FEDERAL RESERVE BANK OF DALLAS
FISCAL AGENT OF THE UNITED STATES
DALLAS, TEXAS 75222

Circular No. 74-241
September 9, 1974

To All Treasury Tax and Loan Depositaries
In the Eleventh Federal Reserve District:

Enclosed is a copy of a Report on a study of Tax and Loan Accounts compiled by the Department of the Treasury.

The Report presents a brief history of Tax and Loan Accounts, as well as an analysis of the value of the accounts to commercial banks and the Treasury Department. In addition, the Report includes information related to the earnings and costs of maintaining such accounts.

Additional copies of the Report may be purchased from the Superintendent of Documents, United States Government Printing Office, Washington, D. C. 20402.

FEDERAL RESERVE BANK OF DALLAS
Fiscal Agent of the United States

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Department of the Treasury

June 1974

REPORT ON A STUDY OF TAX AND LOAN ACCOUNTS

REPORT

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TAX AND LOAN ACCOUNTS

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For sale by the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C. 20402

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REPORT ON A STUDY OF TAX AND LOAN ACCOUNTS

I. SUMMARY

After analyzing the responses to the current questionnaire and reappraising the tax and loan system, these conclusions have been reached:

- Although the system's strictly monetary purposes may be less crucial than in earlier years, tax and loan accounts remain of major importance as a monetary management tool and as a highly efficient collection system.
- At the higher level of interest rates prevailing in recent years, the implicit costs to the Treasury of holding interest-free tax and loan accounts has risen substantially beyond the value to the Treasury of those services provided by the banks that have been inherently or traditionally associated with such accounts.
- Tax and loan accounts should be retained, but means should be developed (1) for employing a portion of these funds in ways that provide added returns to the Treasury, and (2) for compensating banks for a limited number of services performed by fees paid from appropriations.
- Legislative actions will be required to make possible the most efficient employment of Treasury cash in interest-bearing assets and to provide appropriations for payments for certain services performed by financial institutions.

II. PURPOSE AND FUNCTION OF THE TREASURY TAX AND LOAN ACCOUNT SYSTEM

The tax and loan account system was originated in 1917 by Secretary of the Treasury McAdoo in the Administration of President Wilson when the financing of World War I increased the size of the Federal Government's financial operations. Over the years it has been improved and expanded, and it has been expressly or impliedly endorsed by every Secretary of the Treasury, Democratic and Republican.

Facilitating monetary policy

The principal purpose of the system originally—to promote the smooth functioning of the economy by reducing the impact of Government financial operations on the distribution and level of bank reserves and on the money market—is still of major importance.

The peaks and valleys in the timing of the flow of money between the public and the Government would be, without some device for smoothing them out or compensating for them, of sufficient magnitude to cause sharp changes in bank reserves, resulting in undesirable fluctuations in money market interest rates and in the availability of loanable funds in the banking system. Treasury tax and loan accounts were devised to prevent these drastic swings. As taxes are paid and as banks subscribe for new issues of designated Treasury securities (for their own or customers' accounts), the funds are transferred on each bank's books from the payer's account to the Treasury's tax and loan account. The Treasury can then draw down the tax and loan balances as it actually needs funds to cover disbursements, thereby matching the flow of collections with the flow of payments, minimizing their impact on bank reserves and the money market.

At one time the Treasury attempted to keep its balance at the Federal Reserve as near a constant level as possible, striving thereby to neutralize the money market effect of Treasury financial operations. In recent years, however, the Treasury has

sought to increase its Federal Reserve balance when its total balances are relatively high in order to minimize the size of its idle tax and loan balance. Thus the Treasury balances are being managed in a way designed to capture for the Treasury (via increased earnings of the Federal Reserve) greater earnings without subverting the system's original purpose of smoothing out extreme fluctuations in bank reserves and distortions in the money market.

As described later, the nature of this money market and banking problem has changed in recent years from large seasonal fluctuations in Treasury receipts to sharp day-to-day shifts in net cash requirements.

Fostering distribution of Treasury securities

Another of the original purposes of the system was to facilitate the distribution of huge issues of Treasury securities by providing an incentive for banks to serve as "underwriters," holding the securities for a period until an investment demand developed. Since the Treasury must meet its needs for cash by borrowing in relatively large blocks, a sale of Treasury securities would, without a device such as the tax and loan account system, create abrupt fluctuations in bank reserves and tend to result in congestion and higher rates in the market for newly-offered securities. In some situations, by letting each bank subscribing for securities pay for them by crediting its own tax and loan account, the system has provided a means, as described above, of avoiding this disruption. At the same time, the system has provided an incentive to the banks, in the form of a few days' delay in relinquishing payment, for subscribing to a new issue. This incentive has served its purpose of building an "underwriting" network for Treasury securities that has helped enable the Treasury, alone among major issuers, to market securities without commissions or spreads of any kind.

With the market for Treasury securities now more highly developed, the need for this method of distribution has tended to diminish, but it nevertheless continues to be a significant function of the tax and loan account system.

Providing a collection system

While the system was originally established for purposes of monetary management and the sale of securities, it has evolved over the years into a collection system that has significant advantages for the Government in the efficient inflow of most of its revenues, now handling nearly $200 billion of revenues annually. Each business concern makes tax payments through its own bank; the company's check, when drawn on its bank, does not have to flow beyond that bank. The bank charges its customer and simultaneously credits the Treasury tax and loan account. This saves delay in check clearings and avoids the expense to the Treasury of handling large volumes of remittances, which entail not only detailed internal processing and depositing in banks, but also burdens incident to returned uncollectible checks. To the extent that alternative collection systems would involve a delay in the deposit of receipts into usable Treasury balances—and virtually all alternative systems would involve such delays—the costs associated with tax and loan accounts would reappear in another, perhaps less identifiable, guise.

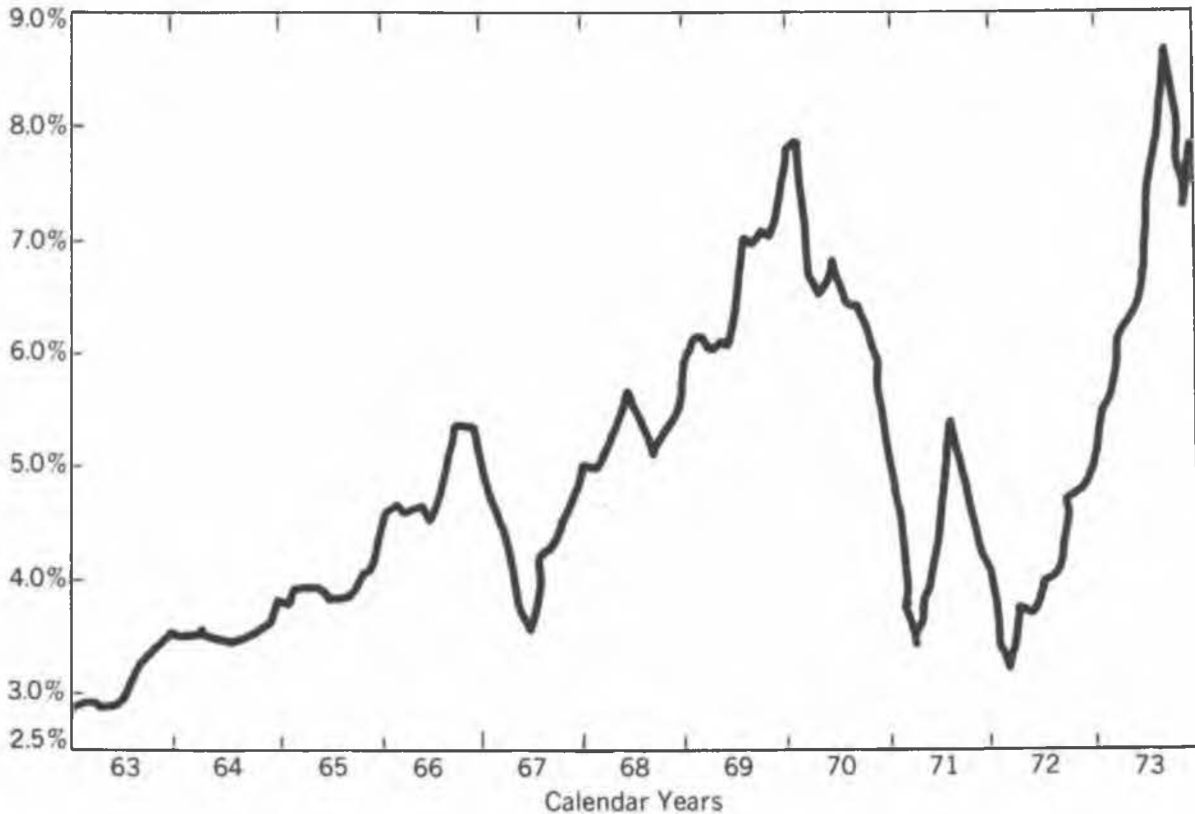
Along with the increase in dollar volume of taxes flowing through the tax and loan accounts has come an increase in the frequency of required payments. This has smoothed out the flow of receipts, a factor in the shift of emphasis from the monetary management uses of the tax and loan system to the economical collection objectives of the system.

III. PREVIOUS STUDIES

Studies by the Treasury in 1960 and 1964 explained in detail the purposes and operations of the tax and loan account system and the public benefits derived from it. These studies compared the earning value to the banks (and implicit cost to the Treasury) of the interest-free deposits to the costs of services provided by banks—all in aggregate terms.

The Treasury decided to make this study because almost ten years had elapsed since the last study of the relationship between the value of the tax and loan account balances and the services provided by banks. In that time, there had been

a four-fold increase in the amount of taxes flowing through tax and loan accounts. Essentially because of the higher level of receipts and outlays of the Government, the size of tax and loan account balances had also increased, although this increase has been modest relative to the flow of payments through the accounts. The level of interest rates had also been higher, reaching two peaks when interest rates were the highest in U.S. history (as reflected in the following chart).



