

Federal Reserve Notes

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FED AGREES TO GAO STUDY OF SUPERVISION

The Federal Reserve Board of Governors has agreed to a one-time study by the General Accounting Office of the Fed's bank supervisory responsibilities. In commenting on the study, Chairman Arthur Burns said, "We do not consider this study to be an 'audit' in any sense of that term, nor do we understand it to be an inquiry that will be repeated on a regular periodic basis."

Burns added, "I have stated on several occasions that the Board would welcome a meaningful inquiry by the Congress into our performance of our bank supervisory responsibilities, and I believe that the guidelines we have agreed to reasonably delineate the scope of an inquiry that will serve this purpose."

The study came about as a result of a proposal made last January by the Chairman of the House Banking Committee. The other Federal regulatory agencies, the Comptroller of the Currency and the Federal Deposit Insurance Corporation, are also involved in the project.

The study will include the procedures used by Federal Reserve bank examiners in their periodic on-site examinations of state member banks, the manner in which the findings and conclusions of bank examiners are reported, and the manner in which financial data are collected from state member banks for bank supervisory purposes. It will also involve the methods employed to identify and correct problems at banks, the recruiting and training of bank examiners, and the methods the System uses to review its own bank supervisory performance.



A. F. Burns

The GAO study will cover a number of areas of bank examinations, including commercial, foreign operations, electronic data processing and trusts. But the study will not evaluate the overall performance of the System's regulatory functions, such as its policies and procedures for implementing the Bank Holding Act, the Bank Merger Act, consumer protection statutes, the securities laws, or laws or regulations relating to bank reserves, payments of interest on deposits, or securities credit. Monetary policy functions were specifically excluded from the study. The agreement also excluded System operations relating to the payments mechanism, such as check clearing, electronic funds transfer, and currency and securities handling.

"The scope of the study," the Board said, "relates to the examination of state member banks, the detection in those banks of existing or potential unsafe or unsound conditions, or vio-
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FED HIGHLIGHTS NUCLEAR ECONOMICS

The Federal Reserve Bank of San Francisco published this month a comprehensive study of the economic aspects of energy use and energy technology, with the emphasis on nuclear power in California.

"California Energy: The Economic Factors" consists of papers by economists representing a broad spectrum of views on this subject. The study includes contributions from economists representing the Bank of America, California State University at Long Beach, Carnegie-Mellon University, Environmental Defense Fund, Sierra Club, Sherman H. Clark Associates, Stanford University, and the U.S. Energy Research and Development Administration.

The Fed itself takes no position on the question of an appropriate energy policy for the state or nation. But with this publication, it provides a forum for a varied group of economists with expertise in this area.

The study was produced against a background of California's June vote on a "Nuclear Power Plant Initiative," which would limit future nuclear power plant construction and levels of operations in the state. Because California tends to be a trend-setter in many fields, the issue has important nationwide implications.

The central theme of the study is the amount of reliance which should be placed on alternative sources of energy, especially nuclear power and coal. Most of the authors agree that future growth in energy requirements
(continued on page 4)

BALLES SEES IMPROVED BALANCE SHEETS

Bank examiners should be seeing better balance sheets in 1976 as the economy gains strength, President John J. Balles told the Regional Conference of National Bank Examiners in San Diego.


"If history is any guide, loan quality generally should improve during this recovery, just as it deteriorated during the preceding recession," the Fed president said. "The balance sheets you examine this year will reflect the actions of public and private policy-makers in bringing about the present business recovery, but also their earlier actions in generating a still-dangerous inflationary environment. In addition, those records will reflect bankers' cautious attitudes in rebuilding their balance sheets over the past year."

Balles noted two achievements of the banking system that he said had been underplayed in current discussions of the banking scene.

"First, in 1974, the banking system played an essential role in stabilizing the economy at a critical time, at some cost to itself. At mid-1974, bank funds in many cases were the only funds available to some industries (such as the utilities) and to small- and medium-sized firms, as money and capital markets tightened drastically in the face of double-digit inflation." The resultant heavy loan demand strained the liquidity of many banks, but it helped to support the economy at the time it was most needed.

"The big achievement of 1975 was the banking system's ability to regain its own strength, even while contributing to the growing health of the national economy," he said. "Large commercial banks increased their liquid-asset holdings 33 percent in 1975, while sharply reducing their reliance on volatile sources of funds. Meanwhile, banks improved their profits in the face of increased loan-loss provisions and shrinking loan portfolios."

Balles also noted the strength of the current business recovery, which he said should have a salutary effect on commercial banking. In the recovery period since last spring, credit has become more available and less costly, while the problems of banks and other market participants have eased considerably.


