LOANS?
UNSECURED 12% % AUTO 12 % SECURED 12 % HOME IMPROVEMENT --- %
except shares
2. a) DO YOU NOW NEED, OR ANTICIPATE SOON NEEDING, RELIEF FROM THE
12% CEILING? WHY OR WHY NOT yes - we have been forced to offer
money market certificates - but have held our rate at 11% - we are still
losing too much money to outside institutions because we cannot pay the
current MM rate of 12.1% with an effective yield on our loans of 11.3%
b) WHAT RATE ARE STATE CHARTERED CREDIT UNIONS IN YOUR STATE
AUTHORIZED TO CHARGE ON LOANS? 12% so far as I know
3. HAVE YOU CURTAILED ANY LOAN PROGRAM WITHIN THE LAST MONTH? IF SO,
WHAT yes - new, used cars and signature loans
4. DO YOU ANTICIPATE CURTAILING LOANS OR CUTTING BACK SERVICES BEFORE
THE END OF THE YEAR? IF SO, IN WHAT AREAS?
we may have to require advance notice for withdrawals and/or curtail loans
more
5. WHICH OF THE FOLLOWING SERVICES DO YOU OFFER?
SHARE DRAFTS --- CREDIT CARDS --- OPEN-END CREDIT X
6. WILL THE 5% LIQUIDITY RESERVE REQUIREMENT, EFFECTIVE 10/31/79, HAVE
AN IMPACT ON YOUR LENDING? IF SO, WHAT WILL THAT IMPACT BE ---
Yes - we are unable to meet it as of 10-31-79 and depending on our situation
as we get closer to 12-31-79 we may have to drastically cut loans

ADDITIONAL COMMENTS:



National Association of
Federal Credit Unions

P.O. Box 3769
Washington, D.C. 20007

703/522-4770

In response to mounting concerns expressed by numerous credit union leaders from throughout the country, including both members and non-members of the National Association of Federal Credit Unions (NAFCU), during the month of November 1979 NAFCU mailed a survey to all Federally chartered credit unions in order to determine precisely how the 12% statutory loan interest rate ceiling was affecting their operations and member services. The information appearing on this page was provided by a Federally chartered credit union located in:

TENNESSEE

1. WHAT RATES IS YOUR CREDIT UNION OFFERING ON THE FOLLOWING LOANS?
UNSECURED 12 % AUTO 12 % SECURED Share 10.5 (11/1/79) 9 % HOME IMPROVEMENT 12 %
2. a) DO YOU NOW NEED, OR ANTICIPATE SOON NEEDING, RELIEF FROM THE 12% CEILING? WHY OR WHY NOT A very critical need for some relief.
Share certificates up to 12.6%, Bank loans 15%. Some members want to borrow from us at current rates and save with other financial institutions.
b) WHAT RATE ARE STATE CHARTERED CREDIT UNIONS IN YOUR STATE AUTHORIZED TO CHARGE ON LOANS? 17% APR
3. HAVE YOU CURTAILED ANY LOAN PROGRAM WITHIN THE LAST MONTH? IF SO, WHAT All loans have been limited to a maximum of \$2,500 with the exception of these loans using share accounts as collateral. This has virtually eliminated all real estate, automobile, and most other secured-type loans.
4. DO YOU ANTICIPATE CURTAILING LOANS OR CUTTING BACK SERVICES BEFORE THE END OF THE YEAR? IF SO, IN WHAT AREAS? We hope to hold to the above on loan policies. All services are being evaluated at this time.
5. WHICH OF THE FOLLOWING SERVICES DO YOU OFFER?
SHARE DRAFTS yes CREDIT CARDS no OPEN-END CREDIT yes - \$2,500.00
6. WILL THE 5% LIQUIDITY RESERVE REQUIREMENT, EFFECTIVE 10/31/79, HAVE AN IMPACT ON YOUR LENDING? IF SO, WHAT WILL THAT IMPACT BE We will be forced to borrow to meet this requirement - currently 15% and to make repayments of borrowed money will require a reduction in funds available for loans or other purposes.
ADDITIONAL COMMENTS:
A higher loan interest rate would at least discourage some borrowers.

APPENDIX III



32 CHICAGO AVENUE, GROTON, CONNECTICUT 06340

October 25, 1979

Mr. Robert Dugger
 Director of Policy Analysis
 National Credit Union Administration
 2025 M Street N.W.
 Washington, D.C. 20456

Dear Mr. Dugger:

Please convey the feelings expressed in this letter to the N.C.U.A. Board as soon as possible.

I believe we are not in the minority when I state that we need relief from the 12% interest rate ceiling as soon as possible. The Board of Directors of this credit union is seriously considering converting to a state chartered credit union.

We are presently in the fourth week of a strike and have seen a considerable amount of savings from small savers leave the credit union. We also watch as large savers withdraw money to invest in Money Market Funds with local brokerage firms. We have over 25% of our shares in Money Market Certificates costing us over 10%. We have liquidated almost all of our investments and do not meet the 5% liquidity reserve requirements.

We have undivided earnings that will allow us to operate on a negative spread for a limited period of time. We have also adopted new loan policies reducing the maturity on loans and increasing down payments on collateral loans. We are prepared to tighten loan policies again; but what happens after that?

If we continue to operate on a negative spread we will have to lower our dividend rate, which will cause us to lose more shares. If we stop offering Money Market Certificates the money will leave the credit union. The only alternative would be to stop granting loans, which would reduce our income and have an effect on our ability to pay a dividend and provide the services we now offer.

I realize that some congressmen are opposed to raising the ceiling for what appears to me to be ridiculous reasons.

I suggest that the N.C.U.A. seek authority similar to 12 U.S.C. 85., (the law that permits federally chartered banks to charge 1% above the Fed's discount rate), to allow Federal Credit Unions to charge 1% above the C.L.F. lending rate. All credit unions need more than a 1% spread to break even, therefore it would not encourage a Federal Credit Union to expand their loan portfolio.

As this letter is being written we are forced to pay 12.651% on Money Market Certificates in order to prevent the money from leaving the credit union. We urgently need relief from the 12% ceiling.

Sincerely,

John F. Kinney
 General Manager

JFK:prl



OCT 22 1979

**SYRACUSE
UNIVERSITY
FEDERAL
CREDIT
UNION**

1117 East Genesee Street - Syracuse, New York 13210 - 423-2603

October 18, 1979

Hon. Frank Annunzio, Chairman
House Consumer Affairs Subcommittee
Washington, D.C. 20515

Congressman Annunzio:

I have read with interest your comments, regarding "I vow to battle to end battles to increase 12% Federal Credit Union rate ceiling".

As a credit union manager with over 30 years experience in this field, perhaps I might give you a different perspective of the problem.

Our organization, Syracuse University Federal Credit Union with \$6M assets and 3800 accounts, is one greatly in need of interest rate relief.

This month (October) alone, to date, we have had withdrawal of shares of \$506,089.60. Most of that money has gone to high-rate money market certificates.

Besides having to compete with billion dollar banking institutions, who are offering over 11% per annum, we have to contend with Merrill Lynch, etc., and Tuttle Securities, who are offering over 13% per annum.

The one half million dollar loss of shares, which is almost 10% of our assets, coupled with 5% Liquidity Reserve regulation recently enacted means that we must seriously curtail loan activity to our members.

We are urgently in need of relief from the 12% loan rate ceiling in order to effectively compete in the marketplace for our members' money.

Your continued support of the credit union cause is most certainly appreciated.

Very truly yours,

Alfred J. Mariani
Manager

AMJ:bnl
cc: National Credit Union Administration
cc: National Association of Federal Credit Unions

"Big Enough To Serve You . . . Small Enough To Know You"

Ft. Monmouth Federal Credit Union

Ft. Monmouth, New Jersey 07033

542 / 18

September 24, 1979

National Credit Union Administration
Washington, D.C. 20456

Attention: Mr. Lawrence Connell
Administrator

Dear Mr. Connell:

Credit Union's have consistently been in the forefront of consumer issues. We do this in spite of anachronistic regulations such as the Federal 12% A.P.R. cap.

Our credit union movement meets the financial needs of our members. Those needs are dynamic and reflect the major economic and social forces at work in our society. One such force, we are all experiencing, is the increasing economic sophistication of consumers and credit union members. The demand of all consumers is for a fairer return on their savings, (a return which does not penalize them because of erosion by inflation). Your office recognized this pressure with a recent letter urging day of deposit to day of withdrawal dividends.

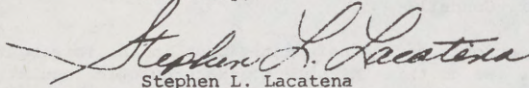
Fort Monmouth Federal Credit Union is situated near one of the most competitive financial markets in the world (New York City). As such, our members are extremely rate sensitive for returns on their savings dollar. An example of this was during the period prior to our authority to offer money market certificates, when we experienced large outflows of funds to money market certificate programs at other institutions.

The costs of funds along with high double-digit inflation are driving up our overall cost of doing business. The squeeze is heightened by the rigid non-economic lid on our ability to earn income. As consumers have become more aware of the structural biases against savers and for borrowers in our country, 12% borrowing is less onerous. The inflexible

12% A.P.R. for federal credit unions during this period of high-inflation and high-interest, must be assessed and modified. We suggest a more flexible interest rate cap which takes into account the fact that interest rates have reached newer historic highs with each new phase of our economic cycle. Credit unions must remain in the forefront of change, representing the interests of consumers. We must have an interest rate cap which is more flexible and responsive to social and market forces.

If timely action is not affected, federal credit unions will begin to reduce dividends, services and expenses. This will lead to an aggravation of system-wide credit union liquidity as our members seek the highest return on their investment (savings). The continuance of the rigid 12% federal A.P.R. will condemn credit union influence to the backwater of the financial community rather than keeping us up front.

Sincerely,

A handwritten signature in dark ink, appearing to read "Stephen L. Lacatena". The signature is fluid and cursive, with a long horizontal stroke extending to the left.

Stephen L. Lacatena
President
Board of Directors

SLL/rgw

cc: CUNA
NAFCU
NJCUL
Senator Harrison Williams
Congressman James J. Howard

APPENDIX IV

- A. An amendment to permit the National Credit Union Administration Board to increase the rate which credit unions may charge for loans to their members:

Section 107(5)(A)(vi) of the Federal Credit Union Act is amended by striking the semi-colon which appears at the end thereof, and adding: ", or at such greater rate as may be prescribed from time to time by the Board;".

- B. An amendment to permit the National Credit Union Administration Board to increase up to a maximum of 18% the rate which Federal credit unions may charge on loans to their members:

Section 107(5)(A)(vi) of the Federal Credit Union Act is amended by striking the semi-colon which appears at the end thereof, and adding: ", or at such greater rate not to exceed 18 per centum per year as may be prescribed from time to time by the Board;".

- C. An amendment to permit the National Credit Union Administration Board to increase up to a maximum of 18% the rate which Federal credit unions may charge on loans to their members, with such authority expiring on December 31, 1981:

Section 107(5)(A)(vi) of the Federal Credit Union Act is amended by striking the semi-colon which appears at the end thereof, and adding: ", or, until December 31, 1981, at such greater rate not to exceed 18 per centum per year as may be prescribed from time to time by the Board;".



Congressional Record

PROCEEDINGS AND DEBATES OF THE 96th CONGRESS, FIRST SESSION

Vol. 125

WASHINGTON, THURSDAY, NOVEMBER 1, 1979

No. 152

Senate

S 15684

THURSDAY, NOVEMBER 1, 1979

S 15685

(Legislative day of Monday, October 15, 1979)

Mr. BUMPERS. Mr. President, I yield to my distinguished colleague from Arkansas (Mr. Pryor) at this point.

Mr. PRYOR. Mr. President, I appreciate my colleague's yielding to me. Senator Bumpers and I were prepared to propose an amendment to the bill at this time. However, after discussion of the amendment with the manager of the bill, the distinguished chairman of the Committee on Banking, Housing, and Urban Affairs (Mr. Proxmire), Senator Bumpers and I have decided against calling up our amendment. Instead, we shall introduce the text of the amendment as a bill within the next few days. It is my understanding that Senator Proxmire has offered to hold hearings on our bill this year.

Mr. President, all Senators may not be aware of a statute that exists today which gives national banks an unfair advantage over many State banks and other financial institutions.

Section 85 of title 12 of the United States Code provides that a national bank may charge 1 percent above the Federal discount rate, notwithstanding any State laws setting an interest-rate ceiling. Such an advantage obviously discriminates in the strongest possible way against State banks or savings and loans in those States where the usury-rate ceiling is below the discount rate. The bill my colleague (Mr. Bumpers) and I shall introduce would merely allow State chartered, federally insured banks, federally insured savings and loans, small business investment companies, and Federal credit unions to charge the same interest rate as national banks.

When the 1-percent-above-discount-rate law was adopted in 1933, it served the laudable purpose of strengthening the fledgling national banking system.

That system has survived and prospered. Now we must be concerned with the survival of the other half of our dual banking system—State banks.

The current statute discriminates against State banks in two ways:

First, national banks are able to realize greater yields on their loans, which strengthens their overall financial position vis-à-vis the State banks; and

Second, State banks are losing deposits to the national banks since they cannot offer the same lending services. This "competitive disadvantage" is a genuine threat to the survival of many State banks.

Consider the situation in my State of Arkansas. We have, as the Senators well know by now, a strict 10-percent interest rate ceiling on all types of loans. A customer seeking a loan to buy a car is unlikely to find the funds at a State bank since State banks can charge no more than 10 percent interest, which is not enough to cover the cost of funds plus service costs. This customer is forced to turn to a national bank which can presently charge 13 percent. That customer is also likely to deposit his money in that bank.

In the golden days of low interest rates, this problem never came up. But as the discount rate has risen to 12 percent in our present, tight-money economy, many States find themselves in a similar predicament. Once-reasonable usury limits of, say, 12 percent, now threaten to strangle the local economy. Under 12 U.S.C. 85, national banks in these States can charge 13 percent on their loans, which is extremely important, since the cost of deposits is rising. State banks have the same expenses as national banks but can charge no more than the State's interest rate ceiling.

This is, strictly speaking, not a "usury" issue but a matter of "competitive equity." Before the discount rate went this high, all banks could compete equally at a lower interest rate level. But when the discount rate is higher than the usury limit, the State banks and savings and loans are placed in an impossible grossly unfair position.

The bill we shall propose, Mr. President, will provide a simple and equitable remedy to a complex and unjust situation.

Mr. President, at this time I yield to my distinguished colleague (Mr. Bumpers).

Mr. BUMPERS. Mr. President, I doubt that there are very many Senators—maybe there are none—in this body who know that, in 1933, there was an amendment adopted to the National Banking Act which says that Federal banks may charge 1 percent more than the Federal discount rate. Until the year 1979, that amendment never made any difference. Even during the great financial crisis of 1974, the highest Federal rate was 8 percent. Now the Federal rate is 12 percent, and as a result of that little-known amendment, the Federal banks in my State are allowed to charge 13 percent, 1 percent above the Federal rate.

On the other hand, as most of the people in this body know, Arkansas State banks are hopelessly locked in by an 1874 constitution to a 10-percent usury rate, which means that in my State, the Federal banks are now charging 13 percent interest and the State banks are limited to 10 percent.

One of three or four things is going to have to happen so the Arkansas State banks can charge something in excess of 10 percent. We have adopted a bill, H.R. 2515, which would apply only to Arkansas and which is over in the House. Either that bill, the Cochran amendment passed by the Senate yesterday is going to have to be accepted, or we are going to have to adopt a bill similar to the one Senator Pryor has just referred to. If we do not, Arkansas, as well as several other States will have a monopolistic banking system.

I suggest to some Senators who are listening that they contact their banking associations back in their States and find out how, if at all, this is going to affect them. It is my understanding that there are 18 States in the United States that will be affected by a bill which would give State-chartered financial institutions the right to charge interest of 1 percent above the Federal discount rate, or 13 percent.

It is absolutely imperative that my State get some relief. In Arkansas, if we do not get H.R. 2515 passed, or if we do not get this bill, H.R. 4988 passed with the Cochran amendment, and the people in my State refuse to adopt a constitutional amendment raising the usury limit next fall, we are back to square one. The Federal banks are still going to be charging 13 percent, if the Federal rate stays the same, and the State banks 10 percent. We have 210 State banks in my State, and every one of them is going to be applying for a Federal charter if something is not done.