These rate levels have provided significantly greater earning potential on tax and loan balances. And finally, it had become obvious through the Treasury's daily operations that banks were providing, without charge, fewer of the services to which values were attached in the previous studies.

Because of these changes, a thorough reappraisal of the system was in order.

IV. GOALS OF THE CURRENT STUDY

The goals of the study were to determine whether the tax and loan account system should be retained, and, if so, in what respects, if any, it should be altered.

No questions had been raised as to the usefulness or effectiveness of the system as a collection device or as an instrument to facilitate the functioning of the money markets and the management of bank reserves. Consequently, the question whether to retain the basic system was reserved for appraisal after the overall cost to the Treasury could be appraised, taking account of the relationship to the value of the services provided for the Government.

The study initially concentrated, therefore, on this latter issue.

V. RELATIONSHIP OF VALUE OF ACCOUNTS TO VALUE OF SERVICES

A. METHODOLOGY

Principal questions

The principal questions underlying this phase of the study were these:

- For which services, under present conditions, should banks continue to be compensated, and at what dollar values?
- Should services continue to be compensated for through tax and loan account balances or should any be compensated for through some other techniques?
- Should the value of services offset by tax and loan account balances be looked at in relation to each bank individually, or should the system-wide value of services and balances continue to be the guiding consideration?

Selection of banks to participate

The first step in seeking answers to the foregoing questions was to send a questionnaire, the text of which is set out in Exhibit 1, to 600 banks. The banks selected included the 300 banks with the largest Treasury tax and loan accounts and a sampling of 300 of the remaining 12,700 banks. The sampling was designed to be representative of the total system, permitting extrapolation of the data for a reasonably accurate picture of the banking system as a whole. How the sample was selected is explained in Exhibit 2.

Capsule summary of the overall response to the questionnaire

Of the 600 banks solicited, 557 returned questionnaires, several of which were received too late to be included in the study. As might have been expected, the majority of the nonparticipants were among the 300 smaller banks selected at random; of the 300 banks with the largest tax and loan accounts, nine saw fit not to participate.

While the percentage of respondents was high, the quality of many of the individual responses was poor. Numerous questions remained unanswered and a significant number of banks failed to provide support for their cost estimates. Some responses were inconsistent or erroneous, and some were irrelevant. After casting aside irrelevant information and obviously inconsistent or erroneous data that could not be corrected, the remaining data were used for the current study.

There was an extreme variation in unit costs among the reporting banks. For example, the costs reported for the handling of Federal tax deposits ranged from a low of 1½¢ per transaction to a high of $3.10 per transaction. Similar ranges occurred in each category of service for which unit costs were reported. An extensive analysis of individual reports indicated a lack of any logical relationship between unit costs reported and factors which might have been expected to have a bearing on them. For example, attempts to relate unit costs to such factors as (1) geographical location of the bank, (2) size of the bank, (3) size of the city, and (4) unit banks vis-a-vis branch bank systems indicated no reasonable relationships. From reviewing the supporting data which some of the banks submitted, it appeared that the most significant single factor influencing the difference in reported unit cost was simply a difference in cost accounting techniques. Another factor, but of less significance, was the difference in the procedure followed in providing a particular service. In arriving at an average cost, we eliminated extremes at both ends and developed weighted averages for the remaining reporting banks. We then extrapolated these data for the groups that the reporting banks sampled, thereby arriving at an overall weighted average cost.

Analysis of services listed by Treasury

At the outset of the current study it was decided that it would be appropriate to assume that banks should be compensated by tax and loan account balances for services directly related to the handling of tax and loan accounts. These services are (1) the maintenance of the tax and loan account itself, and (2) the handling of Federal tax deposits through the tax and loan account. Because of this assumption, questions about these services were separated in the questionnaire as Part I.

It was also decided at the outset that it would be appropriate to assume that only these services were, without further question, compensable; the compensability of other services would depend upon the results of the study. Part II of the ques-

tionnaire, therefore, listed certain other services performed by banks on a voluntary basis and called for activity and cost data relating thereto. The questionnaire also solicited from banks their views as to any services they believed should be compensable by the Government. The questions in this Part, designed to assist in judging whether banks' costs should be compensable, were drafted upon these fundamental assumptions:

- If the service is provided primarily as a customer service or as a marketing device, the Treasury should not compensate the bank.
- If the cost of the service is in one way or another recovered by the bank from the individual recipient (not the Government), the Treasury should not disturb this relationship.

In view of this, the questionnaire told banks the Treasury would work on a hypothesis that if a bank does not provide a particular service to non-customers, or charges a fee to non-customers not charged to customers, the bank is providing the services to its customers on the basis of its overall relationship with them, and consequently any expense involved in providing the service to customers should not be compensable by the Government. Banks generally took no exception to this stated assumption, and it has been retained in the analyses set out below.

B. ANALYSIS OF SERVICES PERFORMED BY BANKS

Services listed by Treasury

The services listed by the Treasury in Part I of the questionnaire were the following:

1. Handling the tax and loan account itself, including Federal tax deposits

These are the only services which are exclusively related to the existence of a tax and loan account and assumed at the outset to be compensable. Reported activity and cost related to the handling of tax and loan accounts is reflected in Exhibit 3.

2. Handling subscriptions to United States securities (other than savings bonds) on original issue and handling matured United States securities

The Treasury was generally aware, before the responses were received, that significant changes had occurred in recent years in the practices of banks in charging fees for, or refusing to provide, these particular services. The data furnished, however, provided concrete information on this subject. The data are summarized in Exhibit 4, which shows that most banks do not handle subscriptions or matured securities without a fee. Of the 540 banks which were responsive to the question, only 108 indicated that they handled subscriptions for non-customers without a fee and only 13 of those 108 reported any actual subscriptions handled. These 13 banks reported handling 131 subscriptions for a total dollar value of $48,896,000. Even for customers, almost two-thirds of the responsive banks indicated either that they charge a fee or do not handle subscriptions at all. Responses concerning matured securities were similar, although more inclined to free service. With respect to non-customers, 219 of 538 responsive banks indicated they would handle matured securities without a fee, but only 57 reported any actual transactions. The 57 banks reported 2,438 transactions for a total dollar value of $175,327,000.

It appears from the foregoing that banks, in handling subscriptions for new issues and in handling matured Government securities, whether for customers or non-customers, generally operate on the basis that these services are provided for the benefit of the recipients of the service and at the recipients' expense. It would appear, therefore, that from their own behavior the banks have not accepted a responsibility to provide such services as an inherent part of their deposit relationship with the Treasury.

3. Redemption of savings bonds

For many years, banks and other financial institutions (e.g., savings and loan associations), acting as paying agents for the redemption of United States savings bonds, have been paid a fee from appropriations to the Treasury's Bureau of the Public Debt at the rate of 15 cents for each of the first 1,000 bonds redeemed during the quarter and 10 cents for each bond in excess of 1,000.

Of the banks responding, 33.5 percent indicated that the present fee is adequate. The remaining 66.5 percent indicated that the fee is not adequate. The details of activity and expenses with respect to the payment of savings bonds are contained in Exhibit 5.

This analysis would indicate that banks should be compensated by some method at a rate higher than the existing fee schedule provides. At present, the value of tax and loan accounts to the banks provides a form of compensation, but that compensation does not bear a close relationship to savings bond volume. Since banks are presently reimbursed for the payment of savings bonds on a fee basis, based on volume data readily available in the Bureau of the Public Debt, and since the same service is provided by other financial institutions (which do not have Treasury tax and loan accounts), a practicable approach would be to provide all or a greater portion of the needed compensation by raising the present fee.

4. Issuance of savings bonds

Data furnished by the banks on activity and costs in issuing United States savings bonds are summarized in Exhibit 6.

For payroll savings plans of employing firms, the savings bonds could be issued by Government offices or by the Federal Reserve Banks. It is obvious, however, that there are unique advantages in having the facilities of the commercial banks for over-the-counter sales. Also, if Government offices or Federal Reserve Banks were to do the job done by banks in payroll savings plans of business concerns, there would be additional direct expense to the Government. One question to be resolved is whether all issuing agents (including financial institutions other than banks) should be compensated for the issuance of savings bonds. If they ought to be compensated, the further question is how the amount of compensation should be determined, and the form that compensation should take. Any compensation to banks should take into consideration the alternative costs to the Government of obtaining the services. For example, on payroll issues the fee paid to banks should be set in light of the costs that would be incurred if the Government itself issued the bonds.

There is a public service tradition in the sale of savings bonds—with many promotional services donated by employers, the Advertising Council, and others—and banks' contributions by way of sales promotions are comparable to voluntary contributions by others. Costs associated with getting and controlling blank bond stock and with inscribing and delivering bonds to buyers are another matter. These are comparable to redemption costs for which a fee is well established. Further, the Government itself provides this service when it is not otherwise available for payroll issues. Consequently, it would appear that banks should be compensated for allocated costs incurred in the issuance of savings bonds, subject to the limitations of alternative cost criteria mentioned above. While such compensation for banks is now implicit in tax and loan accounts, a change to a fee system, as for redemptions, would be a straightforward possibility.

5. Handling of Treasury checks

Typically in the United States, the payee of a check is on his own in negotiating that check. A few exceptions to this general principle, not involving Treasury checks, include (a) requirements in a few States that employers making payroll payments by check make arrangements under which employees can cash their checks, and (b) arrangements that some States have made for welfare recipients to cash their welfare checks.

Data developed from the questionnaires, set out in Exhibit 7, indicate that a very small percentage of payees of Treasury checks cash such checks at banks where they do not have an account. This, however, does not necessarily indicate the extent to which payees do or do not have problems in negotiating their checks. Reports from banks indicate that in several large cities most banks do not cash Treasury checks for non-customers. Hence, payees of Treasury checks who do not have bank accounts presumably are cashing their checks at retail stores, check-cashing agencies, etc. Although we do not receive many complaints in the Treasury directly, those we do receive are invariably from elderly, disabled or poverty-stricken people who do not have bank accounts and who can least afford the discounts, fees or transportation expenses that they must incur to get their checks cashed.

