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Proposals to Facilitate the Implementation of Monetary Policy and to Promote Competitive Equality Among Depository Institutions

Statement by

G. William Miller

Chairman, Board of Governors of the Federal Reserve System

before the

Committee on Banking, Housing and Urban Affairs

United States Senate

February 26, 1979

Mr. Chairman, members of the Committee, the nation's financial system has been undergoing rapid change in recent years, altering the competitive environment in banking and other financial markets and complicating the Federal Reserve's ability to implement monetary policy. These developments are well known to the Committee. Nonmember depository institutions have been growing much more rapidly than member banks. Transactions-type deposit accounts have become more widespread at thrift institutions. And, in general, competition among depository institutions and between those institutions and the open market has become much more intense.

Increased competition enhances the efficiency of the financial system. But, as a result, banks have been re-assessing their costs and many have become less willing to bear the high cost of cash reserve requirements associated with being a member of the Federal Reserve System. Thus, there has been a steady--and in recent years accelerating--decline in the proportion of bank deposits, especially transaction deposits, subject to Federal reserve requirements. Moreover, the continued development of new transactions-type deposits at nonbank depository institutions will further worsen this situation.

DEVELOPMENTS WEAKEN MONETARY CONTROL

It is essential that the Federal Reserve maintain adequate control over the monetary aggregates if the nation is to succeed in its efforts to curb inflation, sustain economic growth, and maintain the value of the dollar in international exchange markets. The attrition in deposits subject to reserve requirements set by the Federal Reserve weakens the linkage between member bank reserves and the monetary aggregates. As a larger and larger fraction of deposits at banks becomes subject to the diverse reserve requirements set by the 50 states rather than by the Federal Reserve, and as more transactions balances reside at thrift institutions, the relationship between the money supply and reserves controlled by the Federal Reserve will become less and less predictable, and the instruments of monetary policy will become less precise in their application.

Our staff has attempted to assess the extent to which growth of deposits outside the Federal Reserve System would weaken the relationship between reserves and money. Their tentative results are shown in Chart I, which depicts the greater range of short-run variability in M-1 and M-2, with a given level of bank reserves, that would develop as the per cent of deposits held outside the Federal Reserve rises. As more and more deposits are held outside the System, this chart suggests that control of money through the reserve base becomes increasingly uncertain.

USE OF RESERVE REQUIREMENTS HAS BEEN RESTRICTED

With the proportion of banks subject to Federal reserve requirements declining, the ability of the central bank to use changes in reserve requirements as a tool of monetary policy has been increasingly undermined. Changes in reserve ratios not only affect a smaller proportion of deposits today than in the past, but the Board also must weigh the potential impact of its actions on the membership problem--and hence on its ability to maintain monetary control over the longer run--each time it deliberates on the uses of this tool. Such concerns inhibit the Board's freedom of action to conduct monetary policy. If reserve requirements were applied universally, as is proposed in S.85, adjustments in reserve ratios to affect the availability of credit throughout the country, or to influence banks' efforts concerning particular types of deposits, may again become a more viable monetary instrument. Moreover, while open market operations in U.S. Government securities currently provide the Federal Reserve with a powerful policy instrument, it is possible that conditions could develop in the future--such as a less active market for U.S. Government securities in a period of reduced Federal budgetary deficits--where more flexible adjustment of reserve requirements might become more necessary to control the monetary aggregates.

... AS HAS BEEN THE DISCOUNT WINDOW

The effectiveness of the Federal Reserve's administration of the discount window also has been potentially compromised by recent developments. Membership attrition and the growth of transactions balances at nonbank depository institutions have resulted in a shrinking proportion of the financial system having immediate access to the discount window on a day-to-day basis.

The discount window, as the "lender of last resort," provides the payments system with a basic liquidity backup by assuring member banks the funds to meet their obligations. But, if the proportion of institutions having access to this facility continues to decline, individual institutions could be forced to make abrupt adjustments in their lending or portfolio policies, because they could not turn to the window to cushion temporarily the impacts of restrictive monetary policies. Risks that liquidity squeezes would result in bank failures could also increase. Thus, the Federal Reserve may find that its ability to limit growth in money and credit in order to curb inflation was being unduly impeded because the safety valve provided by the discount window was gradually losing its effective coverage.

... AND THE PAYMENTS SYSTEM FACES DETERIORATION

The growth of transactions balances at institutions that do not have access to Federal Reserve clearing services also could lead to a deterioration of the quality of the nation's payments system. Reserve balances held at Federal Reserve Banks are the foundation of the payments mechanism, because these balances are used for making payments and settling accounts between banks. Nonmember deposits at correspondent banks can serve the same purpose, but as more and more of the deposits used for settlement purposes are held outside the Federal Reserve, the banking system becomes more exposed to the risk that such funds might be immobilized if a large correspondent bank outside the Federal Reserve experienced substantial operating difficulties or liquidity problems. A liquidity crisis affecting such a large clearing bank could have widespread damaging effects on the banking system as a whole because smaller banks might become unable to use their clearing balances in the ordinary course of business. The Federal Reserve, of course, is not subject to liquidity risk and therefore serves, as Congress intended, as a safe foundation for the payments mechanism.

In sum, the major functions of the Federal Reserve System--to conduct monetary policy in the public interest, to provide backup liquidity and flexibility to the financial system, and to assure a safe and efficient payments mechanism--all have been undermined by recent developments. These developments include, as was noted earlier, attrition in Federal Reserve membership and the spreading of third-party payment powers to nonbank institutions.

DECLINE IN SYSTEM MEMBERSHIP

For more than 25 years there has been a continual decline in the proportion of commercial banks belonging to the Federal Reserve. The downward trend in the number of member banks has been accompanied by a decline in the proportion of bank deposits subject to Federal reserve requirements, as may be seen from Chart II. As of mid-1978, member banks held less than 72 per cent of total commercial bank deposits, down about 9 percentage points since 1970. Thus, more than one-fourth of commercial bank deposits--and over three-fifths of all banks--are outside the Federal Reserve System.

DUE TO THE EXCESSIVE COST OF MEMBERSHIP

The basic reason for the decline in membership is the financial burden that membership entails. Most nonmember banks and thrift institutions may hold their required reserves in the form of earning assets or in the form of deposits (such as correspondent balances) that would be held in the normal course of business. Member banks, by contrast, must keep their required reserves entirely in non-earning form.

The cost burden of Federal Reserve membership thus consists of the earnings that member banks forego because of the extra amount of non-earning assets that they are required to hold. Of course, member banks are provided with services by Reserve Banks, but the value of these services is insufficient to close the earnings gap between member and nonmember banks.

The Board staff estimates that the aggregate cost burden to member banks of Federal Reserve membership exceeds $650 million annually, based on data for 1977, or about 9 per cent of member bank profits before income tax. The burden of membership is not distributed equally across all sizes of member banks. According to staff estimates, shown in the lower panel of Chart III, the relative burden is greatest for small banks--exceeding 20 per cent of profits for banks with less than $10 million in deposits. Further reductions of reserve requirements within existing statutory limits would do little to eliminate the burden for most classes of banks, especially for the smaller banks.

INEQUITY OF COST BURDEN BORNE BY MEMBER BANKS

The current regulatory structure is arbitrary and unfair because it forces member banks to bear the full burden of reserve requirements. Only member banks must maintain sterile reserve balances, while nonmember banks, which compete with members in the same markets for loans and deposits, and thrift institutions, which increasingly are competing in the same markets, do not face similar requirements. Thus, members are at a competitive disadvantage relative to other depository institutions. Among the major countries in the free world, only in the United States has this legislated inequity been imposed on the commercial banking system. It is no wonder that member banks continue to withdraw from the Federal Reserve.

SPREAD OF THIRD-PARTY PAYMENT POWERS

At the same time, the spread of third-party powers to thrift institutions is further increasing the proportion of transactions balances outside the control of the Federal Reserve. Commercial banks' virtual monopoly on transactions accounts, maintained in the past because of their ability to offer demand deposits, is being eroded. Moreover, recent financial innovations have led to widespread use of interest-bearing transactions accounts at both nonbank depository insitutions and commercial banks. These developments have increased both the costs and competitive pressures on banks, no doubt compelling members to reevaluate the costs and benefits of membership and thus playing a significant role in membership withdrawals.

The payments innovations since 1970 have received widespread attention, and include limited pre-authorized "bill-payer" transfers as well as telephone transfers from savings accounts at banks and savings and loan associtions, NOW accounts at practically all depository institutions in New England, credit union share drafts, automatic transfers from savings deposits, and the use of electronic terminals to make immediate transfers to and from savings accounts.

Growth of these transactions-related interest-bearing deposits has been most dramatic in recent years. For example, NOW accounts in New England have grown from practically zero in 1974 to 8 per cent of the region's household deposit balances in mid-1978, as shown in Chart IV, and one-third of these NOW deposits are at thrift institutions. The intense competition engendered by the introduction of NOW accounts has been accompanied by an acceleration of member bank attrition in New England to a rate well beyond that of the nation, as shown in Chart V. This increase in member bank withdrawals is clearly not just coincidental.