I personally think the dual system is a good thing, but we in Arkansas cannot keep it unless we get some relief on this thing.

Mr. PROXMIRE. Mr. President, the Arkansas Senators, I think, have made an excellent point. However, I think they realize that there is no way we can vote on what they propose tonight without a very extensive debate. There is a sharp division and difference of opinion in the Senate. The Senator from Nebraska has made the point very well that we should be very chary about overriding State usury laws.

What this would do would be to provide a national usury limit for everybody. We override all State laws as far as State banks are concerned—not just national banks. This may have merit, and I think it does have a lot of merit. It is very practical. What I would like to propose to the Senators is that we hold prompt hearings on their bill—rather than have it as an amendment to this bill—before our committee this year so that it may be thoroughly considered by the Committee on Banking, Housing, and Urban Affairs as soon as possible.

Would that be satisfactory?

Mr. BUMPERS: Mr. President, that is satisfactory. We shall try to get this bill introduced as quickly as possible.

I want to say in conclusion that the distinguished floor manager has been extremely hospitable, cordial, and accommodating during the consideration of this banking bill and H.R. 2515. He has recognized the very unique problem we have in our State with the Federal rate up to 10 percent.

I understand the problem other Senators have in their respective States with overriding State law. I do not think it is particularly healthy, to be overriding State law. The Senator from North Carolina performed yeoman service here making that point time and time again and I agree with most of what he says. However, these are very unique, difficult, and unprecedented times in the money markets of this country.

We want to express our gratitude to you on the floor to the floor manager for offering to hold hearings on this proposed bill as quickly as he can, and for all the accommodations he has made for both on H.R. 2515, and the Cochran amendment.

My State is in an economic stalemate. No loans are being built in my State except those subsidized by government bonds.

For example, the front page of the Arkansas Gazette has a story saying the Falcon Jet Corp., which has about 1,000 employees at a plant in Little Rock, Ark., needs another 150 skilled employees. Those skilled employees have to be recruited from out of State. However, Falcon cannot recruit them because there is no place for them to live in Little Rock and no houses are being built there.

This is one example I am using to dramatize and focus on my problems, but I know many other Senators have the same problem in their States.

Again I thank the floor manager.

Mr. PRYOR: Will the Senator yield?

Mr. BUMPERS: I yield.

Mr. PRYOR: Mr. President, I, too, would like to add my vote of thanks to the distinguished chairman, the Senator from Wisconsin who has been very courteous to us.

We have, as the Senator understands, extreme economic problems in the State of Arkansas with a constitutionally imposed 10-percent usury limit.

I checked with our Savings and Loan League executive director this afternoon. He informed me that in the last 2 months, to the best of his knowledge, the savings and loan institutions in Arkansas have made fewer than 25 residential mortgage loans to the citizens of our State.

We deeply appreciate the opportunity Senator PAXSON has graciously extended to us to come before his committee and to hold hearings on the pros and cons of our legislation. I hope we can focus attention on this problem and allow those adversely affected by the present law to express their concerns through the proper channels.

Again, we thank the chairman for the courtesies which he has extended to us. We will introduce the bill as soon as possible.

Mr. BUMPERS: Mr. President, I ask unanimous consent that a chart of interest rate ceilings on residential mortgages in 24 States that would be affected by this bill, and an article which appeared in the Arkansas Gazette on October 11, 1979, entitled "Arkansas, 25 Other States, Face Housing Funds Drought," be printed in the Record at this point.

There being no objection, the material was ordered to be printed in the Record, as follows:

Interest rate ceilings Residential Mortgages	
Fixed:	(In percent)
Arizona	12.0
Arkansas	10.0
Hawaii	12.0
Kansas	12.0
Louisiana	12.0
Nebraska	12.0
New Jersey	11.0
New Mexico	10.0
North Dakota	12.0
Oregon	12.0
Washington (State)	12.0
Washington, D.C.	12.0
Wisconsin	12.0
Floating:	
Georgia	10.5
Illinois	11.0
Iowa	11.0
Minnesota	11.5
Mississippi	12.0
Missouri	11.9
New York	12.0
Pennsylvania	11.6
Texas	10.75
Vermont	11.0

Source: United States League of Savings Associations.

ARKANSAS, 25 OTHER STATES, FACE HOUSING FUNDS DROUGHT. Prospective homebuyers will be virtually shut out of mortgage funds in nearly half the states, including Arkansas, beginning in January, savings bank officials said Wednesday.

Twenty-four states will be hit hardest because they have laws limiting mortgage rates to about 12 percent or less, making it unprofitable for banks there to lend mortgage money because they must pay even higher interest rates to borrow.

Thomas Parliament, an economist at the United States League of Savings Associations, pinpointed Arkansas, Washington, Georgia, Illinois, Iowa, Kansas, Missouri, Nebraska, New Jersey, New York and Texas as very mortgage-dry "come the first part of next year."

And in those states without usury ceilings, he said, homebuyers may face mortgages carrying interest rates of 12.5 percent or higher.

Steepest rates will be particularly evident in California and Florida, he said.

Parliament's predictions were echoed by officials of the National Association of Mutual Savings Banks.

Down payments of 5 percent and 10 percent will become virtually extinct, Parliament said. "Twenty percent down payments will have to become the rule," he added.

The dramatic mortgage crunch is the result of new tight-money policies adopted last week and by the Federal Reserve Board in an effort to beat back soaring inflation and limit excessive credit.

The Board increased the discount rate it charges member banks from 11 per cent to 12 per cent and it dramatically altered the way it controls the availability of money and credit.

Many banks immediately increased the interest they charge their best customers from 13.5 per cent to 14.5 per cent, and many economists predict it will reach 15 per cent shortly.

Thrift institutions that can increase their mortgage rates to keep up with the higher cost of money "may weather the coming months," Parliament said.

"SHUT OFF"

But banks in Arkansas, for example, can't charge more than 10 per cent interest on mortgages. At the same time, some pay customers more than 10 per cent interest to deposit their savings in money-market certificates.

"They already are shut off from making mortgages," Parliament said.

No and other economists interviewed Wednesday believe the worst mortgage crunch will be felt in February and March. But already, they note, banks have become very stingy in making loans.

"Many states will have to do something quickly about their usury ceilings," William Wallis, president of the First Federal Savings and Loan Association of Martin County, Fla., near Palm Beach, said.

However, state legislatures do not convene until next year, Parliament said. "It will be four months to six months at the earliest, before usury ceilings could be raised," he added.

Congress is considering legislation giving the federal government powers to override state usury limits. However, that bill is part of a larger package of bank reform, and its fate remains uncertain.

States with usury limits that are absolutely fixed are:

Arkansas, 10 percent; Arkansas, 10 percent; Connecticut, 12 percent; Hawaii, 12 percent; Kansas, 11 percent; Louisiana, 12 percent; Mississippi, 12 percent; Nebraska, 12.5 percent; New Jersey, 10.5 percent; New Mexico, 10 percent; North Dakota, 12 percent; Oregon, 12 percent; South Dakota, 12 percent; Washington, 12 percent; Wisconsin, 12 percent. The District of Columbia also has a fixed rate but it is 15 percent and so presents no problem at this time.

States with floating usury ceilings are: Georgia, Illinois, Iowa, Minnesota, Missouri, New York, Pennsylvania, Texas, and Vermont. These all are currently at 12 percent or less.

Floating usury ceilings can be adjusted to the rise in other interest rates but the process is very slow.

The CHAIRMAN. All right, sir. Fine. Thank you very much.

Mr. Kennedy, you are in favor of this legislation. Let me ask you this. The argument is often made that Congress legislates too much, that many matters are best left to the State legislatures, that we are too intrusive, that the government that is closest to the people governs best.

WHY WE NEED FEDERAL LEGISLATION

What is the American Bankers Association's response to that? Why do we need Federal legislation such as S. 1988, which essentially has as its purpose giving State chartered banks wider powers than their State authorities would grant them?

Mr. KENNEDY. Well, in this particular case, Senator, we need this legislation to equalize the competitive situation as a result of an act which was passed 46 years ago. Insofar as that particular piece of legislation is concerned, I believe this is the first time that it has ever actually been used. Not even in 1974 when we last had high interest rate difficulties, did we have that situation we now have.

In addition to that, I think the fact that we're dealing with the national economy with rates that are regulated by the national economy and to some extent by the actions of the Federal Reserve system creates a situation where it is extremely difficult for States to react fast enough to what is taking place. Consequently it is my opinion, that this ought to be handled at the national level.

The CHAIRMAN. That's a very good answer, but Mr. Sprague indicated that he felt that we ought to keep the pressure on the legislatures, and the best way to do that is not to act and let them recognize that if they're going to spare their financial institutions and their business community and their agricultural interests and so forth, that the agony and trauma of not being able to get money, then they're just going to have to act on that, and then the States would take such actions as would be necessary.

Mr. KENNEDY. Well, I have great respect, as you do, for Mr. Sprague. But I just disagree with him in this particular context, and I believe Governor Schultz pointed out that in 1980 there are some eight of the State legislatures which were not going to meet. And they simply don't move fast enough to take care of it.

The CHAIRMAN. Well, they can. The Governor can always call them if it is important enough to the State to do so. It might cost them a little, but the cost would be far greater if they failed to meet a great need like this one.

Mr. KENNEDY. Well, I think that is certainly correct, sir. I just believe that we're dealing with a national situation in this particular context. And furthermore, I don't have the faith that possibly Mr. Sprague indicated that we're not going to go through this again. And I think we need to be able to handle these types of situations.

The CHAIRMAN. Well, I'm glad to get that, because I think it's very important that your association, which has a great deal of influence in this country, go on record as emphatically as you have here. And as you can see, even from Senator Bumpers' statement, there obviously is a very strong feeling out in the country that all

we have to do is pass a law against high interest rates and the problems are taken care of.

But obviously, the results are really counterproductive.

Mr. Dunn, you say that the best of all solutions would be for the Federal Government to reduce significantly the continuing inflation rate. I can certainly agree with that. But let's face the facts. It's going to take a long time to get inflation down. Some factors we have control over. Some we don't, like the price of oil.

ONE SET OF LAWS—NOT 50

Why shouldn't this Nation have the benefit of a national usury rate? Wouldn't the borrowing needs of every State be better served by one set of laws on usury, rather than 50 State laws?

Obviously, I didn't frame that question myself, but the staff asked it. So I put it to you. I can't think of anything worse than a national usury law. But go right ahead. [Laughter.]

Mr. DUNN. I assume that since I said I agree with everything you said to start with, that this is a question and not a statement.

Mr. Chairman, as has been pointed out previously, in 1974 the discount rate only reached 8 percent. Let me use as a best example my State. Last year we completely revised our usury laws.

The CHAIRMAN. That's the State of Georgia?

Mr. DUNN. Yes, sir. We went to a floating rate on home mortgages. The present rate today for December is 12.5 percent. In January we go to 12.75 percent, which is in the ballpark even today.

The only mistake we made, as we look back—in 1974, the discount rate was at 8 percent. So we said, well, 10.5 percent is ample, certainly, for a simple interest rate. All of a sudden, we found out we made a mistake. There will be an effort in the State of Georgia this year to completely remove the usury limits. I think it has a 50-50 chance of passing.

The easiest thing for me, as commissioner of banking for the State of Georgia, would be to completely support the bill that you have as it is written. But I think it would be a coward's way out. I think it is my responsibility, because of my job in the State of Georgia, and also as past president of the Conference of State Bank Supervisors, being that a majority—now, not completely, but a majority, the democratic majority—have said that they would like a sunset provision in it and would also like to tie the sunset provision to the National Bank Act.

Now, I'm sure—and I was a national banker, Mr. Chairman, for 20 years. So I cannot be considered as prejudiced. I think that if it is tied together, this will equalize our immediate problem, and in the future will also get the national bankers to help us be sure that adequate laws are passed.

As I said before, I am personally confident of the State bank supervisors, and we are completely supportive of not only the emergency situation that Arkansas is in, but also the 32 other States that I mentioned. It is much larger than anyone would imagine.

As I said, we have a survey that we would like to furnish to you to show State by State what the problems are.

The CHAIRMAN. Mr. Duffey, you make a good case for the bill. But what is the argument for making the bill nearly permanent and not temporary? Or, another way of putting it: What is the responsibility of the Texas Legislature to provide competitive equality for State-chartered Texas banks?

Mr. DUFFEY. Well, Senator, I am satisfied, and we are in Texas, with the 2-year revision clause. I think that, certainly in this particular instance on this bill, leaves the State legislature of Texas, if they want to override this, the opportunity to do it.

The realities of the matter are that we did have some usury legislation in the last session. A home mortgage bill allowed it to go to 12 percent on a floating basis. And the realities of having any usury legislation in the next session, in 1981, are very, very slim in Texas.

The CHAIRMAN. Well, if this is important to Texas and this is inequitable for the State banks, why wouldn't the Governor call a special session? There is a lot of money down there, even now, even with the oil shortage. Maybe more than ever, I should say.

Mr. DUFFEY. The Governor keeps wanting to get elected, like many people in the legislature. And raising usury ceilings is a rather unpopular cause.

The CHAIRMAN. Well, it's unpopular everywhere. It's unpopular here, too. That's one of the prices you pay for being Governor.

Mr. DUFFEY. Not being in that position, I can't comment on it.

We are, I will say—and the Governor is an ex-bank board member, and it happens to have been a national bank. The realities of this particular situation that we're addressing in 1988 is that it is a State-national bank problem.

The CHAIRMAN. Well, I don't want to be unfair. I know that Texas and the Southwestern part of our country has had a long, long tradition of resistance against high interest rates. Wright Patman, who was chairman of the House Banking Committee for years, led the fight and became a personification of opposition to high interest rates. So I know it is a very, very strong sentiment down there. But I think the time has come for all of us to realize, as has been pointed out, we live in a national and international monetary situation, where it just can ruin your market by having these arbitrary and statutory limitations, that to try to repeal economic laws, they just don't work.

Mr. DUFFEY. You might realize that Wright Patman's son as a State senator in Texas is leading the fight in the Texas State Legislature for the same thing his father did in Washington. So it is a problem for us and it is something we will be addressing in the next session in a very strong manner.

The CHAIRMAN. Mr. Lascara, you say that 85 percent of NAFCU members state that they have curtailed loans or plan to do so shortly because of the 12-percent limit. How do the borrowers and deposit members of credit unions feel about raising lending rates?

Mr. LASCARA. Well, I think it would be nice if we could live with the traditional 12 percent ceiling that we have lived with for the past 45 years. But the current economic conditions just won't let us survive that way.

The CHAIRMAN. My question is, would your depositors stand still for that? Do they recognize your problem?

Mr. LASCARA. I think they do recognize the problem, and I think that the once reasonable but now repressive 12 percent ceiling has forced them to go out on the market and get loans elsewhere at excessively high rates.

The CHAIRMAN. I should say your borrowers.

Mr. LASCARA. They are being forced to go out in the open market to get loans at much higher rates than we would ever charge them if we had a more realistic ceiling.

The CHAIRMAN. That is beginning to get through, you feel, fairly widely? The borrowers are recognizing that this limitation that you have really hurts them rather than helps them, because the money just isn't there?

Mr. LASCARA. Senator, when they go outside their credit union to secure a loan, they are finding out that it is at 18, 21, or even 36 percent. Their credit union could do business much more economically for them with a reasonable lending ceiling. twelve percent is just unrealistic in today's economy.

BORROWERS FORCED TO PAY 18 TO 30 PERCENT

The CHAIRMAN. Mr. Cugini, you fear that lower income would-be borrowers are being forced to turn to companies charging 18 to 30 percent on loans. Do you have any facts and figures to show how often this is happening?

Mr. CUGINI. Mr. Chairman, I have with me CUNA's economist, Bob Von der Ohe, who does have some facts and figures. And I would like to refer to him.

The CHAIRMAN. How do you spell your name, sir?

Mr. VON DER OHE. The last name is three words, capital V-o-n, small d-e-r, and then capital O-h-e.

