Federal Reserve Notes

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FED CLEARS FOREIGN BANK PURCHASES

The Federal Reserve Board of Governors this month approved foreign-bank purchases of control of three large U.S. banks. With this action, the way was cleared for Standard Chartered Bank, Ltd. (London) to acquire Union Bancorp, which is the holding company for Union Bank, the sixth largest bank in California. The other acquisitions include Hongkong and Shanghai Banking Corp.'s purchase of 51 percent of Marine Midland Banks, Inc., and London-based National Westminster Bank Ltd.'s purchase of 75 percent of National Bank of North America.

The foreign-bank presence in the U.S. market has increased substantially in recent years. Between 1972 and 1978, assets of domestic banks purchased or chartered by foreign institutions increased five-fold, to about $20 billion. That $20-billion figure will more than double now that three major acquisitions have been approved.

The Board's action followed last month's release of a policy statement regarding supervision of foreign-bank holding companies in this country. The Board said that the principle of "national treatment" should be the guiding rule in administering the relevant portions of the Bank Holding Company Act and the International Banking Act of 1978. The Board's policy is designed to further two major goals: 1) the U.S. subsidiary bank should be operated in a safe and prudent manner; and 2) the parent-

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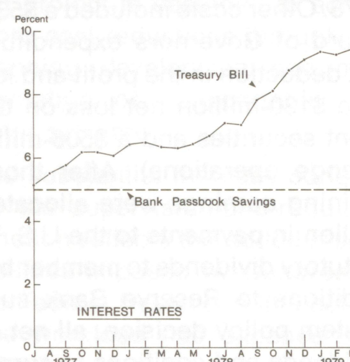
AGENCIES CHANGE CERTIFICATE RULES

Federal regulatory agencies this month changed the rules under which financial institutions can issue 26-week money-market certificates (MMC's). The changes were made to reduce somewhat the cost of MMC's, and to moderate the flow of funds into thrift institutions in the current inflationary period.

The agencies prohibited the compounding of interest on MMC's issued on or after March 15 by insured commercial banks, savings banks, savings-and-loan associations and credit unions. In addition, they eliminated the 1/4-point interest differential between thrift institutions and commercial banks when the certificate ceiling rate is 9 percent or more. However, the full differential remains in effect when the ceiling rate is 8 3/4 percent or less.

The action was announced jointly by the Federal Reserve Board of Governors, the Federal Home Loan Bank Board, the Federal Deposit Insurance Corporation and the National Credit Union Administration. The agencies said that, in addition, they were "actively reviewing the terms on other types of deposits with a view toward providing improved savings opportunities for the small saver."

The agencies noted that their action would affect the savings flows of thrift institutions, but argued that it would permit those institutions to remain competitive in attracting funds for housing. The action should help reduce cost pressures on thrifts, and over the longer run assure continued availability of mortgage credit.



The regulatory agencies created the money-market certificate last June 1 to help maintain a flow of funds into the mortgage market. At that time, with market interest rates rapidly rising, they feared a flow of funds into market (non-bank or thrift) instruments, and out of deposit instruments, that are subject to interest-rate ceilings.

MMC's are issued in minimum denominations of $10,000 with a 26-week maturity. The maximum rate of interest that may be paid on MMC's is tied to the discount rate (auction average) on six-month Treasury bills.

At the end of January, $104 billion in such certificates were outstanding, with more than half of the total being held at S&L's and another third at commercial banks. These certificates then accounted for almost 13 percent of all S&L deposits and for almost 8 percent of all small-denomination (less than $100,000) bank time and savings deposits.

