

# Federal Reserve Notes

FEDERAL RESERVE BANK OF SAN FRANCISCO • OCTOBER 1978

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## CONGRESS PASSES REGULATORY BILL

Just prior to its October 15 adjournment, Congress passed the Financial Institutions Regulatory Act, which prohibits Federally-insured banks or their affiliates from making loans equal to more than 10 percent of their capital accounts to bank officers and major stockholders. (Capital accounts include equity capital and retained earnings.) The legislation, with its limitation on bank insiders' activities, now goes to the President for his signature.

Another feature of the bill requires that any loan made by a bank to an insider of another bank can't be made on preferential terms, and must be reported by the borrower to his bank's board. It also requires each bank to report annually the total amount of loans made to its officers or those owning 10 percent of its stock.

The legislation also bars interlocking directorates among banks, savings institutions and credit unions in the same market region. For large financial institutions, interlocking directorates are barred completely.

Federal bank regulators obtain expanded cease-and-desist and subpoena powers under the bill. In addition, regulators will have less difficulty than before in removing bank officials who jeopardize their bank's safety. Another provision requires any individual who wants to acquire a bank or thrift institution to give 60 days' notice to the appropriate regulatory agency.

The legislation spells out consumer rights and safeguards in electronic funds-transfer systems, such as computerized bank tellers. In an amendment, it extends for two years

## NATIONWIDE EFT SYSTEM COMPLETED

The Federal Reserve System announced last month the completion of a nationwide network for making payments electronically. The system links up some 9,400 banks and 1,500 thrift institutions that are currently members of automated clearinghouse (ACH) associations, along with some 6,000 customer corporations.

The 35 ACH's now in operation—one private and the rest Federal Reserve facilities—consist of computers which clear and sort payments instructions recorded on magnetic tapes. The new system requires no new facilities, but instead makes intensified use of existing Federal Reserve computers and wires.

"Linkage of automated clearinghouse associations in all parts of the nation makes possible the electronic transfer of payments to and from virtually any place in the United States," the Board of Governors said. "The availability of the new payments-system network will enhance and improve financial services to individuals and financial institutions, and encourage the use of the electronic movement of funds as a more efficient and less costly alternative to making payments by check."

The Board said that any payment that can be made by check can also be

the authority for regulatory agencies to set deposit interest-rate ceilings for banks and thrift institutions. The legislation also eliminates the differential on savings accounts subject to automatic transfer and authorizes now accounts for Federally insured institutions in New York State. 

made electronically. Electronic payments already are made for payroll deposits and recurring bills such as mortgages, as well as U.S. Treasury deposits for social-security beneficiaries and the like.

The Board authorized Federal Reserve Banks last April to provide services for a national network of ACH's. The pilot work for the system began in 1976 in conjunction with the National Automated Clearing House Association (NACHA). That association was responsible for training local ACH's in the techniques of interregional electronic-payments transfers. The local associations gave technical assistance to member financial institutions.

Under the new system, any financial institution that is a member of an automated clearinghouse association can present payment instructions recorded on magnetic tape to the nearest ACH for transmission nationwide. Such a magnetic tape might bear instructions to make salary payments to a company's employees located in many parts of the country. The ACH that receives such a tape sends the instructions to other ACH's over the Fed's wire network. The ACH serving the final payment point sorts the instructions by computer and forwards them to designated commercial banks or thrift institutions. These institutions then debit the accounts of customers who are making payments and credit the accounts of customers receiving payments.

"The system parallels the sorting and forwarding of payment instructions on checks," the Fed noted. "But instead it does it electronically rather than by mail or courier, and offers the potential for greatly improved services and cost efficiencies." 

## SUMMARY OF KEY FED DEVELOPMENTS

### **FED RAISES DISCOUNT RATE**

Federal Reserve Banks posted an increase in their discount rate, from 8 to 8½ percent, effective October 16. In approving the increase, the Board of Governors said, "The action was taken to bring the discount rate into closer alignment with increased short-term market interest rates, and in recognition of continued high inflation, the recent rapid rate of monetary expansion, and current international financial conditions."

### **FLOOD INSURANCE**

The Federal Insurance Administration (FIA) has liberalized its guidelines to expedite the closing of loans for real estate located in flood-hazardous areas covered by the National Flood Insurance Program. The guidelines, which became effective on February 17, 1978, stated that before loan-closing a lender should obtain either a copy of the Standard Flood Insurance Policy or a policy application indicating payment of the full premium. However, the FIA subsequently ruled that other documents also are acceptable. A lender now can accept a copy of the mortgagor's check issued in payment of a flood-insurance policy, or alternatively, an agent's certification or letter that a mortgagor has purchased the insurance.