There is no direct data in the sense that you can point to the fact that credit union members, this particular credit union member or the other, has gone. But when looking at the aggregate data, we find that, as we went through the past period of tight money, credit unions continue to have loan growth significantly above that of the other financial intermediaries and finance companies. Credit unions had surplus funds and even as we went into 1978, credit union loan growth was growing faster than consumer credit outstanding.

But as we move into 1979, we found, for example, at the beginning of the year consumer credit was going up at about 19.7 percent, credit union loans outstanding at 21.7 percent. And while consumer credit growth has fallen by September to an annual rate of increase of 15.4 percent, credit union loan growth was only going at 11 percent; and that we are growing now smaller than the rest of the market. And therefore, our members must be going to some other alternative source.

We know that the banking community in many instances, with some of the same kinds of restrictions, are also curtailing consumer lending. And the only obvious conclusion would be that they must be going out into the finance company market, and at the rates that are therefore being charged.

The CHAIRMAN. Would you give us the benefit, for the record, in detail of your study? It sounds very interesting.

Mr. VON DER OHE. Yes. [See p. 95.]

Mr. CUGINI. Mr. Chairman, if I may, in light of that, last Friday the Inter-Agency Coordinating Committee made a series of regulatory moves to help the smaller saver. These changes will go into effect on January 1, 1980. CUNA applauds these moves, because they are beneficial and have an effect on the small savers of our Nation.

But it will increase the cost of funds to financial institutions, and this increased cost certainly is another object lesson for us to increase this rate.

The CHAIRMAN. Well, you're right. But the move that they took over the weekend is much more limited than I thought it was. It is 2½-year certificates, which ties up the money for some time. And the increase in 90-day deposits was a quarter of a percent. So they just weren't able to sell the 4-year certificates that they had, that would have been close to the same amount.

So I doubt very much if this is going to be a big effect, although it will have some.

Mr. CUGINI. It does carry an 11 percent rate, which, again, is close to the 12.

The CHAIRMAN. But people who want liquidity, it puts them in a tougher spot.

Mr. Dunn, is there any danger that this bill might set a precedent whereby the Federal Government begins to authorize other lending powers for State-chartered institutions? If we pass this bill, where do we draw the line?

Mr. DUNN. Mr. Chairman, I think that is a great statement, rather than a question. And I think that is a concern of not only State regulators, but I think it was brought out here by the Federal regulators today that there is always a danger that someone will come along and say, well, you did it in this instance, what's wrong with doing it in another instance.

The CHAIRMAN. We're learning that in the Chrysler case. We did it for Lockheed; why not for Chrysler?

Mr. DUNN. We do, certainly without any question, have an emergency. I would hope that we could pass a bill in the light of an emergency, and look at it again in 2 years. I may be back up here in 2 years and have such a heck of a problem not being able to do what I hope that I'm going to be able to do. I may be one of the people standing up here pleading with you to preempt State's rights.

But I would first like a 2-year opportunity to see if I can't control it myself.

The CHAIRMAN. Let me ask you further, Mr. Dunn, in describing the response of many States to adjust usury restrictions to the current economic conditions, you describe a wild hodge-podge of State regulations that would lead many reasonable men to conclude that more national standards are necessary. What is the economic justification for interest rate restrictions by individual States, when money flows freely across State lines in search of higher rates of return?

Mr. DUNN. That is a difficult question to answer. Therefore, may I answer it from a personal standpoint rather than as a representative of the Conference of State Bank Supervisors?

The CHAIRMAN. All right.

Mr. DUNN. I think that we are in this country coming to the point sooner or later that, if we can't do it from a State standpoint, that it should be taken a look at from a national or even international standpoint. So it is becoming a problem.

But here again, I would prefer to see if the States can't solve their own problems before we come in on a motherhood march to Washington to ask the Federal Government to do it.

EXEMPT FROM USURY RESTRICTIONS

The CHAIRMAN. I want to ask Mr. Cugini a question, and then I want to ask Mr. Kennedy if he would like to comment on it or respond. Mr. Cugini, what happens to financial institutions in States with usury restrictions? If credit unions were exempted from usury restrictions and allowed to charge any amount on their loans, wouldn't it speed up disintermediation toward credit unions?

Mr. CUGINI. Senator, I'm from Rhode Island, and the usury rate in Rhode Island is 21 percent, and we are not having that kind of difficulty.

The CHAIRMAN. But in many other States, as Mr. Dunn pointed out, 32 States are affected by this, a large number of States, at any rate, that have considerably lower usury limits.

Mr. CUGINI. Mr. Von der Ohe, I believe, can comment on that.

Mr. VON DER OHE. Senator, I think one of the obvious examples within the credit union movement itself is the State of California, where the State-chartered credit unions may charge 15 percent and the Federal credit unions in California can charge 12. Even there, the growth of the State-chartered credit unions this year, where they have been able to compete, would suggest that if we were free to pay the rates for savings, therefore charge the rates on loans, that yes, if some other segment of the financial community were in fact regulated, the funds would flow to the credit unions.

But this year the reverse has been true, with the 12-percent ceiling. We have seen a very significant outflow of funds.

The CHAIRMAN. Exactly right, and that documents what it seems to me is the question and the problem here, that if we give you freedom from usury statutes, that the banks and the S. & L.'s and others would suffer disintermediation. That money would come from them to you.

Mr. VON DER OHE. Well, I think the idea here being competitive parity at this particular point in the emergency situation, and then look to the free relief from all rate ceilings for all financial intermediaries as the desirable goal.

The CHAIRMAN. Mr. Kennedy?

Mr. KENNEDY. Thank you, Senator.

In responding to Mr. Dunn's comments, I would like to speak personally, because I am from Arkansas and some might think this is colored by the difficulties that we are having out there. And they are extreme and they are predicated, as I mentioned a few minutes ago, by the fact that we are dealing with a national situation, whether we like it or whether we don't.

We are also dealing with the regulation of the monetary supply on a national basis through the Federal Reserve System, and on

the savings side through regulation Q and a gradual eroding of regulation Q in the form of 6-month money market certificates, in June 1978, the 4-year certificate, and now the 30-month certificate, and of course, a gradual easing of the rates under regulation Q.

In addition to that, these things are happening beyond the control of anybody in the State of Arkansas. And I think that situation is going to continue to exist, and I share the feeling that savers for many, many years, and particularly in high market situations, are subsidizing borrowers, because of the restriction of regulation Q and the ability of lenders and financial institutions to be able to pay commensurate rates.

AGAINST SUNSET LIMITATION

As long as that situation exists, usury limited States are not going to be able to retain the funds which they need to supply their own economy. Those funds go elsewhere. Under those conditions, I see no reason to add a sunset limitation to this particular legislation. I just quite frankly believe that the 2-year right of a legislature to go in and control it would suffice.

The CHAIRMAN. You see, what I was concerned about here, however, was the effect on banks. And as the ABA spokesman here, you are in a strong position to give us the effect if we free credit unions from the usury statutes. Doesn't that suggest that there would be a disintermediation of flow from the banks to the credit unions, because credit unions by and large aren't nearly as big as the banks by any means; although they are growing rapidly? Would this be a concern of yours?

Mr. KENNEDY. Well, let me apologize for answering the wrong question. But in answer to the question, I quite agree that unless the banks were given commensurate relief, that we would suffer some disintermediation as a result of what happened in the case of the credit union request, if it were granted.

In my opinion, we all ought to be able to compete competitively for money, and we need to have a removal of the restrictions in order to do that.

The CHAIRMAN. So you're all under the same, more or less, the same rules?

Mr. KENNEDY. Yes, sir; that's all we would like to have.

The CHAIRMAN. Mr. Cugini?

Mr. CUGINI. Mr. Chairman, I believe that 2 or 3 years ago, when the banks were only paying 5 and 5¼ percent, that Federal credit unions were paying 7 percent on their shares at that particular point in time. And I don't believe that the banks really suffered much disintermediation with that flow into the credit unions.

The CHAIRMAN. Well, you are growing all the time. As your statistics indicated, that's one of the reasons why you're growing faster than any of the other institutions.

Mr. DUFFEY. May I comment also on that, Senator?

The CHAIRMAN. Yes.

Mr. DUFFEY. As the share draft program proliferates, and as the credit unions have transaction powers, and the higher rate ceilings, then you compound the problem.

The CHAIRMAN. Good point.

Mr. DUFFEY. I think that's the major point in this, is that the transaction power ability is much more serious.

The CHAIRMAN. The nature of all financial institutions are changing and will change, particularly if we're able to enact the bill that has passed the Senate and is pending in conference.

Mr. CUGINI. But again, Mr. Senator, our motive for this is we are looking for this for everybody, not just the credit union movement.

The CHAIRMAN. Gentlemen, I want to thank you very much. You have made excellent testimony and we are in your debt.

Our final panel consists of Frank Coffman of the National Savings and Loan League; Albert Hooke, vice chairman of the National Association of Mutual Savings Banks; and Mr. Norman Strunk, executive vice president, U.S. League of Savings Associations.

Gentlemen, we welcome you. This is a very distinguished panel.

Norman Strunk is retiring at the end of this year, after heading up the U.S. League of Savings and Loan Associations for 25 years. And I've been on this committee for 22 years. So we have had parallel careers, and you have always been a very helpful witness. You have testified before the committee many, many times, always to our enlightenment.

You have seen the growth of S. & L.'s and homebuilding during the last generation greatly. I want to congratulate you on a very fine career and best of luck in the future. I just wish you could support our bill. I don't mean this bill, but another bill that is pending, as you well know.

And for that reason, I also want to thank Mr. Coffman, because the National Savings and Loan League does support our bill with enthusiasm and considerable effect. I was told by a House conferee that, after all, that's just the rump group. I said, they've got the wrong part of the anatomy of the horse.

But I don't mean to imply that the U.S. League of Savings Associations is any other part of the anatomy.

I'm going to ask Mr. Coffman to go first.

STATEMENT OF FRANK L. COFFMAN, PRESIDENT, FIRST FEDERAL SAVINGS AND LOAN, HARRISON, ARK., AND MEMBER, BOARD OF DIRECTORS, NATIONAL SAVINGS AND LOAN LEAGUE

Mr. COFFMAN. Thank you, Mr. Chairman. I am Frank L. Coffman, president of First Federal Savings and Loan of Harrison, Ark. I am a member of the board of directors of the National Savings and Loan League, on whose behalf I appear before you today.

I appreciate the opportunity to present the National League's views on S. 1988. The National League supports S. 1988, and commends Senators Bumpers and Pryor for their support of the legislation to provide relief from State usury ceilings. Mr. Chairman, we appreciate your recognition of the importance of this issue and the prompt calling of these hearings.

This legislation is especially critical during present economic conditions, with the present high interest rates. Relief from the unrealistic usury ceiling is imperative if mortgages and other types of lending are to continue in many States.

The Federal Government has created various programs which are designed to achieve a national public housing objective. This

objective is a stable flow of mortgage credit on a nationwide basis. There has been, however, a disruption of this national network for home finance by state usury laws with fixed interest rates, particularly mortgage interest rates.

MORTGAGE CREDIT DRYING UP

These unrealistic low and arbitrary limits result in mortgage credit drying up in those States with below-market usury limits, as funds naturally flow from those States into other market areas where a higher yield can be obtained. The ultimate losers in this situation are the consumers in these States, the potential home buyers, who are effectively denied the opportunities and benefits of homeownership. This obviously hurts housing construction and employment.

A final effort by the structure of some of the State usury laws has created a disparity between certain types of financial institutions. As you know, in my own State of Arkansas, State banks and all savings and loans are limited by the state usury ceiling of 10 percent, while national banks may charge 1 percent above the discount rate, currently about 13 percent.

This state of affairs creates a competitive inequality, not only on the lending side, but on the deposit side, also. While all of us would prefer to see interest rates at reasonable levels, the fact is mortgage credit is up to the 13- to 14-percent level. The ultimate answer, of course, is to bring inflation under control with fiscal and monetary policies.

In the meanwhile, however, it is apparent that usury ceilings below market rates are not only failing to protect the consumers, but in fact worsen inflation on them. The need for immediate action on this issue is apparent. The effect on mortgage lending created by usury ceilings has been disastrous, and the realistic things that we must live with is the outflow of deposits into money market funds and the fact that deposit funds that do not continue to come into our institutions are mainly in the form of money market certificates.

We are paying 11 to 12 percent for these deposits and about 14.5 percent for advances from the Federal home loan banks. We simply cannot pay these rates to obtain funds and lend them out at 10 and 12 percent.

Mr. Chairman, we understand the resistance of many Members of the House and Senate to this bill and other preemption proposals. Only an extreme economic emergency would prompt us to seek a Federal preemption of State laws. The fact is, however, that the housing industry and local economies in more than 20 States are threatened with stagnation, unless our industry can start making new mortgage commitments at current market rates.

In conclusion, Mr. Chairman, on behalf of the National Savings and Loan League, I want to thank you and the members of your committee for your responsiveness to our problems. The usury provisions of H.R. 4986 and H.R. 4998, as they pass the Senate, are certainly welcome and have our strong support.

We urge the committee to act favorably on S. 1988 as soon as possible, so that there will be—or remain—a vehicle in the housing

industry to keep the housing industry alive during the tight money crisis.

Thank you.

The CHAIRMAN. Thank you very much, Mr. Coffman.

[The complete statement follows.]

TESTIMONY OF FRANK L. COFFMAN, JR., REPRESENTING THE NATIONAL SAVINGS
AND LOAN LEAGUE

I am Frank L. Coffman, President of First Federal Savings and Loan, Harrison, Arkansas. I am a member of the Board of Directors of the National Savings and Loan League on whose behalf I appear before you today. I appreciate the opportunity to present the National League's views on S. 1988.

The National League supports S. 1988 and commends Senators Bumpers and Pryor for their support for legislation to provide relief from state usury ceilings. Mr. Chairman, we appreciate your recognition of the importance of this issue and the prompt calling of these hearings. This legislation is especially critical during present economic conditions with unprecedented high interest rates. Relief from unrealistic usury ceilings is imperative if mortgage and other types of lending are to continue in many states.

The Federal government has created various programs which are designed to achieve a national public housing objective. That objective is a stable flow of mortgage credit on a nationwide basis. The establishment of the FHA and VA programs, the creation of federal savings and loan associations, and the chartering of national secondary market mechanisms was, and is still, a basically sound approach to achieving nationwide stability for mortgage finance.

There has been, however, a disruption of this national network for home finance by state usury laws which fix interest rates (particularly mortgage interest rates) below current market rates. These unrealistically low and arbitrary limits result in mortgage credit drying up in those states with below-market usury limits as funds naturally flow away from those states into other market areas where a higher yield can be obtained.

The ultimate losers in this situation are the consumers in these states, the potential home buyers, who are effectively denied the opportunities and benefits of home ownership. In states with restrictive usury ceilings, there is only minimal or no mortgage lending taking place. This, of course, affects housing construction and employment, and places such uncertainty on future plans for housing development as to bring the housing sector to a standstill. This is especially important in the light of the large number of persons who will be reaching household formation age in the decade ahead. Persons in this age group will be denied the opportunity to work and live in certain areas because there will be no housing available to accommodate them, unless usury laws are repealed or substantially altered with respect to mortgage credit.

ECONOMIC CONSEQUENCES

While the impact on individual options for home ownership alone is reason enough to take action on state usury ceilings, a further justification can be found in the threat to local economies in those states with low usury ceilings. Lack of mortgage lending rapidly brings unemployment in housing construction and related industries.

This in turn has a ripple effect throughout the entire economy of the region. Funds which should be available to keep up the economic growth of the region are transferred to other areas, because unsound and unreasonably low interest rates keep financial institutions from obtaining enough return on their loans to meet the rising cost of the money to them.

PARITY

A final effect of the structure of some of the state usury laws has been the creation of a disparity between certain types of financial institutions. As you know, in my own state of Arkansas, state banks and all savings and loans are limited by the state usury ceiling of 10 percent, while national banks may charge 1 percent above the discount rate, currently about 13 percent. This state of affairs creates a competitive inequality not only on the lending side but ultimately on the deposit side. State banks and savings and loans are losing deposits to national banks

because the consumer is going to deposit his or her savings in the financial institution that can offer lending services. Without these deposits, the state banks and all savings and loans have less funds to make mortgage, commercial and consumer loans.