The sharp rise in popularity of MMC's has reflected the widening of the differential between the Treasury bill rate — the rate to

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SUMMARY OF KEY FED DEVELOPMENTS

RESERVE BANK EARNINGS RISE

Gross earnings of Federal Reserve Banks increased 22.7 percent last year to a total of $8,455 million, reflecting a sharp increase in security earnings. (System earnings are derived primarily from U.S. government securities the Fed acquires through open-market operations — one of the tools of monetary policy.) The 12 banking districts of the Federal Reserve System incurred current expenses of $653 million (4.6 percent above 1977), leaving net earnings of $7,803 million in 1978. Other costs included a $53-million assessment for Board of Governors expenditures and a $633-million net deduction in the profit and loss account (mostly due to a $130-million net loss on the sale of U.S. government securities and a $506-million loss on foreign-exchange operations). After those deductions, the remaining earnings were allocated as follows — $7,006 million in payments to the U.S. Treasury, $63 million in statutory dividends to member banks, and $47 million in additions to Reserve Bank surpluses. Under a 1964 System policy decision, all net earnings after statutory dividends and additions to surplus are paid to the U.S. Treasury as interest on Federal Reserve notes.

REGULATION S REVOKED

In its ongoing effort to clarify and simplify all Fed regulations, the Board of Governors has revoked its Regulation S, "Bank Service Arrangements." In effect since 1963, the regulation governed the Board's power to regulate and examine banking services performed for State-chartered member banks by outsiders. A recent amendment to the Bank Service Corporation Act renders the "S" regulation unnecessary. The Board also adopted modifications that would simplify present interpretations and make them conform with the amended Act. The San Francisco Reserve Bank has issued a new Circular 12 — Bank Service Arrangements — that contains a model form that State member banks can use in notifying the Fed of new bank service arrangements.

REGULATION V SIMPLIFIED

The Board of Governors recently simplified its Regulation V, "Loan Guarantees for Defense Production," and consolidated related administrative rules into the regulation. The Board also revised both the interest-rate and guarantee-fee structures applying to such loans. It changed the maximum rate of interest that a financing institution may charge for a V-loan from a fixed maximum rate (which has been 7 1/2 percent) to the rate the institution currently charges its most creditworthy business customers for loans of comparable maturity — unless the governmental guarantor decides a particular loan bearing a higher interest rate is necessary for national-defense purposes.

The Board also modified the scale used for calculating the fee a guarantor may charge for guaranteeing a loan. The guarantee fee now runs from a low of 10 percent of the base interest rate for the guaranteed portion of a loan of which 70 percent or less is guaranteed, to a high of 40-50 percent of the base interest rate on a loan of which 95 percent or more is guaranteed. The base interest rate, which is set by the guaranteeing agency, henceforth is to be 6 percent or more — previously it had been a flat 6 percent.

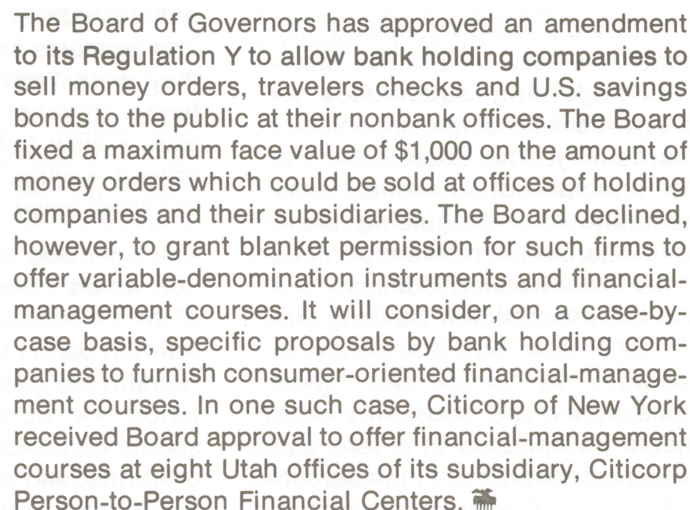
Regulation V grew out of a program begun in World War II to facilitate production or other operations for national defense. The Federal Reserve acts as fiscal agent for the program. The Board has also invited public comment — through April 30, 1979 — on whether the entire V-loan program should be restructured, or even eliminated. (Contact 415-544-2230 for further information.)

CONSUMER COMPLIANCE ENFORCEMENT

The Federal Reserve's consumer-compliance program, initiated on an experimental basis in March 1977, has been revised to include tougher civil-rights enforcement procedures. It has also been placed on a permanent basis. The program covers the 11 consumer-related laws which the Fed has authority to enforce. In its revised compliance program, the Board of Governors emphasized that it will "investigate thoroughly each complaint of discrimination it receives regarding a state member bank, as well as any indication of non-compliance revealed during an examination of a state member bank." The Board also approved civil-rights examination procedures utilizing extensive interviewing, which "reflect the subjective approach necessary" to identify alleged cases of discriminatory lending practices. The Board rejected the idea of using "testers" — individuals who pose as loan applicants to gain first-hand knowledge of disciminatory practices — to establish civil-rights data.

