

Federal Reserve Notes

FEDERAL RESERVE BANK OF SAN FRANCISCO

JULY 1978

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MILLER OUTLINES INFLATION STRATEGY

In his first visit to the West Coast as Federal Reserve Chairman, G. William Miller underscored the Fed's strong commitment to fighting inflation and outlined an eight-point strategy to deal with what he called "our most serious domestic problem." He discussed his plan at a press conference held last month at the Federal Reserve Bank of San Francisco, and again in an address to 1,000 community leaders held under the auspices of the Bay Area Council.

At the press conference, Miller said "The dilemma we face at the Federal Reserve is in trying to react against inflation in the short-term, and in trying to shape a coordinated economic policy so that the Federal Reserve and monetary policy are not left to do the job alone." He said that cooperation is required among the Fed, the Administration, Congress, business and labor.

The Chairman said that the so-called tax revolt, highlighted by California's passage of Proposition 13, is consistent with the Fed's and the Administration's plans to develop improved long-term plans to manage the economy. "We're talking about returning more spending decisions to the people," he said. "A dollar spent by an individual or a company can create a job as well as government spending can."


In his speech to the Bay Area Council, Miller outlined a strategy to reach "full employment, price stability and a sound dollar" within the next five to seven years. Among the points he cited were reduced Federal spending, individual tax reductions, and the stimulation of private capital investment.



G. William Miller, Chairman of the Board of Governors (right) and John J. Balles, President of the Federal Reserve Bank of San Francisco, participating in a press conference at the San Francisco Fed.

He said that high priority should be given to regulatory reform, "to reduce the unnecessary, costly and inflationary burden of government on people and on business." (The Federal Reserve, he noted, has already initiated a full-scale review of its regulations and related interpretations.) His anti-inflation proposals also included programs to expand exports and correct U.S. payments deficits, greater energy conservation and conversion to more energy-efficient systems, and steady production of housing to keep pace with demand.

Miller emphasized that inflation is the nation's most serious domestic problem. "It is the number one issue not because it has precedence over the quest for full employment, but because under present circumstances it is the primary obstacle to achieving full employment."

"Our goal must be to fight inflation," he said, "until we reach our goal of price stability, full employment and a sound dollar. The Fed cannot do the job alone. We need the assistance of the administration, Congress, business, industry, labor and the general public. But together we can turn back inflation." 

FED RELEASES MEMBERSHIP PROPOSALS

The Federal Reserve Board of Governors this month released proposals designed to reduce the membership burden on member banks, and designed also to help bring about competitive equality among financial institutions generally. Implementation of some of the proposals would require Congressional approval, but others could be accomplished under present Fed authority.

A key feature would be the compensation of member banks for the competitive disadvantage they suffer from holding required-reserve balances at Federal Reserve Banks. (Member banks, unlike non-member banks, at present do not earn any return on these balances.) The Fed proposes to pay interest on these reserves, although not in excess of 7 percent of Reserve Bank earnings. At the completion of a two-phase transition period, a 2-percent rate would be paid on required balances in excess of \$25 million, and a near-market rate—amounting to 6 percent in 1977—would be paid on the first \$25 million.

In addition, the Fed would restructure and reduce demand-deposit reserve requirements for member banks. The amount of net demand deposits to which the top marginal rate for reserve requirements would apply would be raised from \$400 million to \$600 million. Banks of smaller size would benefit from a reduction in the required reserve ratios which apply to the first \$600 million in net demand deposits. Together these changes eventually would lead to the release of about \$5 billion in reserves and to increased earnings of about \$320 million annually.

