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STATEMENT ON

H. R. 5568, THE "HOME MORTGAGE CAPITAL STABILITY ACT"

PRESENTED TO

SUBCOMMITTEE ON HOUSING AND COMMUNITY DEVELOPMENT

OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
HOUSE OF REPRESENTATIVES

BY

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RAYBURN HOUSE OFFICE BUILDING
ROOM 2128

Mr. Chairman, I appreciate this opportunity to present the views of the Federal Deposit Insurance Corporation, on the plan embodied in H. R. 5568, the Home Mortgage Capital Stability Act.

The thrift industry currently is experiencing unprecedented difficulties. Government policies, economic conditions, competitive factors in financial markets and management shortcomings have all contributed to the difficulties. The problems -- whatever their origin -- are real, and we commend you for your efforts to address them.

Assuming funds can be allocated to this endeavor without increasing upward pressures on interest rates, the FDIC could accept a well-structured program of temporary financial assistance to distressed financial institutions. In considering such a measure, however, we should recognize that persistent high interest rates are a basic cause of widespread economic troubles and a major cause of the problems of thrift institutions. A program of financial assistance for depository institutions, if not approached within the context of an overall strategy that exerts downward pressure on interest rates, is likely to be self-defeating.

Morever, we believe a program of financial assistance ought to be accompanied by other measures that, together, form a well-rounded program for the revitalization of our depository institutions. Very briefly, we believe that program should include:

1. enactment of the Regulators' Bill;

2. provision of new asset powers for thrift institutions;

3. federal legislation to preempt state usury statutes and prohibitions on enforcement of due-on-sale clauses;

4. comparatively swift deregulation of liabilities with emphasis on a short-term instrument that can compete with money-market instruments; and

5. possibly some soundly-conceived changes in accounting practices -- a matter we are currently working on.

Given such a program, stronger thrifts could begin to diversify their asset structure and return to profitability. Within that context, a program of financial assistance could provide the means for many institutions to weather the transition. Without a comprehensive program, however, we are simply gambling that economic conditions will return to what has always been considered "normal" and that thrifts will then be able to profitably return to the old ways of doing business.

We believe such a course would be imprudent. The marketplace has served periodic notice over the past 20 years that our system of mandatory specialization, accompanied by rigid interest rate controls, is no longer viable. We have not paid adequate heed to those warnings and, as a result, the problems of our thrifts have grown steadily worse.

If we have learned anything from the present plight of the thrift industry, it is that private financial institutions cannot afford to subsidize housing finance and savers are not willing to do so. If we wish to provide a special subsidy for housing finance, it ought to come from general revenues and be paid to any lender as an inducement to make housing loans at below market rates or directly to home buyers to permit them to better afford the market rate.

Having said that, let me turn to the question at hand -- a program of financial assistance. First, we would like to offer our ideas about how such a program should be structured.

Our first tenet is that the assistance should be available only on a selective basis. Inept management should not be subsidized with funds intended to provide temporary relief to victims of unexpected and unprecedented economic conditions. When the Regulators' Bill was before this Committee last year, you thought we were too restrictive in our request to redefine our authority to provide financial assistance under Sec. 13(c) of our Act. As a result, you broadened that authority -- and we have endorsed your language -- but you were careful to leave us discretion to distinguish between those institutions that could really benefit from assistance and those for which it would be a waste of money.

Second, we believe an assistance program should be structured to be economically sound and to create options and incentives for the recipients to correct the underlying causes of the difficulties, principally the interest rate mismatch between assets and liabilities.* Even within the existing framework of law, there is room for some of this, but we cannot overemphasize the need for broader asset powers and deposit deregulation to enable thrift institutions to grow out of their current difficulties by competing effectively and increasing earnings.

We must be frank and tell you that nothing concerns us more than the bill's requirement that 50 percent of net new deposits be invested in one-to-four family mortgages for first time home buyers at an interest rate 1 percent above the institutions' average cost of funds. Much of the present thrift dilemma is attributable to the mismatch between long-term, fixed-rate assets and short-term, high rate liabilities. The bill's provisos would perpetuate and even compound these problems.

Without a short-term deposit instrument to allow depository institutions to compete effectively in current markets, we feel certain there will not be much in the way of net new deposits. Even assuming such an instrument is authorized and new funds are attracted at current market rates, their costs could be well above current average costs. Under the bill's provision requiring that loans be made at 1 percent over average costs, the result could be to lock the institutions into a continuing loss position.

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* It is essential that a limitation-- providing that no extraordinary gains or losses shall be included for purposes of qualification for the program or for quarterly payments -- be imposed to keep the program from becoming a buyout for all the unprofitable assets on the institutions' books. Moreover, any advances under the program should be required to be paid back with interest out of future earnings.

Unless the assisted institutions were able to invest the other 50 percent of their net new deposits at very high returns, it seems highly unlikely that any institution could strengthen its situation under this scenario.

Third, there should be some discipline over management and management practices exacted as a price for financial assistance. On previous occasions this Committee has enacted financial assistance programs for Lockheed, New York City and Chrysler Corporation. In each instance disciplines have been imposed as a price for the taxpayers' support. There is no less reason for such requirements in the measure now before you.

We would urge that any bill grant the regulators clear authority and direction to impose sanctions against management. We have in mind authority to enforce a decrease or prohibit any increase in the compensation of officers, trustees, or directors so long as assistance funds remain outstanding and the authority to require management changes in assisted institutions when believed necessary to achieve operating improvements.

We believe the bill should also grant the regulators authority and direction to place operating controls on the activities of assisted institutions while the assistance remains outstanding. We do not believe that an institution should receive taxpayer funds and then simply continue to do business as usual.

There should also be clear authority and direction for the regulators to terminate payments to those institutions which are clearly on the path to failure. It makes little economic sense to dissipate the taxpayers' money by continued payments to institutions that continue on a down hill path despite the federal assistance.

The bill does not address one serious problem we wish to call to your attention. Some states and localities, most particularly the States of New York and Massachusetts and the City of New York, levy a franchise tax on mutual savings banks. The tax is based on the volume of deposits without regard to whether a bank is making or losing money. The result is that if you were to enact this bill a large percentage of the assistance payments would flow directly through the troubled institutions to the local governments imposing this unjust and burdensome tax. We believe this is undesirable and that you should include in the legislation a proviso which would require that any state or local government with such a tax would have to waive it for institutions being assisted under the Act until repayment is effected.

Mr. Chairman, we understand that it is the Subcommittee's intention to make major modifications to H. R. 5568. For this reason we have confined our comments to the general principles we feel should be considered in your ultimate package. I would be happy to answer any questions and our staff is available to render whatever technical assistance you may desire.