There is no sign that the intense competition will abate. As shown in Chart VI, savings accounts authorized for automatic transfer have grown rapidly at commercial banks across the country since their introduction November 1; and in New York, NOW accounts, which were authorized November 10 for all depository institutions in the State, have been increasing vigorously. In addition, the Federal Home Loan Bank Board has announced its intention to authorize savings and loan associations to offer Payment Order Accounts, or POAs, which are interest-bearing deposits that can serve many of the same functions as NOWs.

These developments have caused the distinctions among banks and thrifts with respect to the "moneyness" of their deposits to become increasingly blurred and have prompted the Federal Reserve to reevaluate its existing measures of the monetary aggregates and to propose redefinitions to reflect the changing institutional environment. The most basic measure of transactions balances, M-1, clearly should include more than just currency and commercial bank demand deposits. And, the broader aggregates should be redefined to emphasize distinctions by type or function of deposit rather than by the institution in which the deposit is held. Changing the money measures to reflect economic reality, including the wider role played by depository institutions other than member banks in the monetary system, would be complemented by legislation for universal reserve requirements.

LEGISLATIVE PROPOSALS POINT IN THE RIGHT DIRECTION

The Board appreciates the priority attention given by the Committee to the important issues of improving monetary control and reducing the inequities in markets in which depository institutions are competing. The legislative proposals set forth by Chairman Proxmire and Senator Tower represent constructive approaches. As was indicated in the last session of Congress, the Board prefers the universal approach of S.85.

This bill proposes universal Federal reserve requirements by establishing reserve ratios applicable to all deposits at commercial banks and to transactions balances at thrift institutions. The definition of transactions accounts includes not only demand deposits, but also the growing number of new third-party payments accounts. Such an approach puts all depository institutions of similar size on an equal competitive basis in the market for transactions deposits. The exemption from any reserve requirement of the first $40 million of transaction balances at all institutions and the first $40 million of other deposits at commercial banks would eliminate the competitive burden of reserve requirements on small institutions while increasing slightly from present levels the proportion of commercial bank deposits subject to Federal reserve requirements. This approach helps assure the continuation of the reserve structure needed for the efficient conduct of monetary policy.

Under this legislation thrift institutions with reservable transactions accounts and all commercial banks would have access to the Federal Reserve discount window. The Federal Reserve could then act as a "lender of last resort" to a broader class of depository institutions and thereby enhance the overall safety and soundness of the depository system, as well as providing more flexibility to financial institutions to respond to changing monetary policy.

The bill also gives all depository institutions access to other Federal Reserve services. With the application of an appropriate price schedule for such services, this action would improve the efficiency of the payments mechanism which underlies all of the nation's ecnomic transactions.

But it should be emphasized that open access to System services, desirable as it may be, is only practicable if the membership problem is resolved, as S.85 does in principle. Without resolution of the membership problem, open access for all institutions at explicit prices would only exacerbate the problem and lead to even greater reduction in the Federal Reserve's deposit coverage, since services would be available to nonmembers that would not bear the burden of sterile reserves.

Thus, as Senator Tower has recognized in his bill, a voluntary approach to solving the membership problem must make it clear that the Federal Reserve has the authority to continue to restrict access to System services.

BUT CERTAIN MODIFICATIONS OF S.85 ARE DESIRABLE

The various features of S.85 redress much of the growing competitive inequity among financial institutions and provide a framework for enhancing the implementation of monetary policy. However, we believe that certain modifications are desirable in order to exploit more fully the potential for improved monetary control offered by this approach and to strike a better balance among the legitimate concerns and interests of the various consitituencies affected by this legislative compromise.

First, while the $40 million exemptions in this legislation would mean that the proportion of deposits subject to direct Federal Reserve control would increase slightly from current levels, we feel that there are important benefits for monetary control in increasing that coverage even further. The Board has a proposal which will provide additional coverage, and hence further enhance monetary control, while at the same time preserving for all depository institutions the earnings protection contained in S.85.

PARTICIPATION IN FEDERAL RESERVE EARNINGS FOR EXEMPTED DEPOSITS

The Board's proposed modification involves establishment of an "Earnings Participation Account" which would result in more institutions maintaining balances at the Federal Reserve; however, their earnings capacity would be protected because the Earnings

Participation Account would accrue interest at the rate earned by the Federal Reserve on its portfolio of securities. To reduce the record-keeping burden, small institutions could be excluded from having to hold this account. This exclusion could amount to the first $10 million of transactions deposits at each institution and $10 million of other deposits at each commercial bank.

For banks, with respect to all deposits, and for other depository institutions, with respect to transactions deposits, their Earnings Participation Account would be held against deposits above the $10 million exclusion and up to the amount of the exemption level, which would be $40 million in the case of S.85. The size of this Earnings Participation Account for each deposit category would equal the reserve ratio applicable to deposits in this category times the amount of deposit liabilities between $10 million and the exemption level. To the extent that an institution holds vault cash in excess of its required reserves on nonexempt deposits, the size of the Earnings Participation Account would be reduced correspondingly.

The return on this account would be equivalent to the average return on the Federal Reserve's portfolio, which includes both short- and long-term securities. Some years this return might be higher than banks would earn on other assets--which are likely to be a combination of loans and liquid instruments--and some years less. On average, over time, there should be little difference.

It should be noted that Senator Tower's S.353 does provide for establishment of an Earnings Participation Account. However, the estimated cost to the Treasury of this bill is considerably greater than other proposals being considered.

... YIELDS EXPANDED COVERAGE, MORE EARNINGS PROTECTION

Chart VII compares the impacts of the Board's proposal with S.85 and with the current reserve system. As can be seen in the upper left-hand panel, the Board's modification has the advantage of increasing the proportion of commercial bank transactions deposits covered by an account at the Federal Reserve-- from the present 73 per cent, and about 75 per cent under S.85, to 94 per cent. This would be accomplished even though the $10 million exclusion would mean that 45 per cent of all commercial banks, as well as virtually all thrifts, would not be required to hold any account at the Federal Reserve.

It is worth emphasizing that now is the appropriate time to bring transactions-type deposits at thrifts under reserve requirements. It will be several years, at least, before any significant number of thrift institutions would actually have to hold non-earning reserves at the Fed. Currently, less than a dozen thrift institutions have deposits in excess of the $40 million exemption of S.85, and all have vault cash considerably greater than the reserve requirement that would apply to such deposits.

RESERVE REQUIREMENTS

While the Board does not strongly object to the particular reserve requirement ratios specified in S.85, it would, assuming the other elements of the proposal are adopted, prefer somewhat lower ratios, on average. Lower average reserve requirements on demand

and time and savings deposits at commercial banks would provide for more equitable treatment, as thrift institutions are not subject to any reserve requirements on non-transactions deposits under the proposed bill.

The exact set of reserve ratios that would balance equity considerations against the loss of Treasury revenue and the need for flexible and effective instruments of monetary policy is, of course, a matter of judgment. There is much to be said for complete equality of treatment between banks and thrift institutions with respect to reserve requirements. This approach would argue, on the one hand, for reducing further the reserve requirements on all non-transactions time and savings deposits at commercial banks, even to zero. But such reductions would be very costly to the Treasury and would also eliminate reserve requirements on time deposits as a policy instrument; the flexibility to vary those requirements has proven useful in the past as a means of influencing banks' liability management and international flows of funds.

Complete equality of treatment could also be obtained, on the other hand, by imposing reserve requirements on thrifts' time and savings deposits that are the same as those borne by banks. But this has the disadvantage of being very costly to thrift institutions, who are, in any event, coming under earnings pressure in the current period of relatively high short-term interest rates.

Thus, the Board believes that the reserve requirement structure suggested in the House bill proposed by Representative Reuss (H.R.7) may be a reasonable compromise. The Board also would not oppose an increase in the exemption level to the $50 million in H.R.7, as long as the modified bill included the establishment of an Earnings Participation Account. With lower reserve requirements and a higher exemption level, more commercial banks would effectively be on the same footing as the thrift institutions with which they compete, in the sense that neither would be forced to hold non-interest earning reserves against their deposits. As shown in the right-hand upper panel of the chart, the number of banks holding sterile reserve balances at Federal Reserve Banks would be sharply reduced from the current level of 5,664 to an estimated 656 under the Board modification. This number is somewhat lower than the estimated 796 banks which would be required to hold nonearning reserves at Federal Reserve Banks under S.85.

The reserve requirement structures of S.85 and H.R.7 are:

Deposit Category	Reserve Ranges (per cent)	
	S.85	H.R.7
Transactions deposits	12 to 14 (13 initially)	8 to 10 (9.5 initially)
Short-term time deposits	4 to 8 (6 initially)	3 to 8 (8 initially)
Savings deposits	1 to 5 (3 initially)	1 to 3 (3 initially)
Long-term time deposits	½ to 2 (1 initially)	1 to 3 (1 initially)

The Board believes that it is particularly important to have a somewhat lower reserve requirement on transactions deposits than under S.85 so as to minimize the incentive for institutions to develop roundabout methods for avoiding the requirement and thereby add to the complexity of administering the reserve structure.

