

P.L. 97-320, GARN-ST GERMAIN DEPOSITORY INSTITUTIONS ACT OF 1982:  
A BRIEF EXPLANATION

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## ABSTRACT

Major financial legislation affecting the competitive framework and regulatory arrangements for depository financial institutions (commercial banks, savings and loan associations, mutual savings banks, and credit unions) was enacted in the 97th Congress. The law, P.L. 97-320, is known as the Garn-St Germain Depository Institutions Act of 1982. This report provides a brief explanation of the problems the legislation is designed to address, a general description of the most important provisions of the Act, and an explanation of specific titles of the law. Additional references are also provided.



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I. INTRODUCTION

Major legislation affecting the competitive framework and regulatory arrangements for commercial banks, thrift institutions (savings and loan associations and mutual savings banks), and credit unions passed the Congress in the last days of the 97th Congress. 1/ P.L. 97-320, the Garn-St Germain Depository Institutions Act of 1982, was signed into law October 15, 1982. The legislation is intended both to correct major structural impediments which have caused operating problems for depository institutions and to provide the Federal financial regulatory agencies with additional powers to deal with financially distressed depository institutions, including a capital assistance program for troubled depository institutions specializing in home mortgage lending.

This report provides a brief explanation of the problems the legislation is designed to address, a general description of the most important provisions

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1/ The Conference Report, which includes the text of the legislation and the explanatory statement of the Conference Committee, appears in the Congressional Record, September 30, 1982, pages H8096-H8122. The Conference Report has been issued as House Report no. 97-899 and Senate Report no. 97-641.

of the Act, and an explanation of specific titles of the law. Additional references are also provided. 2/

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2/ The reader interested in definitions of terms may wish to consult: U.S. Congress. House. Committee on Banking, Finance and Urban Affairs. A reference guide to banking and finance. 97th Congress, 1st session. Washington, U.S. Govt. Print. Off., 1981. 81 p. CRS order number: CP 1247. The guide consists of two parts: a glossary of selected economic and financial terms and organizations, and summaries of significant Federal banking, financial and housing laws.



## II. EXPLANATION OF THE LEGISLATION

As part of their ongoing examination of conditions in the depository institutions system, the House and Senate Banking Committees considered several types of legislation during the 97th Congress. Many of the proposals are included in P.L. 97-320. Other proposals can be expected to be subject to further examination in future Congresses.

P.L. 97-320 is designed to address problems arising from competitive and financial pressures depository financial institutions have experienced in recent years. Since early in 1981, competition has intensified among financial institutions. The high interest rate environment and increasing sensitivity to interest rates have been major contributing factors. The public has continued to adjust the forms in which it holds financial assets as households and businesses have sought high rates of return. Financial institutions, taking advantage of technological developments, have responded by offering new services and packaging services in new ways. The differential impact of laws and regulations on various parts of the financial services industry has also contributed to competitive pressures.

The high interest rate environment has caused financial problems for some depository institutions, especially savings and loan associations and mutual savings banks. In particular, thrift institutions have been subject to severe earnings pressures as a result of their substantial holdings of long-term, fixed-rate mortgages earning lower rates of interest than the rates they must pay to acquire deposit funds. Since 1981 most thrift institutions have reported operating losses and the thrift industry as a whole has experienced a substantial decline in capital (net worth). At the present time, numerous institutions are financially distressed, causing problems which, by law, must be dealt with by the regulators.

The legislation is intended to address these problems through three types of provisions. First, it includes provisions to restructure and broaden the powers of depository institutions in an attempt to lessen the sensitivity of thrift institutions to interest rate cycles and to increase the competitiveness of all forms of depository institutions with less regulated institutions. Second, it includes provisions to increase the flexibility of the Federal regulatory agencies in dealing with troubled depository institutions. Finally, it includes provisions for a capital assistance plan designed to bolster the net worth of home mortgage lending institutions which are suffering earnings problems, thus allowing the institutions to stay in business as ongoing concerns.

The law consists of eight titles. Title I, the Deposit Insurance Flexibility Act, expands regulators' authority to deal with troubled depository institutions. The Act stems from proposals first developed by the regulators in 1980; earlier versions of the legislation were commonly referred to as the "regulators' bill." The Act provides additional flexibility to the Federal regulatory agencies to deal with troubled institutions, including the authority for the Federal insuring agencies to provide financial assistance under a broader range of conditions and in more expanded forms than existed in previous law. The Act also provides guidelines for the Federal depository institution regulators to follow in arranging interstate and interindustry mergers under emergency conditions, and, for the first time, provides a temporary authority to the bank regulatory agencies to arrange interstate mergers in certain instances involving large troubled banking institutions (institutions with assets of \$500 million or more). Certain of the emergency authorities provided the regulators in this Act are subject to a three year "sunset" provision.

Title II, the Net Worth Certificate Act, provides for capital (net worth) assistance to troubled depository institutions specializing in home mortgage

lending. While the program is primarily designed to assist thrift institutions, commercial banks which have portfolio designs similar to those of thrift institutions would also be eligible for assistance.

The law specifies that the assistance be in the form of a "paper for paper" exchange whereby an eligible thrift institution or bank issues capital instruments, called "net worth certificates," to be purchased by the appropriate Federal insuring agency with promissory notes to the institution. The resources of the issuing insurance agencies, the Federal Deposit Insurance Corporation and the Federal Savings and Loan Insurance Corporation, back the governmental promissory notes. These notes would be payable in cash only if an institution were to be liquidated. Otherwise, the promissory notes would be retired as an institution's net worth position improves. Some cash would be generated for the institution during the period the notes are outstanding since the Federal insuring agency would pay interest on its promissory notes. The institution would pay dividends on its net worth certificates only if its earnings would permit.

