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Federal Reserve Notes

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FED RETAINS MONEY TARGETS

Federal Reserve Board Chairman Paul Volcker reported to Congress this month that the Fed would make no change in its money-growth targets for 1982. He told the Senate Banking Committee that the Federal Reserve's objective "is to create an environment conducive to sustained recovery in business activity while maintaining the financial discipline needed to restore reasonable price stability." The 1982 growth target of 2½–5½ percent for the standard M1 measure—currency plus transaction (check-type) deposits—thus would remain unchanged.

The Chairman acknowledged that firm monetary restraint is at least indirectly responsible for strains on the economy, but he said those strains "cannot be easily remedied through accelerated money growth." Volcker said any attempt to drive interest rates lower through speeding up money growth would create more inflation, and would make the current recession "another wasted painful episode instead of a transition to a sustained improvement in the economic environment."

Volcker argued that current pressures on financial markets will be best eased by the adoption of policies to control the Federal deficit. He added that more prudent credit practices on the part of private borrowers and lenders also are necessary to regain financial health.

Volcker said that the Federal Open Market Committee agreed that growth in the money targets around the top of their respective ranges

Paul Volcker

would be acceptable this year. The Committee also agreed that liquidity demand shifts in current economic circumstances might require substantial flexibility and judgment in assessing appropriate needs for money in the months ahead.

In 1983 and beyond, Volcker said, the Open Market Committee "remains committed to restraining money growth in order to achieve sustained noninflationary economic expansion." Thus the monetary ranges now in effect "can appropriately remain as preliminary targets for 1983."

Volcker said an evaluation of economic forces suggests the onset of an economic upturn in the second half of 1982. He said monetary growth along the Fed's current guidelines should accommodate the expansion in real GNP. The ini-

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FED ANNOUNCES PRICING CHANGES

The Federal Reserve Board of Governors has announced planned revisions in priced services offered to depository institutions. The changes were announced on July 29 by E. Gerald Corrigan, president of the Federal Reserve Bank of Minneapolis and chairman of the System's pricing policy committee. The changes will be phased in over a number of months beginning in August.

Among the changes announced are technical revisions in the method for pricing Federal Reserve services and accelerations in the collection of certain classes of checks. Also announced were plans for further reduction of Federal Reserve float and pricing of Automated Clearinghouse (ACH) services. Plans for an electronic check-collection program that had been under discussion will be discontinued.

Next week, the Board of Governors intends to consider a proposal to seek public comment on the issue of noon presentment of city checks. The Board decision in this, and perhaps in other matters, will have an impact on the effective dates of certain services and prices.

In announcing the pricing and service changes, Corrigan emphasized that the Federal Reserve System's continuing objective is to enhance the efficiency of the payments mechanism in a manner consistent with the Fed's overall public responsibilities.

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ALLISON DISCUSSES DELAYED FUNDS AVAILABILITY

Many depository institutions protect themselves against the risk of unpaid checks by delaying the availability of funds. Theodore E. Allison, Staff Director for Federal Reserve Bank Activities, Board of Governors of the Federal Reserve System, discussed this subject in testimony this spring before the Subcommittee on Consumer Affairs of the Senate Banking Committee. Portions of his testimony follow.

Slightly more than one percent of all checks the Federal Reserve collects—about one-half million checks per day—are returned unpaid. We believe that return experience is similar for the checks not collected through the Federal Reserve.

Correspondent institutions and the Federal Reserve grant credit for checks that they collect for depository institutions using an availability schedule which reflects the normal processing and transportation time involved. For example, if a Federal Reserve office is normally able to collect a check in one day, it gives one day availability. Most commonly, the Federal Reserve provides credit within two days. However, reflecting the uncertainty regarding a check's being paid or returned, the credit granted is provisional, and the institution receiving the credit must be prepared to give it up immediately should the check be returned unpaid. Likewise, depository institutions' depositors must also be prepared to make restitution of any funds credited to their account should a deposited check be returned unpaid, even though a delay in availability may have been imposed.

There are several alternatives to the use of checks that can ensure against the problems and risks associated with checks returned unpaid. Many payments—especially those that recur regularly such as salary, dividends, and social security—can be received through automated clearing houses, and others can be handled as wire transfers. Both of these electronic means of payment are secure against loss or theft, and entail immediate and (usually) irrevocable credit to the receiver's account. I will discuss these alternatives in more detail later.