While all of us would prefer to see interest rates at reasonable levels, the fact is that the market rate for mortgage credit is at the 13 to 14 percent level. The ultimate answer, of course, is to bring inflation rates under control through fiscal and monetary policies. In the meantime, however, it is apparent that usury ceilings below-market rates not only fail to protect the consumers, but, in fact worsen the effect of inflation on them.

NEED FOR IMMEDIATE ACTION

The need for immediate action on this issue is apparent. The effects on mortgage lending created by usury ceilings have been disastrous. Where usury ceilings are at or below 12 percent, funds that would normally be invested within the state are flowing to other areas where investments earn a market return. Mortgage lending has virtually come to a halt, except for meeting existing commitments. For example, a savings and loan in a state with a 10 percent usury limit takes a loss of about 2 percent on each loan that it makes to honor existing commitments. There is no way one can continue to make new commitments when the usury ceiling is substantially below the current rate paid on incoming funds.

The realities we must live with are the outflow of deposits into money market funds, and the fact that deposit funds that do continue to come in to our institutions are mainly in the form of money market certificates. We are paying 11 to 12 percent for these deposits and about 14.5 percent for advances from the Federal Home Loan Banks. One simply cannot pay these rates to obtain funds and lend them out at 10 to 12 percent.

While banks have the option of converting to federal charters to escape the state usury limit, savings and loans do not have this option. It is apparent that continuation of the current status would weaken the dual banking system.

Mr. Chairman, we understand the resistance of many members of the House and Senate to this bill and other preemption proposals. Only an extreme economic emergency would prompt us to seek a federal preemption of state laws. That is just what we have before us in more than twenty states. The housing industry and local economies in general are threatened with stagnation in these states unless our industry can start making new mortgage commitments at current market rates.

In addition to the importance of housing to our national economy there is another justification for a federal preemption of usury laws. Market interest rates in Texas, New Jersey, New York, and every other state are virtually dictated by policy decisions made here in Washington. Every savings and loan in the country is subject to the fiscal and monetary policy actions of the Congress, the Treasury, and the Federal Reserve. Decisions made by the federal government over the past several months are directly responsible for the situation we find ourselves in—where the money coming into our institutions is at costs of 11 to 14 percent. For those of us who must live with usury ceilings of 10 to 12 percent, these federal government decisions have been, in effect, decisions to stop our mortgage lending activity. We feel justified, therefore, in urging the federal government to give us relief from usury restrictions since it is the federal government that controls our cost of funds.

In conclusion, Mr. Chairman, on behalf of the National Savings and Loan League, I want to thank you and the members of your Committee for your responsiveness to our problems. The usury provisions of H.R. 4986 and H.R. 4998 as they passed the Senate are certainly welcome and have our strong support. We urge the Committee to act favorably on S. 1988 as soon as possible so that in the event that the other preemption provisions are not adopted there will remain a vehicle to keep the housing industry alive during tight money cycles.

The CHAIRMAN. Mr. Hooke?

STATEMENT OF ALBERT B. HOOKE, PRESIDENT, COMMUNITY SAVINGS BANK, ROCHESTER, N.Y., AND VICE CHAIRMAN, NATIONAL ASSOCIATION OF MUTUAL SAVINGS BANKS

Mr. HOOKE. Thank you. I am Albert B. Hooke, president of the Community Savings Bank of Rochester, N.Y., and vice chairman of the National Association of Mutual Savings Banks.

I am here today to support S. 1988 because it not only will make credit available for mortgage borrowers, but will also help financial institutions get to the point where savers will get a better return. We have heard a great deal about the plight of the small saver, and we feel that usury laws, particularly in those States which have had very low ceilings for many years, has been a major factor in our inability to pay more to all savers.

For example, 7 of our 17 savings bank States have below-market usury ceilings, but those 7 States have 70 percent of our deposits. In New York State, the interest rate at the present time, ceiling, is 10¼ percent and in New Jersey, it's 10½. When we run into interest-rate situations like we have today, we have to go out of the mortgage market because not only is there very little money available, but we're not able, as Mr. Janis previously testified, to sell loans that we could make into the national secondary market. This means that we're unable to perform the service on both sides.

NEGATIVE IMPACT IN EARNINGS

In addition to this, the low ceilings have had a very negative impact in terms of our earnings, which in the long run mean that we are impacted on our ability to compete for deposits. For example, in 1979, we're expecting about 0.32 in New York State as an industry, whereas nationwide our savings banks will earn 0.40 on average assets, or better. In those nonusury States it is even more attractive.

It has been apparent that in States where they do not have usury ceilings that the high interest rates have not had quite the negative impact on buyers. This is because of increases in the value of the housing that they purchased plus the tax advantage on the interest deduction have made it attractive for them, economically, to do this. People do not pull back from higher interest rates for home purchases as many of the opponents of lifting usury ceilings have felt.

As regulation Q ends, it is going to be extremely important for us to have the ability to earn and to be able to do it sooner. And so it is important that we get this now.

We found that the federally chartered commercial banks in our State, for example, with their current 13 percent ceiling, have been able to come into the market and attract people; in fact, they run out of funds rather than run out of borrowers.

We would like to make one suggestion as an amendment to this bill, and that is that the federally chartered institutions not be subject to the State override provision. If only State chartered institutions were subjected to the override, this would equalize the national charters on all fronts.

We thank you for inviting us here today, and we urge that this be passed quickly.

The CHAIRMAN. Thank you very much, Mr. Hooke.

[The complete statement of Mr. Hooke follows:]

STATEMENT OF THE NATIONAL ASSOCIATION OF MUTUAL SAVINGS BANKS

Mr. Chairman and Members of the Committee, my name is Albert B. Hooke. I am President of the Community Savings Bank, Rochester, New York, and Vice Chair-

man of the National Association of Mutual Savings Banks. I am pleased to present the views of the savings bank industry on S. 1988.

This legislation would: (1) provide for the federal pre-emption of state usury ceilings; (2) substitute for both mortgage and non-mortgage loans a new ceiling which would be the higher of either the Federal Reserve discount rate plus one percentage point or the existing state usury ceiling; (3) make this ceiling applicable to all federally-insured financial institutions; and (4) permit states to enact legislation overriding their federal usury ceiling pre-emption. The result would be to apply the usury provisions currently applicable to national commercial banks to other types of institutions, including federally-insured mutual savings banks.

SUMMARY OF SAVINGS BANK INDUSTRY POSITION

The savings bank industry strongly supports S. 1988. This legislation would expand the supply of mortgage funds and other credit to individuals during periods of inflation and high interest rates. It would give access to credit to many borrowers who are now effectively barred from borrowing by below-market usury ceilings. It would greatly enhance the ability of thrift institutions located in states with such usury ceilings to meet the credit needs of their local communities.

This legislation would also be beneficial to the saver. By strengthening thrift institution earnings, S. 1988 would enable these institutions to compete more effectively for savings and to pay higher returns to the "small saver". In another important area, this bill would end discrimination against institutions competing with national commercial banks. This legislation, therefore, is essential to the continued viability of mortgage-oriented thrift institutions in states with below-market usury ceilings.

LONG-STANDING SUPPORT OF USURY CEILING ELIMINATION

It has long been recognized that unrealistic usury ceilings are harmful to mortgage borrowers, savers and financial institutions. Nearly a decade ago, the President's Commission on Financial Structure and Regulation (the Hunt Commission) recommended that "... states remove statutory ceilings on allowable interest rates on residential mortgages." And only this past August, The Report of the President's Inter-Agency Task Force on Regulation Q concluded that "... although there has been improvement since 1970, the existence of low state ceilings has served to divert funds to other states and in states where usury has not been a problem this tendency has been reduced."

Most recently, the Senate-passed Depository Institutions Deregulation Act of 1979 (H.R. 4986) provided for federal pre-emption of state mortgage usury ceilings. The Committee Report noted that "... where state usury laws require mortgage rates below market levels of interest mortgage funds in those states will not be readily available." In addition, the Report stated that "... mortgage rate ceilings must be removed if savings and loan institutions, as directed by other provisions of H.R.4986 as amended by the committee, are to begin to pay market rates of interest on savings deposits."

Our industry supports these views. NAMSAB recently established a special Task Force on Financial Reform Proposals. The Task Force's recommendations were submitted to and approved by the NAMSAB Board of Directors. One of its recommendations urged "... the federal pre-emption of state usury ceilings where such ceilings are below market rates, and the elimination of ceilings on FHA and VA contract rates." The latter would reduce points charged by lenders, which are a hardship on some borrowers.

IMPACT OF STATE USURY CEILINGS

Presently, mortgage interest rates on 1- to 4-family loans are in the thirteen percent area in many states without restrictive usury ceilings. By contrast, usury ceilings in seven of the seventeen savings bank states—representing over 70 percent of the industry's total deposits—were substantially less as of November, the latest date for which data are available. In fact, usury ceilings in New York and New Jersey—despite recent changes in both states to a more flexible usury limit tied to movements in long-term government bond rates—are currently at 10¼ and 10½ percent, respectively.

As a New York State savings banker, I can testify that the results have been predictable and have been repeated time and again, interest rate cycle after interest rate cycle. As market interest rates rise above usury limits, the availability of mortgage credit to local markets dries up. This occurs for two major reasons: (1) disintermediation appears at thrift institutions, because they lack the earning

power to attract savings, thereby reducing the supply of investable funds; and (2) lenders are forced by competition and by earnings pressures to allocate funds to investments paying market rates of return.

The current period of rapid inflation and high interest rates is a case in point. During the first ten months of 1979, the savings bank industry suffered record deposit outflows, excluding interest, of \$5.2 billion or 3.7 per cent of outstanding deposits. As a per cent of deposits, the recorded deposit outflows were even worse in New York State, where savings banks lost 5.8 per cent of their deposits in the January-October period. With available investment capital drastically reduced and expectations of continuing massive deposit outflows, savings banks and other thrift institutions have emphasized liquidity and have continued to add to holdings of liquid assets in anticipation of future depositor withdrawal.

As for earnings, the impact of rising deposit costs and lagging income is evident. For the savings bank industry as a whole, bottom-line net income for 1979 is projected at .40 per cent of assets, down from .58 per cent in 1978. The picture for New York State is even worse, where 1979 net income is projected to drop to .32 per cent of assets.

In terms of the potential local home buyer, the impact of low state usury ceilings should also be obvious. Such mortgage financing as is available during high interest rate periods is generally not adequate to satisfy demands from all potential home buyers. The result is that available funds must be rationed. Such rationing has frequently taken the form of higher required mortgage down payments or delays in accepting loan applications. These practices, needless to say, have had the obvious effect of discriminating in favor of the wealthier borrower or the home buyer who is able to delay his purchase.

A continuation of below market rate usury ceilings in certain states will mean that adequate supplies of mortgage credit are available to these markets only when interest rates are relatively low. Federal pre-emption of state usury ceilings would mean that mortgage credit would be more readily available throughout the entire interest rate cycle. The choice then is between periodically higher costs and more adequate supply, as opposed to outright unavailability of mortgage credit during high interest rate periods. Borrowers willing to pay market rates should have that choice. And based on the continuing home buyer demands in non-usury states, it seems clear that borrowers have demonstrated their willingness to pay market rates in order to assure that adequate mortgage financing will be available. Despite rising mortgage interest rate levels, increases in house prices relative to the rate of inflation still makes home buying good economic sense.

IMPACT ON SAVINGS INSTITUTIONS AND THE SAVER

Whatever reasons may have prompted the original enactment of usury ceilings, their continuation in the current inflationary climate is self-defeating and unjustified. From the vantage point of depositors, it is apparent that the existence of usury ceilings has contributed to the anti-saver bias which exists in our financial system. Usury ceilings have historically kept mortgage interest rates below market levels during high interest rate periods. Concurrently, depositors—the source of mortgage capital—have necessarily been offered less than market rates of interest for their savings. The result has been that depositors have subsidized borrowers, or at least those borrowers fortunate enough to obtain credit in tight money periods.

The Senate-passed Depository Institutions Deregulation Act of 1979 (H.R. 4986), which NAMSB supports, would tend to put depositors and borrowers on a more even footing. As you are aware, this bill would allow deposit interest rates to rise gradually to market levels by phasing out Regulation Q ceilings over a ten year period beginning in 1981. As H.R. 4986 and S. 1988 both recognize, however, mortgage-oriented financial institutions will be unable to pay their depositors market interest rates unless they earn market rates on the asset side of their balance sheets. Elimination of sub-market usury ceilings is one of the actions which are necessary to achieve this result.

As mutual institutions, savings banks pay out all earnings to depositors as interest after provision for operating expenses, taxes and additions to protective reserves. They have no stockholders to benefit from higher earnings. During the first ten months of 1979, interest paid to depositors increased by \$900 million or 14 percent, above the same period last year. This was the greatest January-October increase in deposit interest ever experienced by savings banks and exceeded the previous record set in 1977 by nearly 44 percent.

Substantial increases in interest payments are largely attributable to the 6-month money market certificates. The 6-month CD in the present economic environment continues to be the only type of account that is able to attract significant funds at

savings banks. As of October 31, only seventeen months after their introduction, money market certificates at savings banks totaled \$31 billion or 22 percent of total savings and time deposits. We estimate that currently nearly one-half of these certificates pay yields in excess of 11 percent. By comparison, mortgage usury ceilings in some states are currently less than 11 percent. It goes without saying, that at current interest rate levels, lenders in these low usury ceiling states stand to lose every time they make a local mortgage loan. Lastly, as our 6-month CD experience illustrates, savings banks cannot pay market rates on even a portion of their deposits without being able to charge market rates on their mortgage loans.

DUAL BANKING SYSTEM

Recently, federally chartered commercial banks in New York State and other low usury ceiling states exercised powers given them under the National Banking Act to make real estate loans at rates one percentage point above the Federal Reserve discount rate. This effectively allowed these institutions to circumvent the low usury ceilings existing within their states. State chartered institutions—including state chartered commercial banks as well as mutual savings banks and savings and loan associations—were unable to do so.

The result has been that a few institutions have gained an unfair competitive advantage over competing institutions and this has caused the competitive equality of our dual banking system to be further undermined. S. 1988 would restore equity with regard to mortgage interest rate ceilings by enacting a uniform interest rate ceiling for all types of federally-insured institutions, whether federally or state chartered.

In this regard, we would suggest one amendment. In our opinion, the proposed state override of the federal pre-emption should apply only to state chartered institutions. Such a change would maintain parity between federally chartered commercial banks and thrift institutions.

In summary, the savings bank industry strongly supports federal pre-emption of state usury ceilings. The existence of sub-market state usury ceilings, tends to choke off the supply of mortgage credit to local markets and reduce rates paid to savers. The time for eliminating such restrictive usury ceilings is long over due.

STATEMENT OF NORMAN STRUNK, EXECUTIVE VICE PRESIDENT, U.S. LEAGUE OF SAVINGS ASSOCIATIONS

Mr. STRUNK. Thank you, Senator, Mr. Chairman. I appreciate the generous remarks you made with respect to my career and I might say that the savings and loan business has had a great record in the past 25 years, and we know that we exist, and the things that we do are wholly dependent on laws passed by the Congress. And I have a very warm feeling with respect to the Congress and all that it has done for the business over these years, and we appreciate that.

Today, I am here to testify in complete support of this bill, S. 1988, and I will be very brief.

I submit for the record a more complete statement that includes three exhibits detailing the situation in some 20 States impacted by these usury ceilings. And I also have here a rather long economic working paper. It is a theoretical economic publication that might be helpful.

The CHAIRMAN. Your full statement will be entered into the record.

CANNOT UPGRADE INVESTMENT PORTFOLIOS

Mr. STRUNK. The reality of it today, of course, is that mortgage lending in these 20 or so States is at a virtual standstill. There is no way that institutions like ours, operating in these States, can upgrade their investment portfolios, built in considerable part with 6, 7, and 8 percent loans made years ago, and at the same time pay

market-related rates demanded by the savings public today for money market certificates, and the new 30-month certificate announced last Friday.

