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Federal Reserve Notes

FEDERAL RESERVE BANK OF SAN FRANCISCO **JULY 1977**

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FED SYSTEM HANDLES NEW YORK EMERGENCY

The world's largest financial center unexpectedly shut down for a full business day because of the New York blackout, but emergency procedures ensured a continued flow of funds through the nation's payments system. Still, immense difficulties had to be overcome because the linchpin of that system—the Federal Reserve Bank of New York—was out of commission during the emergency.

On a typical business day, the New York Fed—

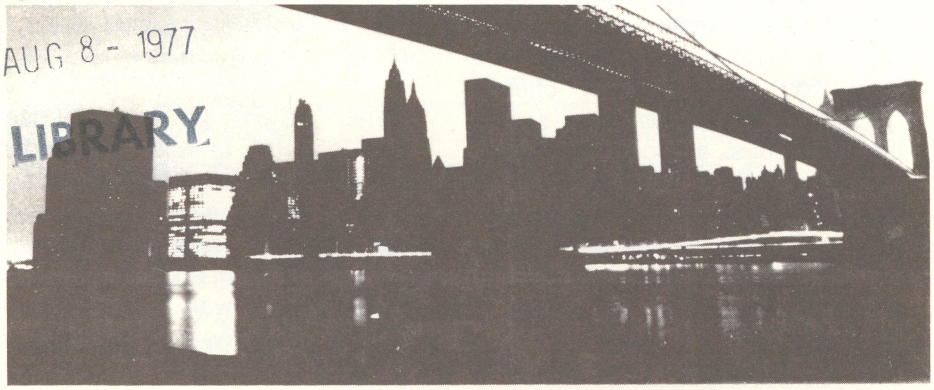
* Handles about 5½ million checks and almost 8 million pieces of currency;

* Processes over $70 billion in securities and Federal-funds transactions through its electronic telecommunications system;

* Buys and sells over $3½ billion in government-securities, in its role as Manager of the Federal Reserve System's Open Market Account, that is, the executant of the central bank's key monetary-policy decisions;

* Buys and sells hundreds of millions of dollars of securities in U.S. markets on behalf of foreign central banks and monetary authorities, in its role as the Federal Reserve's agent in dealing with foreign organizations.

All of these operations were shut down on Thursday, July 14, when the Governor and the Comptroller of the Currency ordered New York City banks to close because of the power blackout. Early that morning, Dale Cunningham, Assistant Vice President of the New York Reserve Bank, dispatched a wire to all twelve Federal Reserve Districts advising them of the New York bank holiday. Later that morning, Tony J. Salvaggio, Senior Vice President of the Dallas Reserve Bank and Chairman of a System Subcommittee on Payment Mechanisms, notified Fed offices throughout the country to put into effect the procedures developed for just such an emergency.



The Manhattan skyline appears under the Brooklyn Bridge, darkened after the power blackout July 13, and with its lights twinkling across the East River July 14 after most of New York's electricity was restored. (Wide World Photos)

In San Francisco, a team of Federal Reserve officials assembled by President John J. Balles worked out a plan to make sure that checks and electronic payments normally destined for New York could be properly handled.

At the outset, Senior Vice President Kent Sims, who administers the San Francisco Fed's discount window, notified the Officers in Charge of the Reserve Bank's five offices that the Federal Reserve would accommodate any reasonable request from a member bank for assistance needed as a result of the unexpected closure of the New York money market.

In addition, San Francisco Fed officers participated in a System-wide conference call linking San Francisco with offices in New York, Washington

(continued on page 2)

NEW YORK EMERGENCY

(continued from page 1)

and elsewhere to plan an overall strategy for the continued functioning of the nation's payments system. The San Francisco Bank's First Vice President, John B. Williams, was in Washington, D.C. on business, but through the conference call he was able to participate in the development of the emergency plan.

Out of these consultations came a procedure for handling checks expeditiously without going through the New York Fed. Normally checks drawn on New York banks and sent to the West Coast, are forwarded to the San Francisco Fed for transmission to the New York Fed. The New York Fed then sorts them by individual banks for debiting and crediting to the appropriate accounts.

In this emergency case, Reserve Banks in San Francisco and elsewhere "fine sorted" their checks so that they could be presented directly to New York City banks for collection, thus preventing a backlog of checks for sorting at the New York Fed. This approach could not be adopted at all Reserve Bank branches, so checks in Portland and Salt Lake City were flown to Seattle for sorting and reforwarding.

Senior Vice President John Carson, who coordinated many of these operations at the San Francisco Reserve Bank, said that these adjustments enabled the Bank to move millions of dollars that would otherwise have been tied up—waiting for power to be restored to New York's computers and check-processing equipment.

These emergency measures continued around the clock throughout Thursday and into Friday, July 15. San Francisco Reserve Bank officials participated in another conference call at 5:30 a.m. Friday, and heard the good news that the message switch at the New York Federal Reserve Bank was back in operation. For the first time in a day-and-a-half, communications could flow smoothly from coast-to-coast.

