

Federal Reserve Notes

FEDERAL RESERVE BANK OF SAN FRANCISCO • OCTOBER 1979

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FED ANNOUNCES TIGHTENING MOVES

The Federal Reserve announced a major shift in monetary policy on October 6. The System developed three separate actions, designed to promote better central-bank control over the expansion of money and credit, to curb speculative excesses in financial and commodity markets, and thereby to help dampen inflationary forces.

First, the Board of Governors unanimously approved Reserve Bank actions to increase the discount rate — the rate member banks pay when borrowing from their district Federal Reserve Bank. The increase, from 11 percent to 12 percent, increases the cost of banks' borrowed reserves. Secondly, the Board established an 8-percent marginal reserve requirement on increases in four "managed liabilities" — large time deposits (CDs), Eurodollar borrowings, repurchase agreements involving Treasury securities, and Federal-funds borrowings from non-member institutions. Banks have relied increasingly on such sources in recent months, to help finance a rapid expansion in bank credit.

Lastly, the Federal Open Market Committee, comprised of all seven members of the Board of Governors and five of the twelve Federal Reserve Bank Presidents, unanimously approved a change in the method used to implement monetary policy. This change involves placing greater emphasis in day-to-day operations on controlling the supply of bank reserves, and less emphasis

on controlling short-term fluctuations in the Federal-funds rate — the rate commercial banks pay to borrow short-term funds from each other, generally on an overnight basis.

In announcing these actions, the Board stressed that appropriate restraint of growth in the supply of money and credit is an essential part of any program to reduce inflationary expectations. Such restraint will help to avoid new uncertainties about the outlook for prices and help to restore a stable base for financial, foreign-exchange and commodity transactions.

Under the provisions of the Humphrey-Hawkins Act, the Federal Reserve sets yearly targets for the growth of the monetary aggregates (the most widely known being M_1 , which consists of currency plus bank demand deposits) and bank credit (bank loans and investments). The Board noted that the aggregates and bank credit had grown more rapidly in recent months than was consistent with established targets or with the nation's basic economic objectives. The latest Fed actions are designed to contain money and credit growth in the months immediately ahead, and thus provide assurance that the System's basic objectives can be achieved.

The new marginal reserve requirement applies only to increases in the four managed liabilities mentioned earlier if held by member banks, Edge corporations (institutions chartered

(Continued on page 2)



E. A. Thomas

FED NAMES THOMAS TO EXAMINATION POST

The Federal Reserve Bank of San Francisco made a number of changes this month affecting its bank-supervision and bank-relations activities, centering around the appointment of Eugene A. Thomas as Vice President in Charge of the Supervision, Regulation and Credit Department. Thomas replaces Henry B. Jamison, who is retiring next month.

In other senior-level appointments, the Bank promoted Harry W. Green to Vice President in Charge of the Bank Holding Company and International Regulation Section, and Merle E. Borchert to Director of Bank Examinations. Green adds international examinations to his present responsibility for bank holding companies, while Borchert replaces Thomas in the examination post.

(Continued on page 3)

COLDWELL CRITICIZES REMOTE DISBURSEMENT

Federal Reserve Governor Philip Coldwell, speaking in New Orleans last month, reminded bankers that the Federal Reserve is firmly opposed to the practice of remote disbursement and does not intend to bear the cost of "float" associated with it. Coldwell urged his audience to evaluate the opportunities and benefits offered by an electronic-settlement system, and to consider how such a program might fit into bank cash-management schemes.

Remote disbursement involves writing a check on a distant bank in order to lengthen check-collection times. In contrast, a Fed-proposed electronic-settlement program is aimed at speeding and improving the clearing of checks. Electronic settlement is a concept involving the capture of data encoded on checks, with the System's communication network being used to deliver the data and to effect settlement.

Governor Coldwell said that the Fed's interest in electronic settlement had been prompted by the need to modernize check settlement, and also to reduce the risk of float on large dollar items in the event of weather-caused transportation delays or other problems. It is in the best interest of all parties to the collection process, he said, to keep funds flowing in the face of disruptions.

Coldwell emphasized that electronic settlement offers clear opportunities for bankers to reduce their operating costs. Electronic-based rather than paper-based systems may result in lower service charges and reduced depository bank balances. Electronic settlement, he added, creates favorable cash-management opportunities in the form of predictable funds availability.

He warned his banker audience that the Federal Reserve is reviewing its policies for handling checks of high dollar value, not



P. Coldwell

only in regard to the implications for electronic settlement, but also in relation to Federal Reserve efforts to improve other aspects of the payments mechanism. But he noted that many institutions had cooperated fully with the Fed's earlier request to reduce remote disbursement and float. Since the first of the year, float has declined significantly, he said, "although we are not yet where we would like to be and intend to be."