S. 1988 would provide some relief in this deteriorating environment. And it would provide parity for savings and loan associations with their national bank competitors. But mortgage ceilings set at 1 percent above the Fed's discount rate do not provide a totally satisfactory solution to the problem of binding usury ceilings, as illustrated by exhibits 2 and 3 of my more complete written statement.

Not only do discount rate adjustments track imperfectly with mortgage market movements, but at no time in the past 6 years has the discount rate-plus-1 percent level matched the marketplace mortgage rates, at least as measured by the FNMA rates.

Of course, your committee and the Congress have grappled with the usury problem in other legislation. Public Law 96-104 is helping with the business and farm loans in Arkansas, and the housing bill, with its override for FHA title I and title II loans, is now nearing enactment.

Of even greater promise for conventional loan lenders, home buyers and home sellers is a language in your committee's version, the Senate's version, of H.R. 4986. Considering the date, however, it appears that this extensive package cannot be resolved by the end of this session. Therefore, in addition to S. 1988, the subject of today's hearing, and as an interim help to home buyers and sellers, we support H.R. 4998 as passed by the Senate a week ago.

That legislation would get home mortgage lending started again in the 20 States that we're talking about here in these hearings. We hope that the House will share that view and accept your initiative without further change.

Again, I have appreciated the opportunity to be with you many times in the past and again to be here today.

The CHAIRMAN. Very good. Now, there's a rollcall vote. I'm going to have to leave in about 90 seconds—or 120 seconds, so I'm going to have to be very quick.

Mr. Strunk, we appreciate your support for the preemption of State usury laws, but as you look forward to usury preemption and VRM authority nationwide, don't you think it's fair that regulation Q be phased out, also?

Mr. STRUNK. In due time, sir.

The CHAIRMAN. Well, we take 10 years to do it in our bill.

Mr. STRUNK. I think we are fussing about the formula for the phasing out. You would phase the ceilings up and we would phase them to market levels, in a much, I think, less arbitrary manner.

The CHAIRMAN. Well, I hope we can get together and work something out, because I think it is to the interest of everybody that we do that.

Mr. Hooke, testimony here is that mortgage lending is at a virtual standstill in 21 States. Your view is the same. What is your estimate of the number of housing units that will not be built in 1980 unless the usury ceilings are lifted?

Mr. HOOKE. I don't have one.

The CHAIRMAN. You heard Chairman Janis' testimony?

Mr. HOOKE. Yes, but I am not familiar with his formula.

The CHAIRMAN. Well, he based it on four separate studies that seem to have been made in several different States. If money for home lending is drying up, where are thrifts investing their funds?

Mr. HOOKE. Well, in general, in the New York State area, there has been very little available, and those banks which have any funds are putting them back into liquid investments. This is the most prudent course when bankers are not sure what's going to happen and how much higher rates are going to go.

The CHAIRMAN. Mr. Coffman, you talk in your statement about mortgage money drying up in various States, too. Can you tell us what that literally means? Are no homes being built in Arkansas?

Are loans not available, or are they only available selectively? And if so, what are the selection criteria?

Mr. COFFMAN. No. 1, we are filling our commitments as we have outstanding in the communities like where I live. There is no mortgage money being lent, period, except for the State bond money and the county bond money that was approved back on April 26, and which is roughly a million dollars in areas where I live, in each county.

MONEY MARKET CERTIFICATES

Money is coming in to us through the money market certificates. We are turning around and reinvesting that in the home loan bank and the DID account, which is one-eighth of 1 percent under the Fed fund's rate. That's where all of the savings and loan people are putting their money in Arkansas. It's the only place you can put it.

We can't loan it at 9-3/4, which is our normal rate in Arkansas, and pay these folks 11.75.

The CHAIRMAN. That is a very vivid picture of the ultimate effect of this usury ceiling. I appreciate it very much. Gentlemen, thank you so much. I apologize, but I'm going to have to run. Again, you have made a very, very fine record. We deeply appreciate it.

And Norm, I hope you will be in to testify again. You have a world of experience and wisdom here, and you can be very helpful to us.

Mr. STRUNK. That is part of my job description for the next several years.

The CHAIRMAN. Very good.

[Whereupon, at 12:05 p.m., the hearing was adjourned.]

[Complete statement of the United States League of Savings Associations and additional material received for the record follows:]

STATEMENT OF NORMAN STRUNK, EXECUTIVE VICE PRESIDENT, U.S. LEAGUE OF SAVINGS ASSOCIATIONS

Mr. Chairman, my name is Norman Strunk of Chicago, Illinois. As Executive Vice President I appear today on behalf of the United States League of Savings Associations¹ and its 4,450 member savings and loan associations nationwide.

¹ The United States League of Savings Associations (formerly the United States Savings and Loan League) has a membership of 4,450 savings and loan associations representing 99% of the assets of the \$510 billion savings and loan business. League membership includes all types of associations—Federal and state-chartered, insured and uninsured, stock and mutual. The principal officers are: Ed Brooks, President, Richmond, Va.; Rollin Barnard, Vice President, Denver, Col.; Lloyd Bowles, Legislative Chairman, Dallas, Tex.; Norman Strunk, Executive Vice President, Chicago, Ill.; Arthur Edgeworth, Director-Washington Operations; and Glen Troop, Legisla-

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The U. S. League appreciates your invitation to present its views on S. 1988, a bill by Senators Pryor and Bumpers "to equalize the competition between State and national banks".

Title I of S. 1988 would extend to all Federally-insured commercial banks, savings and loan associations, credit unions, mutual savings banks, and to small business investment companies, a privilege now available only to national banks—namely, to charge rates of interest on loans up to a ceiling of 1 percent above the current Federal Reserve System discount rate—regardless of State-imposed statutory or constitutional usury limitations. As a consequence, given the 12 percent discount rate currently applicable, national banks today enjoy an exclusive advantage for lending activity in an estimated 21 jurisdictions (see Exhibit 1).

Title II would alleviate a corollary problem encountered in a few jurisdictions—such as Arkansas and Texas, and until recently, California—where rigid usury laws may arguable interfere with the ability of financial institutions to accept deposits.

The U.S. League supports S. 1988, to relieve the disparity in treatment which has placed savings and loan associations at a disadvantage relative to national banks.

The case against usury restrictions is well known. Economists use terms and phrases like "anachronistic", "outmoded", "market interference", and "inefficient allocation of housing capital" to describe their pernicious effect. Unquestionably usury restrictions artificially distort the flow of credit in modern America. To achieve economic rates of return, lenders constrained by ceiling rates must resort to discounts, which then add to the front-end costs of obtaining financing. In the home lending business, usury laws and administered rates penalize most those who are most disadvantaged—the first-time home buyers. In short, usury ceilings harm those they were designed to protect.

An "Economic Working Paper" entitled "Usury Ceilings: the Threat to Housing", prepared by the U.S. League's Economics Department, reviews in greater detail these familiar consequences and their impact on the quantity of funds flowing into residential mortgages. We are pleased to provide that document for the extended record of these hearings.

Beyond any theoretical discussion there is the reality facing homebuyers and home finance-specialized institutions today. Mortgage lending is at a virtual standstill in twenty-one States.

This Committee is very familiar with the popularity of market-related savings instruments. The six-month Money Market Certificate now provides more than one-fourth of the total savings base of savings and loan associations and the percentage climbs every month. At today's rate levels, and in anticipation of substantial roll-overs of existing MMCs at comparable levels in the immediate future, the escalation in our cost of funds tests the ability of many thrift institutions to keep pace—given our portfolios containing many loans at 5½ percent, 6 percent, 7 percent—clearly uneconomic rates of return. Federal Home Loan Bank Board Chairman Jay Janis has recently written to your Committee, and testified before the Joint Economic Committee, on the implications of these trends for institutional earnings.

The situation is troublesome throughout the country. It is critical in states with below-market usury ceilings. There is no way that savings and loan associations operating in the twenty-one states cited in Exhibit I can upgrade their investment portfolios to accommodate the rates demanded today by the savings public since they cannot prudently afford to make home loans at 10 percent and 11 percent while paying depositors 11 and 12 percent.

In testimony in 1978 before your Housing Subcommittee on the need for alternative mortgage instruments—in the early months following the arrival of the MMCs—we explained that the fastest-growing source of funds for home finance had become tied directly to short-term swings in market interest rates while the investment side of our business remained locked (with very few exceptions) as firmly as ever to 25 and 30 year home mortgages. We warned that the "cart is before the horse". That rigid cart is built not only of fixed-rate loans; it consists of rigid usury laws, as well. Unless we release the hand-brake of usury laws, the cart can't roll forward in twenty-one jurisdictions. Obviously, such market innovations as variable rate mortgages are of no use in states where usury laws prevent lenders from originating loans at the rates demanded by today's economic conditions.

S. 1988, and other initiatives I will mention in a moment, will provide immediate relief in this deteriorating environment for home finance. Importantly, the Pryor-Bumpers bill will restore parity among the competing institutions supplying resi-

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tive Director. League headquarters are at 111 E. Wacker Dr., Chicago, Ill. 60601; and the Washington Office is located at 1709 New York Ave., N.W., Washington, D.C. 20006. Telephone: (202) 637-8900.

dential, commercial and agricultural credit. (I would also note that it will achieve partial comparability with other creditors, such as the Farm Credit System, which do not recognize state-imposed usury limits.)

It is important to recognize, however, that while providing parity and some short-term relief, mortgage ceilings set at 1 percent over the Federal Reserve's discount rate do not provide a totally satisfactory solution to the problem of binding usury ceilings. Exhibits 2 and 3 make it abundantly clear that the discount rate tracks imperfectly with the movement of rates in the mortgage market (as measured by the Federal National Mortgage Association's free market auction yields). In fact, as shown in the exhibits, a ceiling of 1 percent above the Fed's discount level fails to equal marketplace mortgage rates at any time in the past six years.

Before commenting briefly on other approaches to the national problem of usury law distortions, we would like to suggest two refinements to the language of S. 1988. We recommend that the scope of institutions covered by the legislation be expanded to include all members of the Federal Home Loan Bank System. This could at some point assure parity for home financing provided by non-FDIC and non-FSLIC insured institutions which are, just the same, Federally-regulated. For clarity's sake, we would also recommend that Title I of S. 1988 recite the District of Columbia, Puerto Rico, Guam, and the Trust Territories in addition to the reference to "State". (D.C. is so mentioned in Title II of the bill.)

As this Committee is well aware, the First Session of the 96th Congress has already grappled with the usury law problem in other legislation. Public Law 96-104 provides an override to July 1, 1981 (generally) for business/agricultural loans above \$25,000. Your Committee is to be commended for the override (of indefinite duration) provided FHA Title I and Title II loans in H.R. 3875, the Housing and Urban Development Amendments of 1979 where, I understand, a Conference Report is awaiting final action. On enactment of the Housing Bill, comparable treatment for Veterans Administration-guaranteed loans is assured by Title IV of the recently-enacted Public Law 96-128. These are welcome developments.

Of even greater promise is the language provided in H.R. 4986 passed by the Senate on November 1. Home lending by savings and loan associations, the primary source of mortgage credit in America, is customarily done on conventional terms; less than 8 percent of portfolios are FHA/VA. Thus, the application of H.R. 4986 to conventional lending is of far greater significance to savings and loan associations and our borrowers. In the event that the remaining time for this Session prevents lasting resolution of the many other issues in H.R. 4986, we are hopeful that your Committee, and your counterparts in the House of Representatives, will approve the Senate-passed usury override provisions for home lending early in the coming year.

As an interim help to homebuyers and sellers, we support H.R. 4998, as passed by the Senate a week ago. We were pleased to join with the other major organizations representing housing and home finance—the National Association of Homebuilders, the National Association of Realtors, the Mortgage Bankers Associations, the National Association of Mutual Savings Banks, and the American Bankers Association—in support of H.R. 4998 as an expedient for dealing temporarily with the problem created by usury restraints for conventional lending in the twenty-one jurisdictions cited previously.

In conclusion, I would repeat again our opposition to the economic distortions created by usury laws to the detriment of the homebuying and homeselling public. We support measures such as S. 1988, which would provide parity among the institutional competitors providing credit for the American public. S. 1988, the 1979 Housing Bill, and H.R. 4998 are needed immediately so that home mortgages might again become available in an estimated 21 States. The usury override language in the Senate version of H.R. 4986 provides even greater promise for solving the usury law problem in the future, and we urge its adoption in the Second Session if time does not permit resolution of other issues in the remaining days of this Session.

I have appreciated this opportunity to present the views of the U.S. League and look forward to your questions.

EXHIBIT 1—Extent of Competitive Disadvantage Suffered by S. & L.'s in 21 States With Usury Ceilings
Below Federal Reserve Discount Rate + 1 percent (13 percent)

[As of December 1979]

State	In percent	
	Usury ceiling	Rate disadvantage
Arizona ¹	² 12.0	-1.0
Arkansas	² 10.0	-3.0
Georgia	³ 12.5	-.5
Hawaii	² 12.0	-1.0
Iowa	³ 12.25	-.75
Kansas	² 11.0	-2.0
Louisiana	² 12.0	-1.0
Mississippi	² 10.0	-3.0
Missouri	³ 11.4	-1.6
Nebraska	² 12.5	-.5
New Jersey ¹	² 10.5	-2.5
New Mexico	² 10.0	-3.0
New York	³ 10.25	-2.75
North Dakota	² 12.0	-1.0
Oregon ⁴	² 12.0	-1.0
Pennsylvania ⁴	³ 12.0	-1.0
South Dakota	² 12.0	-1.0
Washington	² 12.0	-1.0
Texas	³ 12.0	-1.0
Vermont	³ 12.0	-1.0
Wisconsin	² 12.0	-1.0

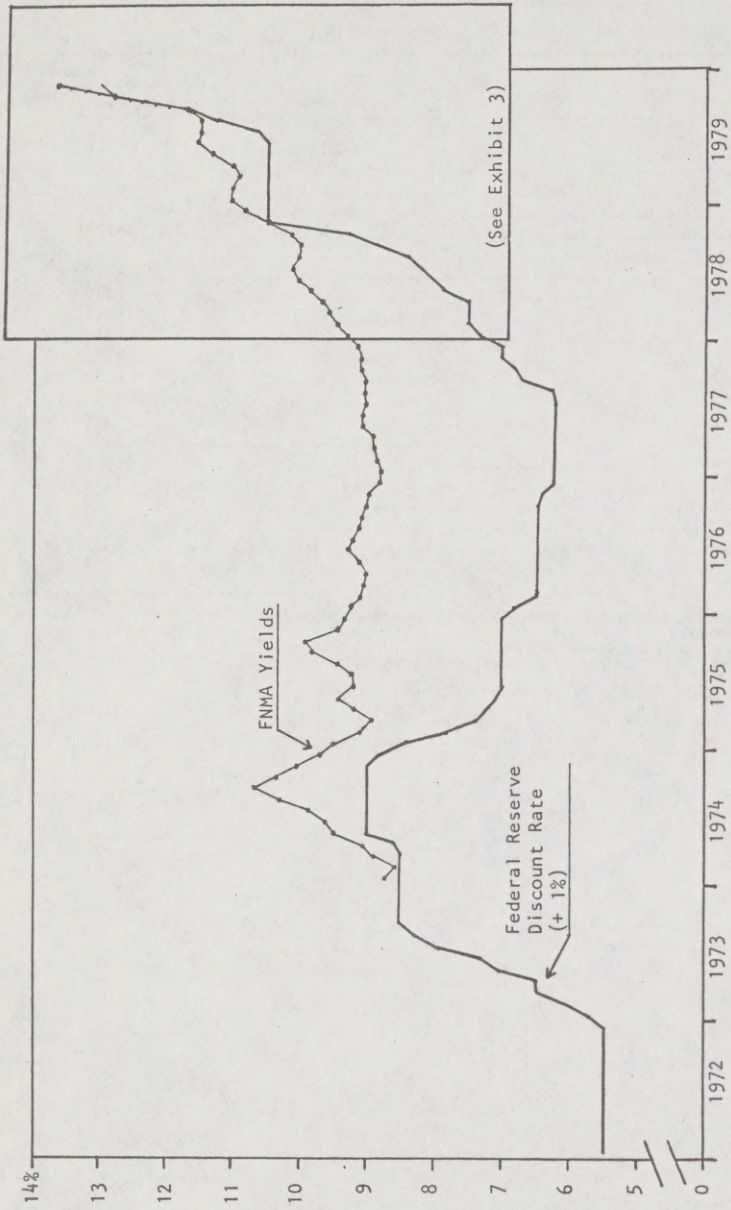
¹ Both Arizona and New Jersey have legislation to raise their usury ceilings that may be enacted during December.