In the aftermath of the blackout, some problems remained unresolved. Beyond the physical processing of transactions lay the more difficult issues of payment of interest and possible penalties on debts or other transactions that would normally have been cleared on the day of the blackout. In particular, bankers and lawyers wrestled with the difficult question of what interest payments would be due on debts left unsettled for the extra day, such as transactions in Federal funds and negotiable time certificates. But apart from these continuing problems, the emergency showed conclusively that the nation's payments system can handle unexpected crises with considerable efficiency.

JACKSON URGES ATTENTION TO CREDIT JUDGMENTS

Legislation to protect consumers from credit discrimination has been beneficial, but creditors still must retain the freedom to make distinctions between customers, according to Federal Reserve Governor Philip C. Jackson, Jr., speaking before a recent meeting of the American Bar Association. He added that standards of creditworthiness must reflect the creditor's risk-premium charges as well as the characteristics of the applicant.

"When we limit by law a creditor's legal capacity to judge creditworthiness, we are tampering with a major component of our economic system," Jackson said. "I believe the Congress in framing the Equal Credit Opportunity Act tried to walk the fine line between arbitrary, capricious and irrational considerations of creditworthiness on one hand, and a wide latitude for creditors to make individual credit judgments on the other. The statute is generally successful in making this fine distinction."

However, Jackson argued that there is not a great deal of margin for errors in credit judgment. Increased losses and collection costs tend to drive up the cost of the distribution of goods and services for all consumers.

"All of us need to be reminded that creditworthiness is a concept which exists only in the value system of a specific creditor for a specific transaction. It must exist also in qualitative and quantitative terms. When determining that an applicant is creditworthy, a creditor decides that the probabilities that the debt will be repaid are sufficiently high so that the creditor is willing to assume that risk of nonpayment."

Jackson cited "usury" laws as an example of society attempting to prohibit the use of distinctions in extending credit. Many usury laws, he said, amount to price-control legislation. These laws have seldom worked except where the ceiling was placed high enough to enable most transactions to take place. Even then, high-risk borrowers were discriminated against, because the price ceiling was set below the rate necessary to provide for their needs.

He argued that greater attention also should be paid to the concept of geographic discrimination—commonly known as redlining. To provide more factual analysis for creditors, he urged local governments to produce maps showing older areas which have not suffered abandonment or vandalism. In addition, charting of foreclosures by location, amount and type of loan would help lenders estimate the probabilities of future market price stability in blighted central-city neighborhoods.

In the search for solutions to credit inequities, Jackson warned against overreacting with government rules and regulations. "If we can resist the temptation to demand that government 'do everything,' it is more likely that the private sector will become active."

Concluding, he said, "The past record on this type of approach has been poor, for seldom have we given it a real chance to work. Impatient to get quick results, mistakenly thinking that government action only costs the other fellow, we continue to demand more and more intervention. Yet it is a rare case when passing a law and throwing money at it cures any problem."

Welcome to the District FIDELITY NATIONAL BANK

The most recent Northern California bank to become a member of the Federal Reserve System has a rich tradition even though it's only four months old. Fidelity National Bank is the newest financial institution in Concord (California) but its office is in the 140-year-old Don Salvio Pacheco Adobe.

The adobe building, the oldest in Concord, is a city and state historical landmark. Thus, businesspeople and families conduct their banking business in the restored home of a Mexican grandee.

Chairman and President Rein Veerkamp heads the Fidelity National Bank management team. In his diversified career, he has served in both large and small banks, and in virtually all phases of banking from lending to administration.

Veerkamp served as president of banks in Colorado and Florida before returning West to organize Fidelity National. He received a BA degree from the University of California at Los Angeles, and also attended the Stonier Graduate School of Banking at Rutgers University.

Rounding out the senior officer team are Executive Vice President Thomas Stark and Vice President and Cashier Robert Vaughn.

Fidelity National is located in a neighborhood shopping center not far from Concord's central business district, so the bank offers shopper's hours rather than banker's hours. Fidelity is open from 9 to 5 and to 6 p.m. on Fridays. The drive-up windows have similar extended banking hours.

"We're one of the few places in the nation," sums up Veerkamp, "where you can drive up to a state historic site and take out a home-improvement loan—all on the same visit."

From left to right (front row) Robert E. Scott, Business Manager, Mt. Hood Community College; John Piacentini, Owner, Plaid Pantry Stores; Angelo Carella, Vice President in Charge, Portland Branch, Federal Reserve Bank of San Francisco; James Conlon, Director, Bureau of Engraving and Printing; Steve Hickok, Field Representative, Senator Mark O. Hatfield's Office; Joseph McEvoy, Divisional Vice President and Controller, Meier and Frank Company; David Orkney, President, G.I. Joe's, Inc.; (Back Row) James Durkheimer, Secretary-Treasurer, Wadhams and Company; Frank Jensen, Fred Meyer Savings & Loan Association; and Percy Loy, President, Kubla Khan Food Company.

