Federal Reserve Notes

FEDERAL RESERVE BANK OF SAN FRANCISCO • September 1983

Serving Alaska, Arizona, California, Hawaii, Idaho, Nevada, Oregon, Utah & Washington

ACH SERVICE EXPANDED

To provide originators of ACH payments with additional processing time as well as better funds availability for their deposits, the Federal Reserve has modified its automated clearinghouse service. It will permit all types of automated clearinghouse transactions to be deposited at the nighttime deposit deadline. In conjunction, the Board of Governors approved an interim fee schedule for nighttime ACH deposits, which became effective with the implementation of the new service on October 6, 1983.

Since 1979, the use of the nighttime deposit deadline has been restricted to cash concentration debits. Cash concentration debits are used by businesses to draw down balances held at a number of depository institutions in order to accumulate funds for investments or other purposes at primary institutions.

The interim fee schedule for the ACH nighttime deposit deadline follows.

Per Item Surcharge to Originators

Debits	5 cents
Next-day Settlement Credits	2 cents
Two-day Settlement Credits	0 cents

Copies of the Board's notice are available from the Corporate Services Department at (415) 974-2752. For further information, please contact the Payments Officer of the Federal Reserve Office serving your institution: Robert B. O'Donoghue, San Francisco at (415) 974-2135; Ross Ashman, Los Angeles at (213) 683-8351; H. William Pennington, Portland (503) 221-5903; Robert R. Richards, Salt Lake City at (801) 322-7887; and Kenneth L. Peterson, Seattle at (206) 442-5105.

TIME DEPOSITS DEREGULATED

Only passbook savings, NOW accounts of less than $2500, and 7-31 day time deposits of less than $2500 now have "Regulation Q" interest ceilings. The Depository Institutions Deregulation Committee (DIDC) voted at its June 30 meeting to eliminate all other rate ceilings effective October 1. (Money market deposit accounts will continue to have a minimum denomination of $2500.)

All time deposits will still be subject to federally mandated early withdrawal penalties, but these penalties will generally be less than before. For time deposits with maturities of *more than one year*, the minimum penalty is loss of three months' simple interest on the amount withdrawn; for time deposits with maturities of *32 days to one year*, the minimum penalty is loss of one month's simple interest on the amount withdrawn; for time deposits of *7 to 31 days*, it is the *greater* of (a) all interest earned on the amount withdrawn during the latest deposit period, or (b) all interest that could have been earned on the amount withdrawn during a period equal to half of the maturity period.

Depository institutions may impose more stringent early withdrawal penalties, but any penalty policy should be clearly disclosed.

Regulatory provisions designed to enforce early withdrawal penalty rules, such as provisions on grace periods and on loans secured by time deposits, will remain in effect. Also, because a minimum of $2500 will be required for any 7-31 day time deposit to be ceiling-free, many restrictions on these accounts will remain in effect. These restrictions include provisions on loans, additional deposits, automatic transfers to other accounts, withdrawals, premiums, finders' fees, prepayment of interest, and payment of interest in merchandise.

The new rules apply only to deposits entered into, extended, or renewed on or after October 1, 1983.

In a separate action, the DIDC agreed to have its chairman forward to Congress a letter recommending the speedy removal of the statutory prohibition against the payment of interest on demand deposits.

For further information, please contact Bob Mulford or Bill Cooper in our Law Department at (415) 974-2256 or 974-2254.

REGULATIONS AND OPERATIONS UPDATE

Regulation D—Reserve Requirements: The Federal Reserve Board has recently published an updated Regulation D pamphlet as amended effective June 20, 1983. Copies of the pamphlet may be obtained by writing to our Supply Department: Federal Reserve Bank of San Francisco, P.O. Box 7702, San Francisco, CA 94120.

Regulations G, T and U—Securities Credit Regulations: The Federal Reserve Board adopted complete revisions of Regulation G, governing extensions of credit on securities by persons other than banks, or brokers and dealers, and Regulation U, which governs extensions of credit on securities by banks. The revisions were made as part of the Board's regulatory improvement project and became effective August 31, 1983.

Earlier this year, the Board similarly modernized Regulation T which covers extensions of credit on securities by brokers and dealers. That revision is effective November 21, 1983, or any earlier date after June 20, 1983 at the option of the creditor. The Board has since amended Sections 220.2(s), 220.17(a)(3), and 220.17(a)(9) to include language inadvertently omitted or that was the result of typographical errors.