² Fx: Fixed ceiling.

³ Fl: Floating ceiling as of December 1979.

⁴ 12 percent limit on loans under \$50,000. No limit on loans over \$50,000.

Exhibit 2: Comparison of FNMA Yields with Federal Reserve Discount Rates (plus one percent), 1972-79.



Sources: Federal Reserve Board and Federal National Mortgage Association.

EXHIBIT 3: Comparison of FNMA Yields with Federal Reserve Discount Rates (plus 1 percent) for 1978 and 1979

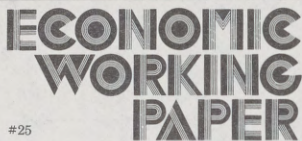
Year/month	Percent		Spreads
	FNMA yields	Federal Reserve discount rates (+ 1 percent)	
1978:			
January	9.329	7.370	1.959
February	9.487	7.500	1.987
March	9.607	7.500	2.107
April	9.714	7.500	2.214
May	9.898	7.840	2.058
June	10.092	8.000	2.092
July	10.187	8.250	1.937
August	10.099	8.430	1.669
September	10.015	8.830	1.185
October	10.197	9.260	.937
November	10.565	10.500	.065
December	10.845	10.500	.345
1979:			
January	11.075	10.500	.425
February	11.045	10.500	.545
March	10.940	10.500	.440
April	11.034	10.500	.534
May	11.355	10.500	.855
June	11.567	10.500	1.067
July	11.524	10.690	.834
August	11.517	11.240	.277
September	11.747	11.700	.047
October	12.847	12.770	.077
November	13.659	13.000	.659
December	NA	NA	

Sources: Federal Reserve Board and Federal National Mortgage Association.



UNITED STATES LEAGUE of SAVINGS ASSOCIATIONS

®111 E. WACKER DR. / CHICAGO, ILL. 60601 / TEL. (312) 644-3100



USURY CEILINGS: THE THREAT TO HOUSING

by Thomas J. Parliment

Associate Economist

James S. Kaden

Research Assistant

Economics Department

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Executive Summary

The adverse impact of usury ceilings on housing starts and mortgage lending in states where interest rates have reached the usury ceiling has been documented by two Presidential Commissions and numerous academic studies. However, until the present only a few states were affected at one time or another by usury ceilings which were fixed below market mortgage rates. Today, due to strong housing demand and an overall high level of interest rates, the usury ceilings in a large number of states threaten to jeopardize the health of many robust housing markets. The scale of the usury ceiling problem can be attested to by noting that:

- Fifteen states currently have fixed usury ceilings of 10% or less.
- These states accounted for 30% of total housing starts in the U.S. in 1978. Two of these states alone, Florida and Texas, contributed 15% of all housing starts last year.
- In 11 of these states the population is growing faster than the national average.

This study focuses on the results of previous research and offers new research findings concerning the characteristics of home purchasers with the purpose of explaining how usury ceilings on residential mortgage interest rates affect the very people they were designed to protect--the single-family home buyer. The study finds usury ceilings injurious to the public interest in two important ways:

- (1) The reduction in the supply of mortgage credit in states having usury ceilings of 10% or less is disproportionately borne by young, low- to moderate-income households who are entering the home market for the first time. In states where market rates have reached usury ceilings, up to 80% of first-time home buyers will be screened out of the home market as a result of the virtual elimination of low-downpayment mortgages.
- (2) Usury ceilings will create a loss of an additional 100,000 to 150,000 housing starts and approximately \$2 billion of construction spending in 1979. The resulting loss of jobs and income in the housing sector will be transmitted via a "ripple effect" to the rest of the economy, and will account for an additional spending reduction of \$1.4 billion.

The policy recommendations based on the findings of this study are:

- (1) Usury statutes which fix rates at 10% or less should be immediately reviewed by respective state legislatures to prevent imminent damage to the housing markets in these states.
- (2) If existing fixed rate usury statutes are to be replaced by "floating rate" ceilings, state legislatures must exercise caution in decisions regarding both the type of interest rate index chosen and the magnitude of the spread established between the index and the ceiling. They must make sure that the floating rate ceiling will not interfere with the market determination of mortgage rates over every phase of the economic cycle.

Introduction

Laws regulating the charging of excessive interest on loans (usury) probably represent civilization's oldest form of financial regulation. Usury laws have evolved from an ethically rooted prohibition against all interest charges to become a system of rate ceilings designed to protect unsophisticated consumers from the exploitive practices of lenders with differential market power. In addition to possessing this aura of consumer protectionism, usury ceilings have been perceived as a means of insuring the availability of relatively inexpensive credit to the mainstream of the American populace.

However, usury ceilings on residential mortgages are currently performing neither of these functions. Instead, usury ceilings are choking off mortgage flows in a significant proportion of the nation's housing markets--a result that is clearly injurious to the public interest.

The timing couldn't be worse. The demand for housing remains strong, fueled by high levels of household formations and the desirability of homeownership in an inflationary environment. Ironically, many of the housing markets with the most dire need for new housing construction are in those states with the lowest fixed usury ceilings. Thus, the decline in mortgage availability that is already occurring in states with fixed usury ceilings of 10% or less will frustrate the attempts of many people to buy a home. These states are listed on the next page.

States with fixed usury ceilings on contract rates for conventionally financed residential mortgages of 10% or less as of January 15, 1979

Arkansas	10%	New Jersey	9.5%
Florida	10%	New Mexico	10%
Georgia	10%	South Carolina	9% up to \$ 60,000 10% up to \$100,000
Idaho	10%	South Dakota	10%
Louisiana	10%	Tennessee	10%
Maryland	10%	Texas	10%
Missouri	10%	Vermont	9.75%
Mississippi	10%		

Note: Eight states have no usury ceilings; 17 states and Washington, D.C., have ceilings in excess of 10%; 9 states have floating usury ceilings; New York is in the process of changing to a floating ceiling in quarterly steps.

Treatment of "fee income or loan discounting" by residential lenders will differ from state to state. The effective mortgage yields resulting from these considerations will determine compliance in each state.

Sources: Federal Banking Law Reporter (Chicago: Commerce Clearing House, 1978); and U.S. League of Savings Associations.

Housing starts in 1979 will be slowed considerably in the 15 states. The reduction in housing starts will differ from state to state, but it can be expected that housing starts will be reduced to a level from 10% to 30% lower than they otherwise would have been.

The housing slowdown will fall largely on middle-income young households who are attempting to purchase their first home. These are the people who just will not be able to afford the higher downpayment required by lenders as they ration mortgage money among the substantial number of households continuing to search for a home.

In addition, policymakers are attempting to keep the brunt of recessionary forces from being felt first and hardest in the housing sector. A new savings instrument, the money market certificate, has been designed to keep thrift institutions competing for savings flows in a period of high interest rates, thereby sustaining the flow of mortgage credit to the housing sector. However, this effort is clearly being countermanded where usury ceilings are still fixed at 10% or less.

The problem is serious. The timing and depth of the recession that is predicted to occur in late 1979 or early 1980 may rest in the hands of state legislators rather than with the U.S. Congress. The slowdown in housing in the 15 states noted in the table on page 2 during the coming year will be substantially quickened by these arbitrary ceilings and will fuel recessionary forces in the economy.

This paper shows that usury laws in those states where statutes are currently fixed at 10% or less for residential mortgages do not benefit either the interests of the individual home purchaser or the general economic welfare of the state. It accomplishes this task through an examination of the impact that usury ceilings have on the mortgage market and an estimation of the effect usury ceilings are likely to have in the housing market.

The first section of the paper reviews the impact that usury ceilings have on the availability of mortgage credit. It discusses both how these rate ceilings reduce the quantity of funds flowing into residential mortgages and how usury ceilings affect the distribution of mortgages among borrowers.

The next section analyzes the factors which condition the impact of usury ceilings on the housing market. It includes projections of the potential impact of usury ceilings on the housing market in 1979. The third and final section of the study presents a summary of findings and several policy recommendations.

An appendix at the end of this report gives the important findings of selected pieces of research concerning the impact of usury ceilings.

I. Usury Ceilings and the Availability of Mortgage Credit

Usury ceilings have an impact on the housing market that is directly related to how much they reduce the availability of mortgage credit. In this section it will be shown that this impact is evidenced in two important ways. First, restrictions limiting the rate of return on residential lending forces funds to flow into alternative uses where the rates of return are not fixed, thereby reducing the total supply of residential mortgage credit. Second, lenders must ration the mortgage credit that they can make available, a practice which inevitably reduces the availability of mortgages to such specific groups as young, low- to moderate-income households buying a home for the first time.

Impact on the Supply of Mortgage Credit

Briefly described, usury ceilings act just like any other price fixing scheme. When market determined mortgage interest rates are below fixed usury ceilings, they do not interfere with the flow of mortgage credit. But when market pressure forces mortgage interest rates above usury ceilings, the quantity of mortgage credit demanded at the usury ceiling exceeds the quantity of credit that is willingly supplied at that ceiling price, thereby creating a shortage in the supply of mortgage credit.

This result has been acknowledged in numerous studies on usury ceilings. For instance, in the 1969 Report of the Presidential Commission on Mortgage Interest Rates (the Duesenberry Commission),⁵

it is noted that "states with unrealistically low usury ceilings ... should recognize that in the long run they are only preventing some of their residents from obtaining loans." In another study, Austin and Lindsley,¹ using data from the Ohio market, where a binding usury ceiling was in effect during the period examined, concluded that at least one out of every five prospective homes was eliminated from the home market by the usury ceilings. And in yet another study, France⁶ concluded that the amount of lending in markets where usury limits are binding is 23% lower than in markets where usury ceilings are not binding.

The explanation of this result is fairly straightforward. Fewer mortgage loans are made because the supply of funds available for such loans has been reduced. These funds have ceased to flow into the residential mortgage market because more profitable alternatives exist. The fact is that there are numerous other types of loans and market instruments whose rates of return are not fixed by state usury statutes. FHA and VA mortgages have their own interest rate limits set by federal regulatory agencies and they are not subject to state usury ceilings. Neither purchasers of out-of-state mortgages nor commercial borrowers are affected by usury ceilings. And, of course, rates of return on competing financial instruments are not fixed by usury ceilings.

Therefore, in an attempt to protect only those consumers who are deemed unable to safeguard their self interest, states have created an artificial imbalance in the rates of return on the assets in which lending institutions can invest. Not surprisingly, funds, seeking the

highest return relative to risk, flow into those assets of comparable risk whose returns are not fixed by usury ceilings. Kohn, Carlo and Kaye,¹¹ in an analysis of New York State's experience with usury ceilings from 1966 to 1976, substantiate this finding. They conclude, "[During the period when market rates exceed usury ceilings] ... there occurs a shift away from in-State, conventional one- and two-family mortgage loans to out-of-State mortgage loans and in-State conventional loans on other than one- and two-family homes." This undoubtedly was a major factor which prompted the New York State Legislature to abandon fixed usury ceilings in December 1978.

Thus, the evidence supports the conclusion that when market rates rise above statutory rates in usury states, the supply of residential mortgage credit is reduced.

Distributional Consequences of Usury Ceilings

Faced with a shortage in the supply of mortgage credit relative to demand, lenders must ration what credit is being made available at ceiling rates. That is, lenders making mortgage loans at rates below competitive market rates must compensate by reducing risk on these loans. Increasing downpayments, decreasing loan term and setting maximum loan limits are the primary means by which lenders implement a rationing policy, and this inevitably has its greatest effect on families with low to moderate incomes who are just entering the housing market.

Thus, perhaps the most important effect of usury ceilings on the mortgage market is the discriminatory impact that credit rationing produces on the borrower.

Numerous studies have long noted the impact of usury ceilings on borrowers of lower income and wealth. These households may often be classified in a higher risk category and, therefore, are the first to be rationed out of the market when market rates rise above usury ceilings. Basically, all of these studies claim that lenders attempt to consider the factors of both risk and return when evaluating additions to their portfolio. For instance, in a seminal article concerning credit rationing, Jaffee and Modigliani⁸ conclude that "imposing rate uniformity increases credit rationing as it reduces the matching of rate variability with risk variability." That is, lenders must offset the reduced return on mortgage investments with reduced risk exposure on these investments.

In their study of New York State, Kohn, Carlo and Kaye¹¹ conclude that "the usury ceilings, combined with the effect of disintermediation, led to a tightening up of non-price terms on mortgage loans in the form of larger downpayments and shorter maturities."

Rosen¹⁸ explains how these two tools of credit rationing -- downpayments and loan term -- affect the supply of mortgage credit. "The supply effect of changing downpayment requirements revolves around the risk of default on the mortgage. Everything else being equal, lower

downpayment requirements increase the risks of the lender and so reduce his supply of mortgage loans. On the supply side, a longer amortization period will increase the risks of lending, as equity will be built up more slowly, and so should have a negative impact on the supply of funds."

Thus, the fact that usury rates which are fixed low relative to prevailing market rates do result in credit rationing is consistently set forth in all of the studies on the subject. It is then assumed that the credit rationing process screens out a proportionately higher number of high risk borrowers, a class of borrowers who in turn will consist of a proportionately higher number of young, low- to moderate-income households. This assumption, however, had never been empirically verified. Data have not been available that would show the relationship between loan terms (specifically downpayments) and the age and income categories of borrowers. This missing link can now be supplied.

Recently, new evidence has been developed which firmly supports the contention that the elimination of low downpayment mortgages has a much greater impact on both young households and families with low- to moderate incomes. This evidence is based on data gathered by the U.S. League of Savings Associations from a nationwide survey of 8,500 purchasers of single-family homes who obtained conventional mortgages at savings and loan associations during 1977. The differential use of low downpayment mortgages by borrowers in different age and income

categories is displayed in Exhibits I.1 and I.2. The exhibits concentrate on the situation facing first-time home buyers, who do not have the advantage of equity from a previously owned home to help make their downpayment.

Exhibit I.1 shows the downpayments made by first-time home buyers in four different age categories. Low downpayment mortgages are of great importance to young home buyers. Over half the first-time home buyers under age 30 paid less than 20% down on their homes. The home buyers in this age group represent almost 63% of all first-time home buyers. Almost a third of these young home buyers entered the home market by means of a 90% or 95% mortgage. In fact, even for first-time home buyers in their 30s, downpayments of less than 20% of the purchase price remained important. About two-fifths of these home buyers paid less than 20% down, while one-quarter of them made a downpayment of 10% or less.

The fact that low- and moderate-income home buyers rely substantially on low downpayment mortgages is shown in Exhibit I.2. About 45% of first-time home buyers with family incomes of less than \$15,000 and 54% of home buyers with family incomes between \$15,000 and \$25,000 paid less than 20% down on their homes. These combined groups represent 71% of all first-time home buyers.

It is clear, therefore, that low downpayments are important to all first-time home purchasers and especially so to both young and low- to moderate-income households. But what would have been the effects on these home buyers of eliminating low downpayment mortgages?

Exhibit I.1: Downpayments of first-time home buyers, by buyer age

Age of first-time home buyers	Downpayment as a percentage of purchase price				Percentage of all first-time home buyers in age group
	5.0%	5.1% to 10.0%	10.1% to 19.9%	Total less than 20%	
18 to 29	5.5%	26.2%	20.0%	51.7%	62.9%
30 to 39	5.9	19.6	17.0	42.5	26.2
40 to 49	4.3	16.8	13.0	34.1	7.0
50 and over	0.8	11.0	10.2	22.0	3.9

Source: Homeownership: Affording the Single-family Home, U.S. League of Savings Associations, Economics Department.