Coldwell warned that the Federal Reserve — and the Congress — intend that "the full economic impact of remote disbursement be carried by the participants in the practice. In that context, consideration of changes in our policies regarding large-dollar-value items would be consistent with our need to discourage remote disbursement while reducing the level of Federal Reserve float." In particular, he suggested that the Federal Reserve may require that large-value checks written on banks outside the immediate city of the receiving bank be settled immediately by wire transfer.

Coldwell also commented on the pricing of Federal Reserve services. He said that "while demand for Fed check processing may change, our involvement in the payments system will not. We will continue to exercise an active regulatory role while providing a public alternative to private check-collection arrangements."

TIGHTENING MOVES

(Continued from page 1)

specially to engage in overseas financial activities), or the U.S. agencies and branches of foreign banks. These institutions are required to hold an additional 8-percent reserve against the increase in the aggregate amount of such liabilities over the amount they held during the two-week base period ended September 26. This marginal reserve requirement is waived for institutions with aggregate liabilities in the four categories of less than \$100 million. The marginal reserve applies to the aggregate level of reserved managed liabilities so that an increase in one component — for example, large CDs — may be offset by a decrease in another without an overall increase in reservable total.

The marginal reserve requirement is directed toward the specific sources of funds that have financed the expansion of bank credit in recent months. Member banks in early October held more than \$240 billion in such managed liabilities. In the previous three months alone, these liabilities had increased by about \$17 billion — financing about half of that period's total increase in bank credit.

Under the new policy of focussing on bank reserves, the Federal Reserve will attempt to hit target growth rates for the quantity of bank reserves. In achieving this objective, the rate at which banks can issue deposits (the main element in the money supply) also will be largely determined. One result of the change in emphasis has been wider initial day-to-day fluctuations in the now market-determined Federal-funds rate. Although these fluctuations are expected to diminish somewhat as the market gains more experience with the new operating procedure, implicit in the shift is the willingness to accept greater interest-rate variability in order to get tighter control over money-supply growth.

EXAMINATION

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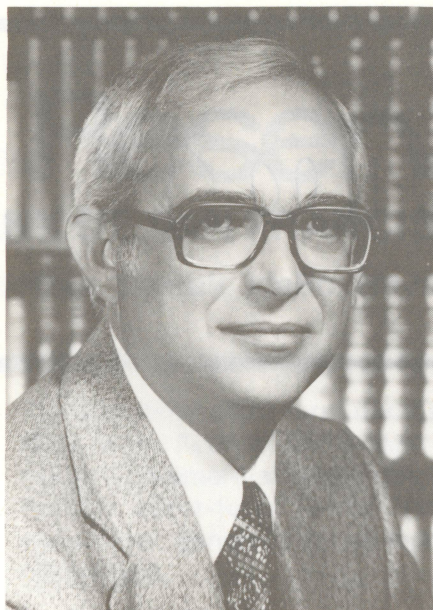
Thomas joined the Bank in 1960 after receiving a B.A. at Pennsylvania State University and an M.A. in Economics at the University of North Carolina. Over the years, he carried out a number of assignments at various Bank offices, and in 1974 became Assistant Vice President and Chief Examiner. In 1975, he was promoted to Director of Bank Examinations, and in 1978 to Vice President in charge of that activity.

Green joined the Bank in 1975 as Director of Bank Holding Company Regulation. He previously served a number of years in the field of bank examination and bank holding-company supervision with the Federal Reserve Bank of Kansas City. He received a B.B.A. degree from the University of Oklahoma, as well as a degree from the Stonier Graduate School of Banking at Rutgers University.

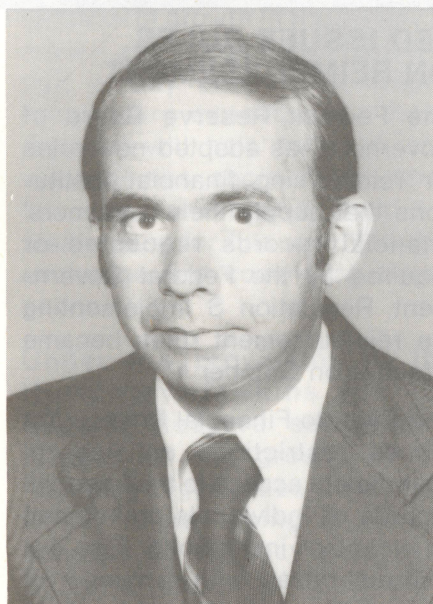
Borchert joined the Bank's examination staff in 1972, and after several promotions, in 1975 became Examining Officer in Charge of the Los Angeles Commercial Examination Unit. He attended Nebraska State College in Kearney, Nebraska. In his new position, he will have District-wide responsibility for the Commercial Examination activity.

Reporting to Green will be Rodney E. Reid, who was promoted this month to Assistant Vice President. Reid will be in charge of three units — International Examinations (San Francisco), International Examinations (Los Angeles) and Bank Holding Company Inspections.