EFFECT ON DEPOSIT COVERAGE AND BANK EARNINGS

The bottom panel shows that the Board's modified version of S.85 would provide a greater earnings benefit to the banking system than S.85. Attachment A presents a listing of individual member and nonmember commercial banks and MSB's which would be subject to Federal reserve requirements or would be required to hold an Earnings Participation Account under S.85 as modified by our proposal. This listing is similar to that shown on pages 11 to 183 of the Committee print, Summary of the Monetary Policy Improvement Act of 1979, which showed the banks covered under S.85. An asterisk in the far right column indicates that it is a bank added to the list by the Board's proposal--that is, it has deposits above the excluded level but below the exemption level of S.85. These added banks would hold an Earnings Participation Account at the Federal Reserve and thus expand the Federal Reserve's coverage of deposits, but they would not hold any nonearning required reserve balance at Reserve Banks because their deposits are below the exempted level. Banks without an asterisk were on the Committee list before. Column 4--entitled EPA--shows the amount of the Earnings Participation Account each institution would hold. If this column is zero, the bank at the end of 1977 had sufficient vault cash in excess of its required reserves that it would have had no Earning Participation Account.

The additional institutions holding accounts at the Federal Reserve would keep the earnings benefit of the exemption level proposed by S.85, since they would participate in the Federal Reserve's earnings on funds that they would be required to maintain in the Earnings Participation Account. Moreover, the combination of the higher exemptions and the different structure of reserve ratios in the modified bill means that any institution required to hold sterile reserves would have its burden reduced relative to that of S.85. This structure enhances the earnings capacity of all institutions and minimizes the competitive burden on individual institutions.

In sum, the Board proposal would have the clear advantage of expanding significantly the coverage subject to reserve requirements, thereby enhancing the implementation of monetary policy. At the same time, it would increase the earnings benefit for depository institutions over those provided in S.85 at a modest additional cost to the Treasury. Finally, exclusion of the first $10 million of transactions-type deposits and $10 million of other deposits from any reserve requirement would reduce the record-keeping burden of the proposal, with relatively small policy impact.

TREASURY REVENUES

Based on the 1977 level of deposits, and assuming all the provisions of the bill had been in effect for some time, it is estimated that the provisions of S.85 themselves would reduce Treasury revenues by about $60 million. This estimate allows for recapture by the Treasury through tax payments by banks and stockholders of a portion of the earnings benefits accruing to banks.

The Board's modification would have a somewhat larger impact on Treasury revenues than S. 85 but still keeps the cost within reasonable bounds. It is estimated that the net cost to the Treasury would be about $173 million.

It must be stressed, however, that in the absence of legislation to stop membership attrition, the Federal Reserve will lose increasing amounts of revenue over time as member banks leave the System. Thus, after making allowance for the loss of Federal Reserve revenues from continued attrition that would otherwise be occurring, these proposals would result in little, if any, net cost to the Treasury in the future. Moreover, in the first three years after the program is implemented the Treasury will not incur any loss in revenue because the Federal Reserve intends to transfer a sufficient portion of its earned surplus to maintain net Treasury revenues during this period.

Attachment B provides language for a series of amendments to S.85 that would implement the various aspects of the Board's proposed modification.

ADDITIONAL MODIFICATIONS

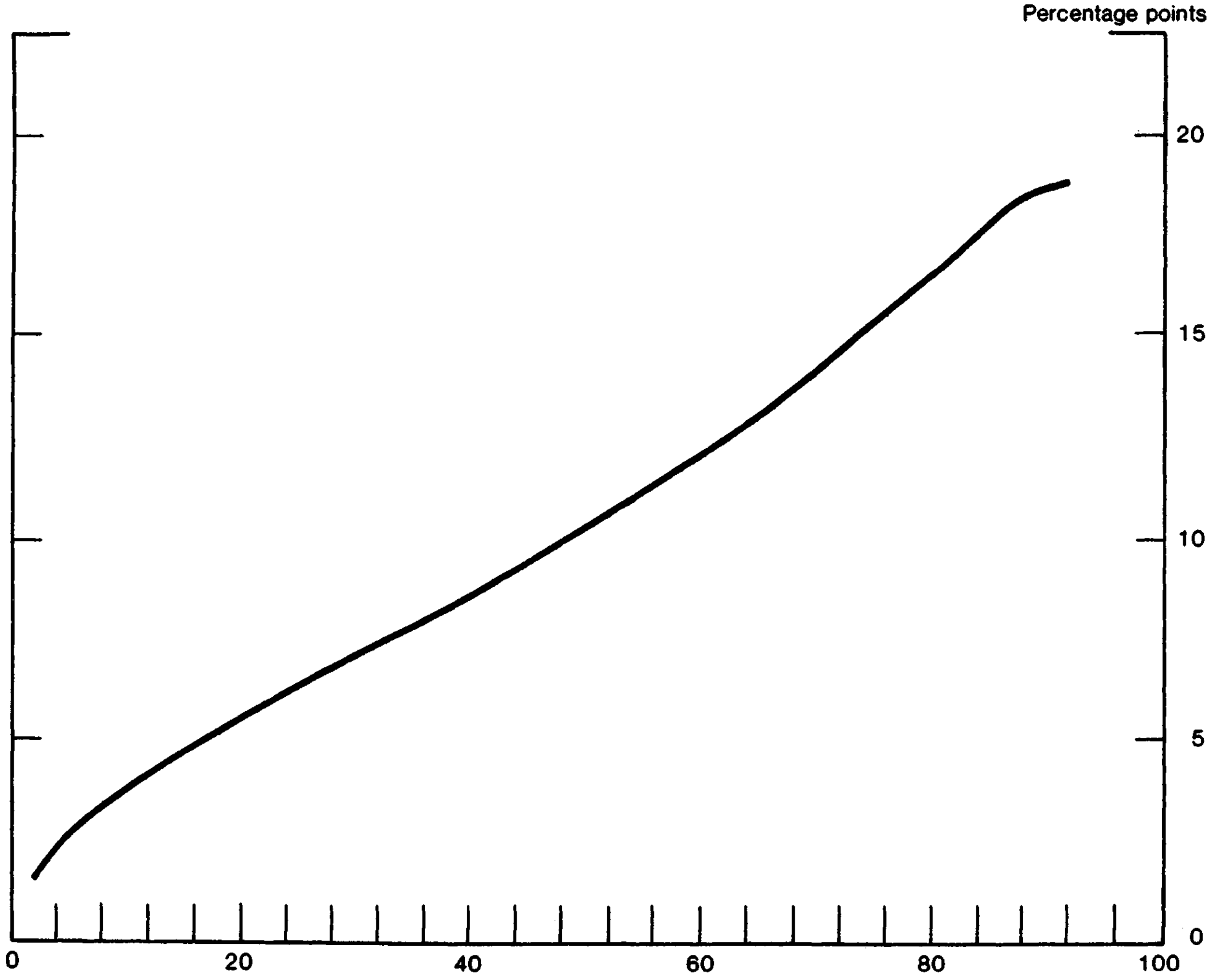
Another modification proposed by the Board concerns the pricing of Federal Reserve System services. The System has already expended considerable effort in formulating pricing principles and in developing pricing alternatives for the services we provide. A preliminary schedule of prices for check and automated clearing house services was announced last November. Price schedules for other Federal Reserve services, such as coin and currency services, wire transfers and the safekeeping of securities, are under consideration. Although we intend to implement service charges as rapidly as we can after the membership problem is solved, we believe that the July 1, 1980 implementation date set in S.85 may not afford sufficient flexibility to develop a well designed system. An amendment which would eliminate the fixed date and thus provide the necessary flexibility is presented in Attachment C. Additional more technical amendments to clarify reporting requirements, access to the discount window, and the application of reserve requirements to foreign obligations of banks, and to conform other provisions of the Federal Reserve Act, also are attached for the Committee's consideration.

Mr. Chairman, thank you for the opportunity to present the Federal Reserve's view on the Monetary Policy Improvement Act of 1979.