Exhibit I.2: Downpayments of first-time home buyers, by income

Annual income of first-time home buyers	Downpayment as a percentage of home purchase price				Percentage of all first-time home buyers in income group
	5.0%	5.1% to 10.0%	10.1% to 19.9%	Total less than 20%	
Less than \$15,000	5.6%	23.2%	15.9%	44.7%	22.0%
\$15,000-\$24,999	6.4	27.4	20.7	54.1	49.3
\$25,000-\$34,999	4.6	18.8	54.1	40.7	18.3
\$30,000 or more	2.9	11.6	49.3	29.3	10.4

Source: Homeownership: Affording the Single-family Home, U.S. League of Savings Associations, Economics Department.

In other words, if first-time buyers had to make 20% downpayments, would they have been able to make the same housing purchase?

Exhibit I.3: Downpayments and affordability for first-time home buyers

	Actual downpayment made			
	5.0%	5.01% to 10.0%	10.1% to 19.9%	Total less than 20%
Percentage of first-time home buyers unable to afford 20% downpayment	87.4%	86.5%	75.0%	82.1%

Source: Homeownership: Affording the Single-family Home, U.S. League of Savings Associations, Economics Department.

Exhibit I.3 shows for different downpayment categories what percentage of first-time buyers using a low downpayment mortgage would not have been able to meet a 20% downpayment on their home. Four out of five first-time home buyers who actually made less than a 20% downpayment on a home would not have been able to purchase that home if a 20% downpayment had been required. That is, a substantial number of first-time home buyers are being permitted entry into the housing market by paying less than 20% down on a house--home buyers who, for the most part, would not have been able to gain entry otherwise.

The ability to acquire a mortgage with a low downpayment is the key to homeownership for the majority of American households who have low to moderate incomes, who are young and who are making their first home purchase. Population statistics show that the number of these households is going to increase substantially through the next decade. Yet these are the first people who are harmed when usury ceilings close off the supply of mortgage credit.

This analysis of the impact of usury ceilings on the mortgage market suggests several strong conclusions. There is no doubt that when market rates rise above the usury ceilings in a particular state, the availability of residential mortgage credit within that state is severely impeded. The total flow of funds into residential housing is curtailed and the availability of mortgage credit to young, low-to moderate-income home buyers is severely reduced. The severity of this distributional impact of usury ceilings may come as a surprise to many state legislators, but it is a consequence that few would be likely to condone.

II. Empirical Estimates of the Impact of Usury Ceilings on the Housing Market

Thus far, this paper has shown the impact that usury ceilings can have on the mortgage market. This section of the study will show what impact the reduced supply of funds for residential mortgages has on the housing market. Specifically, it will empirically estimate the reduction in the number of housing starts and the magnitude of the spending loss that will be attributable to usury ceilings in those states where the statutory rates are fixed at 10% or less. It will also discuss how key demographic and economic factors will exacerbate the usury ceiling problem in these states. First, however, this section of the study will briefly review the results of several empirical analyses of the impact of usury ceilings on the housing market.

Reviewing the Results of Other Empirical Studies

Over the past decade, numerous studies have analyzed the problem of usury ceilings. Attempts were made to relate the level of housing starts in markets under a yoke of usury ceilings to the level of activity in nonusury markets. Allowances were made for all the factors normally having an influence the supply and demand for housing and mortgage credit in these different markets. These other factors in the housing market were all held constant so the impact of usury ceilings on housing starts could be uniquely determined. For instance,

Robins¹⁵ concludes in his article that in markets where usury ceilings are below market rates, the level of single-family home building is approximately 28% lower than in markets where the usury limit is not binding. His model runs single-family housing starts against a number of important economic and demographic variables such as real per capita income, population levels, population growth, population density, housing prices and a dummy variable measuring the impact of usury limits.

Rosen¹⁸ has supplied the most sophisticated approach to an empirical estimate of the impact of usury ceilings on housing markets to date. He concludes that permit activity in markets where the usury limit is binding is 20% lower than in markets where the usury limit is not binding. The permit equation includes, as independent variables, measures of the cost of housing relative to other goods (both sales price and the CPI homeownership component are used), a measure of real income, a measure of household formations and several mortgage instrument parameters (mortgage interest rates, loan-to-value ratio, and a proxy for the availability of savings flows). All these factors were held constant while the impact solely attributable to usury ceilings was determined.

In an appendix to this paper we discuss these and several other studies individually, providing a synopsis of their salient observations.

These various studies were unanimous in their finding that housing markets where usury rates fell below market mortgage rates suffered lower levels of housing starts. Actual estimates of the magnitude of the net additional decline in single-family housing starts attributable to usury ceilings range from 10% to 30%. That is, all things considered, single-family housing starts in states where usury ceilings restricted mortgage rates from reaching market levels were 10% to 30% lower than the levels of starts in nonusury states. This information is used to assess the impact that usury ceilings are likely to have in 1979.

Making Some Projections

Nineteen hundred seventy-nine provides an excellent case study in considering the impact of usury ceilings on the housing market. It is important to estimate the magnitude of this impact on housing starts, since never before have so many large and robust housing markets been encumbered by usury ceilings, and the effects are certain to be felt nationally.

Exhibit II.1 shows how the change in housing starts expected for the U.S. in 1979 is distributed between states with usury ceilings of 10% or less and all other states. Different estimates are presented for three different housing start forecasts and for five different assumptions regarding the additional decline in total housing starts attributable to rate ceilings in usury states.

Exhibit II.1: Impact of the 1978-'79 estimated change in housing starts on states with usury ceilings of 10% or less

Estimates of additional decline in housing starts attributable to low usury ceilings	1979 U.S. housing starts forecast				
	1,900,000 (-100,000 from '78) (optimistic)		1,700,000 (-300,000 from '78) (moderate)		1,500,000 (-500,000 from '78) (pessimistic)
5%	1978-'79 change in:				
	low-ceiling states				
	- 50,945 (- 8.5%)		-110,951 (-18.5%)		-170,957 (-28.5%)
	- 49,055 (- 3.5%)		-189,049 (-13.5%)		-329,043 (-23.5%)
	all other states				
10%	1978-'79 change in:				
	low-ceiling states				
	- 71,947 (-12.0%)		-131,953 (-22.0%)		-191,959 (-32.0%)
	- 28,059 (- 2.0%)		-168,047 (-12.0%)		-308,041 (-22.0%)
	all other states				
15%	1978-'79 change in:				
	low-ceiling states				
	- 92,949 (-15.5%)		-152,955 (-25.4%)		-212,962 (-35.5%)
	- 7,051 (- 0.5%)		-147,045 (-10.5%)		-287,038 (-20.5%)
	all other states				
20%	1978-'79 change in:				
	low-ceiling states				
	-113,952 (-19.0%)		-173,957 (-29.0%)		-233,963 (-39.0%)
	+ 13,951 (+ 0.9%)		-126,043 (- 9.0%)		-266,037 (-19.0%)
	all other states				
25%	1978-'79 change in:				
	low-ceiling states				
	-134,953 (-22.5%)		-194,959 (-32.5%)		-254,965 (-42.5%)
	+ 34,953 (+ 2.4%)		-105,041 (- 7.5%)		-245,035 (-17.5%)
	all other states				

Sources: U.S. Department of Commerce; U.S. League of Savings Associations, Economics Department.

The range of these assumptions takes into consideration the fact that single-family starts generally represent 70% to 75% of total starts. In fact, we may also expect these usury ceilings to slow multifamily starts through their impact on the development of condominium projects. Even though most condominium developments are multiunit buildings whose construction is financed by loans outside the control of statutory ceilings on residential mortgages, the absorption of these condominiums by the market relies on the availability of single-family mortgages which are within the control of these ceilings. This consideration is important for housing markets in the South and the Southwest, where condominium developments have been especially popular.

Exhibit II.1 clearly points out that housing starts will slow more precipitously in usury states than in the rest of the economy in 1979. For instance, take the intermediate forecast for housing starts in 1979 of 1.7 million units, and make a conservative assumption that there will be a 10% greater decline in starts in usury states as compared with all other states. Given this assumption, the 300,000 unit decline in housing starts from the 1978 level that is forecasted to occur during 1979 would have to come about via a 22% decline in housing starts in usury states and a 12% decline in housing starts in the rest of the nation.

In fact, the deleterious effect of usury ceilings on housing starts is made painfully clear when we observe how difficult it becomes to support an optimistic housing forecast of 1.9 million units for 1979. If usury ceilings generate any kind of negative impact at

all, housing starts in all the other states would have to remain virtually unchanged at their 1978 level to bear out an optimistic forecast--a highly unlikely possibility.

This table demonstrates the startling national importance of housing markets in usury states. This stems directly from the realization that 30% of the nation's two million housing starts in 1978 occurred in those 15 states where 10% usury limits will shackle the housing markets in 1979.

The Local Impact

It is important to develop a more detailed picture of the decline in housing starts in order to characterize more specifically the economic losses to be suffered in states with ceilings of 10% or less.

Exhibit II.2 shows one reasonable estimate of the impact that usury ceilings are likely to have in those states where they have been fixed at 10% or less. Assuming a 1979 national housing forecast of 1.7 million units and a "moderate" impact estimate of 10% due to usury ceilings, one can project that usury states will suffer a total decline in housing starts from 1978 levels of 132,000 units with 60,000 units of this decline attributable to usury ceilings. Of course, the distribution of this decline among these states does assume that usury ceilings will have the same percentage of impact in each state, although this is not likely to be strictly true due to

Exhibit II.2: Usury ceiling related decline in housing starts for 1979*

State	1978 estimated housing starts	Total 1979 forecasted decline in housing starts	Decline in housing starts attributable to usury ceilings
Arkansas	10,581	2,243	1,020
Georgia	40,006	8,709	3,960
Florida	160,105	34,968	15,900
Louisiana	30,620	6,730	3,060
Maryland	33,215	7,257	3,300
Mississippi	11,444	2,507	1,140
South Carolina	27,361	5,938	2,700
Tennessee	29,338	6,466	2,940
Texas	158,197	34,572	15,720
Missouri	31,507	6,862	3,120
South Dakota	5,527	1,188	540
Idaho	11,202	2,375	1,080
New Mexico	15,351	3,299	1,500
New Jersey	37,333	8,181	3,720
Vermont	3,797	792	360
Total	605,584	131,953	60,000

* Assuming a housing forecast of 1.7 million units and a marginal impact of 10% due to usury ceilings.

Note: Figures may not add to total due to rounding

Sources: U.S. Department of Commerce; U.S. League of Savings Associations, Economics Department.

variance in local housing market conditions. Nevertheless, these approximations give substance to the concern of both lenders and builders in each of these states that usury ceilings will not only have a severe impact on their housing market but will result in adverse spillover effects on their state economies.

An approximation of the damage usury ceilings will cause to state housing markets and economies can be seen in dollar terms in Exhibit II.3. The table utilizes data on the value of permits authorized on construction published by the Department of Commerce. Column 1 contains the 1979 forecasts for the average construction value per housing unit for each of the 15 states. We can obtain a reasonable approximation of the amount of dollars in construction activity foregone (column 3) by multiplying column 1 by column 2 (the decline in housing starts due to the usury ceiling, assuming as before a 10% assumed impact due to the usury ceiling). In Arkansas, for example, the dollar amount in construction activity foregone is equal to $\$33,880 \times 1,020$, or \$34.6 million.

It is estimated that even under a moderate assumption regarding the impact of usury ceilings, the 15 states currently having statutory rates of 10% or less will lose just over \$2 billion worth of construction activity in 1979. The state in which the cost of usury ceilings is estimated to be greatest will be Texas, where more than \$530 million in construction activity is shown to be forfeited. Florida also is estimated to lose nearly \$500 million in construction activity.

Exhibit II.3: Estimated economic loss due to the reduction in housing starts attributable to usury ceilings

	(1)	(2)	(3)	(4)
State	1979 forecasted average value per housing unit ¹	Decline in housing starts due to usury ceiling in '79	\$ Amount of construction activity foregone (thousands of \$)	\$ Amount of spending foregone in state's economy ² (thousands of \$)
Arkansas	\$ 33,880	1,020	\$ 34,558	\$ 57,711
Georgia	30,508	3,960	120,810	201,750
Florida	31,341	15,900	498,320	832,190
Louisiana	28,924	3,060	88,507	147,810
Maryland	36,401	3,300	120,120	200,600
Mississippi	27,103	1,140	30,897	51,599
South Carolina	30,094	2,700	81,254	135,690
Tennessee	30,950	2,940	90,993	151,960
Texas	33,896	15,720	532,850	889,860
Missouri	33,090	3,120	103,240	172,410
South Dakota	36,701	540	19,819	33,097
Idaho	38,974	1,080	42,092	70,294
New Mexico	37,568	3,299	123,940	206,970
New Jersey	39,282	3,720	146,130	244,040
Vermont	26,780	360	9,641	16,100
Total		60,000	\$2,043,171	\$3,412,100

¹These 1979 forecasts were calculated by assuming that the average value of housing starts would increase by the same percentage it did in the 1977-'78 period. For example, in Arkansas the average value per housing start increased by 14% from 1977 to 1978. The 1979 forecast figure (\$33,880) = 1.14 X 1978 figure (\$29,696).

²These figures were calculated assuming a conservative marginal propensity to consume of .4. This yields a multiplier of $\frac{1}{1-MPC} = \frac{1}{1-.4} = 1.67$. Column (4) = 1.67 times column (3).

This multiplier is one cited for use in local economic impact analysis in Methods of Housing Analysis, James W. Hughes, ed., (New Brunswick, N.J.: Rutgers University, Center for Urban Policy Research, 1977).

Source: U.S. Department of Commerce; U.S. League of Savings Associations, Economics Department.

The damage attributable to usury ceilings in these states does not end here, however. The decline in construction spending means a direct loss of income to those people supplying materials and labor to the construction sector. As a result of this loss in income, they in turn must reduce their purchases of goods and services. For instance, assuming that 40% of the \$34.6 million spending/income foregone in Arkansas (\$13.8 million) would have been spent on goods and services, this amount is also lost to the Arkansas economy. The assumption (cited in Exhibit II.3) that only 40% of income will be respent locally, is an estimate made after taking account of leakages into savings of households and firms, leakages from the spending stream through various forms of taxation and spending outside the local economy. The estimate is very conservative.

This process of calculating the total reduction in spending due to an initial spending decline is called the multiplier effect, and it would result in an ultimate reduction in spending of \$57.7 million, which is 1.67 times the initial decline of \$34.6 million. That is, the usury ceiling related decline in housing starts and construction spending would "ripple" through the state's economy causing a loss of spending and jobs amounting to an additional 67% of the initial economic loss. For the economy as a whole this means an additional \$1.4 billion of reduced spending, bringing the negative impact of usury ceilings to \$3.4 billion.

Thus, the potential economic cost of usury ceilings to state economies is substantial. It is clear that reduced levels of housing starts, reduced incomes and reduced employment will result if usury ceilings are allowed to remain fixed below market mortgage rates.

These estimates of the impact of usury ceilings on the housing markets in these states held constant the influence of a number of demographic and economic factors. Significantly, today's usury states generally have more pronounced demographic and economic factors affecting them. As a result, it is worthwhile to consider these factors as well as in our review of the impact of usury ceilings on these state economies.

Key Factors Currently Affecting Housing Demand

The impact that usury ceilings have on housing markets is conditioned by a number of factors relating to both national and state housing and mortgage markets. At present, demographic characteristics such as population growth, age structure and migration patterns represent strong forces which are determining the current and future demand for housing.

Household Formations: Trends in household formations and the age structure of our population, for example, set the scene for strong national housing demand. The post-World War II baby boom is now giving us a population flush with young households needing housing.

Exhibit II.4 shows the actual and projected household formations through the year 1990. High rates of net annual household formation of 1.622 million per year in 1977-1980 and 1.566 million per year in 1980-1985 represent a driving force behind the demand for housing.

Changing Age Structure: Additional knowledge about the impact of demographic change on the demand for housing can be drawn from viewing the changing age structure of the population through the remainder of this century. This is shown in Exhibit II.5. People in this, the most active home buying age brackets (25-34 and 35-44), will constitute the dominant age group of our society through 1995.

Population Migration: More important from our point of view, however, are the characteristics of population growth in those states with ceilings of 10% or less. The severity of the damage done to housing markets by usury ceilings relates to both the rate and type of population increase in these states. Data describing these population characteristics are displayed in Exhibit II.6.