The Federal Reserve meanwhile has asked Congress to impose universal re-
(continued on page 3)

SUMMARY OF KEY FED DEVELOPMENTS

TT&L PROGRAM POSTPONED

The U.S. Treasury Department has postponed the implementation date for the new Treasury Tax and Loan Investment Program. It was to have started on July 6, but was delayed because Congress did not vote the funds necessary for the Treasury to make fee payments to financial institutions. Under the planned program, the Treasury would earn interest by investing its operating cash balances. At the same time, it would pay fees for certain services rendered by financial institutions, for which previously they had not been compensated. A revised effective date for implementation of the TT&L Investment Program will be announced by the Treasury after Congress appropriates funds for fee payments. For further information, contact the Fiscal Department of your nearest Federal Reserve office.

DISCOUNT RATE BOOST

The San Francisco Reserve Bank boosted its discount rate from 7 percent to 7¼ percent, effective July 3. The discount rate applies to loans made by Federal Reserve Banks to member banks. Commenting on this latest move, the Board of Governors said that the Fed took action "in recognition of increases that have occurred recently in other short-term interest rates, and to bring the discount rate into closer alignment with short-term rates generally."

EQUAL CREDIT GUIDELINES

The Board of Governors last month issued proposed guidelines for the enforcement of the Equal Credit Opportunity Act, the associated Regulation B, and the Fair Housing Act. The Equal Credit Opportunity Act prohibits discrimination against a credit applicant on the basis of such factors as age, sex, marital status, race, religion or national origin. The Act also requires written notice of credit denials. The Fair Housing act prohibits the denial of credit in residential lending on such "prohibited bases." For further information, contact the San Francisco Reserve Bank's Consumer Affairs Unit (415) 544-2226. Comments on the uniform guidelines should be sent by September 1, 1978, to Equal Credit Opportunity Guidelines, Room B-4107, Washington, D.C. 20551.

EXECUTIVE LOANS

The Board of Governors has amended its Regulation O which deals with loans by member banks to executive officers. The amendment prohibits a member bank from extending credit to

an executive officer under a bank credit card, check credit or similar plan if the terms are more favorable than those offered to the general public. The amendment became effective June 30. For further information, contact the Reserve Bank's Supervision, Regulation and Credit Department (415) 544-2242.

GENERAL INSURANCE

Interested parties now have until August 1 to comment on the amendment to Regulation Y (Bank Holding Companies) dealing with general insurance. The amendment authorizes bank holding companies to act as general insurance agents in communities with less than 5,000 population, or in communities that have a clearly demonstrated need for insurance-agency facilities. The Board of Governors extended the comment deadline to encourage public participation in the issue. All material should be addressed to the Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551, and refer to Docket No. R-0050-B. For further information, contact the San Francisco Reserve Bank's Bank Holding Company Section (415) 544-2235.

RECORDS FOR CERTIFICATES OF DEPOSIT

The Treasury Department has adopted a rule that requires any bank or financial institution that sells or redeems a certificate of deposit on or after June 1, 1978, to maintain a record of the transaction. The record must include the name, address, and taxpayer-identification number of the purchaser or owner. This amendment to the Financial Recordkeeping and Reporting of Currency and Foreign Transaction Regulation is designed to prevent individuals from concealing interest earnings on these financial transactions. Contact W.L. Rickards (415) 544-2242 for further information.

FACE-TO-FACE INTERVIEWS

The Board of Governors has withdrawn a 1965 interpretation of its margin regulations (Regulations G and U), that requires face-to-face interviews for bank acceptance of "purpose statements," indicating whether a loan will be used for purchasing securities. The new interpretation permits lenders to accept purpose statements through the mail under certain circumstances. This could be done if the lender adopts a program that requires detailed information from the borrower and incorporates procedures to verify the truth of the information. Lenders intending to start such a program should discuss their plans with the Reserve Bank's Consumer Affairs Unit (415) 544-2226.