Also reporting to Green will be Robert A. Johnston, who transferred from Assistant Vice President, Bank Relations, to Assistant Vice President, Applications and Analysis. Johnston will supervise the Applications, Analysis and Structure functions in the Bank Holding Company and Interna-



H. W. Green



M. E. Borchert

tional Regulation Section.

In the Bank and Community Relations Department, Marion Otsea has been promoted to Bank and Community Relations Officer and assigned as Department Manager. In this position, she will report to Vice President Robert C. Dietz.

Other changes affect the renamed Credit and Regulatory Compliance Section (formerly Credit and Consumer Affairs Section) of the Supervision, Regulation and Credit Department. Wayne L. Rickards will transfer to this unit as Bank Regulations Officer, and will manage the bank's

MORTGAGE-BACKED SECURITIES EXEMPT

The Federal Reserve Board of Governors, in two decisions this month, voted to exempt certain mortgage-backed securities from reserve requirements and interest-rate ceilings.

In the first case, the Board exempted certain securities backed by a pool of five-year rollover mortgages. (The interest rates on "rollover mortgages" can be adjusted every five years to reflect changes in banks' cost of funds.) Under a proposal by the National Bank of Detroit, the bank is committed to refinance the mortgages at the end of each five-year period, provided the mortgages are not in default.

In its second decision, the Board reversed a 1976 ruling that defined mortgage-backed securities tied to a standby letter of credit as deposits subject to reserve and ceiling regulations. The Bank of America had proposed to substitute its own letter of credit for third-party insurance on existing mortgage pools. The letter of credit would act to guarantee payments of principal and interest on the mortgages in the pool up to 10 percent of their initial principal balance.

In both cases, the Board decided that the proposed securities technically were not deposits.

Consumer Affairs and Special Examinations activities under the supervision of Assistant Vice President W. Gordon Smith. "Special Examinations" include those whose primary objective is to enforce regulatory compliance rather than to assure the safety and soundness of the institution under examination. This area includes consumer-compliance examinations, as well as inspections under Federal Reserve Regulations G and U, which concern credit extended to finance securities transactions.

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FED REVOKES REG Z EXCEPTION

A controversial amendment to Federal Reserve Regulation Z — Truth in Lending — that allowed an exception to the “cooling off” period for consumers who pledge their homes as security in open-end credit arrangements will be revoked as of March 31, 1980. Truth in Lending requires that where a home is used as collateral for a consumer loan, the lender must give notice that the borrower has a three-day “cooling off” period in which to cancel the deal.

In July 1978, the Board of Governors amended Regulation Z to exempt one type of transaction from this notice requirement — namely, individual advances under open-end credit arrangements (such as credit-card transactions) when the creditor and the seller are not the same or related persons. The amendment required that the right-of-recission notice must be given for such an open-end credit transaction only under certain conditions — when the credit plan was first opened, when the credit line was increased, whenever terms of the account were changed, whenever a security interest in a home was added to an existing open-end credit plan, and thereafter once annually.

FED ISSUES RULES ON REIMBURSEMENT

The Federal Reserve Board of Governors has adopted new rules for reimbursing financial institutions that supply their customers' financial records requested or required by the Federal Government. Regulation S implementing the reimbursement rules became effective on October 1.

The Right to Financial Privacy Act places restrictions on Federal government access to the financial records of individuals maintained by financial institutions. The Act also authorizes, with a number of exceptions, reimbursement to institutions for costs associated with providing such records.

Regulation S provides for payment to financial institutions for the reasonably necessary costs directly incurred in assembling or providing customer financial records. Such costs include personnel time (to be reimbursed at the rate of \$10/hour); paper reproduction costs (15¢ per page); and actual transportation costs.

Only financial institutions, including credit-card issuers, are entitled to such reimbursement. But banks receive no reimbursement when they provide records of corporations and partnerships comprised of more than five individuals.

SAN FRANCISCO FED HOSTS ECONOMISTS

Several dozen academic economists discussed a variety of theoretical and policy issues at the Fall Academic Conference hosted this month by the Federal Reserve Bank of San Francisco. The conference, for the third straight year, provided a useful forum for the exchange of views between Federal Reserve economists and leading academics from Western institutions.

Featured on the program was a discussion of recent monetary-policy developments by three leading academics and Reserve Bank President John J. Balles. The academic participants were Milton Friedman, the Nobel laureate; Edward Shaw, Professor (Emeritus) at Stanford University; and Sven Arndt, Professor at the University of California (Santa Cruz).

Six formal papers on monetary topics were presented at the conference, by Arthur B. Laffer and Robert I. Webb (University of Southern California), Charles R. Nelson (University of Washington), John J. Makin (University of Washington), Paul Evans (Stanford University), John Rutledge (Claremont Men's College), and Levis A. Kochin (University of Washington).

400 Sansome St., San Francisco, CA 94120

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Phone (415) 544-2184