As a result, a state member bank that accepts any of these documents will be in compliance with Federal Reserve Regulation H (Membership of State Banking Institutions). However, the standard flood-insurance policy does not become effective for 15 days from the date of application, so that a state member bank legitimately may decide to delay a loan closing for 15 days. This would ensure that there is no interim period when a loan is not covered by flood insurance. For further information, contact the Reserve Bank's Law Department (415) 544-2254 or 544-2256.

### **REVISED OTC LIST**

A revised list of over-the-counter (OTC) stocks that are subject to Federal Reserve margin requirements is now available. The new list includes 1,157 OTC stocks, including 81 stocks listed for the first time. Margin regulations generally limit the amount of credit that can be used to buy or carry securities. Stocks on the OTC list are subject to the same margin requirements as stocks listed on national stock exchanges. The requirement currently is 50 percent, which means that at least 50 percent of a stock's purchase price must be paid in cash to obtain credit for the remaining 50 percent. For further information, call the Reserve Bank's Consumer Affairs Unit (415) 544-2226.

### **CREDIT ON NONCONVERTIBLE BONDS**

The Federal Reserve has amended its Regulation T (Credit by Brokers and Dealers), regarding the use of credit for buying nonconvertible corporate bonds in the over-the-counter (OTC) market. Before adoption of the amendment, credit could be extended by brokers or dealers only for bonds listed on a national securities exchange. The amendment provides that they may also extend and maintain credit on unlisted nonconvertible bonds sold on the OTC market. However, at the time credit is extended, the outstanding principal amount of an issue cannot be less than \$25 million, and all payments of principal and interest must be current. In addition, each issue must be registered with the Securities and Exchange Commission (SEC) and the issuer must provide current reports under SEC regulations. Securities that meet these criteria will be designated "OTC margin bonds." For further information, contact the Reserve Bank's Consumer Affairs Unit (415) 544-2226.

### **POLICY ON TAX TRANSACTIONS**

The Board of Governors has approved a policy statement on tax transactions between state member banks and their parent holding companies. The statement was substantially unchanged from one that was issued for comment in June. According to this ruling, a bank holding company should serve as a source of strength for its subsidiary banks and should not exercise its control to their detriment. The Board criticized the accounting practice whereby assets and income are transferred from subsidiary banks to the parent company without offsetting benefits to subsidiaries. The Board also encouraged holding companies to develop written tax agreements with their bank subsidiaries specifying intercorporate tax-settlement policies. It did not prescribe any specific tax-accounting methods, but it added that whatever methods are employed should give bank subsidiaries equitable treatment. For further information, call the Reserve Bank's Bank Holding Company Section (415) 544-2235.

### **HOLIDAY NOTICE**

The Portland Branch of the San Francisco Reserve Bank will be closed on Friday, November 10, in observance of Veterans' Day. All other offices of the Bank will be open for business. All Bank offices will be closed on Thursday, November 23 for Thanksgiving Day.

## TOP COURT UPHOLDS AUTO LEASING RULE

The Supreme Court this month upheld the Federal Reserve's authority to allow bank holding companies to conduct auto-lease financing. The high court refused to review a petition which was brought by the National Automobile Dealers Association (NADA) against a ruling made last February by the U.S. Court of Appeals for the District of Columbia.

The Federal Reserve Board of Governors first permitted bank holding companies to engage in auto-leasing activities in April 1974, on the grounds that these activities are closely related to banking and also benefit the public. The auto trade group then sought a court ruling on whether the regulation should apply to auto leasing. The court referred the matter back to the Board of Governors, which in October 1976 again concluded that auto leasing under certain conditions represents a permissible non-banking activity for holding companies. The NADA again took the Fed to court, and this matter then went all the way to the Supreme Court for review.

The Fed's regulation permits personal-property leasing provided the lease serves as the functional equivalent of a credit. The lessor holding company cannot acquire an inventory of property for leasing, and it must dispose of the property or lease within two years of the expiration of the initial lease. The bank holding company also cannot provide such non-financial services as lending autos during servicing, or auto maintenance and repair. 🏠

## SIMPLIFIED REPORT FOR SMALL BANKS

The Federal bank-regulatory agencies have proposed a simplified version of the Reports of Condition and Income ("Call Reports") that would significantly reduce the reporting burden for over 90 percent of the nation's commercial banks. The reports would apply to banks with only domestic offices and with assets of less than \$100 million—probably over 13,000 of the nation's commercial banks. If the proposal is approved, the new forms would be used for reports as of December 31, 1978.



N. H. Teeters

## TEETERS APPOINTED NEW FED GOVERNOR

Nancy H. Teeters was sworn in late last month as the first woman Federal Reserve Governor. The ceremony took place in the White House and was conducted by Vice President Walter F. Mondale.