Looking at these growth and migration statistics, we find that in all but four of the states, the rate of population growth exceeds the national average. The rapid rates of growth in already populous states, like Florida and Texas, make the prospect of a housing slowdown in these states a problem with significant social repercussions, simply due to the sheer numbers of frustrated home buyers. Furthermore, a majority of the housing markets being adversely affected by

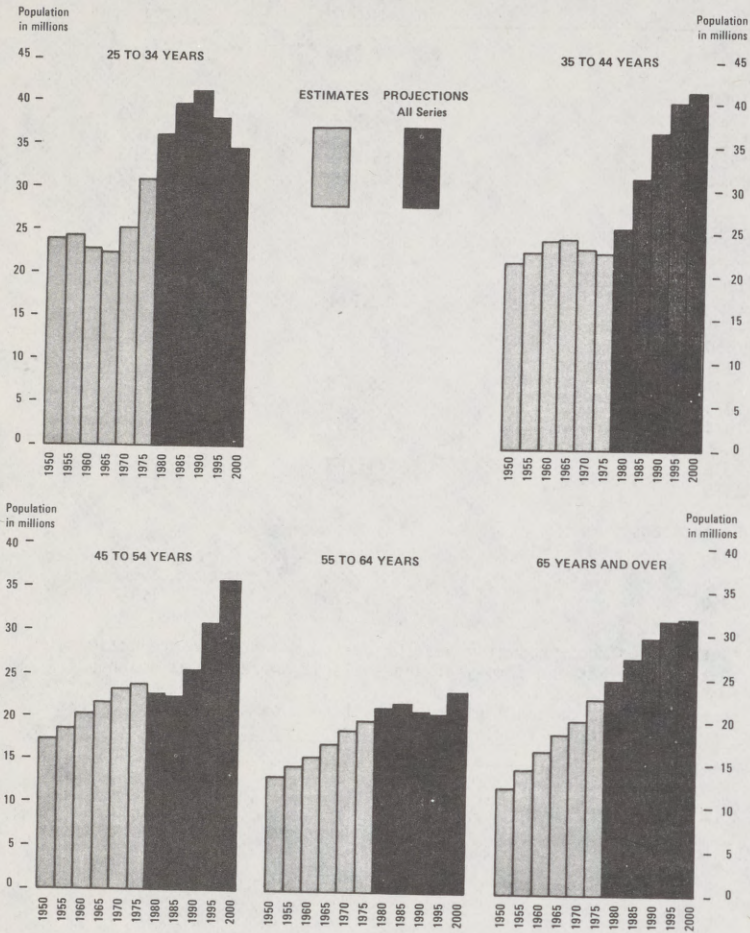
Exhibit II.4: Total households and net household formations

Year	Households (in thousands)	Net annual household formation*
1955	47,874	912
1960	52,799	985
1961	53,557	758
1962	54,764	1,207
1963	55,270	506
1964	56,149	879
1965	57,436	1,287
1966	58,406	970
1967	59,236	830
1968	60,813	1,577
1969	62,214	1,401
1970	63,401	1,187
1971	64,778	1,904
1972	66,676	1,898
1973	68,251	1,575
1974	69,859	1,608
1975	71,163	1,304
1976	72,867	1,704
Projections:		
1980	79,356	1,622
1985	87,188	1,566
1990	94,270	1,416

*Net change from preceding year or period shown. For projections, total change between five-year intervals is expressed as an annual average.

Source: U.S. Department of Commerce, Bureau of the Census, Current Population Reports--Population Estimates & Projections, Series P-25-607.

Exhibit II.5: Estimates and projections of the population of the United States by age: 1950 to 2000



Source: Projections of the Population of the United States: 1977 to 2050, Series P-25, No. 704, July 1977, U.S. Department of Commerce, Bureau of the Census.

Exhibit II.6: Population growth and in-migration in states with usury ceilings of 10% or less
(numbers in thousands)

State	1977 population	1970 population	1970-'77 increase	1970-'77 % increase	Increase due to in-migration	% increase
Arkansas	2,144	1,923	221	11.5%	128	57.9%
Georgia	5,048	4,588	460	10.0	144	31.3
Florida	8,452	6,791	1,661	24.5	1,478	89.0
Louisiana	3,921	3,645	277	7.6	19	6.9
Maryland	3,139	3,924	215	5.5	42	19.5
Mississippi	2,389	2,217	172	7.8	13	7.6
South Carolina	2,876	2,591	285	11.0	98	34.4
Tennessee	4,299	3,926	373	9.5	178	47.7
Texas	12,830	11,199	1,632	14.6	716	46.6
Missouri	4,801	4,678	123	2.6	- 33	0
South Dakota	689	666	23	3.5	- 11	0
Idaho	857	713	144	20.2	79	54.9
New Mexico	1,190	1,017	173	17.0	74	42.8
New Jersey	7,329	7,171	158	2.2	- 76	0
Vermont	483	445	38	8.5	18	48.6
U.S. total	216,332	203,305	13,027	6.4	--	--

Source: U.S. Department of Commerce; U.S. League of Savings Associations, Economics Department.

usury ceilings of 10% or less are in "sun-belt" states which have high levels of in-migration from the North and the East. Column 6 in Exhibit II.6 shows what percent of the total population increase in each of these states is due to in-migration. These special demographic factors are very important.

In-migrants represent an immediate drain on housing starts--instant demand, so to speak. In contrast, natural population increases (excess of births over deaths) occurring within a state represent increases in households already in possession of some form of housing. Thus the greater the proportion of population increase represented by in-migration, the greater will be the demand for housing. Nine usury states have substantial proportions of their population growth attributed to net in-migration. In Florida, for instance, nine out of 10 people added to the population since 1970 have come from outside the state; in Texas almost half the population growth is accounted for by in-migration. Thus, population growth and migration patterns in most of these usury states create considerable pressure for a more rapid increase of the housing stock. These patterns also create an environment in which the social and economic costs of a housing slowdown in 1979 will be especially formidable.

III. Summary and Policy Recommendations

The case against usury ceilings and their effect on single-family mortgages is simply stated. Usury ceilings harm the people they were designed to protect.

Usury ceilings on residential mortgages create a shortage in the supply of funds for home buying which hurts people in several ways. The households who can least afford it are screened out of the housing market, while jobs are lost and incomes are lowered as residential construction activity slows.

Unfortunately, too many Americans now must suffer these negative effects. Usury laws at present affect the citizens in 15 states where legislatively fixed ceilings on contract interest rates are restricting lenders from charging a competitive rate on home mortgages. These states currently represent 30% of the nation's housing starts.

Thus, the policy recommendation necessary to rectify the situation is relatively straightforward -- eliminate fixed usury ceilings as they apply at this time to residential mortgages.

Three variations on this basic recommendation present themselves. First, the usury statutes on residential mortgages can be repealed and not be replaced with any other type of ceiling. Second, the existing fixed usury rates can be reset to fixed levels above present market rates. Third, the fixed usury rates can be replaced with "floating ceilings" which are adjusted in accordance with market circumstances.

Ten states now have floating usury ceilings, as shown in Exhibit III.1. Six of these states peg their ceilings from 150 to 250 basis points above the monthly index of long-term (10 years or greater) U.S. government bond yields. The other four states peg their ceilings 300 to 500 basis points above an index of short-term rates.

Since the negative impact of usury ceilings is set in motion when market rates bump up against these ceilings, the first alternative (no ceiling) would remove all possibility of such occurrences. However, both the second and third alternatives leave open the possibility that ceilings could be set which could become entangled with market mortgage rates.

The second alternative -- setting a new fixed usury ceiling above current market rates -- only reduces the probability of market interference if the ceiling is set substantially above current market rates. The present economic environment indicates that mortgage rates should reach their cyclical peak over the next 12 to 18 months. Therefore, setting new fixed ceilings 200 to 300 basis points above current mortgage rates should provide enough leeway to accommodate the mortgage market -- at least during the present cycle. Arizona, for example, legislated a new fixed ceiling on residential mortgages of 12% as of September 1978. Of course, given the way in which 8% to 10% annual rates of inflation are becoming part of our economic structure, it is a matter for conjecture at just what point in the future newly fixed ceilings will once again encumber the market.

Exhibit III.1: States with floating usury ceilings, as of January 1, 1979.

States pegged to short-term rates:

- Alaska.....Ceiling rates on residential mortgages set 500 basis points above Federal Reserve discount rate at end of previous quarter.
- Delaware.....Ceiling rates on residential mortgages set 400 basis points above Federal Reserve discount rate.
- Montana.....Ceiling rates on residential mortgages set 400 basis points above Federal Reserve discount rate.
- Ohio*.....Ceiling rates on residential mortgages set 300 basis points above discount rate for 90-day commercial paper in effect at Fourth District Federal Reserve Bank.

States pegged to long-term rates:

- Illinois.....Ceiling rates on residential mortgages set 250 basis points above monthly index of long-term (10 yr.) U.S. government bond yields for second preceding month.
- Iowa.....Ceiling rates on residential mortgages set 200 basis points above monthly index of long-term (10 yr.) U.S. government bond yields.
- Minnesota.....Ceiling rates on residential mortgages set 250 basis points above monthly index of long-term (10 yr.) U.S. government bond yields rounded to nearest .25%.
- New York**.....Ceiling rates on residential mortgages set 200 basis points above monthly index of long-term (10 yr.) U.S. government bond yields.
- Pennsylvania....Ceiling rates on residential mortgages for principal amounts of \$50,000 or less set 250 basis points above monthly index of long-term (10 yr.) U.S. government bond yields.
- West Virginia*..Ceiling rates on residential mortgages set 150 basis points above long-term (10 yr.) U.S. government bond yields.

*Savings and loan associations are exempt from usury statutes in Ohio and West Virginia.

**New York State moved from a fixed usury ceiling of 8½% in December 1978 to a floating ceiling. The ceiling was adjusted immediately to 9.5% and will move up to the floating ceiling at a rate of 25 basis points per quarter.

Source: Federal Banking Law Reporter (Chicago: Commerce Clearing House, 1978); The Mortgage Banker, October 1978; U.S. League of Savings Associations, Economics Department.

For "floating ceilings," the probability of market interference depends on which index of market rates is used to set the mortgage ceiling and the number of basis points allowed between the index and the rate ceiling. Exhibit III.2 shows the spread existing between long-term U.S. government bond yields and conventional mortgage rates on new homes on a quarterly basis since 1974. It can be observed that this spread exceeded 200 basis points during 40% of these periods and, in fact, equalled 250 basis points during the fourth quarter of 1976. It is suggested, therefore, that if long-term bond yields are to be used as an index, ceilings should be pegged at least 250 to 300 basis points above them to avoid any circumstances in which market rates would rise above the ceiling.

In Minnesota, for example, the floating ceiling hovered around market mortgage rates for most of 1976. In an analysis of Minnesota's floating ceiling, RoInicks, Graham and Dahl¹⁶ conclude that, "Minnesota's floating ceiling has been less restrictive than the old 8% ceilings in that conventional loans are more available. Nonprice terms have not eased, however. This suggests that to give consumers a full range of home financing options, the ceiling should be significantly above market [mortgage] rates, not floating with it."

These three authors sound a warning that should be used as a guide by state legislatures as they consider the repeal of their present usury statutes. That is, in adopting a "floating rate" ceiling it is crucial to make sure that the ceiling stays well above market rates on mortgages.

Exhibit III.2: Spread between mortgage rates on new homes and long term U.S. government bond yields

Year and quarter	Conventional mortgage rates on new homes	Long term U.S. government (10 yr. or greater) bond yield	Spread (basis points)
1974 I	8.593%	6.633%	196
II	8.753	7.045	171
III	9.080	7.268	181
IV	9.270	6.993	228
1975 I	9.170	6.679	249
II	8.940	6.962	198
III	8.907	7.061	185
IV	9.010	7.237	177
1976 I	8.950	6.927	202
II	8.927	6.871	206
III	9.023	6.794	223
IV	9.073	6.572	250
1977 I	8.997	6.954	204
II	8.960	7.115	185
III	9.020	6.965	206
IV	9.077	7.143	193
1978 I	9.197	7.577	162
II	9.377	7.850	153
III	9.667	7.927	174
IV	9.907	8.147	176

Source: Federal Reserve Board

Perhaps one way of insuring this result in a floating ceiling would be to use as an index the conventional mortgage yields established in the secondary market. One hundred to 150 basis points could be added to this index in setting the ceiling. This procedure would yield a rate ceiling unlikely to be surpassed by market mortgage rates.

For those states with usury ceilings currently fixed at 10% or less the primary policy directive is clear: To avoid substantial damage to your housing markets, usury statutes must be amended to allow residential mortgage credit to be extended at market rates.

AppendixSummary of Conclusions From Selected Pieces of ResearchConclusions From Studies Based on Empirical Analysis:

- . Ostas¹³ states explicitly that the effect of a 100 basis point difference between what lenders would like to charge and what the usury limit allows them to charge is a 11% to 19% reduction in housing permit volume. Using pooled Federal Home Loan Bank Board data for the 1965-'70 period, Ostas tests for the impact of usury limits on building permits, loan-to-value ratios, amortization periods, and fees and charges. His tests amount to single variable regressions for five different equations. The estimated coefficient's t-values are all significant at the .05 level. The R^2 values are relatively high for all five equations specified. Finally, the Durbin-Watson statistic does not suggest any significant serial correlation in any of the equations.
- . Robins¹⁵ concludes in his article that, in markets where usury limits are below market rates, the level of single-family homebuilding is approximately 28% lower than in markets where the usury limit is not binding. The model runs single-family housing starts against a number of important demographic and economic variables such as real per capita income, population levels, population growth, population density, housing prices and a dummy measuring the impact of usury limits. An R^2 of .70 is recorded and all coefficients are significant except for housing prices. Construction data are sampled from 77 Standard Metropolitan Statistical Areas for the year 1970.

Rosen¹⁸ concludes that permit activity in markets where the usury limit is binding is 20% lower than in markets where the usury limit is not binding. The permit equations include measures of the cost of housing relative to other goods (both sales price and the CPI homeowner-ship component are used), a measure of real income, a measure of household formation and several mortgage instrument parameters (mortgage interest rates, loan-to-value ratio and a proxy for the availability of mortgage-real savings flows) as independent variables. These permit equations appear to be well specified with all variables consistent and an R^2 of .80. Data collected are monthly from the year 1965 to 1974 for 16 Standard Metropolitan Statistical Areas.

France⁶ concludes that the amount of lending in markets where usury limits are binding is 23% lower than in markets where usury limits are not binding. Quarterly data from the first quarter of 1966 through the first quarter of 1975 are used, and the model is estimated using the ordinary least squares technique. The regression results indicate that nearly 90% of the variation in the volume of mortgage loans granted for purchasing single-family dwelling units can be explained by changes in the explanatory variables. These explanatory variables are net savings flows, change in outstanding advances, market interest rates and seasonal dummy variables. The coefficients are all statistically significant and the Durbin-Watson statistic shows no evidence of serial correlation in the equation.

- . Austin and Lindsley¹ conclude that in markets where usury limits are binding, the level of homebuilding activity is 20% lower than in markets where usury limits are not binding.
- . Sikes¹⁹ found that due to the usury limit, residential construction in Missouri fell by 30% from the first eight months of 1973 to the first eight months of 1974.

Conclusions From Other Studies Based on Observation:

- . Kohn, Carlo and Kaye¹¹ conclude their study of usury limits in New York with three important observations. First, there is a relatively lower level of building permits issued due to the usury limit. Second, the joint effect of the usury limit and disintermediation leads to a tightening up of nonprice terms on mortgage loans in the form of larger downpayments and shorter amortization periods. Third, there occurs a shift away from in-state, conventional one- and two-family mortgage loans to out-of-state mortgage loans and in-state conventional loans on other than one- and two-family homes.
- . Keleher and King⁹ conclude that binding usury limits adversely affect loan volume. As a result, those sectors which tend to be credit dependent can be expected also to be adversely affected. This, of course, includes the home buying market.
- . Brimmer⁴ concludes that the general effect of usury-induced restrictive lending criteria is to limit the range of choices available to households -- both for housing itself and for the financing of that housing.

- . Bowsher³ concludes that usury limits ration out the more risky, lower income groups from the loan market and in so doing bring about anticompetitive effects not only in the credit market, but also in the product market.

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