Among the requirements to qualify for aid are that an institution:

- have a net worth equal to 3 percent or less of assets;
- have incurred losses during the preceding two quarters;
- not have incurred losses as a result of speculation or mismanagement;
- agree to comply with all terms which the insuring agencies set forth, including those specified in the legislation;
- have a net worth of no less than 1/2 percent of its assets after purchase of its net worth certificates by the insuring agency; and
- have at least 20 percent of its loans in residential mortgage instruments.

In general, the amount of aid available to an institution is determined by a sliding scale which takes into account both the level of net worth and actual losses of an institution. An institution whose net worth is between 2 and 3 percent of assets could receive an amount equal to 50 percent of period operating losses; between 1 and 2 percent, 60 percent; and between 0 and 1 percent, 70 percent. However, the insuring agencies have flexibility to vary these formulas, provided that an insuring agency not purchase certificates from an institution equal to more than 100 percent of the institution's operating losses for the preceding period.

State-insured institutions which otherwise qualify for capital assistance are permitted to receive aid, provided the State insurance fund agrees to indemnify the appropriate Federal insurance fund for any losses incurred by that agency as a result of providing assistance, and provided the State insurance fund maintains a specified level of assessments on its members.

These new authorities expire three years after enactment of the legislation.

Title III is entitled the Thrift Institutions Restructuring Act. It contains three types of provisions of particular note. First, it broadens certain deposit, loan, and investment powers of federally chartered thrift institutions, both in areas where those institutions already have operating authority and in areas that are new to them. The provisions which allow thrift institutions to develop relationships with commercial customers are considered to be especially significant. Federal thrift institutions are permitted to put up to 10 percent of their assets in commercial loans by January 1, 1984, and may accept demand deposit accounts from commercial loan customers. At the same time, the deposit interest rate differential allowed

thrift institutions over commercial banks on certain types of accounts is to be phased out by January 1, 1984.

Second, the Act provides for the establishment of a new type of account available to all forms of depository institutions to be "directly equivalent to and competitive with" money market mutual funds (MMFs). Among the regulatory distinctions affecting the competition between depository and non-depository institutions have been the exemption of MMFs from the reserve requirements, interest rate limitations, and other regulations promulgated by the Federal depository institution regulators. On the other hand, MMFs are not eligible for Federal deposit insurance. The Act directs the Depository Institutions Deregulation Committee, which administers deposit interest rate ceilings, to write regulations for the new account within 60 days of the legislation's enactment.

Third, the title overrides State-imposed restrictions on enforcement of due-on-sale provisions in mortgage contracts, with certain exceptions. 3/

Other significant changes are included in Title VI which limits insurance activities of bank holding companies, particularly underwriting and sale of property and casualty insurance, and Title VIII, known as the Alternative Mortgage Transaction Parity Act of 1982. According to the Conference Report, Title VIII "authorizes non-federally chartered housing creditors to offer alternative mortgages in accordance with the Federal regulations issued by the

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3/ According to a definition provided by the United States League of Savings Associations:

In signing for a mortgage with a due-on-sale clause the borrower agrees to pay the loan in full when the home is sold. This allows lenders to upgrade mortgage portfolios in times of fluctuating interest rates.

appropriate Federal regulatory agencies. Thus, those creditors will have parity with federally chartered institutions."

Additional provisions relating to national and member banks, amendments to the Federal Credit Union Act, and miscellaneous depository institution amendments appear in Titles IV, V, and VII, respectively.

Among proposals not included in the final legislation which were included in some versions of earlier legislation are provisions dealing with securities activities of depository institutions and usury ceilings. Proposals that would have allowed depository institutions to offer mutual funds directly, including money market mutual funds, and that would have expanded other permissible securities activities for depository institutions were excluded. Proposals to override certain types of State usury ceilings, including those on consumer loans, and to extend the Federal preemption of State usury ceilings on business and agricultural loans provided for in P.L. 96-221 beyond the current expiration date of April 1, 1983, were also dropped. These proposals as well as other changes for depository institutions are expected to be considered in the 98th Congress.

III. ADDITIONAL REFERENCES

U.S. Congress. Conference Committees, 1982. Conference report on H.R. 6267, Net Worth Guarantee Act. H. Rept. No. 97-899, 97th Congress, 2nd session. Washington, U.S. Govt. Print. Off., 1982. 94 p.  
Also issued as S. Rept. No. 97-641.

U.S. Congress. House. Committee on Banking, Finance and Urban Affairs. A reference guide to banking and finance. 97th Congress, 1st session. Washington, U.S. Govt. Print. Off., 1981. 81 p.  
CRS order number: CP 1247.

U.S. Library of Congress. Banking and depository institutions: current legislative issues [by] F. Jean Wells. [Washington] 1982. CRS Issue Brief 82029 regularly updated.

----- Capital (net worth) assistance for depository financial institutions specializing in home mortgage lending, by F. Jean Wells. [Washington] 1982. 39 p. (CRS Report no. 82-135E)

----- Deposit interest rate regulation; the Depository Institutions Deregulation Committee [by] William Jackson. [Washington] 1981. CRS Issue Brief 81130 regularly updated.

----- Money and banking: a listing of selected CRS analytical reports of current legislative interest available to Congress, by F. Jean Wells. [Washington] 1981. 9 p. (CRS Report no. 81-251E)

----- Money market mutual funds [by] William Jackson. [Washington] 1981. CRS Issue Brief 81057 regularly updated.