If the Treasury were to provide for unlimited free check-cashing facilities, by compensation to banks through the tax and loan accounts or otherwise, several highly undesirable results could ensue. One result would be to cause major disruptions in present practices that payees follow in cashing their checks, with no particular benefits derived. For example, employees at a particular Government installation in the center of a city who have bank accounts in suburban areas would

likely, in many instances, cash payroll checks at a bank close to the installation if Treasury arranged with such bank to cash payroll checks for non-customers without charge. Since the employees are now able to negotiate their checks at their own banks, any action on our part would involve a substantial expense without offsetting advantage. Another undesirable result would be a negative impact on the trend toward the use of bank accounts by all members of our society, an objective which may become not only desirable but imperative when the growing volume of funds transfers becomes so great that new methods of handling them are required.

There seems to be no doubt that cashing checks for non-customers should not be made a compensable service generally. While check-cashing arrangements may in some hardship cases become desirable as a matter of public policy, there appears to be no need or justification at this time for assumption by the Government of the responsibility for providing check-cashing facilities for recipients of Treasury checks.

Services identified by banks

In addition to the services specifically covered in the questionnaire, banks were requested to report any other services they were performing on behalf of the Government for which they felt they were entitled to compensation by the Government. For purposes of analysis, a review of other services reported by banks has classified such services into two categories—those performed voluntarily and those which are mandatory under specific statutory requirements. Services in these categories are discussed separately below.

1. Voluntary services

In analyzing the voluntary services listed by the banks, we applied the same criteria used to evaluate whether banks' costs of providing the specific services listed in the questionnaire by Treasury should be compensable.

The most frequently reported voluntary services, and the number of banks that submitted data with respect to each service, are set out in Exhibit 8. The reporting of these services required the following comments.

a. Making income tax forms available

The Treasury benefits from the service rendered by banks in stocking Internal Revenue Service forms and making them available to the public. Undoubtedly, banks do so not only as a customer service and as a marketing device, but also as a service to the public generally. This seems, however, to be a service that falls into a range of activities that banks undertake to promote a public service image rather than a service for which they should be directly compensated.

b. Handling United States commemorative coins

As with income tax forms, the Treasury gets some benefit from the service rendered by banks and making available to the public application forms for special commemorative coins, such as the Eisenhower silver dollar. For the same reasons cited in 'a' above, it does not appear that specific compensation is required.

c. Food stamp program

The custody and sale of food stamps is, by law, the responsibility of the States. The Federal program agency, the Department of Agriculture, gives the States the option of doing this work (i) through their own county or local agents, or (ii) by contractual arrangement with banks or other financial institutions.

When States elect to use their own facilities, they bear all the costs of custody and sale, even where banks are involved because the State agencies wish to use them for the custody of stamps. When States elect to contract with banks to handle sales, the contracts cover compensation for all their services.

Banks may also be involved in the program in handling the proceeds of stamp sales. When States use their own facilities for selling stamps, the proceeds may be delivered to banks either for deposit to the credit of the Treasury or for conversion to bank drafts for transmission to Federal Reserve Banks; in either capacity banks perform as Depositaries and Financial Agents of the Government and are compensated by Treasury balances other than tax and loan balances. When States contract with banks to sell stamps, disposing of the proceeds is not a separate step and the contracts providing compensation for selling stamps cover disposition of the proceeds.

Finally, banks may be involved in the program when they receive deposits of stamps taken in trade by their commercial customers. When banks receive these deposits, they are doing it as a part of their normal customer relationships, and as such, compensation for the activity comes from the customers' accounts.

In sum, a source of compensation is provided for every service a bank may render in the food stamp program, and there is no need for providing additional compensation through tax and loan account balances.

d. Sale of Federal transfer stamps

A number of banks erroneously reported this as a service. These stamps were actually discontinued years ago. (Public Law 89–44, June 21, 1965.)

e. Exchange of 'E' bonds for 'H' bonds

Banks are presently reimbursed by fees for the re-

demption of series 'E' savings bonds. However, they render a valuable service to those individuals exchanging 'E' bonds for series 'H' savings bonds for which they are not compensated. The actual issuance of the 'H' bonds is handled by Federal Reserve Banks, but banks often assist the subscribers in filling out their applications. Since the total number of annual exchanges is less than 300,000, the overall impact on the banking system is, of course, not significant. It would appear, however, that banks should be compensated for the assistance provided in the conversion of 'E' bonds to 'H' bonds.

2. Mandatory services

In general, the mandatory services which banks listed in their completed questionnaires are services provided not only by banks but by other financial institutions and other business concerns. Since the Congress, in imposing the various reporting and recordkeeping services which the banks listed, made no provision for compensation, we believe that if there is to be any compensation it should be provided by Congressional authorization. A list of the mandatory services most frequently reported by banks in their responses is set out in Exhibit 9. That list also reflects the number of banks reporting each of the services.

C. ANALYSIS OF EARNING VALUE OF TREASURY TAX AND LOAN ACCOUNTS

Two significant elements affect the earning value of Treasury tax and loan accounts: (1) the volatility of the balances, and (2) the requirement that these balances be collaterally secured. Because of these two elements, it would appear that it would be appropriate to invest the balances in short-term money market instruments which are in the class of securities eligible as collateral, and, for analysis purposes, to use the rate on one of these instruments as a measure of the earning value of the balances. The responses to the questions contained in the questionnaire concerning the earning value of the tax and loan account balances, summarized in Exhibit 10, indicate that this view was shared by many banks. In considering which specific category of money market rates should be used, it would appear that the Treasury bill rate is a reasonable measure. While many banks agreed that the value of balances was at least equivalent to the rate on Federal funds, this rate would not be appropriate for those banks that found it necessary to invest the tax and loan balances in securities eligible for collateral as contrasted to those banks that could pledge eligible securities from their existing portfolios.

While the difference between the Treasury bill rate and other money market rates varies considerably in the short run, the averages of each of the several categories of money market rates over time are not significantly different. Therefore, the use of the bill rate would not in the long run provide significantly different results from the use of other money market rates. An added factor in favor of utilizing the bill rate is that for those banks applying an earning factor in analyzing accounts of large customers, the 91-day Treasury bill rate is used more frequently than any other rate.

In summarizing the overall results of the study, the earning rate used was the average rate on new issues of Treasury 91-day bills during the five-year period ended December 31, 1972, which was 5.5 percent. While that is substantially less than the rate during the past few months on new issues of Treasury 91-day bills, it seemed more reasonable for purposes of the study to use a longer-term average.

In computing the earning value in the study, the average bill rate was adjusted to give effect to bank reserve requirements and to the Federal Deposit Insurance Corporation assessment, which is computed as a percentage of balances. The rates used, therefore, range between 4.51 percent and 5.06 percent, the difference being a function of the reserve requirement for the particular bank involved.

The problem of assessing the cost of tax and loan account deposits to the Treasury (as opposed to the value to the banks) introduces some additional complications. In concept, assuming appropriate legal powers and institutional arrangements were available, the Treasury could convert these funds to earning assets, and considerations similar to those already discussed would be relevant. However, in practice (and apart from the money market problems that the tax and loan account system is designed to avoid) **full** investment of these balances would not be possible unless interest were to be paid on demand balances themselves. Indeed, alternative collection systems would appear to involve some lag between taxpayer payments and conversion of those payments into investable funds because of the time required for the recording and clearance of checks.

D. CONCLUSION

It is readily apparent that the aggregate earning value of tax and loan accounts to the banks far exceeds the aggregate cost to banks of those services that are directly attributable to handling the account, principally the processing of tax deposits. For the 600 banks in the survey, imputed annual earnings exceeded the expenses of handling the accounts by $170 million. Projecting the survey data to the total universe of tax and loan depositaries, the estimated excess of imputed earnings was over $300 million. These data are summarized in Exhibit 11.

If the costs of issuing and redeeming savings bonds—the other services judged to be compensable (see later discussion)—are added, banks in the aggregate still show a large excess of earning value over service costs, an excess of $260 million based on the survey data.

It should be noted that this excess of earning value does not purport to increase **bank** profits derived from tax and loan accounts nor the benefit that would accrue to the Federal budget from abandoning the tax and loan account system or from investing the deposits in earning assets.

Many banks, in competing for tax and loan account deposits, may indirectly pass on part or all of the earning value of a tax and loan account to the taxpaying customers. To this extent, the result is to reduce the effective cost of banking services to the taxpaying public. In the case of new Treasury security issues, payable through the tax and loan account, part of the earning value is reflected in lower costs of borrowing by the Treasury itself. Finally, to the extent bank profits are increased, the Federal budget would recover part of the earning value through the corporate income tax.

Apart from the latter factor, the extent to which the Federal budget would benefit from a conversion of tax and loan accounts into earning assets would depend upon the relative efficiency of alternative collection systems, their costs relative to costs now incurred by banks, and the efficiency that could be achieved in investing the balances. The latter consideration raises the further question of appropriate changes in regulatory or legislative provisions now limiting the Treasury's ability to invest cash balances.

In particular, it must be recognized that alternative collection systems would involve a delay in the conversion of checks in payment of taxes to usable Treasury balances and a corresponding delay in the payment of those checks by the drawee banks. Under the tax and loan system, the payment by the drawee banks is accelerated when they receive tax deposits directly from their customers to the credit of tax and loan accounts. This must be considered in any analysis of the implicit cost of the system. If it were not compensated for, banks would be motivated to decline to accept tax deposits from their customers because their investable funds would be reduced simply by the bank being a part of the tax and loan system.

Finally, assuming the tax and loan account system is retained, some profit in the handling of the accounts would presumably be necessary to provide those incentives to banks necessary for the effective operation of the system. If, for instance, capital equivalent to 5 percent of the average tax and loan balance in 1972 of $6.8 billion was appropriate (given that such balances are invested in high quality, liquid assets) a net return of some $44 million, before taxes, would be required to provide an after tax rate of 10 percent on invested capital.

