CHECKING VS. SAVINGS: THE LINES BLUR

by William N. Cox

A Tennessee credit union permits its members to write a check-like instrument against deposited funds.

A Louisiana bank's automatic teller machines let depositors shift funds between checking and savings accounts.

A Florida savings and loan association allows its customers to pay bills with phoned-in deposit transfers.

A Georgia stockbroker makes it easy for wealthier clients to write checks on their investment balances.

These examples, drawn from hundreds around the Sixth District, have something important in common. They are evidence of a blurring of the distinction between traditional checking and savings accounts. They allow the consumer to combine more conveniently the advantages of each.

If his funds are in a bank checking account, the consumer can transfer them easily to someone else, but they earn no interest.[1] If his funds are in a traditional savings account, he earns interest, but it is relatively awkward and inconvenient to transfer them to anyone else. Most businesses and government units operate on a big enough financial scale that it is worthwhile for them to minimize their noninterest-bearing checking account balances. They can hire managers to ferry funds back and forth from one account to another. Most consumers, however, do not find the small amount of interest earned worth the inconvenience of moving the funds around.

This is all changing. The innovations cited at the beginning of this article all provide more convenient ways for the consumer to earn interest on transferable funds. They are, in fact, a few local skirmishes pointing the way toward new substitutes for checking and savings accounts in the Southeast. Elsewhere in the country, stiff competitive struggles among various kinds of financial institutions have already moved past or around the judges, legislators, and regulators and into the marketplace.

For several years, commercial and mutual savings banks in New England have been offering "Negotiable Order of Withdrawal" (NOW) accounts. Functionally, these are interest-bearing checking accounts. Consumers there have adopted them enthusiastically. Congress is considering the extension of NOW accounts to the rest of the country. Nationally, a Federal court has approved credit unions' use of the share draft—the "check-like instrument" mentioned in our opening sentence. The Federal Reserve and the FDIC have announced new regulations permitting bank customers to "cover" checking account overdrafts with savings account funds automatically. Each development is somewhat different, of course. But the trend is evident, and the pace is quickening.

Financial institutions in this region and across the country are reassessing their objectives, their powers, their costs, and their markets in the context of a broader competitive struggle. Many banks want permission to underwrite industrial revenue bonds but are looking warily at the movements of investment banks, retailers, and foreign banks toward traditional banking turf. Savings and loan associations generally desire broader lending powers and new types of home mortgages but are anxious to preserve their ability to offer a premium interest rate on savings accounts. Credit unions can now issue home mortgages but are worried about losing their tax advantages.[2]

Will this be a breakthrough for the consumer? Consumers will benefit from the new competition among institutions,

[1] The Banking Act of 1933 says, in part "No member bank shall directly or indirectly, by any device whatsoever, pay an interest on any deposit which is payable on demand." This is the basic legal impediment to combining checking and savings accounts directly.

[2] A separate concern relates to monetary policy. Monetary growth, as measured by the Federal Reserve in its M_1 and M_2 definitions, basically means the growth of checking and savings account balances at banks. The spread of the innovations we have been discussing will, at best, add substantial uncertainty to the meaningful measurement of monetary growth.

but it will be no bonanza. It is very likely that the low-balance/high-transactions customer will be worse off, whereas the high-balance/low-transactions customer will be pleased. On a conventional bank checking account, which earns no interest, the bank usually "pays" its depositor by absorbing most of the costs of the checking services provided. On typical accounts, the bank-absorbed costs, over and above service charges, are equivalent to an implicit interest payment of about 4½ percent.[3] But if it turns out that checks can be written on an account bearing explicit interest, financial institutions will have to charge for the services, either directly on a per-item basis or implicitly in the form of minimum account balances. ■

[3]Stephen H. Axilrod and others, "The Impact of the Payment of Interest on Demand Deposits," Table III-1. This study by the staff of the Board of Governors of the Federal Reserve System was released to the public on February 1, 1977.

DISINTERMEDIATION?

by John M. Godfrey

When analysts begin to foresee strong public and private credit demands and rising interest rates, their attention quickly turns to the prospect of disintermediation—the shift of consumer funds from banks and other financial intermediaries to higher yielding open market securities that results in a net loss of time and savings deposits. Commercial banks and other thrift institutions experienced bouts of disintermediation in 1966, 1969-early 1970, and, to a lesser extent, in 1973-74 as interest rates rose. Yields obtainable from Treasury bills and notes, commercial paper, and money market mutual funds rose significantly above the maximum rates that the regulated banks and thrift institutions were allowed to pay for deposits subject to interest rate ceilings.

With interest rates higher now than at any time since 1974, disintermediation has become a growing topic of conversation. However, a sustained reduction in interest-bearing deposits at District member banks is unlikely in the near future, mainly because the region's banks have shifted the composition of deposits toward those accounts which are well insulated from withdrawals. Nearly one-half of the time deposits are no longer subject to Regulation Q interest ceilings, and other liberalizations of regulations have allowed banks to offer more competitive rates on other time deposits. Passbook savings accounts seem to be less sensitive to the level of interest rates than in the past. Furthermore, interest rates have not reached 1974 levels. Even with a further rise in market rates, potential disintermediation problems could be minimized by raising the interest rate ceilings.

Recent History. Building a more stable deposit base has taken time and a number of regulatory changes. In the 1969-70 period, member banks could offer only very limited interest rate incentives to attract and retain longer maturity consumer deposits. They could pay depositors only 4 percent on passbook savings and short maturity time deposits and only 5 percent for time deposits maturing in 90 days or more. Although some banks did establish time deposits that were automatically renewable at each maturity date, the depositor retained the option of withdrawing his deposit each quarter without penalty. When interest rates rose, member banks lost $300 million (about 7 percent) in savings deposits from late 1968 through early 1970. Banks outside the District's larger cities, however, were able to increase total consumer time deposits.

During that period, the area where banks were most vulnerable to competition from higher open market rates was negotiable CDs in denominations of