Delayed Funds Availability

Delayed funds availability is one way that institutions may protect themselves from the risks involved in the event a check is returned unpaid by the paying institution to the institution in which it was first deposited. Delayed funds availability is practiced by all types of depository institutions but varies widely among individual institutions. A study done by Federal banking agencies in 1978 found that 38 percent of the commercial banks surveyed had adopted some formal delayed funds availability policy, often specifying widely different procedures and criteria.

Some institutions rarely or never delay availability. Frequently, institutions tailor the delay by considering their own exposure to individual risk—how well known the depositor is to the bank, the amount of the check, the average time required for collection and return of unpaid checks between this institution and the paying institution, and so forth. In other cases, institutions apparently delay funds on all checks or all out-of-town checks.

Whether the delay is imposed selectively or not, delayed funds availability is often characterized as "unfair" to depositors. Institutions, however, defend the practice as a means of protecting themselves from losses associated with returned checks. But there is no mechanism for informing an endorsing institution affirmatively that a check has been paid. One way for an institution to avoid loss in the event a check is returned unpaid is to delay the depositor's use of the funds. The longer the delay the less risk that the check might be returned and loss incurred by the institution. Thus, in view of the check collection system in this country, selective delayed availability policies and practices have a legitimate business basis and may contribute to the safety and soundness of depository institutions.

It is frequently charged that delayed funds availability practices are intended to generate increased revenues for depository institutions at the expense of depositors. It may well be that certain institutions are able to enhance their revenue through the practice of imposing blanket rather than selective delay policies. This would be true since blanket delay programs are relatively easy to implement and affect all or most checks deposited.

However, a selective delayed availability policy may entail considerable expense for the institution, since training employees to identify the need for and length of delay is costly, and selectively imposed delays are handled as exceptions to routine procedures. Moreover, delayed availability policies are just one of a number of terms and conditions—including service levels, check fees, required balances, hours of operation, location of branches, and interest rates—which must be considered as a whole in determining the costs and benefits of the account relationship for the customer. Thus, a less selective policy, such as imposing a delay on all out-of-area checks deposited, which would seemingly be more profitable for the institution, might be used in conjunction with lower fees or lower minimum balance requirements than would otherwise be the case. In effect, a less costly, less selective policy could be part of a product preferred by customers who are more interested in low fees and low minimum balances than a short delay in using their funds.

The Federal Reserve has made an effort to keep informed of delayed availability practices and problems, both because of its role in the monitoring of consumer complaints about banking practices and because of its responsibility for the effectiveness of the payments system. For example, we have a formal procedure for receiving, tabulating, and investigating consumer complaints involving banks. In the last five years the number of complaints involving delays in getting the use of funds has consistently been only about one or two percent of the total number of consumer complaints.

(Allison's comments will be concluded in the next issue of Federal Reserve Notes.)

FED PLANS FOR WIRE CHARGEBACK

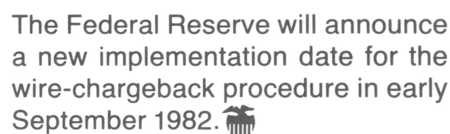
The Federal Reserve System has announced new procedures for processing inter-district return items and cash-letter adjustments of $50,000 and over. Originally the System had planned to implement this "wire chargeback" procedure in all Reserve districts on July 19, but it has now postponed implementation because of requests from financial institutions for additional lead time to prepare for the new procedures.

In the case of both inter-district return items and cash-letter adjustments, the Fed would initiate a wire credit/charge procedure through the Federal Reserve Communications System. This procedure is one of several implemented by the Fed to match credit availability with actual collection experience.

Currently, the Fed accepts inter-district return items for immediate credit even though they often cannot be presented for payment to institutions for one or two days. The Fed will still offer immediate credit on return items to customers, but the wire-chargeback procedure will enable the receiving Reserve office to debit the endorsing institution's account on a same-day basis.

The originating Reserve office will initiate the wire chargeback only after the physical item has been received. The Fed does not intend that this wire chargeback would substitute for the payor bank's initiating a normal advice of non-payment for an item of $2,500 or more.