Taking all these factors into account in appraising the earning value of the tax and loan accounts, the conclusion is that:

- In recent years, in reflection of higher market interest rates, the implicit cost of the accounts to the Treasury (or to put it another way, the earning value to the banks and their taxpaying customers) has risen to a multiple of the value of the related services provided the Treasury.

VI. RETENTION OF TAX AND LOAN ACCOUNTS

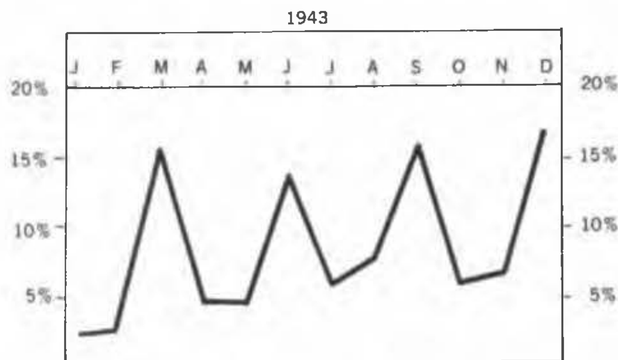
Money market purpose

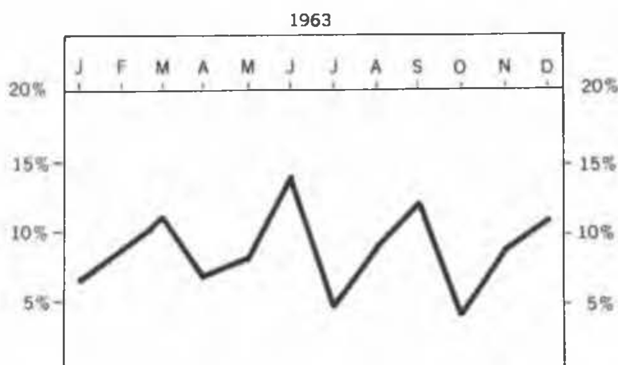
Having concluded that in recent years the implicit cost to the Treasury of tax and loan accounts has risen substantially above the value of related services, it became necessary to reappraise the question whether the accounts should be retained

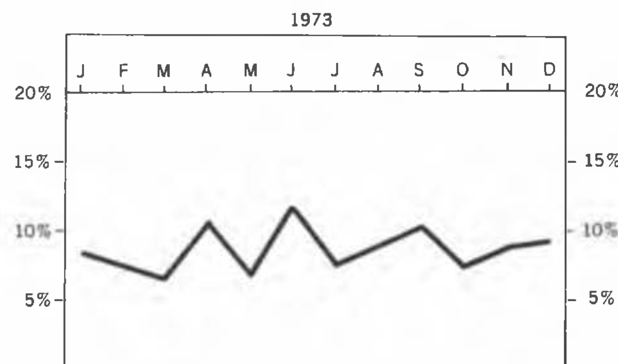
in the form in which they have been known, i.e., in a form which leaves funds in the banking system to facilitate the functioning of the money markets and the management of bank reserves. The accounts could, of course, be retained solely as a collection device, with credits to the accounts passed through immediately to the Treasury's checking account at the Federal Reserve Banks, leaving only enough balance with each commercial bank to compensate it for handling the account. In the past, however, it has been felt that the national interest was best served by drawing funds from the banking system in a way that meshes as much as possible with the return of funds to the banking system through disbursements, thus facilitating Federal Reserve actions to regulate bank reserves. The result has been the balances in tax and loan accounts which we have concluded have earning values in excess of account servicing costs. The critical question, then, is whether the system should be revised to the extent of providing for transfers of funds into Federal Reserve Banks in excess of those which mesh with the Federal Reserve's efforts to regulate bank reserves, leaving it to the Treasury or Federal Reserve to devise other methods of dealing with the effect on bank reserves, the money markets, and the distribution of bank deposits.

NET BUDGET RECEIPTS

Monthly Receipts as a % of Total Calendar Year Receipts







Changes in money markets

Since the inception of tax and loan accounts, a number of substantial changes have taken place which have changed the relative magnitude and significance of the impact of Treasury cash operations on the Nation's money markets.

Over the years since the inception of the tax and loan account system, changes in tax payment dates and changes in the timing and amounts of new issues of Government securities (for cash) have substantially reduced the seasonal swings of cash flows into the Treasury. The following charts ("Net Budget Receipts") reflect net receipts in the years indicated and demonstrate the reductions in month-to-month fluctuations.

Also, over the past ten years the size of Treasury tax and loan accounts has been relatively stable whereas other factors in the Nation's money markets have increased substantially. The result, of course, is that the relative significance of Treasury tax and loan accounts has decreased. The following table reflects a comparison of certain significant data as between 1963 (the base year for the last previous tax and loan study) and 1973 (in billions):

Monetary Statistics	1963	1973	Percent Increase
Average Member Bank Reserves	$ 20.7	$ 35.1	70%
Money Stock (MI)	153.5	270.4	76
Federal Funds Sold	2.0[1]	27.7	1,285
Total Assets of Commercial Banks	361.6	806.4	123
Average Tax and Loan Balance	5.3	5.6	6

[1] Federal Funds Sold first shown as separate line in June 1966 Federal Reserve Bulletin, which reflected $2,103,000,000 as of December 31, 1965.

In the earlier days of the tax and loan system, money markets were highly regionalized and the significance of leaving Treasury cash receipts in the bank of origin until the Treasury was ready to disburse such receipts was very significant. At the present time, the flow of funds among banks in all parts of the country, as for example via the Federal funds market, has substantially reduced the significance of leaving the funds where they originated. Were it not for the one problem described below, the retention of the tax and loan system as a collection device with the elimination of the balance in tax and loan accounts (with the banks simply remitting deposits daily to the Federal Reserve Banks) might be feasible without undue strain.

The problem that cannot at this time be adequately resolved without the continuation of the maintenance of tax and loan account balances is the impact of the large swings in the Treasury's operating cash over the course of a few days. These swings, which reach the magnitude of increases and decreases of over $3 billion in one and two-day periods, occur each month. The operating cash balance drops sharply because of heavy disbursements early in each month, and the balance rises as cash is replaced later in the month, with particularly large increases after the fifteenth of each tax payment month. The drops in balances result from those Government benefit programs where payments are concentrated on single days, such as social security benefits, civil service retirement, and veterans benefits. For example, Treasury checks totaling approximately $5.5 billion for social security benefits are delivered to payees on the third of each month and the greater part are presented for payment against Treasury's operating balance at the Federal Reserve Banks in the following two days. The increases in balances occurring later in each month are the result of substantial tax payments. The following table reflects some of the larger day-to-day swings in the past few months:

Date	Changes in Treasury Operating Balance (In billions of dollars)
December 4, 1973	$-1.4
December 5, 1973	-1.7
December 18, 1973	+2.4
December 19, 1973	+1.1
December 20, 1973	+1.1
January 7, 1974	-1.7
February 5, 1974	-1.9
March 5, 1974	-2.5

For somewhat longer periods of time, the fluctuations run to larger amounts as shown in the following table:

Date	Changes in Treasury Operating Balance (In billions of dollars)
December 17, 1973 to December 31, 1973	$+7.5
January 3, 1974 to January 9, 1974	-4.2
January 15, 1974 to January 30, 1974	+5.0
March 15, 1974 to March 22, 1974	+4.6
April 1, 1974 to April 11, 1974	-6.0

The Federal Reserve Board has formally advised the Treasury that it believes that a procedure which called for transfer of the bulk of Treasury's deposits from commercial banks to Federal Reserve Banks would unduly complicate monetary policy.

Conclusion

After thorough reappraisal, we believe that, despite the changes that have taken place, the sharp swings in Treasury inflows and outflows still cannot be efficiently compensated for by other operations of the Treasury, the Federal Reserve and the commercial banks working together, and the principle of tax and loan accounts remains of major importance for the smooth functioning of the money markets. While the time may come when this is not true, we believe that for the present the use of tax and loan accounts for their basic purpose in smoothing out the effects of Treasury operations should be preserved. We conclude, therefore, that:

- The present system should be preserved in a form which leaves funds in the banking system until they are required for out payments.

VII. CAPTURING EARNINGS ON TAX AND LOAN ACCOUNTS

Since we concluded on the one hand that tax and loan accounts should be retained for money management purposes, and on the other hand that the implicit cost has become high relative to the services provided, it became necessary to consider ways of realizing a return on those balances. There are a number of ways in which this can be done. It developed in the course of our appraisal of the methods, however, that there are also a number of constraints which surround the conversion of tax and loan accounts to earning assets.

Of the wide range of potential methods for recouping earnings, three merit particular discussion. Other methods considered which might have achieved the result sought were discarded either because of complexity or lack of directness or because they would have required unacceptable changes in basic regulatory philosophy.

The most direct solution to the earning problem would be to require banks to pay interest directly on tax and loan balances. This was authorized by the original tax and loan legislation (31 U.S.C. 771), and at one time interest was in fact earned on these demand deposits. In 1933, however, the Congress found it desirable to prohibit the payment of interest on demand deposits (12 U.S.C. 371a and 12 U.S.C. 1828(g)) because of strong feelings that it enabled large banks to compete unfairly with small banks, led to a competitive ratcheting up of interest costs, and encouraged dangerously speculative loans. If a proposal to remove the prohibition for Government deposits were to be placed before the Congress, it seems inevitable that the question would be reopened for all types of demand deposits. The Administration's position on this issue, as contained in the recommendations to the Congress for change in the U.S. financial system, was that the payment of interest on demand deposits should remain prohibited for all institutions and we do not propose the U.S. Government be placed in a privileged position in this respect.

A second way of realizing earnings would be to put a portion of tax and loan balances into time deposits. The constraint here is the Federal Reserve regulation which provides for earning interest on deposits only if the time is 30 days or more. The average life of a tax and loan deposit is only about 10 days. There are periods for which a limited part of the balance could be placed on deposit for 30 days. At best, however, the earnings would fall far short of the full earning potential of the balances. If the Federal Reserve were to reduce the allowable time period for time deposits, the earning potential of the tax and loan balances would be improved; but it would take a period as short as seven days if this approach were to be reasonably satisfactory.