"The improved business environment thus should permit banks to work with borrowers to prevent most loan defaults," he said. "With loan-loss reserves now built up to record levels, banks generally are in much better shape than they were a year ago to handle such contingencies. Banks may encounter difficulties from the overhang of problem loans and from the continued weakness of business-loan demand, as we can see from the early 1976 decline in large banks' earnings, yet many of the worst problem cases appear to be more manageable in 1976 than they were in 1974 and 1975." 

WELCOME TO DISTRICT

On May 10, the Twelfth Federal Reserve District welcomed a new member bank—Valley Bank and Trust Company, Salt Lake City, Utah, with total assets of almost \$180 million and total deposits of about \$160 million.

Valley Bank and Trust Company, formed nearly 30 years ago in an area south of Salt Lake City, has now grown to a total of 17 offices.

The bank is under the direction of Fred H. Stringham, President, who has held that position for the past three years. Robert R. Fitts is Chairman of the Board.

The bank's other senior officers include Senior Vice President John G. Wells, Senior Vice President E. H. Thronsen, Senior Vice President and Secretary Robert D. Myrick, Senior Vice President and Branch Administrator Gaylen C. Larsen, and Senior Vice President Gayle Taylor. 

MORE COMMENT TIME ON POOLED FUNDS

The comment time on the Federal Reserve Board of Governors' pooled-funds proposal has been extended to July 9. Earlier this year, the Board invited public comments on a proposal to amend Regulation Q with respect to interest-rate ceilings on pooled funds.


The proposal would prohibit member banks from paying interest on pooled funds of \$100,000 or more at a rate above established Reg Q ceilings. No interest rate ceiling is imposed on deposits of \$100,000 or more. The Board expressed its concern that the practice of pooling funds to circumvent the present regulation could lead to disruptive shifts of funds at financial institutions. The Board proposal spelled out new guidelines with respect to pooled funds, and similar amendments were proposed by the Federal Deposit Insurance Corporation and the Federal Home Loan Bank Board.

GAO STUDY

(continued from page 1)

lations of law or regulations, and the process by which the Federal Reserve seeks to remedy such conditions or violations and to protect the solvency and soundness of state member banks."

Chairman Burns stressed that the Board and the GAO have agreed to maintain the absolute confidentiality and integrity of the examination process. "I should point out that the Board has discussed the agreement at great length," Burns said. "All of the Board members were profoundly concerned about violating our long tradition of maintaining rigid confidentiality of bank examination reports."

He said the agreement offers assurance that confidentiality will be maintained during the entire examination process by the GAO. In addition, the House Banking Committee will not require GAO to breach its obligations of confidentiality under this agreement, or otherwise make available to the committee any information concerning the identities of banks or individuals covered by the GAO study. 

OVERDRAFT SERVICE ISSUE CLARIFIED

The Federal Reserve Board of Governors recently clarified its proposed "overdraft" amendment to Regulation Q, which governs interest on deposits. The amendment would permit Federal Reserve member banks to transfer funds automatically from savings accounts to demand deposits whenever they couldn't make payment on customers' checks because of insufficient funds. The proposed service would permit customers to instruct their banks to add funds automatically to demand-deposit accounts when balances fell below specified levels.

According to the Fed's clarification, the proposed overdraft service would be a voluntary program available only at the request of customers. The Fed issued the clarification in response to public concern that the service would be mandatory.

The Board originally proposed a May 10 cutoff date for public comment on the amendment. In reviewing the comments to date, however, the Board found that some misunderstanding existed over the nature of the overdraft service. Public comment now will be accepted through June 14.

"The overdraft service is completely voluntary," the Board stated. "Bank customers will not be required to obtain the transfer service. Banks would not be authorized to transfer a depositor's funds from a savings account unless the depositor voluntarily had entered into an agreement previously with the bank specifically authorizing this transfer practice."

The Board's proposal is intended to provide an alternative to bank customers to avoid having their checks returned because of insufficient funds. A depositor could simply instruct his bank to transfer funds from savings to checking when an overdraft occurs. The service could also be used to replenish the customer's checking account if the depositor

DUE-COURSE RULE POSES PROBLEMS

A Federal Trade Commission consumer-protection regulation affecting the "holder-in-due-course" doctrine could have serious effects for the consumer credit industry and the overall economy, according to Federal Reserve Chairman Arthur Burns.

"The Board is sympathetic to efforts to promote consumer credit terms that are fair to both borrowers and creditors," Burns wrote the FTC this month. But he added, "Based upon numerous comments received from lenders and our staff analysis of this rule, we believe that the consumer credit business may be seriously disrupted if the rule goes into effect as scheduled. Such disruption, if it occurs, could have harmful consequences for the economy."

The holder-in-due-course doctrine refers to the centuries-old legal tradition that requires consumers to honor their financial obligations to a third party regardless of any dispute with a merchant over faulty merchandise. The FTC ruling would upset this precedent by making an indirect lender liable for claims pressed by a con-


wishes to maintain a specified minimum balance in his account.