MONEY ORDER SALES

The Board of Governors has approved an amendment to its Regulation Y to allow bank holding companies to sell money orders, travelers checks and U.S. savings bonds to the public at their nonbank offices. The Board fixed a maximum face value of $1,000 on the amount of money orders which could be sold at offices of holding companies and their subsidiaries. The Board declined, however, to grant blanket permission for such firms to offer variable-denomination instruments and financial-management courses. It will consider, on a case-by-case basis, specific proposals by bank holding companies to furnish consumer-oriented financial-management courses. In one such case, Citicorp of New York received Board approval to offer financial-management courses at eight Utah offices of its subsidiary, Citicorp Person-to-Person Financial Centers.



COLDWELL OUTLINES TIGHT FED BUDGET

The Federal Reserve Board of Governors has approved a budget of $753 million for operating expenses of Federal Reserve Banks in 1979, according to Governor Philip Coldwell in testimony before the Senate Banking Committee last month. Coldwell noted that this budget provided for a 4.8-percent increase in operating expenses, compared with a 5.3-percent increase in 1978 and an average 7.5-percent annual growth between 1974 and 1977.

Federal Reserve Banks anticipate operating in 1979 with a staffing level of 23,161 — a 2.1-percent decline from the 1978 level. Over the entire 1974-79 period, Reserve Bank employment has been reduced by 3,482, for an average annual decline of 2.8 percent. Productivity gains, adjusted to reflect the costs of substituting capital for labor, have averaged 9.9 percent annually over this period — a rate several times greater than the productivity increase of the private sector.

In Coldwell's words, "Such increases in productivity reflect the System-wide commitment to operational improvements and the intensified cost competition among the Reserve Banks. While the dramatic improvements of 1974-78 seem likely to slow in coming years, there are still some improvements which we hope to realize in the period ahead."

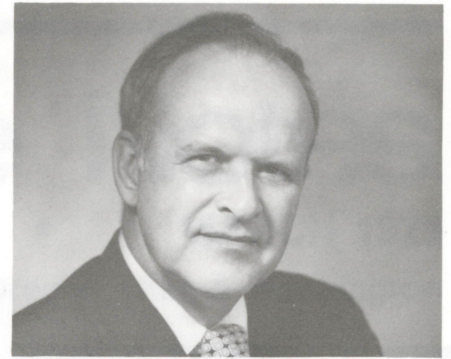
Expenses for services to financial institutions and the public, which account for three-fourths of all expenses, are projected to rise only 4.8 percent in 1979, reflecting improvements in both the payments-mechanism function and the cash function. During 1979, the production of payments services will be affected by the promotion of the automated-clearinghouse program, which involves expanding automated payments as an alternative to paper checks. The Federal Reserve expects to stimulate expanded ACH volume through the planning of new programs and the improvement of operating schedules, worked out in collaboration with the U.S. Treasury and the National Automated Clearinghouse Association.

In the cash function, greater efficiencies are expected as more highspeed currency equipment becomes operational. This equipment counts currency, detects counterfeit notes, sorts mixed denominations, determines the fitness of notes, and destroys notes deemed unfit for circulation, all at the rate of about 50,000 notes per hour. In Coldwell's words, "Utilization of these machines will provide a better quality of currency to return to circulation, provide a greater degree of accuracy, and reduce the level of manual involvement."

Coldwell observed varying patterns of growth in spending for other Reserve Bank functions. He projected a 3.6-percent increase this year in services to the U.S. Treasury and government agencies, a 7.8-percent increase for supervision and regulation activities, and a 6.0-percent increase for monetary-and economic-policy activities.