Chart I

Effect of Member Bank Attrition On Short-Run Predictability of Monetary Aggregates

Absolute Range of Unpredictable Variability in Two-month Growth Rates



Per cent of Bank Deposits Not Subject to Reserve Requirements

Chart II

Percentage of U.S. Commercial Banks and Deposits in the Federal Reserve System

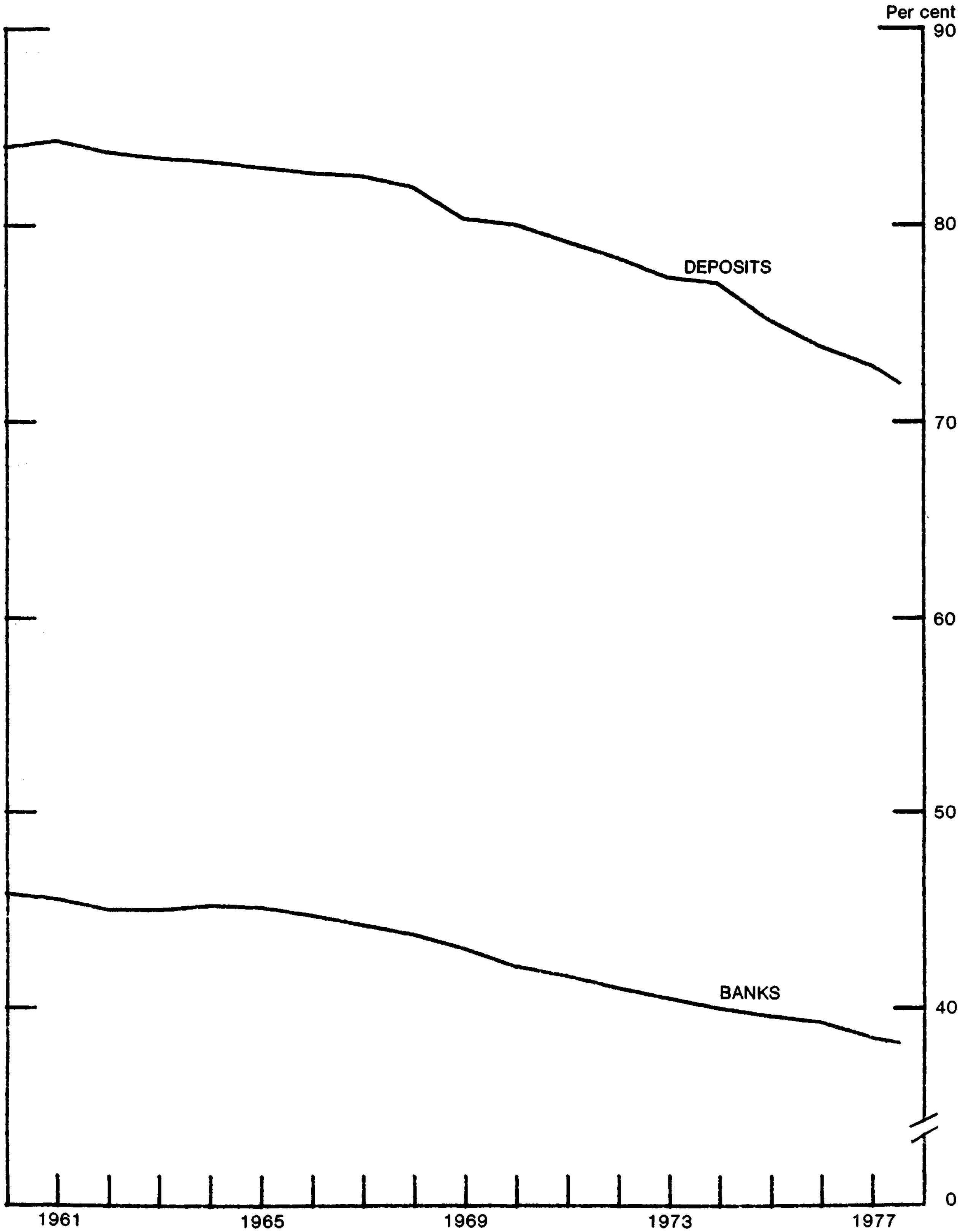


Chart III