The wire chargeback or advice of adjustment for inter-district cash-letters deposited would be handled in a similar fashion. A cash-letter adjustment form will be sent on the same day the account balance is debited or credited, and telephone notification of each adjustment will be made the same day a transaction is posted.



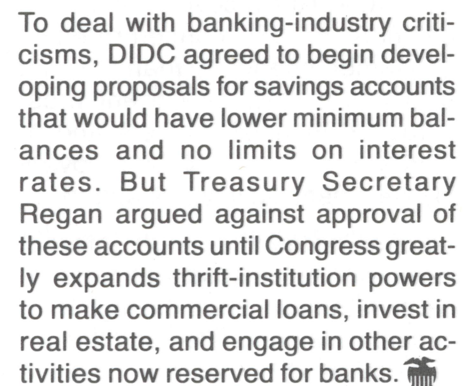
The Federal Reserve will announce a new implementation date for the wire-chargeback procedure in early September 1982.

DIDC APPROVES NEW SAVINGS ACCOUNT

The Federal Depository Institutions Deregulation Committee has approved a new savings account designed to help banks and thrift institutions compete more effectively with money-market mutual funds. The accounts would require a minimum daily balance of $20,000, and would pay interest rates pegged to the Treasury's three-month bill rate.

Thrift institutions could pay the bill rate on this new account, while commercial banks would be limited to paying one-quarter-percentage point less. The term of the account could range from 7 to 31 days.

Institutions can begin offering the new accounts on September 1. Depositors will not be permitted to write checks on the accounts, and they will suffer some loss of interest payments for early withdrawal.



The committee agreed to eliminate the interest-rate ceiling on the new account on May 1983. Also, the ceiling rate would be suspended whenever the three-month bill rate declines to 9 percent or less for four consecutive weekly auctions.

To deal with banking-industry criticisms, DIDC agreed to begin developing proposals for savings accounts that would have lower minimum balances and no limits on interest rates. But Treasury Secretary Regan argued against approval of these accounts until Congress greatly expands thrift-institution powers to make commercial loans, invest in real estate, and engage in other activities now reserved for banks.

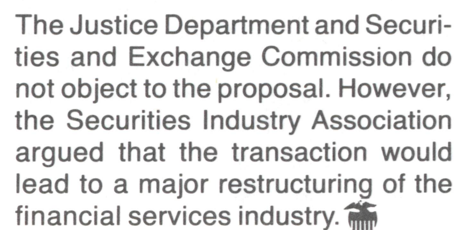
FED SETS HEARING ON B OF A-SCHWAB MERGER

The Federal Reserve Board of Governors has ordered public hearings starting September 13 on an application by BankAmerica Corporation to acquire Charles Schwab Corporation, a discount brokerage firm.

The Board ordered the hearings after receiving a protest from the Securities Industry Association against the acquisition. It said that the hearings before an administrative-law judge would provide the central bank "with a full record of any disputed material fact involved in the proposal."

BankAmerica Corporation announced its intention to acquire the country's second-largest discount brokerage firm in November 1981. The acquisition would provide BankAmerica with a broader range of consumer-financial services. BankAmerica contends that the operation of a discount brokerage operation does not contravene the Glass-Steagall Act—the law separating securities and brokerage functions from banking—because discount brokers only execute orders rather than serve as dealers.

The merger would be contingent on Federal Reserve approval. Ownership of brokerage firms is not on the list of approved activities for bank-holding companies.



The Justice Department and Securities and Exchange Commission do not object to the proposal. However, the Securities Industry Association argued that the transaction would lead to a major restructuring of the financial services industry.

FED ANNOUNCES PRICING CHANGES

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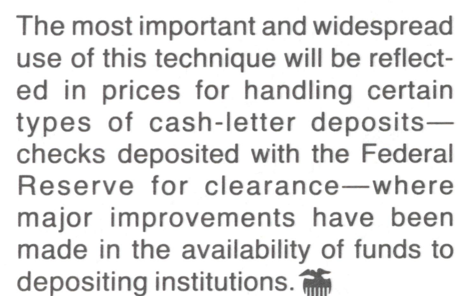
The System's initial pricing strategy, which was based on detailed cost estimates, involved calculating individual product costs and then adding a private-sector adjustment factor. The revised pricing technique recognizes that the value of some services might be different from their costs, and takes into account prevailing market practices.