Mrs. Teeters fills the unexpired term of former Fed Chairman Arthur F. Burns, which runs until January 21, 1984. Before accepting the appointment to the Fed, Mrs. Teeters was the chief economist of the House Budget Committee. She was once a staff economist at the Board of Governors, and also served on the staffs of the Council of Economic Advisers, the Office of Management and Budget, and the Congressional Research Service of the Library of Congress. From 1970 to 1973 she was a senior fellow at the Brookings Institution. Mrs. Teeters received degrees from Oberlin College and the University of Michigan. 🏠

The proposal was made jointly by the Comptroller of the Currency, the Federal Reserve Board of Governors and the Federal Deposit Insurance Corporation. The agencies asked for comment by November 15, specifically with reference to the feasibility of the \$100-million bank-asset ceiling proposed for the simplified reports.

Call Reports are the basic financial reports that must be made semi-annually or quarterly by all Federally insured banks. The proposed new forms would eliminate about 40 percent of the reporting now required with the standard forms. Banks with

## BOARD ISSUES ATS GUIDELINES

In a recent public statement, the Federal Reserve Board of Governors announced guidelines for member banks to follow in advertisements or programs designed to promote the new automatic-transfer service. Banks are authorized to offer the ATS service beginning November 1.

The Fed said that ads or promotional materials should clearly indicate that the automatic-transfer service involves two separate accounts—a savings and a checking account. Banks also should avoid referring to the ATS service as equivalent or similar to paying interest on checking accounts. Because of this, such statements as "interest on checking," "interest checking account," "interest-paying checking plan," and "almost like interest on checking," are not permissible. These statements might convey the incorrect impression that depositors would receive interest on demand deposits—something that is prohibited by law.

Additionally, the Board said banks should not refer to the automatic-transfer service as "checking on savings" or "checkable savings." Such statements could result in the mistaken belief that checks may be drawn on interest-bearing savings accounts. This is a service presently limited by law to the six New England states. The Fed also said that member banks should inform their depositors at the time the ATS service is authorized that the bank reserves the right to require at least 30 days' notice for an automatic withdrawal of savings deposits. 🏠

assets of over \$100 million, or those with foreign offices or Edge Act subsidiaries, would continue to use the standard Reports of Condition and Income.

The reduction of the reporting burden would result from several factors. The simplified forms would eliminate numerous specific items from separate reporting—particularly details of loan and deposit activity. In addition, they would reduce the frequency of reporting from semiannually to annually, sometimes for entire sections, for the Report of Income. 🏠

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## PRESIDENT SIGNS FOREIGN BANK ACT

President Carter has signed into law the measure regulating the activities of foreign banks in the United States. The International Banking Act of 1978 extends Federal control over the branches and agencies of foreign banks operating in this country, and over commercial-lending companies controlled by foreign banks that are engaged in banking activities. The act does not change the status of state-chartered banking subsidiaries of foreign banks.

The measure restricts the interstate branching privilege of foreign banks. In the future, any foreign-bank branch located outside of the bank's "home" state would be limited to accepting deposits related to international banking and finance. In the home state, each branch could do a full banking business. However, foreign banks that already have offices in more than one state would be able to continue their present operations under a "grandfather" provision. (Under such a provision, institutions established before a certain date can remain free of later restrictions.)

The act empowers the Federal Reserve to impose mandatory reserve requirements on Federal branches and agencies of foreign banks. State

## UNIFORM RATING SYSTEM ADOPTED

The Federal bank regulatory agencies have adopted a uniform interagency system for rating the trust departments of the nation's commercial banks. This new common yardstick is expected to improve the evaluations of trust-department activities contained in reports to Congress and the public.

The new trust-rating system has two main elements. First, Federal examiners will rate trust departments in six critical areas: supervision and organization of the trust department; the department's operations, controls

branches and agencies also are subject to similar regulation if their parent bank has \$1 billion or more in worldwide assets. The branches holding reserves would gain access to Federal Reserve System services.

The Act also allows foreign citizens to serve on the boards of national banks. This opens the possibility of foreign-bank subsidiaries applying for national charters. For further information on this legislation, contact the Reserve Bank's Bank Relations Department (415) 544-2352. 🐞

and audits; asset administration; account administration; conflicts of interest; and earnings and volume trends. Each of the areas will be rated on a scale of 1 (the highest) to 5 (the lowest category).

Secondly, examiners will assign a composite rating to each trust department. This overall rating will be determined by adding the individual numerical ratings for each critical area. Under this system, a numerical score of 6 to 8 will amount to a composite rating of 1, meaning superior performance in almost every respect. On the opposite end of the scale, a numerical score of 27 to 30 will result in a composite rating of 5, meaning critically-deficient performance in major respects.

The regulatory agencies stated that the new rating system recognizes the consumer-oriented nature of trust-department activities. "The system emphasizes the trust department's proper role in carrying out its fiduciary responsibilities in the public interest," the joint statement read. "Examiners are encouraged by the new system to focus on any conditions that could adversely impact the interests of account beneficiaries, and to recommend corrective action before any such conditions might give rise to loss either to account beneficiaries or to the bank." 🐞