FED RELEASES MEMBERSHIP PROPOSALS

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serve requirements on all transactions balances—such as so-called NOW accounts as well as demand deposits—as a means of equalizing competition among all depository institutions with third-party payment powers. (NOW accounts, or negotiable orders of withdrawal, are deposits combining the interest-bearing features of savings accounts and the third-party transactions features of commercial-bank demand deposits.) The proposed legislation would make transactions accounts at all Federally-insured depository institutions subject to reserve requirements set by the Federal Reserve, except for institutions holding less than \$5 million in such accounts. The proposal also calls for a reduction in the lower end of the range of reserve requirements—from 3 to ½ percent—for member-bank time-and-savings deposits other than transactions accounts.

For non-member institutions, reserve requirements would be phased in gradually over time. Their required reserves could be held at member banks or Federal Home Loan Banks, provided that the funds were passed through to Federal Reserve Banks.

Another important element in the Federal Reserve package would be the institution of charges for services rendered by the Fed. Today, member banks "pay" for Fed services through the maintenance of reserve balances with Reserve Banks. But the Fed is now proposing explicit pricing as a means of encouraging more efficient provision and utilization of Fed services, in conjunction with the steps taken to reduce the membership burden. With "unbundling," the System would impose prices similar to charges levied for comparable services offered in the private sector, with due regard for the need to maintain a satisfactory level of service throughout the nation.

The first phase of the new pricing program would involve charges for payments services, such as check processing, check transportation, and automated clearing-house services. During this phase, the Fed would permit all non-member depository institu-

tions—thrifts as well as banks—to deposit intra-regional checks and drafts at regional check-processing centers (RCPC's), according to the same charge schedule levied upon members. The present access which non-member banks have to these services would be extended to non-member *non-bank* institutions as well. Non-member institutions would be required to settle through the reserve account of a member bank.

The second phase of the program would involve charges for other Fed services, such as shipping of coin and currency, transfer and settlement of reserve balances, and securities handling. Access for non-members would be provided on the basis of equality of treatment with respect to balances held by member and non-member institutions at the Fed, and member and non-member institutions would receive the same compensation for maintaining these balances.

As background to these proposals, the Federal Reserve noted that 551 banks have withdrawn from the System over the past decade, and that the majority of newly-formed banks have chosen not to join. As a result, the proportion of commercial-bank deposits held by member banks has declined sharply, from 83 percent in 1965 to about 73 percent today. In earlier years, most banks that withdrew were smaller banks, for whom the System provided less attractive services than those available through correspondent banks. More recently, however, the withdrawals have included an increasing number of larger banks. In 1977, for example, 15 of the 69 banks that left the System had deposits of over \$100 million.

The decline in membership can be traced to the rising trend of market interest rates, which has increased the implicit cost of assets frozen in the non-earning reserves required of member banks. Many banks have concluded that the benefits of Federal Reserve membership do not offset the cost of System reserve requirements. In the U.S., the dual-banking system of national and state chartering gives banks the option of non-member status, because state-chartered banks are not required by law to be System members.

State non-member banks are subject to

state reserve requirements, which vary from state to state but usually are effectively lower than System requirements, whatever the formal level of reserve ratios. This is so because many states allow U.S. government securities to serve as reserves, which pay interest directly. Again, most states permit reserve assets to be held as balances at (correspondent) banks, which earn an indirect return in the form of various banking services provided by the correspondents. Thus, non-member banks gain access to the national payments mechanism through member correspondent banks, and pay a lower net cost in the process.

In contrast, member-bank reserves are limited to cash and deposits at Federal Reserve Banks. These assets bear no interest, and their indirect value depends on what each bank receives in the form of Federal Reserve services.

Following World War II, the value of these services more than matched alternative market yields, but the picture has changed considerably with the inflation-caused upsurge in market interest rates of the past decade or so. Instead of market yields of 1-to-2 percent, banks are now able to earn rates of 5-to-7 percent on their earning reserves, so that a net benefit from System membership has turned to a net burden for many banks. According to some estimates, the aggregate burden could exceed \$650 million annually.