Estimated Burden of Federal Reserve Membership

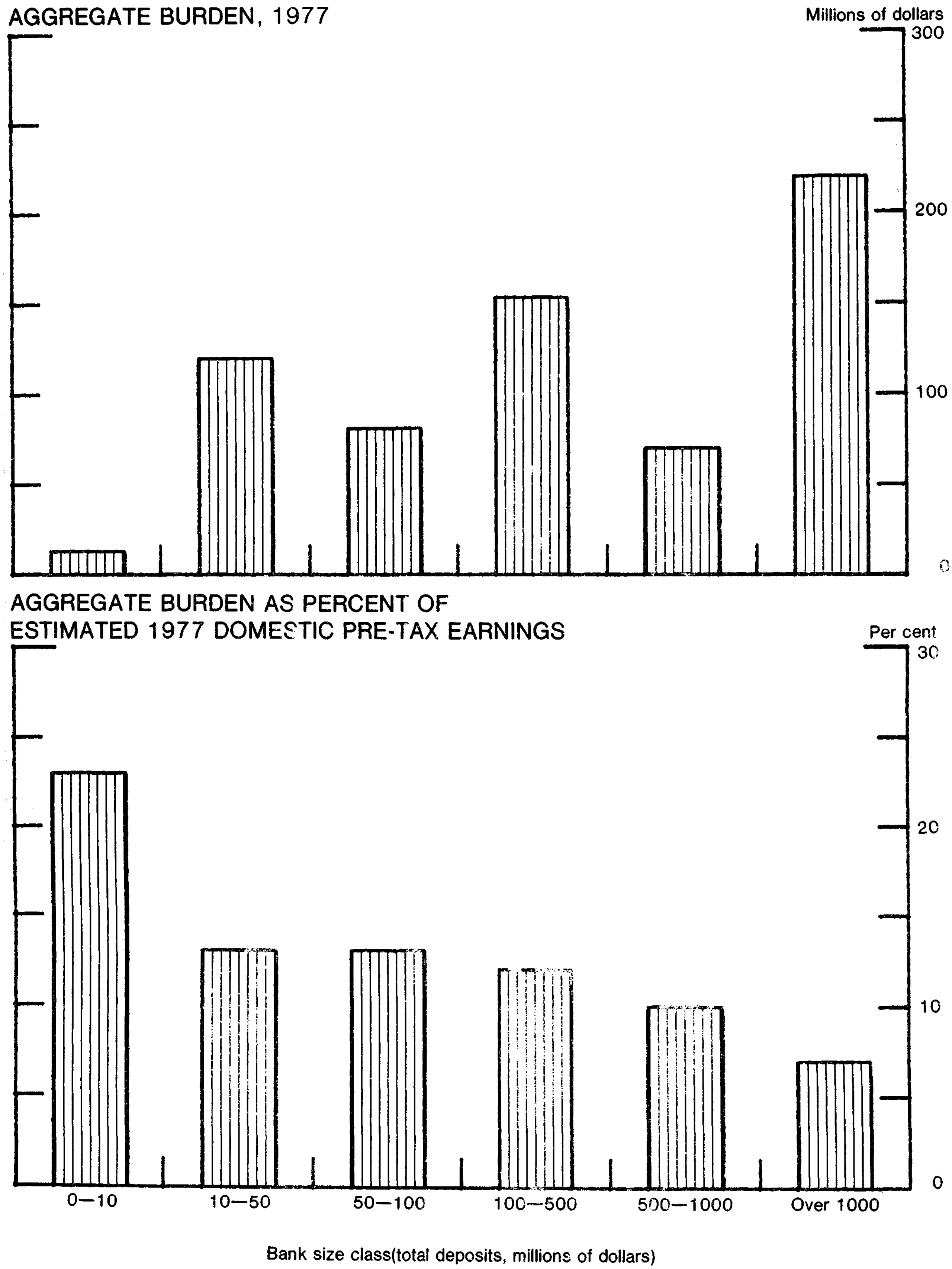


Chart IV

NOW Accounts as Percentage of Household Deposit Balances in New England

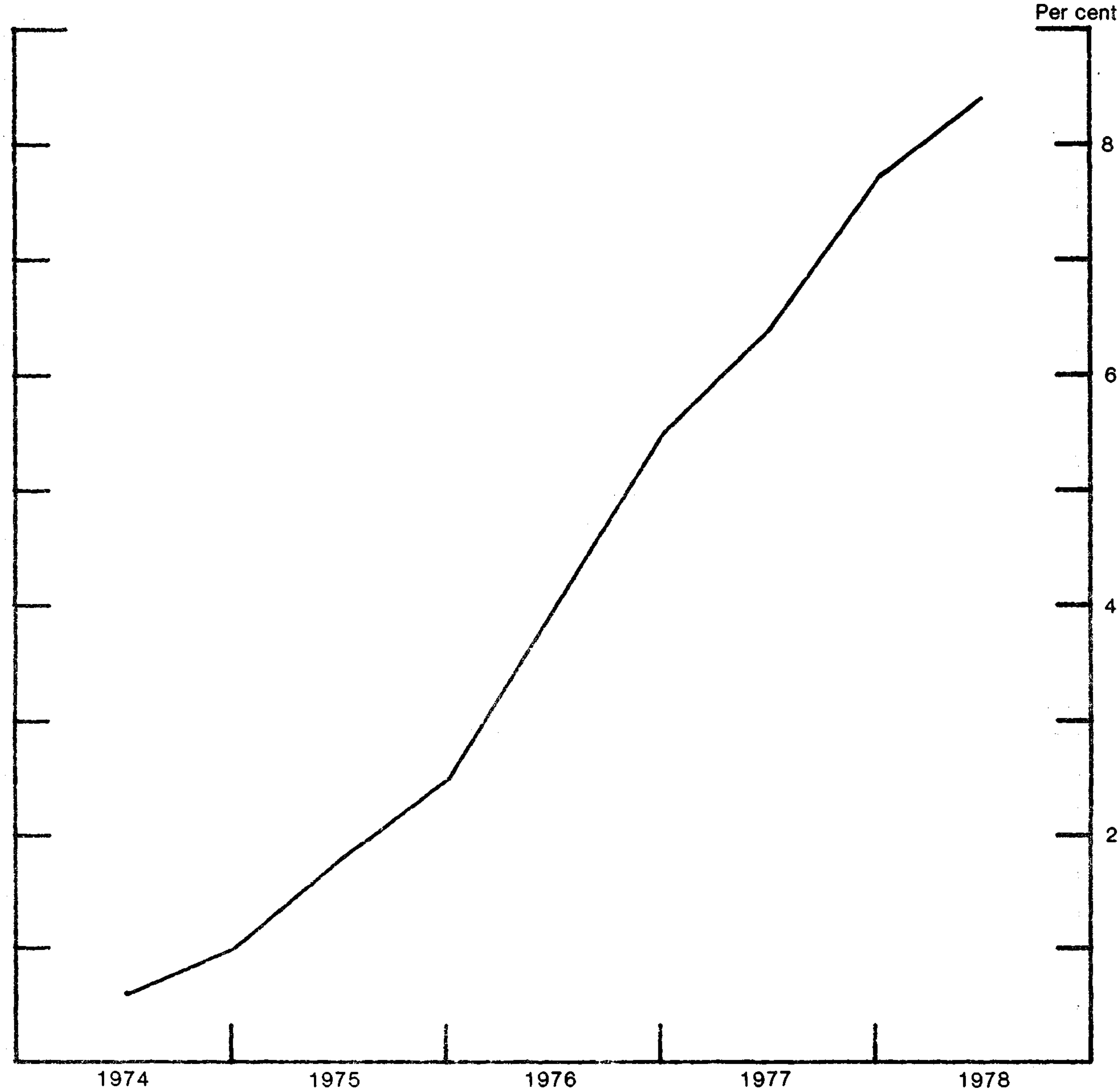


Chart V

Percentage of New England Commercial Banks and Deposits in the Federal Reserve System

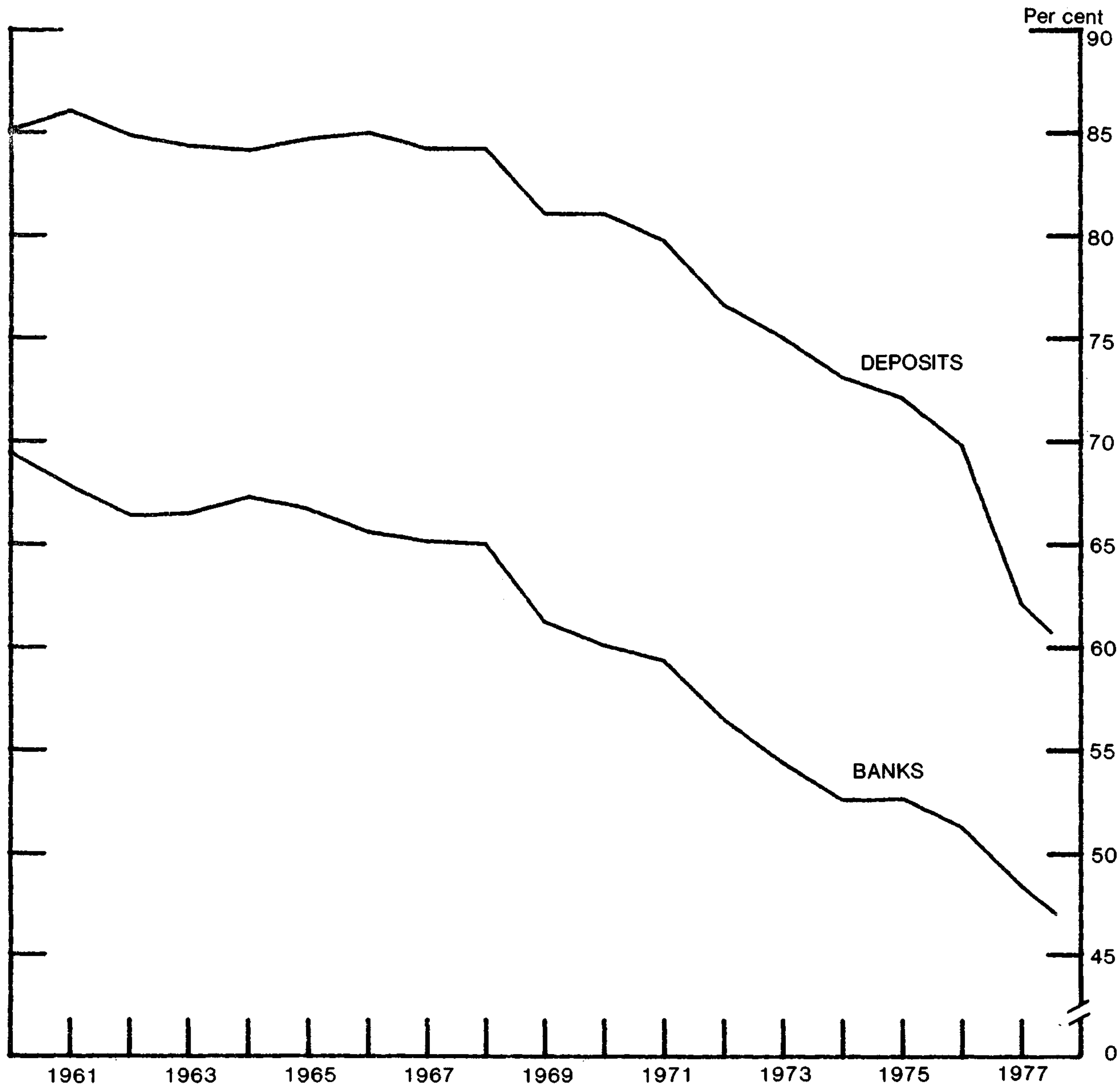
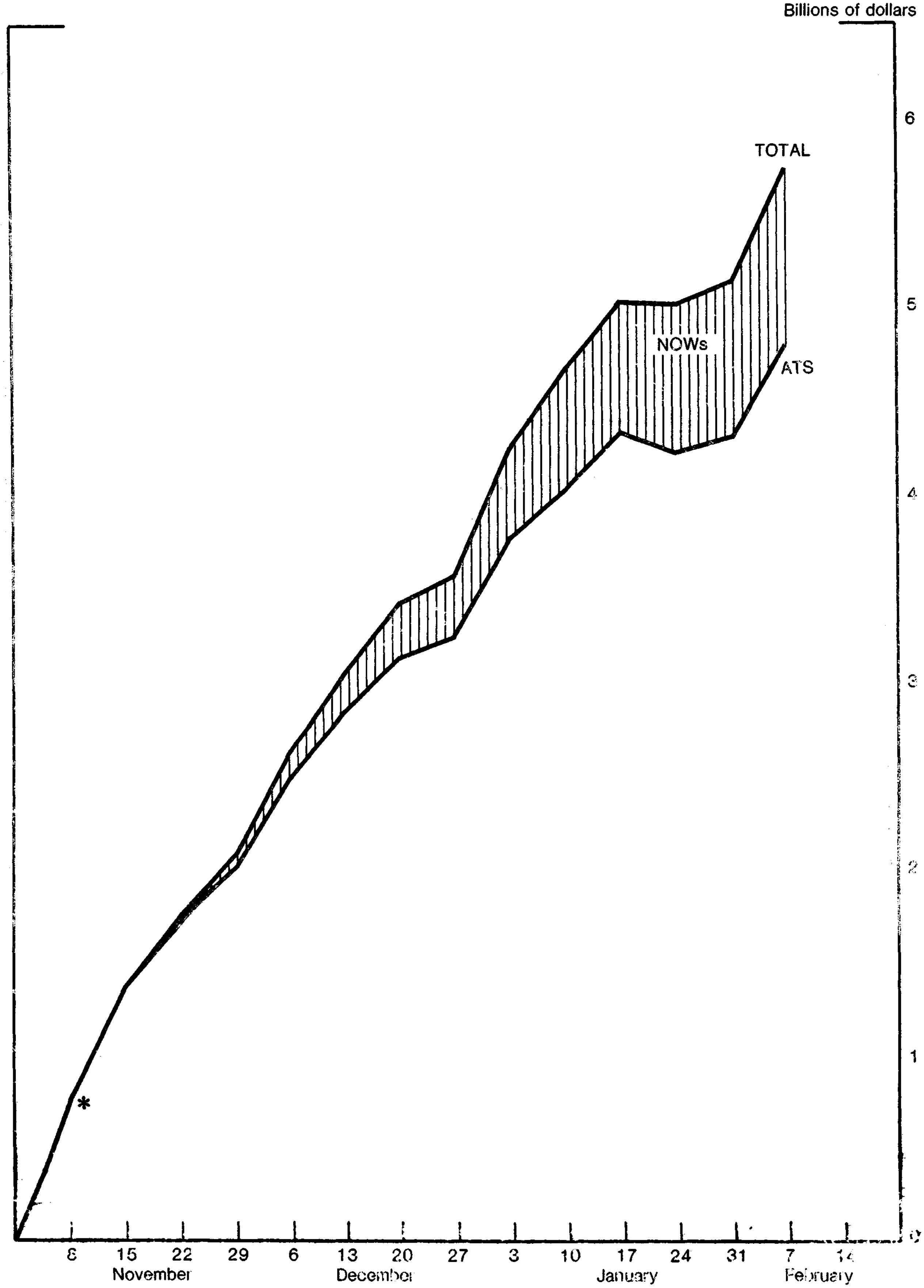