Depositors would be able to transfer funds in multiples of \$100 or more. The depositor would be required to forfeit a minimum of at least 30 days interest on the funds transferred. The forfeiture provisions would aid in preserving the effectiveness of the statutory prohibition against the payment of interest on demand deposits. The proposed minimum forfeiture amount would be 42 cents per \$100 transferred if the bank pays interest at the rate of five percent on its savings deposits. Member banks, however, would be permitted to impose any service charge for such transfer services as long as it equals or exceeds the minimum and has been agreed upon by the bank and its depositors.

sumer who has suffered damages because the purchased item failed or was improperly serviced. The rule affects banks and finance companies that lend money for consumer purchases on such items as automobiles and appliances, but only if the lender has a contract or other relationship with the seller. This is known as an indirect loan, where the bank or finance company becomes the third-party lender. Direct loans between a consumer and his bank or finance company are not covered by the rule.

In Burns' view, "The most serious problems concern the definition of a 'purchase money loan.' The Board believes that the definition is overly broad and will create uncertainty about the applicability of the rule to several important categories of consumer credit. The rule as drafted will greatly complicate the signature loans that banks and other financial institutions commonly make to their most creditworthy applicants. The rule could also unduly complicate overdraft checking account systems which millions of customers are using today," he added.

"The Board is concerned also about the absence of any time limit on the duration of the creditor's liability. This may make creditors hesitate to offer long-term loans to finance home improvement projects or mobile home purchases. In addition, a creditor's liability for claims for personal injury and property damage arising from the goods or services purchased should be eliminated, as it is in credit card purchases under the Truth-in-Lending regulations."

Chairman Burns added that the Board was anxious to promote consumer credit terms that are fair and equitable to both borrowers and creditors. He said this goal would be served more effectively by issuing simultaneously the rules applying to sellers and a rule applying to creditors that was proposed last year by the FTC. The FTC at this point has only issued the rule applying to sellers. In this way the necessary clarifications and technical refinements can be considered for both rules. 

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NUCLEAR ECONOMICS (continued from page 1)

will be lower than the rates experienced in earlier decades, but that some growth still will occur. A choice among energy alternatives will therefore have to be made. The study's major themes include the direct costs of providing energy to consumers from alternative sources, the social and environmental costs associated with these alternatives, the reliability of various power sources, and the potential for energy conservation as an alternative to building more energy capacity.

The full collection of papers should be of interest to individuals involved in the areas of energy, environment, public policy and economics. In addition, the Fed has published a pamphlet which provides a concise overview of the entire study, with each of the eight papers distilled in 300-word summaries. This pamphlet will probably be most useful for students and the general public.

Single copies of these publications are available at no charge from the Public Information Section, Federal Reserve Bank of San Francisco, PO Box 7702, San Francisco 94120. Phone (415) 544-2184 or 544-2350. Multiple copies of both publications are available to academic and non-profit institutions. 

EQUAL CREDIT AMENDMENTS ADOPTED


Several implementing amendments to Regulation B—Equal Credit Opportunity—have been adopted by the Federal Reserve Board of Governors to carry out Congressional legislation prohibiting discrimination in the granting of credit on grounds of sex or marital status.

One amendment relates to credit extended under the student-loan program. It permits lenders to ask student borrowers questions about their marital status and the income of the applicant's spouse. The amendment also allows creditors to obtain the signature of the applicant's spouse to determine if the student qualifies for assistance on the basis of need.


Another amendment requires creditors to retain copies of the notices of action taken on applications for credit. This is in addition to the existing

requirement that lenders retain copies of customer's applications. If a lender notifies a customer by form letter of an action taken, a notation in the customer's file that such a letter was sent will satisfy the new requirement.

A third amendment provides that in business transactions of \$100,000 or more, a creditor need not explain the reasons for denial of credit. In business transactions of less than \$100,000, creditors must explain the reasons for denial if requested to do so in writing.

The amendments just announced relate to the original form of the Equal Credit Opportunity legislation. The Federal Reserve is now developing further amendments to implement changes in the law made by Congress this year. 

MORE TWOS ON THE WAY

Initial demand for the two-dollar bill turned out to be much greater than expected, as the public lined up at thousands of commercial banks on April 13 to get its first glimpse of the new bill. Before long, the vaults of many commercial banks were depleted, and cash officers had to reorder from Reserve Banks to replenish dwindling supplies. 

The Treasury plans to make a second general release of two-dollar bills on July 4 to commemorate the nation's bicentennial. For all of 1976, the Treasury plans to release \$850 million in twos. It will then maintain a production volume of \$800 million annually to assure widespread distribution of the bill.