A third way of getting earnings on tax and loan money would be to invest the unneeded balances on a day-to-day basis in short-term money market instruments, preferably with the banks holding the tax and loan balances. At the present time, corportions, states, cities, and other entities can establish arrangements with banks for the day-to-day investment of their operating cash balances in excess of daily needs in various money market instruments such as Treasury obligations acquired under repurchase agreements. The Treasury does not have authority, however, to invest in this way. Also, the magnitude of Treasury balances as compared to any single corporation or political subdivision is such that forms of investment would be required that would not unduly disrupt money market rates. If the Treasury had authority to invest, actual investments could take whatever form would be most advantageous to the Treasury and at the same time least disruptive to the money markets. For instance, one way to accomplish both objectives would be for the Treasury to make loans on a secured basis to each bank maintaining a tax and loan account. This could be done when the funds would be available for a given period of time—say three to seven or more days—in a fixed percentage relationship to the tax and loan balance with the bank. In effect, the Treasury would invest through a particular bank by withdrawing funds from the tax and loan account with that bank. The investment would thus be accomplished at rates which would parallel current market rates for similar investments; but, by not actually entering the market, the impact on market rates would be nearly eliminated.

On balance, given the limitation on time deposits to 30-day minimum maturities, it is believed that the direct investment technique outlined above should be chosen as a method to

realize earnings on the balances. It is simple and straightforward, it is consistent with cash management practices in industry and in state and local governments, and it involves the least disruption of existing institutional arrangements. Our conclusion is, therefore, that:

- Congress should consider legislation authorizing the Treasury to invest in money market instruments for cash management purposes.

Pending congressional action on investment authority, it is the Treasury's intention to pursue vigorously the two avenues that are clearly available without legal or regulatory changes:

First, we will intensify our efforts to increase our balances at the Federal Reserve Banks, to the extent consistent with money-market stability; conversely, this will decrease our balances in tax and loan accounts. This necessarily means that the Federal Reserve System will have to compensate for greater swings in the Treasury balance at Federal Reserve Banks through existing techniques such as open market operations.

Second, we will experiment with placing funds in 30-day time deposits. Our preliminary conclusion is that converting tax and loan balances at particular banks into time deposits at the same banks would be administratively cumbersome and that, without extensive restructuring of the tax and loan system, relatively smaller portions of the balances of large banks than of small banks could be converted. An alternative that might be less cumbersome and more equitable would be for the Treasury to call specific amounts from tax and loan accounts and simultaneously offer to place the same aggregate amount into time deposits at tax and loan depositaries, accepting bids for such deposits in a competitive auction similar to a Treasury bill auction. At best, this too would be somewhat cumbersome and, it must be emphasized, only marginally productive in terms of earning potential.

VIII. REIMBURSEMENT FOR SERVICES

The final item for consideration is the question of compensating banks for services they perform for the Government.

Looking at individual bank in the study, nearly all banks had an earning value well in excess of the cost of services provided, but some far more than others, even when the average tax and loan balances were comparable in size. There was no consistency in the relationship between the earning values of tax and loan accounts and the scope or volume of services provided by banks for the Government, whatever services might be considered to be in the Government's behalf.

To ameliorate these differences, and to permit obtaining a fuller return on tax and loan balances without discouraging a large number of banks from participating in the system, certain services rendered by banks which we believe should be compensable, but which are not directly related to the existence of the tax and loan accounts, might be compensated for from appropriated funds. Allowance of offsets against the earning value of tax and loan accounts is a possible alternative. However, the appropriation process appears more straightforward and equitable because (1) institutions which do not maintain tax and loan accounts usually also perform those services and as a matter of equity should receive compensation if banks do, and (2) the activity level of those services is not related to the activity level or earning value of tax and loan accounts.

For those services that are within the Treasury's area of responsibility, we believe that only those relating to savings bonds should be compensable through appropriation—specifically issuance of savings bonds, redemption of savings bonds, and exchanges of 'E' for 'H' savings bonds. Services directly related to the tax and loan account and incidental services can appropriately be related to the residual value of the tax and loan accounts.

For services in other areas of responsibility, we cannot make final judgment, although applying the criteria stated in section V would eliminate many on their face. In any event, we believe that these judgments should be made by the responsible agencies with the knowledge that they would also have responsibility to seek the necessary financing.

The conclusion is, therefore, that:

- A system should be developed for compensating banks for the issuance and redemption of savings bonds by fees paid from appropriations.

QUESTIONNAIRE

ON TREASURY TAX AND LOAN ACCOUNTS

Name and location of bank ______________________________

____

For the general guidance of respondents:

Exclusions: *Nothing in this questionnaire pertains to special services performed by a bank (1) in the capacity of a depositary and financial agent of the Government, or (2) in an office located at a Federal Government installation. No data relating to these services are to be included in any of the responses.*

Additions: *Every bank should feel free to attach to this questionnaire any statement it wishes to make to present its views beyond the responses to the specific questions covered.*

FOR SUBMISSION TO:

Fiscal Assistant Secretary
Department of the Treasury
Washington, D. C. 20220

____
(Name and Location of Bank)

PART I

TREASURY TAX AND LOAN ACCOUNT BALANCES AND DEPOSITS; AND EXPENSES INCURRED IN SERVICING THE ACCOUNT, INCLUDING PROCESSING FEDERAL TAX DEPOSITS

A-Balances - calendar year 1972 /in thousands of dollars/

Month	Balance Per Books of Your Bank				Balance Per Federal Reserve Bank Books			
	End of Month	High	Low	Daily Average 1/	End of Month	High	Low	Daily Average 1/
January.....								
February.....								
March.......								
April.......								
May.........								
June........								
July........								
August......								
September								
October.....								
November....								
December....								
Totals....	XXXXXX	XXXXXX	XXXXXX		XXXXXX	XXXXXX	XXXXXX	
Average daily balance for the year 2/	XXXXXX	XXXXXX	XXXXXX		XXXXXX	XXXXXX	XXXXXX	

1/ The average daily balance for each month should be computed by totaling the balances for all calendar days of the month and dividing by the number of calendar days in the month. For nonbusiness days, repeat the balance as of the preceding business day.

2/ For these purposes it will be sufficiently precise to divide the preceding total by 12.

____
(Name and Location of Bank)

B - Deposits to Treasury tax and loan account during calendar year 1972, representing:

1. Sales of savings bonds .... $__________

2. Subscriptions for new issues of Government securities.................................... $__________

3. Federal tax deposits......................... $__________

Total....................................... $__________

____
(Name and Location of Bank)

C - Expenses in servicing Treasury tax and loan account and processing Federal tax deposits in calendar year 1972

1. Servicing Treasury tax and loan account:

   a. Credits:
      (1) Number of entries .... ________ (Number)
      (2) Expense per entry 1/ .... $________
      (3) Total expense /(1) times (2)/............. $________

   b. Debits:
      (1) Number of entries......................... ________ (Number)
      (2) Expense per entry 1/...................... $________
      (3) Total expense / (1) times (2)/............ $________

   c. Other expenses, if any 2/..................... $________

   d. Total expense,servicing account................ $________

2. Handling Federal tax deposits:

   a. Number of items processed.................... ________ (Number)

   b. Per-item expense factor 1/................... $________

   c. Total expense /for "a" times "b"/............ $________

   d. Other expenses, if any 2/.................... $________

   e. Total expense, Federal tax deposits.......... $________

3. Total expense / 1d plus 2e /..................... $________

1/ Please attach to this page a separate explanation of the basis for computing these expenses. Please list each major processing step and the direct and indirect cost allocated to each step. For handling Federal tax deposits, if the per-item expense exceeded (1) your charges for each collection item handled under lock-box arrangement, or (2) your charges to customers for deposits consisting of a single check, please explain the basis for the difference.

2/ Please describe on a separate sheet attached to this page.

____
(Name and Location of Bank)

D. *Earning value of tax and loan account balance*

1. *Is the value to your bank of the loanable balance in the tax and loan account (ledger balance on your books, less legal reserve) at least equal to the Federal funds rate (as published in the Federal Reserve Bulletin)?.....* ________ *(Yes or No)*

2. *If no, give your reasons* ______________________________

3. *What published rate (e.g., Treasury bill rate, prime bankers acceptance rate, etc.) do you feel more closely approximates the value of the TT&L account balance to your bank? If you do not feel that a published rate, per se, is a reasonable measure, please indicate what formula tied to a published rate is realistic* ____________

P A R T II

OTHER SERVICES

Except as otherwise indicated, any data reported in Section A through F of this Part should be for the quarter ending March 31, 1973. Wherever data at the levels requested are not available directly from existing records, it will suffice for these purposes if the information for the entire quarter is estimated, using as a base the actual data for a current period of 30 days. Where figures furnished are other than actual data compiled for the entire quarter, please identify them as estimates and explain the estimating method used.

For some of the services covered in this Part (e.g., cashing Treasury checks, handling subscriptions for Government securities and handling matured Government securities) an assumption appears fundamental: If a bank does not provide such services to noncustomers, or charges a fee for noncustomers not charged for customers, it may reasonably be assumed that the bank is providing the service to customers on the basis of its over-all relationship with them. Consequently, any expense involved in providing the services to customers should not be compensable.

____
(Name and Location of Bank)

A - *Handling Treasury Checks*

1. *Do you cash Treasury checks for noncustomers?* .... ________ *(Yes or No)*

   a. *If yes, do you charge a fee?*.................... ________ *(Yes or No)*

   b. *If you charge a fee, insert the amount or describe it here if it is variable* ____________ $________

2. *Data on Treasury checks for the quarter:*

   a. *Cashed for customers*............................ ________ *(Number)* $________

   b. *Cashed for noncustomers*......................... ________ *(Number)* $________

   c. *Included in deposits by business firms, other banks and individuals*.......................... ________ *(Number)* $________

   d. *Totals* [*a through c*] .... ________ *(Number)* $________

3. *Describe method used to distinguish between 2a, b and c.* ____________

4. *What is your per-check expense for cashing Treasury checks for:*

   a. *Customers* 1/.................................... $________

   b. *Noncustomers* 1/................................. $________

5. *Data on Treasury reclamations from your bank in calendar year 1972 relating to forged, altered and other fraudulently negotiated checks:*

   a. *Number of checks and dollar value*................ ________ *(Number)* $________

   b. *What part of "a" has been or is likely to be recovered from the depositors or others, except from your own insurance coverage*..................... ________ *(Number)* $________

1/ Please describe on a separate sheet (attached to this page) the factors considered and the method used in determining, separately, each of these per-check expenses.