The most important and widespread use of this technique will be reflected in prices for handling certain types of cash-letter deposits—checks deposited with the Federal Reserve for clearance—where major improvements have been made in the availability of funds to depositing institutions.

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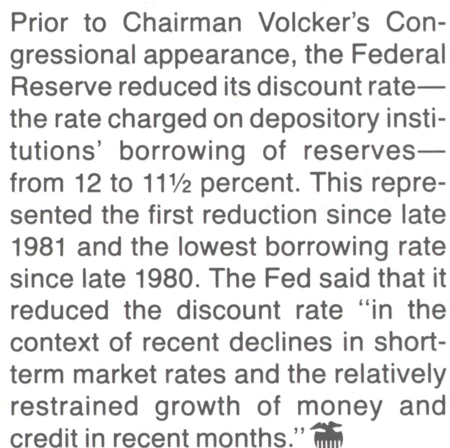
tial phase of the recovery "is likely to be more heavily concentrated in consumer spending than in past business cycles, as current pressures in financial markets and liquidity strains may inhibit recovery in investment activity," he added.

Volcker noted that high interest rates will likely discourage residential construction, while the high level of corporate bond rates and the deterioration in corporate balance sheets from years of short-term borrowing may restrain capital spending. He added that the improved price performance this year has helped reduce the inflation rate. However, he said that recorded inflation rates may be higher in the second half, although prospects appear excellent "for continuing the downtrend in the underlying rate of inflation."

Prior to Chairman Volcker's Congressional appearance, the Federal Reserve reduced its discount rate—the rate charged on depository institutions' borrowing of reserves—from 12 to 11½ percent. This represented the first reduction since late 1981 and the lowest borrowing rate since late 1980. The Fed said that it reduced the discount rate "in the context of recent declines in short-term market rates and the relatively restrained growth of money and credit in recent months."

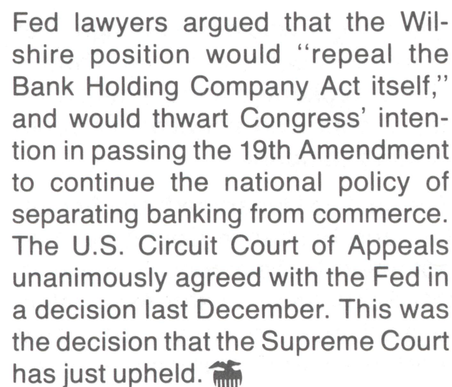


SUPREME COURT BACKS FED RULING

The U.S. Supreme Court has backed rulings by the Federal Reserve and a lower Federal court that Wilshire Oil Company of Texas has violated the Bank Holding Company Act by continuing to own the Trust Company of New Jersey. In declining to review the Wilshire case, the Supreme Court strengthened the central bank's hand in dealing with non-banking companies which want to own and operate a bank under an expanded reading of the legal definition of a bank.

The Bank Holding Company Act says that a bank is a bank if it takes demand deposits and makes commercial loans. Wilshire argued, however, that Trust Company was no longer a bank because it reserved the right to a 14-day delay on checking withdrawals, and thus no longer took demand deposits.

Fed lawyers argued that the Wilshire position would "repeal the Bank Holding Company Act itself," and would thwart Congress' intention in passing the 19th Amendment to continue the national policy of separating banking from commerce. The U.S. Circuit Court of Appeals unanimously agreed with the Fed in a decision last December. This was the decision that the Supreme Court has just upheld.



CITICORP GAINS DATA PROCESSING APPROVAL

The Federal Reserve Board of Governors has cleared the application of Citicorp of New York to engage in a wide variety of data-processing and transmission activities through a subsidiary to be called Citishare Corporation. The application had been opposed by the Association of Data Processing Service Organizations and several companies that engage in data-processing services.

The Fed ruling clears the way for Citishare to offer a wide range of electronic services—including electronic funds transfer, home banking, and the processing and transmitting of banking, financial and economic data. Citishare also intends to provide packaged financial systems to depository institutions, and to sell excess capacity on data processing and transmission equipment.

The Fed's ruling follows the recommendations of an administrative-law judge who had been appointed by the Board last year to hold hearings. The judge concluded last March that Citicorp's data activities were closely related to banking, and thus should be permissible for a bank-holding company.