Chart VI

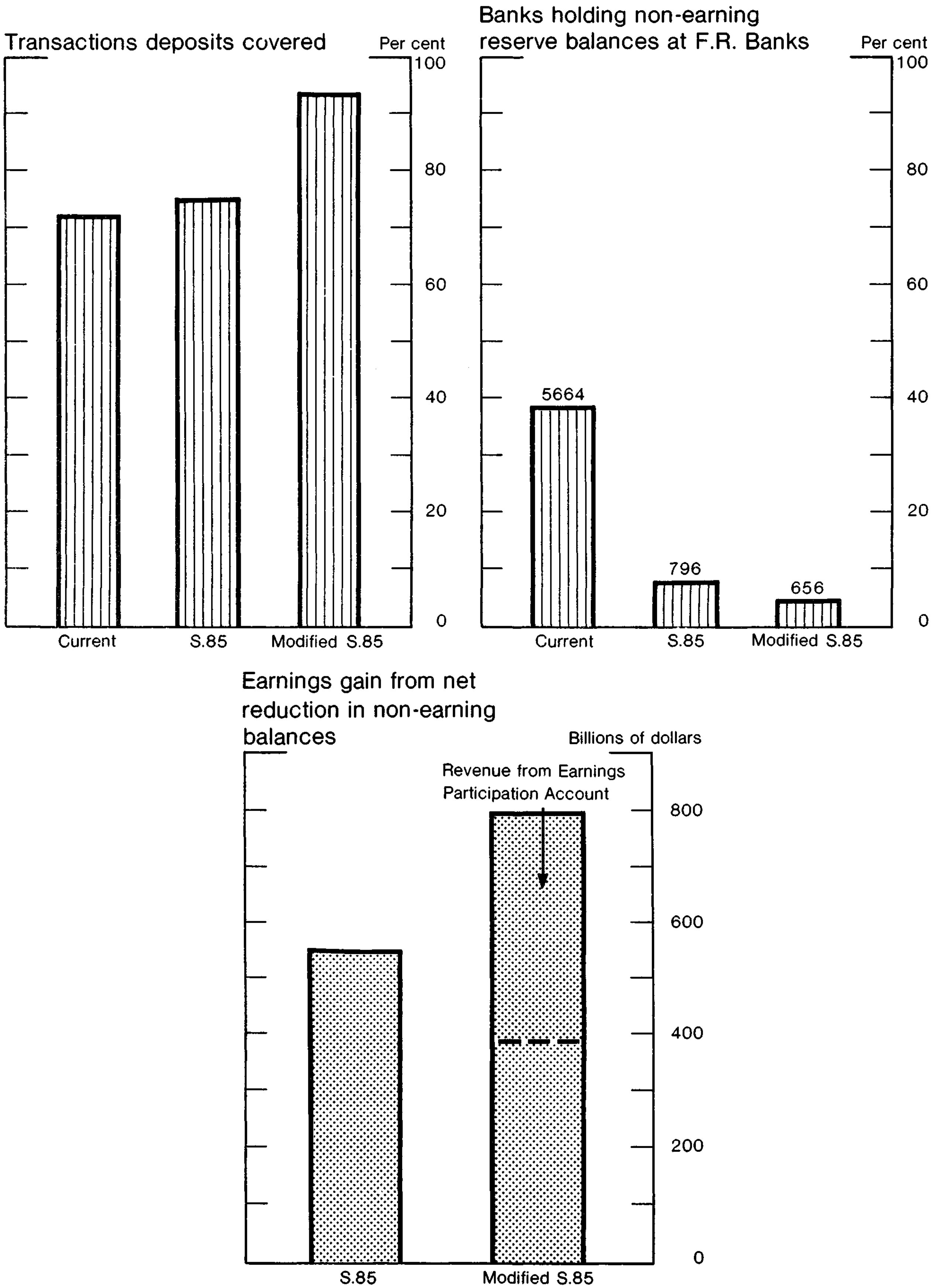
Rapid Growth of ATS Accounts Nationwide and NOW Accounts in New York State



* NOW account authorization not effective until November 10.

Chart VII

Effects of Proposals on Commercial Banks



Based on December 1977 deposits.

Attachment A to

Proposals to Facilitate the Implementation

of Monetary Policy and to Promote Competitive

Equality Among Depository Institutions

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Benefit to Banks Covered by Modified S.85

Key to Column Headings

(1) TDEP	Total domestic deposits as of the end of 1977.
(2) VLTCSH	Vault cash as of the end of 1977.
(3) 1977 REQBAL	Estimated amount of reserve balances as of the end of 1977 required by current law to be held at Federal Reserve Banks (i.e., required reserves minus vault cash).
(4) NEW EPA	Amount that would have been held in Earnings Participation Account at the end of 1977 under modified S.85.
(5) NEW REQBAL	New required reserves minus vault cash that would have been held at the F.R. Banks under modified S.85.
(6) DIF	Reduction in non-earnings required reserve balances at Federal Reserve Banks that would have been held under modified S.85. A negative amount represents an increase.
(7) *	A bank covered by modified S.85 but not by S.85.

Examples for Member Banks

(A) The table shows that the first bank listed, Albertsville National Bank, had deposits of $21,933,000 in December 1977. Vault cash amounted to $366,000, and required non-earning balances at the Federal Reserve were $641,000.

Under modified S.85, this bank, as of the end of 1977, would not have had to hold any non-interest earning balances at the Federal Reserve because neither its transactions-type deposits nor the sum of its other deposits was greater than $50 million. Albertsville National therefore would have saved the $641,000 it held in non-interest bearing reserve balances at the Federal Reserve at the end of 1977.

Since its vault cash is in excess of required reserves (which would be zero), all vault cash would have been counted in lieu of the Earnings Participation Account. The Earnings Participation Account thus would have been zero because its vault cash was greater than the reserve ratios times the non-excluded deposits (deposits in excess of $10 million per account category).

(B) As of December 1977, Birmingham Trust National Bank had domestic deposits of $828,915,000, vault cash of $6,100,000 and sterile balances at the Federal Reserve Bank of $39,847,000. Because it had both transactions deposits and other deposits well in excess of the $50,000,000 exemptions, Birmingham Trust, under modified S.85, would have had to meet reserve requirements with all of its vault cash and reserve balances of $27,342,000. The difference between the actual 1977 sterile balances and those under modified S.85 result in a savings of $12,505,000.

In this case, no vault cash would have been applied in lieu of the Earnings Participation Account because required reserves would have exceeded the bank's holdings of vault cash. Thus, the Earnings Participation Account of Birmingham Trust will equal the reserve ratio on transactions deposits (9.5 per cent) times $40 million plus the weighted reserve ratio on other deposits times $40 million, or $5,162,000.

Examples for Nonmember Banks

(A) The first nonmember bank listed is The Bank of Abbeville, which had total deposits, as of the end of 1977, of $23,421,000 and vault cash of $240,000. Under existing law, no nonmember bank has any Federal reserve requirements. Under modified S.85, this bank would have continued to have no Federal reserve requirements because its transactions deposits and other deposits are well below the $50 million exemption level per account category.

Since vault cash of the Bank of Abbeville would have been in excess of required reserves (which are zero), all vault cash would have been counted in lieu of the Earnings Participation Account. Thus, this bank would have had no Earnings Participation Account because vault cash was greater than the reserve ratio times the non-excluded deposits.

(B) Central Bank of Birmingham had total deposits of $510,662,000 in December 1977. Vault cash was $3,050,000, and it had no Federal reserve requirements. Under the modified S.85, required reserves would have been covered by its vault cash holdings plus $17,509,000 in sterile reserve balances. This results in a net increase in nonearnings reserve balances of $17,509,000.

In this case, no vault cash would have been applied in lieu of the Earnings Participation Account because required reserves would have exceeded the bank's holdings of vault cash. Thus, the Central Bank of Birmingham would have maintained, under modified S.85, an Earnings Participation Account of 9.5 per cent times $40 million in transaction balances plus the weighted average reserve ratios on $40 million of other deposits, or $5,459,000.