____
(Name and Location of Bank)

B. Handling subscriptions to U.S. securities (other than savings bonds) on original issue.

1. Do you handle subscriptions to U.S. securities for:

   a. Noncustomers.................................. ________ (Yes or No)

   b. Customers.................................... ________ (Yes or No)

2. If yes, do you charge a fee for:

   a. Noncustomers.................................. ________ (Yes or No)

   b. Customers.................................... ________ (Yes or No)

3. If yes, how is the fee computed for:

   a. Noncustomers ________________________

   b. Customers ________________________

4. Expense in handling subscriptions for the quarter 1/. $________

5. Please furnish the following data for the quarter:

   a. For noncustomers:

      (1) Cash offerings:

         (a) Number of tenders or subscriptions for the quarter .... ________ (Number)

         (b) Total dollar value.................... $________

         (c) Total expense incurred 1/ .... $________

      (2) Exchange offerings:

         (a) Number of subscriptions for the quarter: ________ (Number)

         (b) Total dollar value...................... $________

         (c) Total expense incurred 1/ .... $________

____
(Name and Location of Bank)

b. For customers:

(1) Cash offerings:

(a) Number of tenders or subscriptions for the quarter............................. ________ *(Number)*

(b) Total dollar value....................... $__________

(c) Total expense incurred 1/............... $__________

(2) Exchange offerings:

(a) Number of subscriptions for the quarter................................ ________ *(Number)*

(b) Total dollar value..................... $__________

(c) Total expense incurred 1/ .... $__________

*(3) What part of the expense on line (1)(c) and (2)(c), in servicing customers, has been recovered from the customers in one way or another?*______________________
____
____

1/ Describe in detail, on a separate sheet attached to this page, how any expenses shown in this section were computed.

____
(Name of Bank and Location

C. Handling matured Government securities.

1. Do you handle matured Government securities for:

a. Noncustomers.................................. ______ (Yes or No)

b. Customers..................................... ______ (Yes or No)

2. If yes, do you charge a fee for:

a. Noncustomers.................................. ______ (Yes or No)

b. Customers..................................... ______ (Yes or No)

3. If yes, how is the fee computed for:

a. Noncustomers ______________________________
____

b. Customers ______________________________
____
____

4. Expense in handling matured securities for the quarter 1/ .... $______

5. Please furnish the following data for the quarter:

a. For noncustomers:

(1) Number of transactions for the quarter..... ______ (Number)

(2) Total dollar value......................... $______

(3) Total expense incurred 1/................... $______

b. For customers:

(1) Number of transactions for the quarter..... ______ (Number)

(2) Total dollar value......................... $______

(3) Total expense incurred 1/................... $______

c. What part of the expense on line b(3), in servicing customers, has been recovered from the customers, in one way or another? ______________________________
____
____

1/ Describe in detail, on a separate sheet attached to this page, how any expenses in this section were computed.

____
(Name and Location of Bank)

D. Issuing U.S. savings bonds.

1. Payroll savings plans of customers:

a. Number of savings bonds issued in the quarter ... ________ (Number)

b. Dollar value /_purchase price_/.................. $__________

c. Expense, per item 1/ .... $______

d. Total expense /_a times c_/...................... $__________

e. To what extent is the expense /_item d_/ recovered from the customer?______________________________

____

____

f. Do you also provide payroll accounting service for customers on whose behalf you issue savings bonds? Explain if necessary. ______________________ ________ (Yes or No)

____

____

2. Bond-a-month plan:

a. Number of savings bonds issued in the quarter by periodic charges to accounts of individual depositors.. ________ (Number)

b. Dollar value /_purchase price_/................... $__________

c. Expense, per item 1/ .... $______

d. Total expense (a times c)......................... $__________

3. Over-the-counter sales:

a. Number of savings bonds issued in the quarter..... ________ (Number)

b. Dollar value /_purchase price_/................... $__________

c. Expense, per item 1/ .... $______

d. Total expense /_a times c_/ .... $__________

4. Please indicate, for each of the three categories above, the number of business days (on the average) that elapse from the time you receive payment for the savings bonds to the time you credit the payment to the Treasury tax and loan account:

a. Item 1 .... ________

b. Item 2 .... ________

c. Item 3 .... ________

____

1/ Describe in detail, on a separate sheet attached to this page, how any expenses shown in this section were computed.

____
(Name and Location of Bank)

E. *Paying (redeeming) U. S. savings bonds.*

1. *Number of transactions for the quarter 1/ ....* ________ *(Number)*

2. *Number of bonds paid: 1/*

   a. *For customers.................................* ________ *(Number)*

   b. *For noncustomers..............................* ________ *(Number)*

   c. *Total [a plus b] ....* ________ *(Number)*

3. *Total reimbursement for line 2c [paying agent fee]* $________

4. *Do you feel the present fee schedule is adequate?...* ________ *(Yes or No)*

5. *If your answer to item 4 is "No", please indicate what you feel the fee schedule should be and give your reasons.* ________________________________

1/ For example, one individual redeeming 3 bonds would be counted as one transaction on line 1 and three bonds on line 2.

____
(Name and Location of Bank)

F. *Recordkeeping, reporting and other services that are mandatory under Federal statutes*

There is a basic issue of principle whether a bank's expenses in doing things specifically required by law should be compensated for by the earning value of a Treasury tax and loan account. In connection with this issue, two questions are relevant:

1. Does the statute requiring the recordkeeping or reporting provide for reimbursement in any form? If not, what is the justification for providing it administratively through Treasury tax and loan accounts? If a statute does provide for compensation, what would be the justification for supplementing it indirectly through the value of Treasury tax and loan accounts?

2. Are other business firms (in particular other types of financial institutions), which do not have the benefit of Treasury tax and loan accounts, similarly required to comply with the statute?

We welcome any views you may wish to express on this issue of principle. Please make your statement on a separate sheet, attached to this page.

If there are any particular services in this category that you feel are properly compensable through your tax and loan account, please list them separately, and indicate for each the magnitude of the service and your rationale. For any listed service, please indicate the expenses incurred.

SELECTION OF BANKS FOR THE SURVEY

Of the more than 13,000 banks with tax and loan accounts, we decided to send questionnaires to a group of 600, which we felt was small enough to be manageable for our survey but large enough to provide a valid sample.

In determining which banks to use, we first selected the 300 banks with the largest average balances. Each of these average balances was more than $1.5 million, and in the aggregate they represented almost three-fourths of the total average balances. At the other extreme we excluded all banks with average balances that were too small to have any material bearing on the study. An average balance of only $38,000 was a logical breaking point for this purpose, and that criterion resulted in complete exclusion of 5,758 banks, which had less than one percent of the aggregate balances.

To select the other 300 banks from among the remaining 6,953 banks, we first divided these banks into 16 average-balance categories. The number of banks selected from each category gave effect to the total number of banks and the total average balances in each category, with equal weight to both factors.

To ensure the selection of banks from throughout the country, the United States was divided into four virtually equal regions based on the number of banks in each State. The number of banks selected from each region for each category was based solely on the number of banks. This was also the factor used to determine from which States within a region the banks were selected.

Each of the average-balance categories was then subdivided into as many subcategories as there were banks to be selected. At this point the name of a State was randomly selected, and the bank in that State which came nearest to the midpoint of that subcategory was selected for the study.

In the exhibits which follow, the results of our re-study are shown in categories consistent with the three broad classifications of banks which have been in use over the years. These classifications and the groupings for this study are explained in the following paragraphs.

In order to facilitate the scheduling of withdrawals from tax and loan accounts, banks maintaining such accounts have long been administratively divided into three groups (A, B or C) based on the size of their accounts; the dollar volume of credits in an account during one year determines the bank's classification in the following year. When we began selecting banks to participate in the re-study, there were 13,011 banks maintaining tax and loan accounts, classified as follows:

Group A	11,180 (the smallest)
Group B	1,557 (the intermediate)
Group C	274 (the largest)

Questionnaires were sent to all of the 274 C banks and the 26 B banks with the largest tax and loan accounts, thereby aiming at total coverage for the 300 largest banks in the system. Of the remaining banks, 108 B banks and 192 A banks received the questionnaire by random selection as described above.

This mix of 600 banks, representing a workable questionnaire volume of less than 5 percent of the total number of banks in the system, met the objective of coverage for the greatest portion of the dollar flows in the system as well as a cross section of that portion of the coverage which related to the smaller dollar flows.

The following table summarizes the total number of banks in each group, the number which received the questionnaire, the number which did or did not respond, and the number which were not furnished a questionnaire:

	Total No. of Banks	Received Questionnaires			Did Not Receive Questionnaires
		Total	Responded	Did not Respond	
Group C	274	274	267	7	0
Group B:					
Largest in Group B	26	26	24	2	0
All Others in Group B	1,531	108	103	5	1,423
Total, Group B	1,557	134	127	7	1,423
Group A:					
Largest within Group A (for sampling)	5,422	192	163	29	5,230
Smallest (excluded)	5,758	0	0	0	5,758
Total, Group A	11,180	192	163	29	10,988
Grand Total	13,011	600	557	43	12,411

SERVICING TAX AND LOAN ACCOUNTS AND PROCESSING FEDERAL TAX DEPOSITS

The reports submitted by banks showed the costs incurred in servicing tax and loan accounts and in processing Federal Tax Deposit forms (FTDs) during the 1972 calendar year. In servicing the tax and loan account itself, the costs related primarily to the handling of debit and credit entries; banks also reported other miscellaneous costs such as periodic audit and reconcilement of the account. Of the reporting banks, 453 banks furnished information regarding the costs for servicing the account. These costs totaled $819,246. By extrapolating the cost data submitted by the 453 reporting banks to cover the 12,558 remaining banks which did not participate in the study, or which did not include the necessary data in their returned questionnaires, it was determined that the estimated costs of the 12,558 nonreporting banks would be $2,681,442. The total estimated cost of the 13,011 banks for servicing the account would therefore be $3,500,688.