TREASURY OFFICIAL LAUDS PORTLAND PLAN

In a recent interview with the *New Yorker* magazine, James A. Conlon, Director of the U.S. Bureau of Engraving and Printing, glowingly described the "Portland Plan" developed by the Federal Reserve office in that city for promoting use of the two-dollar bill.

"The Portland Fed got together with some of the big retail people and persuaded them to give the two a shot. The evidence from Portland is very heavy that the two could be useful to stores everywhere—fewer bills to handle, fewer to count."

Conlon recently flew to Portland and presented certificates of appreciation to those who engineered the "Portland Plan." He told the audience that their efforts had demonstrated the practical benefits which can accrue from cooperative government-citizen action.

Participants in the meeting also received letters of commendation from Senator Mark O. Hatfield. "In your hard work we find both economy and inspiration," Hatfield said. "For those determined to show that individual ideas can help mightily in solving the problems of government, your participation in this promotion is a significant example. You have clearly shown that independent action can replace government expenditure. Your efforts have paid off in real savings to taxpayers."

The Portland Fed's shipments of two-dollar bills had been virtually static at the beginning of the year, but they then increased dramatically as retailers began marketing the two. The Fed office currently distributes an average of $44,000 in twos a day, compared with about $19,000 before the beginning of the campaign. Shipments of ones meanwhile have been slashed 15 percent.

Percy Loy, President of Kubla Khan Food Company and a member of the Federal Reserve's Consumer Advisory Council, spearheaded the campaign in collaboration with Vice President Angelo Carella of the Portland Fed. Loy convinced retailers to utilize the two widely in making change.

Large chains and supermarkets that had never ordered twos began stockpiling them. Retailers overcame the basic objection in using twos—no room in the cash drawer—by simply moving the twenty underneath and putting the two in its place.

Loy and Carella noted that widespread acceptance of the note could save taxpayers from $4 to $7 million annually, since twos go twice as far as ones at half the printing cost. About 60 percent of the total currency stock presently is made up of one-dollar bills.

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BOARD SUPPORTS REGULATORY REFORM

The Federal Reserve System supports regulatory reform and the simplification of existing rules and procedures, Governor J. Charles Partee recently told the Senate Committee on Governmental Affairs. He was testifying in regard to the Regulatory Reform Act (S.600) which provides for a detailed review of the effects of the regulatory process on an agency-by-agency and also industry-by-industry basis.

Partee said that Federal legislation and implementing regulations often have the unintended effects of introducing rigidities and imperfections into industries and markets. "All too frequently the results have been a lessening in competition, a reduced resilience to deal with economic change, and a higher and more rigid structure of costs and prices which the consuming public must inevitably bear."

Partee said that in banking the costs of compliance with regulations are often high. He cited the numerous reports that must be filed with bank regulatory agencies, or that must be filled out and kept accessible for enforcement purposes. He called this a hidden tax, imposed by the regulators on the regulated, that is ultimately passed on to consumers. He noted, however, that the Federal Reserve System has reduced the overall volume of the reports it receives by about seven percent in the last year and a half.

Turning to the Regulatory Reform Act, the Fed official said that the Board of Governors would like to see some clarification of certain key features such as the "sunset" provisions of the legislation. These provisions require the termination of regulatory enforcement authority, or even an entire agency, in the event that no reform plans are enacted within a prescribed time period.

Partee noted that there were no explicit provisions in the bill providing for the continuation of a variety of essential functions that are not regulatory in nature, but which account for the bulk of the Federal Reserve's activities. These would encompass "central banking, monetary policy, oversight of the Reserve Banks, operation of the discount mechanism, bank supervision and incidental regulations of the Federal Reserve necessary to carry out these functions."

Thus he argued, "In view of the problems associated with the sunset provision, the Board would urge a narrower and more specific delineation of the aspects of banking and finance to be covered by the bill."

FED ISSUES RULING ON WIRE TRANSFERS

The Federal Reserve Board of Governors last month amended its regulation on check collections (Reg J) to cover the wire transfer of funds between member banks.

Under the amended regulation, which becomes effective September 1, the unchanged section on checks will become Subpart A, and the new ruling on wire transfers will be codified under a new Subpart B. Up to now, procedures for wire transfers have been covered by Reserve Bank operating circulars.

During the past 10 years, wire transfers have increased sharply from \$6½ trillion in 1967 to \$35 trillion last year. The average wire-transfer transaction amounts to roughly \$2 million.

The new Subpart B of the regulation concerns only the wire transfer of funds. It does not deal with other electronic payments such as those processed through automated clearing houses, or point-of-sale transactions where electronic means are used to verify checks or to charge customers' bank accounts for purchases. However, the Board of Governors is preparing a third subpart to Regulation J, which will deal with the processing of payments recorded on magnetic tape.