NOTE: The full listing of Attachment A is 200 pages long. Only a few representative pages are provided here. The complete attachment is available upon request.

DSB	NAME	LOCATION		(1) TDEP	(2) VLTCSH	(3) 1977 REQBAL	(4) NEW EPA	(5) NEW REQBAL	(6) DIF (3)-(5)	
6010020	ALBERTVILLE NATL BANK	ALBERTVILLE	AL	21933	366	641	0	0	641	*
6010040	FIRST NB OF ALEXANDER CITY	ALEXANDER CITY	AL	42342	1349	881	0	0	881	*
6010050	ALICEVILLE BK & TR CO	ALICEVILLE	AL	16979	251	506	0	0	506	*
6010090	ANNISTON NATIONAL BANK	ANNISTON	AL	57239	700	1829	729	0	1829	
6010100	COMMERCIAL NB OF ANNISTON	ANNISTON	AL	58006	1039	1713	267	0	1713	
6010110	FIRST NB OF ANNISTON	ANNISTON	AL	81102	1814	2074	723	0	2074	
6010180	FIRST AL BANK OF ATHENS NA	ATHENS	AL	36876	583	1482	144	0	1482	*
6010200	FIRST NB OF ATMORE	ATMORE	AL	32111	387	1034	0	0	1034	*
6010230	AUBURN NATIONAL BANK	AUBURN	AL	26805	320	875	0	0	875	*
6010240	CENTRAL BANK OF AUBURN NA	AUBURN	AL	22887	537	522	0	0	522	*
6010255	1ST AL BK OF BALDWIN CTY NA	BAY MINETTE	AL	23484	753	401	0	0	401	*
6010300	BIRMINGHAM TRUST NAT BK	BIRMINGHAM	AL	828915	6100	39847	5162	27342	12505	
6010308	CITY NB OF BIRMINGHAM	BIRMINGHAM	AL	109328	1216	4870	3314	0	4870	
6010320	FIRST NB OF BIRMINGHAM	BIRMINGHAM	AL	1120037	14329	58436	5363	41691	16745	
6010325	NATIONAL BANK OF COMMERCE	BIRMINGHAM	AL	23563	531	658	0	0	658	*
6010339	SOUTHERN NATIONAL BANK	BIRMINGHAM	AL	51975	732	2045	744	0	2045	*
6010360	NATIONAL BK OF BOAZ	BOAZ	AL	17487	240	516	0	0	516	*
6010410	FIRST NATIONAL BANK	BREWTON	AL	41640	373	1520	296	0	1520	*
6010455	FIRST NB OF BUTLER	BUTLER	AL	24604	508	378	0	0	378	*
6010460	CENTRAL STATE BANK	CALERA	AL	15260	225	406	0	0	406	*
6010480	CAMDEN NATIONAL BANK	CAMDEN	AL	20083	259	633	0	0	633	*
6010570	FIRST NAT BK OF CLANTON	CLANTON	AL	18557	263	562	0	0	562	*
6010580	PEOPLES SAVINGS BANK	CLANTON	AL	19740	327	640	0	0	640	*
6010630	FIRST NAT BK OF COLUMBIANA	COLUMBIANA	AL	25163	284	1087	0	0	1087	*
6010660	LEETH NAT BK OF CULLMAN	CULLMAN	AL	27662	673	764	0	0	764	*
6010670	PARKER BANK AND TRUST CO	CULLMAN	AL	18711	243	713	0	0	713	*
6010638	CENTRAL BANK OF ALABAMA NA	DECATUR	AL	511589	7452	20913	4944	10465	10448	
6010690	FIRST NAT BANK OF DECATUR	DECATUR	AL	64544	996	2833	1268	0	2833	*
6010735	CITY NATIONAL BANK OF DOTHAN	DOTHAN	AL	31591	688	1035	0	0	1035	*
6010740	FIRST ALABAMA BK OF DOTHAN	DOTHAN	AL	84933	1023	3209	2024	0	3209	
6010750	FIRST NAT BK OF DOTHAN	DOTHAN	AL	116332	3281	2301	724	0	2301	
6010825	FIRST NB OF EUFAULA	EUFAULA	AL	16235	439	211	0	0	211	*
6010850	FIRST NAT BK OF BALDWIN CTY	FAIRHOPE	AL	46304	619	1593	252	0	1593	*
6010890	FIRST NB OF FAYETTE	FAYETTE	AL	18242	698	180	0	0	180	*
6010910	FIRST NB OF FLORENCE	FLORENCE	AL	135004	2336	4698	3099	0	4698	
6010915	SHOALS NAT BK OF FLORENCE	FLORENCE	AL	21105	399	503	0	0	503	*
6010970	AMERICAN NB OF GADSDEN	GADSDEN	AL	61029	1443	1787	287	0	1787	*
6010985	1ST AL BK OF GADSDEN NA	GADSDEN	AL	38170	785	1165	0	0	1165	*
6011050	FIRST NB OF GREENVILLE	GREENVILLE	AL	46542	768	1441	0	0	1441	*
6011090	FIRST NB OF GUNTERSVILLE	GUNTERSVILLE	AL	39060	599	1212	5	0	1212	*
6011115	MARION COUNTY BANKING CO	HAMILTON	AL	32392	534	1398	108	0	1398	*
6011150	HEADLAND NATIONAL BANK	HEADLAND	AL	23771	240	762	0	0	762	*
6011163	AMERICAN NATIONAL BANK	HUNTSVILLE	AL	39452	785	1323	31	0	1323	*
6011170	1ST AL BK OF HUNTSVILLE NA	HUNTSVILLE	AL	155664	3812	4962	3314	0	4962	
6011130	HENDERSON NB OF HUNTSVILLE	HUNTSVILLE	AL	67626	1679	2072	587	0	2072	
6011190	PEOPLES NB OF HUNTSVILLE	HUNTSVILLE	AL	38474	1122	861	0	0	861	

DSB	NAME	LOCATION		(1) TDEP	(2) VLTCSH	(3) 1977 REQBAL	(4) NEW EPA	(5) NEW REQBAL	(6) DIF (3)-(5)	
6010010	BANK OF ABBEVILLE	ABBEVILLE	AL	23421	240	0	0	0	0	*
6010015	FIRST BANK OF ALABASTER	ALABASTER	AL	15370	374	0	0	0	0	*
6010030	ALEXANDER CITY BANK	ALEXANDER CITY	AL	19940	340	0	0	0	0	*
6010065	CITIBANC OF AL ANDALUSIA AL	ANDALUSIA	AL	29491	362	0	0	0	0	*
6010070	COMMERCIAL BANK	ANDALUSIA	AL	40644	502	0	0	0	0	*
6010120	BANK OF ARAB	ARAB	AL	17585	282	0	0	0	0	*
6010123	SECURITY BANK AND TRUST CO	ARAB	AL	16533	454	0	0	0	0	*
6010190	BANK OF ATMORE	ATMORE	AL	32781	298	0	20	0	0	*
6010205	EXCHANGE BANK	ATTALLA	AL	16694	267	0	0	0	0	*
6010229	AUBURN BANK & TRUST CO	AUBURN	AL	14606	212	0	0	0	0	*
6010250	BALDWIN COUNTY BANK	BAY MINETTE	AL	24743	436	0	0	0	0	*
6010258	FIRST ALA BK OF MOBILE CTY	BAYOU LA BATRE	AL	18528	383	0	0	0	0	*
6010295	BANK OF THE SOUTHEAST	BIRMINGHAM	AL	28729	802	0	0	0	0	*
6010305	CENTRAL BANK OF BIRMINGHAM	BIRMINGHAM	AL	510662	3050	0	5459	17509	-17509	
6010310	FIRST AL BANK OF BIRMINGHAM	BIRMINGHAM	AL	319352	6672	0	5170	3201	-3201	
6010323	METROBANK	BIRMINGHAM	AL	34024	667	0	0	0	0	*
6010350	BANK OF BLOUNTSVILLE	BLOUNTSVILLE	AL	21242	304	0	0	0	0	*
6010370	SAND MOUNTAIN BANK	BOAZ	AL	28540	582	0	0	0	0	*
6010390	BANK OF BREWTON	BREWTON	AL	22737	457	0	0	0	0	*
6010450	CHOCTAW BANK OF BUTLER	BUTLER	AL	24032	333	0	0	0	0	*
6010520	CHEROKEE COUNTY BANK	CENTRE	AL	26687	402	0	0	0	0	*
6010530	FARMERS AND MERCHANTS BANK	CENTRE	AL	32458	326	0	28	0	0	*
6010690	BANK OF DADEVILLE	DADEVILLE	AL	16584	282	0	0	0	0	*
6010693	FIRST STATE BK OF DECATUR	DECATUR	AL	36175	587	0	0	0	0	*
6010720	ROBERTSON BANKING CO	DEMOPOLIS	AL	25302	541	0	0	0	0	*
6010780	ELBA EXCHANGE BANK	ELBA	AL	20833	212	0	0	0	0	*
6010805	CITIZENS BANK	ENTERPRISE	AL	31130	308	0	146	0	0	*
6010810	ENTERPRISE BANKING COMPANY	ENTERPRISE	AL	58470	487	0	818	0	0	
6010820	EUFAULA BANK AND TRUST CO	EUFAULA	AL	31237	278	0	29	0	0	*
6010870	CITIZENS BANK	FAYETTE	AL	18426	312	0	0	0	0	*
6010890	ESCAMBIA COUNTY BANK	FLOMATON	AL	18092	229	0	0	0	0	*
6010920	FARMERS AND MERCHANTS BANK	FOLEY	AL	27402	387	0	0	0	0	*
6010922	SOUTH BALDWIN BANK	FOLEY	AL	22471	328	0	0	0	0	*
6010925	FORT PAYNE BANK	FORT PAYNE	AL	23507	492	0	0	0	0	*
6010930	FORT DEPOSIT BANK	FORT DEPOSIT	AL	19465	306	0	0	0	0	*
6010960	ALABAMA CITY BANK	GADSDEN	AL	35235	715	0	0	0	0	*
6010990	EAST GADSDEN BANK	GADSDEN	AL	25700	248	0	0	0	0	*
6010995	AMERICAN BANK	GENEVA	AL	15812	282	0	0	0	0	*
6011030	CITIZENS BANK	GENEVA	AL	20872	123	0	0	0	0	*
6011055	GREENVILLE BANK	GREENVILLE	AL	23359	597	0	0	0	0	*
6011080	1ST AL BANK OF GUNTERSVILLE	GUNTERSVILLE	AL	23018	345	0	0	0	0	*
6011110	TRADERS AND FARMERS BANK	HALEYVILLE	AL	43308	675	0	0	0	0	*
6011140	CITIZENS BANK OF HARTSELLE	HARTSELLE	AL	25051	385	0	0	0	0	*
6011143	FIRST AL BANK OF HARTSELLE	HARTSELLE	AL	20928	502	0	0	0	0	*
6011160	BANK OF HEFLIN	HEFLIN	AL	29855	574	0	0	0	0	*
6011165	BANK OF HUNTSVILLE	HUNTSVILLE	AL	48563	838	0	0	0	0	*