During the 1972 calendar year, 34,643,786 FTDs were processed by depositaries. The 530 reporting banks which furnished the number of FTDs processed handled 16,456,515 or 47.5% of the total number. Of these 530 banks, 449 also furnished information regarding the costs for processing FTDs. The following table is based upon an analysis of such costs:

Class	Number of Banks	Number of FTDs Processed	Universal Weighted Average Cost Per FTD [1]	Total Cost for Processing FTDs
A	109	171,838	$.4217	$ 72,464
B	81	570,373	.4217	240,526
C	259	14,637,496	.4217	6,172,632
Total	449	15,379,707		$6,485,622

The 12,562 banks which did not participate in the study, or which did not include the pertinent data in their returned questionnaires, handled the remaining 19,264,079 FTDs, which, at a weighted average cost of $.4217 per FTD, would establish their total estimated cost as $8,124,763. The total estimated cost to all 13,011 banks for processing FTDs would therefore be $14,610,385.

In their responses to the questionnaire, some reporting banks included certain items such as audit, reconciliation, and postage under "Other Expenses" in servicing the tax and loan accounts. Other banks, however, included these items under "Other Expenses" in processing FTDs. The simplest and most equitable means of measuring these expenses reported by banks is to express the total expense for servicing the account and for handling FTDs in terms of cost per FTD processed. As illustrated in the above table, the weighted average cost for processing FTDs was $.4217 per FTD. Following this same approach, the estimated cost of servicing the tax and loan account itself would be equivalent to $.1011 per FTD. Therefore, the combined weighted average cost for processing FTDs and servicing the account would be $.5228 per FTD. The combined cost for the 449 banks which furnished

cost figures is expressed in terms of "cost per FTD processed" in the following table:

Class	Number of Banks	Number of FTDs Processed	Combined Universal Weighted Average Cost for Servicing the Account and Processing FTDs (Per FTD)[1]	Total Cost for Servicing the Account and Processing FTDs
A	109	171,838	$.5228	$ 89,837
B	81	570,373	.5228	298,191
C	259	14,637,496	.5228	7,652,483
Total	449	15,379,707		$8,040,511

[1] The weighted average cost was determined by first extrapolating the activity and cost data submitted by reporting banks to cover the nonreporting banks, by categories, and then computing a universal weighted average cost for all 13,011 banks which maintain tax and loan accounts and process FTDs.

On this basis, the estimated costs for the 12,562 banks which did not participate in the study, or which did not include the pertinent data in their returned questionnaires, would be $10,070,562, and the total estimated cost for all 13,011 banks for processing FTDs and servicing the account would be $18,111,073.

U.S. SECURITIES (OTHER THAN SAVINGS BONDS)
HANDLING SUBSCRIPTIONS ON ORIGINAL ISSUE AND HANDLING MATURED SECURITIES

Number of Banks Surveyed 600
Number of Banks which Submitted Responses to Questionnaire 555

I. Responses to the Section on Handling Subscriptions on Original Issue.

	Number	Percent
Noncustomers		
(1) Banks that do not handle subscriptions for noncustomers	224	40.4%
(2) Banks that handle subscriptions for noncustomers for a fee	208	37.5
(3) Banks that handle subscriptions for noncustomers **without a fee**	108 [1]	19.4
(4) Banks that did not complete this section	15	2.7
Totals	555	100.0%
Customers		
(1) Banks that do not handle subscriptions for customers	54	9.7%
(2) Banks that handle subscriptions for customers for a fee	276	49.7
(3) Banks that handle subscriptions for customers **without a fee**	188	33.9
(4) Banks that did not complete this section	37	6.7
Totals	555	100.0%

[1] However, of these 108 banks, only 13 reported any actual subscriptions handled.

II. Responses to the Section on Handling Matured Securities.

	Number	Percent
Noncustomers		
(1) Banks that do not handle matured securities for noncustomers	209	37.6%
(2) Banks that handle matured securities for noncustomers for a fee	110	19.8
(3) Banks that handle matured securities for noncustomers **without a fee**	219 [2]	39.5
(4) Banks that did not complete this section	17	3.1
Totals	555	100.0%
Customers		
(1) Banks that do not handle matured securities for customers	33	6.0%
(2) Banks that handle matured securities for customers for a fee	124	22.3
(3) Banks that handle matured securities for customers **without a fee**	357	64.3
(4) Banks that did not complete this section	41	7.4
Totals	555	100.0%

[2] However, of these 219 banks, only 57 reported handling any matured securities.

EXHIBIT 4

REDEMPTION OF U.S. SAVINGS BONDS DURING CALENDAR YEAR 1972

During the calendar year 1972, of the 107,944,004 Series E Savings Bonds and Savings Notes redeemed and charged to the Bureau of the Public Debt, 105,141,168 were redeemed by paying agents for a fee.

Each paying agent receives reimbursement quarterly for bonds redeemed at the rate of $.15 each for the first 1,000 bonds paid and $.10 each for all over the first 1,000. During the calendar year 1972 all paying agents received reimbursement in the amount of $13,696,352 for paying 105,141,168 savings bonds, or an average of $.13026 per bond.

The following table reflects the number of Series E Savings Bonds and Savings Notes redeemed by banks as compared to all other paying agents:[1]

Class of Agent	Number of Bonds Paid	Percent of Number Paid	Number of Agents
Banks	96,729,875	92%	14,706
Others	8,411,293	8	2,256
Total	105,141,168	100%	16,962

Of the reporting banks, 445 furnished information regarding the number of savings bonds redeemed and indicated what they felt the appropriate fee should be for the redemption of savings bonds. The following table is based upon an analysis of these per-item fees:

Class	Number of Banks	Number of Savings Bonds Redeemed	Universal Weighted Average Fee Per Savings Bond [2]	Total Cost
A	125	669,580	$.2941	$ 196,923
B	70	1,314,816	.2941	386,687
C	250	35,201,368	.2941	10,352,722
Total	445	37,185,764		$10,936,332

After deducting an estimated 2,272,995 savings bonds redeemed by banks which did not maintain tax and loan accounts (principally mutual savings banks), the 12,566 tax and loan depositaries which did not participate in the study, or which did not include the pertinent data in their returned questionnaires, redeemed the remaining 57,271,116 (96,729,875—[37,185,764 + 2,272,995]) savings bonds redeemed by banks, which, at a weighted average cost of $.2941 per bond, would establish their total estimated cost as $16,841,889. Thus, the total estimated cost to the 13,011 tax and loan depositaries, based upon the suggested fee schedule provided by the reporting banks, would be $27,778,221.

[1] While the total number of bonds paid is on an actual basis, the breakdown between classes of paying agents is an estimate based on data developed in a previous year.

[2] The weighted average fee used above was determined by first extrapolating the activity and cost data submitted by reporting banks to cover the nonreporting banks, by categories, and then computing a universal weighted average cost for all 13,011 banks which maintain tax and loan accounts.

ISSUANCE OF U.S. SAVINGS BONDS DURING CALENDAR YEAR 1972

Reports provided by the Federal Reserve Banks for calendar year 1972 show that banks accounted for approximately 53% of the savings bonds issued during that year. The following table reflects the number of savings bonds issued by banks as compared to all other issuing agents:

Class of Agent	Amount of Bonds	Number of Bonds	Percent of Number Issued	Number of Agents
Banks	$ 3,089,373,865	69,100,100	53%	14,637
Others	2,741,870,604	61,318,719	47	3,958
Total	$ 5,831,244,469	130,418,819	100%	18,595

Of the banks which responded to the questionnaire in the current study, 434 furnished information concerning the distribution of savings bonds issues among payroll-savings, bond-a-month, and over-the-counter sales; that information is summarized in the attached table. The table also reflects the results of an analysis of the costs reported by banks for issuing the savings bonds by the three methods.

From the table, it can be seen that the 434 reporting banks issued 25,124,889 of the 69,100,100 savings bonds issued by banks, at a cost of $10,491,499. After deducting an estimated 1,714,974 savings bonds issued by banks which did not maintain tax and loan accounts (principally mutual savings banks), the 12,577 tax and loan depositaries which did not participate in the study, or which did not include the pertinent data in their returned questionnaires, issued the remaining 42,260,237 (69,100,100—[25,124,889 + 1,714,974]) savings bonds, at an estimated cost of $20,201,126. Thus, the total estimated cost to the 13,011 banks for issuing 67,385,126 savings bonds would be $30,692,625.

VARIOUS CATEGORIES OF ISSUANCES OF SAVINGS BONDS AND RELATED COSTS

Category of Savings Bond Issuance	Class of Bank	Number of Banks	Number of Bonds	Universal Weighted Average Cost Per Bond [1]	Total Cost
1. Payroll Savings	A	146	116,380	$.32	$ 37,242
	B	97	556,988	.32	178,236
	C	191	17,591,375	.32	5,629,240
Subtotal		434	18,264,743		5,844,718
2. Bond-a-Month	A	146	11,694	.56	6,549
	B	97	64,308	.56	36,012
	C	191	591,076	.56	331,003
Subtotal		434	667,078		373,564
3. Over-the-Counter	A	146	150,348	.69	103,740
	B	97	415,925	.69	286,988
	C	191	5,626,795	.69	3,882,489
Subtotal		434	6,193,068		4,273,217
4. Total All Issues		434	25,124,889		$10,491,499

[1] The weighted average cost was determined by first extrapolating the activity and cost data submitted by reporting banks to cover the nonreporting banks, by categories, and then computing a universal weighted average cost for all 13,011 banks which maintain tax and loan accounts.