The problem of membership, moreover, encompasses not only non-member commercial banks but also a wider group of non-bank financial institutions. Savings-and-loan associations, mutual savings banks and credit unions boast even lower reserve requirements than non-member banks, while taking on many of the characteristics of commercial banks. In the Northeast, many of these thrift institutions have begun to offer NOW accounts, which in effect are interest-earning demand deposits. NOW accounts as such are still limited to that one part of the country, but transactions-type accounts have been appearing elsewhere, in the form of S&L remote-payments terminals and credit-union share drafts. The Fed's proposal for uniform reserve requirements thus would lead to competitive equality for all depository institutions. 🍁

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Bank of San Francisco, P.O. Box 7702, San
Research Information Center, Federal Reserve
cution is distributed to commercial banks by the
Burke, Ronald Getz and Karen Rusk. The publi-
Federal Reserve Notes is produced by William

400 Sansome St., San Francisco, CA 94120

Federal Reserve Bank of San Francisco

REGULATORY AGENCIES PROPOSE CRA RULES

The four federal agencies that regulate commercial banks and savings-and-loan associations have proposed uniform regulations to implement the Community Reinvestment Act (CRA). CRA is designed to assure that banks and thrift institutions provide equal service for all borrowers in their communities.

Despite some differences in detail, which basically reflect differences in institutions supervised—the rules proposed by the Federal Reserve, the Federal Home Loan Bank Board, the Federal Deposit Insurance Corporation, and the Comptroller of the Currency are uniform in substantive matters. Under their proposals, a lending institution's directors would have to adopt a CRA statement by February 1, 1979. The statement would define geographically the area served by the lender, and would set forth the lending policies applicable to that area. The institution would have to review its statement at least once a year.

Under CRA, Federal agencies are required to assess the records of the institutions they regulate when considering applications for branches, mergers, charters, deposit insurance, holding-company acquisitions and office relocations. In a joint statement, the agencies said that "it is more likely that community credit needs will be met when members of the community are aware of the avail-

BOARD BACKS INCREASE IN PUBLIC DIRECTORS

The Federal Reserve Board of Governors has announced a proposal to increase public representation on the Boards of all Reserve Banks by having six Class C directors at each bank instead of three. The change is designed to respond to the Federal Reserve Reform Act of 1977, which urged the Fed to broaden its representation from groups such as consumer, labor and service interests.

At present, each Federal Reserve Bank

ability of credit, the lending institutions are well informed about community credit needs, and such institutions make a sincere effort to meet those needs. It is the purpose of the proposed regulations to encourage each institution to help meet the credit needs of its entire community, while preserving for every institution the flexibility necessary to operate in a safe and sound manner."

The agencies asked for comments on the proposal by August 15. They specifically requested comment on whether small lenders (assets under \$10 million) that are located outside metropolitan areas should be exempted from providing the CRA statement. Comments should be directed to Theodore E. Allison, Secretary, Federal Reserve Board of Governors, Washington, D.C. 20551.

Board has nine directors. These nine are divided into three classes—Class A, B and C. Class A Directors represent member banks, while Class B and C represent the public and are to be selected with due (but not exclusive) consideration to the interests of agriculture, commerce, industry, services, labor and consumers. Both Class A and B Directors are elected by member banks. Class C Directors are appointed by the Board of Governors. The Fed proposal to increase the number of Class C directors requires legislation by Congress.

In a separate but related matter, the Board of Governors adopted amendments to its conflict-of-interest regulation applicable to the directors of Federal Reserve Banks and Branches. The revised regulation, which is entitled "Reserve Bank Directors—Actions and Responsibilities," was mailed last month to all member banks in the San Francisco District. The regulation reflects changes brought about by the Federal Reserve Reform Act making conflict-of-interest provisions in the United States Code applicable to Reserve Bank directors, officers and employees. The amendments principally involve the identification of financial interests that might preclude a director from participating in particular matters, and define financial interests that the Board has determined to be too remote or inconsequential to affect the actions of directors. The revisions to the regulation went into effect on May 31. 🍀

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