Comment: These amendments provide an exclusion from reserve requirements of up to $10 million for transaction deposits of depository institutions and an exclusion up to $10 million for time and savings deposits of banks. An institution's transaction deposits in excess of $10 million but not more than $50 million, and a bank's total time and savings deposits in excess of $10 million but not more than $50 million are exempted from reserve requirements. Reserve requirements will be imposed on a depository institution's transaction deposits that exceed $50 million and a commercial bank's total time and savings deposits that exceed $50 million. A depository institution will maintain in an Earnings Participation Account at the Federal Reserve Bank (or passed through to the Federal Reserve by another institution) an amount resulting from first, multiplying the appropriate reserve ratios in effect for each deposit category by the level of the institution's exempted deposits for each deposit category and, second, deducting from this figure the amount by which the institution's vault cash exceeds its reserve requirements. The institution's Earnings Participation Account will earn interest at a rate equal to the average return earned on the Federal Reserve's securities portfolio.

The amendments also provide for the following initial reserve ratios and ranges on deposits:

	Initial	Ranges
Transaction	9.5%	8-10%
Savings	3%	1-3%
Short term time	8%	3-8%
Long term time	1%	1-3%

Section 4 is amended as follows:

(a) By striking the figure "40,000,000" each time it appears on page 5 at lines 6 and 13, on page 6 at lines 7 and 17, and on page 9 at lines 20 and 21, and substituting the figure "50,000,000" in lieu thereof.

(b) By striking the figures "13", "14", and "12" that appear on page 5 at lines 6, 7, and 8 and on page 6 at lines 17, 18, and 19 and substituting in lieu thereof the figures "9.5", "10", and "8", respectively.

(c) By striking the figures "40,000", "6", and "4", that appear on page 5 at lines 13, 14, and 16 and substituting in lieu thereof the figures "$50,000,000," "8", and "3" respectively.

(d) By striking on page 5 the words "one-half of 1" that appear at line 22 and the figure "2" that appears at line 23 and substituting in lieu thereof the figures "1" and "3" respectively.

(e) By striking the figure "5" that appears on page 6 at line 3 and substituting in lieu thereof the figure "3".

(f) By adding at the end thereof the following new subparagraphs:

"(11) Every depository institution shall maintain in an Earnings Participation Account at a Federal Reserve Bank of which it is a member or at which it maintains an account a balance determined by multiplying the amount of its transaction deposits that are in excess of $10 million but not more than $50 million by the reserve ratio in effect for transaction accounts and, in addition, every bank shall maintain a balance determined by multiplying the amount of the total of its savings and time deposits that are in excess of $10 million but not more than $50 million by the reserve ratio in effect for each category of savings and time deposits. If the total savings and time deposits of a bank exceeds $50 million, the amount of its savings and time deposits against which a balance shall be maintained shall be determined by multiplying $50 million by the proportion that the bank's deposit in the respective categories bear to the total of its deposits in the categories.

"Any amount by which a depository institution's holdings of vault cash exceeds its reserve requirements on its reservable deposits shall be deducted from the institution's required Earnings Participation Account Balance.

"The Earnings Participation Account of a depository institution shall earn interest at a rate equal to the average rate earned on the securities portfolio of the Federal Reserve System during the calendar quarter immediately preceding the interest payment date. The Board is authorized to adopt rules and regulations relating to the issuance and administration of Earnings Participation Accounts."

Section 5 is amended by inserting after the word "Reserves" on line 4 the words "and balances."

Attachment C

Section 6 is amended by striking all that follows the word "services" on line 13 until the period on line 15.

Comment: This eliminates the requirement that by July 1, 1980 the Board have put into effect a schedule of fees for Federal Reserve services.

Attachment D

In Section 3, the second sentence of the new paragraph added to the end of Section 11(a) of the Federal Reserve Act is amended to read as follows:

"Such reports shall be made (1) directly to the Board in the case of member banks and for all deposit liabilities in the case of other depository institutions maintaining transaction accounts as defined in Section 19 of this Act, and"

Comment: This amendment clarifies that depository institutions with transactions deposits will file reports on all deposit liabilities directly with the Board.

Attachment E

Section 4 is amended by striking subsection (7) on page 8 and inserting in lieu thereof the following:

"(7) A depository institution possessing transaction accounts shall be entitled to the same discount and borrowing privileges as member banks."

The following section is inserted as section 10.

"Abolition of Penalty rate"

"Section 10. Section 10(b) of the Federal Reserve Act (12 U.S.C. 347b) is amended by striking all after the first sentence thereof."

Comment: These provisions provide access to the Federal Reserve discount window to all depository institutions possessing transaction accounts and eliminate the penalty rate now required by the Federal Reserve Act when borrowing institutions collateralize their loans with ineligible paper.

Attachment F

Section 4 is amended by adding to subsection (5) on page 7 the following:

> "Nonmember banks shall be required to maintain reserves based upon the activities of their foreign branches and subsidiaries to the same extent required by the Board of foreign branches and subsidiaries of member banks."

Comment: This provision authorizes the Board to require nonmember banks to maintain reserves against the obligations of their foreign branches and subsidiaries on the same basis required of member banks' foreign branches and subsidiaries.

Section 9, entitled "Effective Dates," is redesignated as Section 11 and the following is substituted in lieu thereof:

ACCESS TO CLEARING SERVICES

"Sec 9. (a) The first paragraph of section 13 of the Federal Reserve Act (12 U.S.C. 342) is amended as follows:

(1) by inserting after the words "member banks" the words "or other depository institutions".

(2) by inserting after the words "payable upon presentation" the first and third times they appear, the words "or other items, including negotiable orders of withdrawal or share drafts".

(3) by inserting after the words "payable upon presentation within its district," the words "or other items, including negotiable orders of withdrawal or share drafts".

(4) by inserting after the words "nonmember bank or trust company," wherever they appear the words "or other depository institution".

(5) by inserting after the words "nonmember bank" after the second colon the words "or other depository institution".

(b) The thirteenth paragraph of section 16 of the Federal Reserve Act (12 U.S.C. 360) is amended as follows:

(1) by striking out the words "member banks" wherever they appear and inserting in lieu thereof "depository institutions".

(2) by striking out the words "member bank" wherever they appear and inserting in lieu thereof "depository institution".

(3) by inserting after "checks" wherever it appears the words "and other items, including negotiable orders of withdrawal and share drafts."

(c) The fourteenth paragraph of section 16 of the Federal Reserve Act (12 U.S.C. 248(o)) is amended by striking out "its member banks" and inserting in lieu thereof "depository institutions."

Comment: In order to assure equal treatment for all depository institutions these amendments conform various sections of the Federal Reserve Act relating to clearing facilities by eliminating the distinctions drawn by the Act between member and nonmember depository institutions.