HANDLING TREASURY CHECKS

In requesting data on the services listed in Part II of the questionnaire, Treasury realized that some of the data might not be available from existing records at the levels requested. In these circumstances, banks were requested to estimate, using as a base the actual data for a current period of 30 days and explaining the estimating method used.

It was obvious from the responses that many of the estimated figures did not meet the test of reasonableness. This was particularly true with respect to the responses received in connection with the handling of Treasury checks. We nevertheless used all reported figures on handling Treasury checks to compile the following tables, since we had no objective means available to verify the accuracy of the data.

Of the banks responding to the questionnaire, only 304 provided the requested breakdown between Treasury checks cashed for customers, cashed for noncustomers, and deposited. For those banks, the table below shows the composite result of this breakdown, indicating that a very small percentage of payees of Treasury checks cash such checks at banks where they do not have an account.

	Number	Percentage
Cashed for noncustomers	2,893,138	3.6%
Cashed for customers	13,017,916	16.1
Deposited	65,066,578	80.3
Total	80,977,632	100.0%

In addition to the data requested as to the volume of checks handled, banks were asked to provide data on their per-check expense for cashing Treasury checks for customers and for noncustomers. The 277 banks responding to this request reported the following data:

	Number	Per-Check Expense
Cashed for noncustomers	2,843,776	$.278
Cashed for customers	12,829,601	.205

Banks were also requested to provide data on the amounts reclaimed from them by the Treasury during 1972 for forged, altered, and other fraudulently negotiated Treasury checks, and the amounts subsequently recovered by banks from depositors or others (except from their own insurance coverage). The 226 banks responding to this request reported the following data:

	Reclaimed by Treasury	Recovered by Bank from Depositors or Others	Percentage
Number of Checks	32,938	27,730	84.2%
Dollar Amount	$5,074,600	$4,289,700	84.5
Average Amount of Check	$ 154	$ 155	

In 1972 the Treasury reclaimed approximately $11,150,000 for paid Treasury checks and refused payment on an additional $5,000,000. Thus, of the total $16,150,000 relating to forged, altered, and other fraudulently negotiated Treasury checks during 1972, it seems reasonable to conclude that banks suffered estimated losses of approximately 15% of the dollar amount or an estimated $2,422,500.

EXHIBIT 8

VOLUNTARY SERVICES

Service	Total Number of Banks Referring to the Service
1. Supplying income tax forms to the public	84
2. Handling commemorative coins	41
3. Participating in the food stamp program	114
4. Selling Federal transfer stamps	14
5. Exchanging 'E' Bonds for 'H' Bonds	77

EXHIBIT 9

MANDATORY SERVICES

Service	Total Number of Banks Referring to the Service
1. Reporting interest and dividend payments to IRS (Form 1099)	136
2. Handling IRS tax liens and subpoenas	114
3. Keeping financial records and reporting currency and foreign transactions	67
4. Keeping records and making reports involving Treasury's foreign assets control operation	27
5. Complying with provisions of the Interest Equalization Tax Act	17
6. Microfilming checks under the Bank Secrecy Act	15
7. Maintaining list of "Designated Nationals"	11
8. Obtaining taxpayers' ID numbers or Social Security numbers on new accounts	8

EARNING VALUE OF THE TAX AND LOAN ACCOUNT BALANCE

In response to the question "Is the value to your bank of the loanable balance in the tax and loan account (ledger balance on your books, less legal reserve) at least equal to the Federal funds rate (as published in the Federal Reserve Bulletin)?", 279 banks, or 50.3% of the respondents, indicated "yes."

The banks were then asked what published rate most closely approximates the value of the tax and loan account balance to the bank. A number of banks took this opportunity to qualify their "yes" response to the first question. The following summation of the responses to this question shows that more than 60% of the banks felt that some rate other than the Federal funds rate was the best measure of the value of the balance to their bank:

Rate Cited	Number of Banks Citing Rate	
A. Federal funds rate		
A–1 Federal funds rate	212	
A–2 Federal funds rate reduced by either a specified number of basis points or a certain percentage of the Federal funds rate	16	
A–3 An average of the Federal funds rate and one or more other money market rates	10	
Total number of banks which cited the Federal funds rate or some variation thereof		238
B. Treasury bill rate		
B–1 Treasury bill rate (unspecified)	88	
B–2 Treasury bill rate reduced by either a specified number of basis points or a certain percentage of the Treasury bill rate	5	
B–3 90-day Treasury bill rate	54	
B–3a 90-day Treasury bill rate reduced by either a specified number of basis points or a certain percentage of the 90-day Treasury bill rate	4	
B–4 30-day Treasury bill rate	23	
B–5 15- to 30-day Treasury bill rate	2	
B–6 Short term (unspecified) Treasury bill rate	4	
B–6a 14-day Treasury bill rate	2	
B–6b 7- to 10-day Treasury bill rate	3	
B–7 An average of the Treasury bill rate and one or more other money market rates (other than the Federal funds rate)	4	
Total number of banks which cited the Treasury bill rate or some variation thereof		189
C. Prime rate		12
C–1 Prime rate reduced by either a specified number of basis points or a certain percentage of the prime rate		5
D. Federal Reserve Bank rediscount rate		14
E. Bankers acceptance rate		5
F. Passbook savings rate		6
G. No acceptable published rate		21
H. No comment (included in this category were banks which did not answer any of the questions on this topic and those which responded "no" to the first question but did not suggest an alternate rate)		31
I. Others (no rate included in this category was cited by more than four banks)		34
TOTAL		555

EXHIBIT 11

SUMMARY OF ESTIMATED INCOME AND EXPENSE FOR THE 600 T&L DEPOSITARIES SURVEYED *

	No. of Banks	Balance per Banks' Books	Less Reserves of	Net Balance	Earnings on Net Balance @ 5.5%	Less TT&L and FTD Costs	Earnings after TT&L and FTD Costs	Less Costs for Handling Savings Bonds			Net Earnings
								Issuance	Redemption	Total	
Largest Banks											
All C Banks	274	$3,588,318	$549,013	$3,039,305	$167,162	$ 9,345	$157,817	$13,495	$ 9,071	$22,566	$135,251
Largest B Banks	26	75,601	9,677	65,924	3,626	157	3,469	353	187	540	2,929
Subtotal	300	3,663,919	558,690	3,105,229	170,788	9,502	161,286	13,848	9,258	23,106	138,180
All Other Banks											
All Other B Banks Selected	108	120,626	14,958	105,668	5,812	225	5,587	671	318	989	4,598
Selected A Banks	192	42,780	4,749	38,031	2,092	159	1,933	185	54	239	1,694
Total	600	$3,827,325	$578,397	$3,248,928	$178,692	$9,886	$168,806	$14,704	$ 9,630	$24,334	$144,472

SUMMARY OF ESTIMATED INCOME AND EXPENSE FOR ALL T&L DEPOSITARIES *

	No. of Banks	Balance per Banks' Books	Less Reserves of	Net Balance	Earnings on Net Balance @ 5.5%	Less TT&L and FTD Costs	Earnings after TT&L and FTD Costs	Less Costs for Handling Savings Bonds			Net Earnings
								Issuance	Redemption	Total	
Largest Banks											
All C Banks	274	$3,588,318	$549,013	$3,039,305	$167,162	$9,345	$157,817	$13,495	$ 9,071	$22,566	$135,251
Largest B Banks	26	75,601	9,677	65,924	3,626	157	3,469	353	187	540	2,929
Subtotal	300	3,663,919	558,690	3,105,229	170,788	9,502	161,286	13,848	9,258	23,106	138,180
All Other Banks											
All Other B Banks	1,531	1,709,968	212,036	1,497,932	82,386	2,987	79,399	8,417	4,229	12,646	66,753
Largest A Banks	5,422	1,208,087	134,098	1,073,989	59,069	4,470	54,599	5,378	1,522	6,900	47,699
Smallest A Banks	5,758	263,180	29,213	233,967	12,868	1,152	11,716	3,050	461	3,511	8,205
Total	13,011	$6,845,154	$934,037	$5,911,117	$325,111	$18,111	$307,000	$30,693	$15,470	$46,163	$260,837

* Dollar amounts in rounded thousands.

RATE OF RETURN ON TAX AND LOAN BALANCES, SELECTED BANKS

The following comparisons of pairs of C banks illustrate the disproportionate relationships which now exist between the value of services provided by banks having virtually identical tax and loan account balances:

Bank Identification	Average Daily T&L Balance	Estimated Total Expense [1]	Estimated Net Rate of Return on Balance [2]
C–137	$ 98,533,000	$ 746,145	3.75%
C–116	105,344,000	43,029	4.47
C–121	53,837,000	463,087	3.64
C–117	51,021,000	74,259	4.36
C–147	43,082,000	1,232,630	1.65
C–95	47,335,000	98,431	4.30
C–260	28,784,000	265,822	3.59
C–25	27,186,000	73,198	4.49
C–71	23,895,000	265,125	3.40
C–197	23,215,000	38,120	4.35
C–67	14,729,000	264,641	2.71
C–187	14,520,000	33,986	4.52
C–159	13,914,000	198,726	3.08
C–104	13,714,000	32,467	4.27
C–77	12,210,000	187,533	2.97
C–49	12,318,000	31,241	4.50
C–156	5,009,000	108,837	2.34
C–113	5,019,000	16,112	4.44
C–111	4,688,000	354,468	(3.05) [3]
C–138	4,779,000	23,069	4.27

[1] This figure reflects expenses incurred in servicing the account, handling Federal tax deposits, and issuing and redeeming U.S. Savings Bonds by using weighted average item-costs for all banks maintaining tax and loan accounts.

[2] Computed by dividing net earnings by average balance. To determine the gross earnings on balance, the average rate on new issues of 90-day Treasury bills during the five-year period ended December 31, 1972, was used. That rate was then adjusted to give consideration to the bank's reserve requirement and the FDIC assessment.

[3] In this instance, expense exceeded income primarily due to the large number of U.S. Savings Bonds issued by the bank.