In the area of services to the Treasury and government agencies, two developmental projects are underway relating to the marketing, safekeeping and servicing of U.S. government securities. One project involves identifying future control safeguards and other operational factors which must be considered in transferring government securities among Reserve Banks by automated means. These findings will be coordinated with those from other areas, such as funds transfers, in the final design specification for the Federal Reserve communications requirements in the 1980's.

The second project in this area involves the joint development and installation of computer programs by the San Francisco, Kansas City and St. Louis Reserve Banks, to automate the transferring of securities and the accounting for collateral. This pilot resource-shar-



P. COLDWELL

ing project is designed to achieve more cost reductions through joint planning, development and implementation of transportable computer software.

The substantial increase budgeted for the supervision-and-regulation function reflects the added responsibilities imposed by Congress on the Federal Reserve in this activity. The workload had expanded significantly in earlier years because of new responsibilities stemming from consumer regulations, bank holding-company supervision and the processing of holding-company applications. In 1979, the workload will be intensified further because of the passage of the International Banking Act, the development and expansion of data surveillance systems, the added applications processing required by the Community Reinvestment Act, and the implementation of various sections of the Financial Institutions Regulatory and Interest Rate Control Act.

In this same area, the Federal Reserve is now reviewing all its regulations to determine the extent to which they are meeting current policy goals. This review also requires the redrafting of all regulations to incorporate changes in policy, format and style.

In the area of monetary and economic policy, Coldwell described several expanded programs for 1979. These encompass the evaluation of new market developments, research on various aspects of monetary control, and research on regional and local economies, along with reviews of many statistical collection and reporting requirements.

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FOREIGN BANKS

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bank holding company should be a source of strength to the U.S. bank. The statement added, however, that "It is the general policy of the Board not to extend U.S. banking supervisory standards extra-territorially to foreign-bank holding companies."

The statement said that foreign organizations that seek to acquire U.S. banks must obtain the Board's prior approval. In each situation, the Board will "seek to assure itself of the foreign bank's ability to be a source of financial strength and support to the U.S. subsidiary bank." Following the establishment of a holding company, Board supervisory procedures will be aimed primarily at promoting the safety and soundness of the subsidiary.

To this end, the Board announced several implementing initiatives. These include increasing examiner surveillance of inter-company transactions and common customer credits, requiring additional financial information at the time of the application, and soliciting the views of foreign regulatory authorities with regard to the foreign banks subject to their jurisdiction.

Other steps would include improving financial information on foreign-bank holding companies, and instituting quarterly reports on transactions between U.S. subsidiary banks and their foreign parents. In addition, the Board proposes to amend its Regulation Y, to ensure that only those foreign companies that are principally engaged in banking abroad would qualify for exemption from the nonbanking prohibition of the Bank Holding Company Act.

CERTIFICATE RATES

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which they are tied — and deposit ceiling rates. In the first month that MMC's were offered, the spread between the T-bill rate and the bank passbook-savings rate was less than 2 percentage points, but by March 1979, it had widened to about 4 1/2 percentage points.

Under the new rules, institutions may advertise an annual effective rate of interest for MMC's based upon reinvestment after six months of both principal and interest, if the ads comply fully with previously issued guidelines. Advertisements also must state that Federal regulations prohibit compounding of interest. Further information may be obtained from the Law Department, Federal Reserve Bank of San Francisco, (415) 544-2254 or 544-2256.

FED STUDY MEASURES CONSUMER AWARENESS

Consumer awareness of interest rates has increased significantly since the enactment of the Truth in Lending Act of 1968, according to the Consumer Credit Survey recently released by the Federal Reserve Board of Governors. The survey was developed primarily by Professor Thomas Durkin of Pennsylvania State University, and the field work was done by the University of Michigan.

Among the survey respondents, 76 percent were familiar with the annual percentage rate noted in instalment contracts. Consumers also were well aware of the size of payment required. On the other hand, most interviewees said that truth-in-lending statements were not read carefully.

Survey data showed a sharp increase in consumer-credit usage over the 1970-77 period. The median instalment debt owed by borrowers, especially in the middle- and upper-income brackets, roughly doubled over that period — rising almost twice as fast as consumer prices. The percentage of survey respondents using bank credit cards more than doubled, to 35 percent of all households, while non-bank credit-card use experienced much smaller growth.