Copies of the revised regulations are available from the Corporate Services Department at (415) 974-2752. For further information, please contact David Vandre in Consumer Affairs at (415) 974-2965.

Reference Guide for Regulation T: To aid understanding of the Federal Reserve Board's newly revised Regulation T, the Board has published a cross-reference of section numbers of the new and old regulations. The charts should help persons trace the regulatory treatment of specific issues addressed by the regulation.

Copies of the charts are available from the Corporate Services Department at (415) 974-2752.

Regulations L and O—Management Official Interlocks and Loans to Executive Officers: After considering public comment on its proposals, the Federal Reserve Board has adopted amendments to its Regulations L and O.

Regulation L prohibits certain interlocking relationships among officials of financial institutions, including depository holding companies and their affiliates. The five Federal financial institutions regulators are preparing a joint Federal Register notice of revisions in their regulations implementing the Depository Institutions Interlock Act, to be published shortly.

The changes in Regulation O were prompted by the Garn-St Germain Act of 1982 which amended Section 22 of the Federal Reserve Act. Previously, the Federal Reserve Act and the Board's Regulation O limited loans by a state member bank to executive officers to specific dollar amounts for a home mortgage, education of an executive officer's children and for all other purposes. The new legislation, supported by the Federal Reserve, eliminated these specific dollar limitations. The amendments to Regulation O became effective October 11, 1983.

Copies of the Federal Register notice for Regulation O are available from the Corporate Services Department at (415) 974-2752. For further information on either regulation, please contact Wayne Rickards in Supervision, Regulation and Credit at (415) 974-2242.

Regulation Y—Bank Holding Companies: The Federal Reserve Board has amended its Regulation Y to add securities brokerage and related margin lending to the list of activities generally permissible for bank holding companies. Bank holding companies may now engage in these activities by following the regular notification or application procedures described in Regulation Y.

The action codifies a previous position taken by the Board in approving the acquisition by BankAmerica Corporation of Charles Schwab Corporation, a retail discount securities broker. In its final ruling, as in its approval of the BankAmerica/Schwab application, the Board specified that the brokerage activities are to be restricted to buying and selling securities solely as agent for the account of customers (and shall not include securities underwriting or the provision of investment advice), and that margin lending in securities is to be conducted by a nonbank subsidiary of the bank holding company, according to the Board's Regulation T (Securities Credit by Brokers and Dealers).

The Board's notice is available from the Corporate Services Department at (415) 974-2752. For further information, please contact Robert Johnston in Supervision, Regulation and Credit at (415) 974-2352.

Cash Transportation Prices Revised: Because armored carrier agreements for Los Angeles, Salt Lake City and Seattle territories provide for a price increase in the second year, cash transportation fees have been revised and the new fees will become effective October 27, 1983.

Specific fees for each zone in the three territories are available from Charles L. Huffstetler in Los Angeles at (213) 683-8466, Don Sheets in Salt Lake City at (801) 322-7828 and E. Ronald Liggett in Seattle at (206) 442-4492.

TIMELY VENDOR PAYMENTS BY EFT

The U.S. Treasury's Bureau of Government Financial Operations (BGFO) now requires most Federal agencies to make vendor payments of $25,000 or greater through Treasury's link to Fedwire—the Treasury Financial Communications System (TFCS). The new requirement took effect October 1, 1983. BGFO, responsible for disbursing most Federal payments and managing Federal monies, estimates civilian agencies alone account for the disbursement of over $20 billion of such large dollar vendor payments annually. The move to electronic funds transfer is expected to improve both the timing and control of Federal vendor payments.

Companies will realize several benefits from the government's use of the TFCS to make vendor payments. First, since the TFCS has the capability to make payment on the exact due date, vendors will receive payments in a more timely manner. Second, payments can be made directly to the vendor's account at a financial institution, eliminating the uncertainty and time associated with postal delivery and check processing. Third, since vendors will be confident that payments will be made in a more timely manner, they will be in a better position to forecast cash flows. Other information such as invoice and contract number needed to identify payments will still be furnished in the actual payment message provided to the vendor's financial institution.

For additional information about the Treasury program, contact the Timely Bill Payment Project Team, Treasury Department, Bureau of Government Financial Operations, Treasury Annex #1, PB 704, Washington, D.C. 20226. The telephone number is (202) 634-5770.

OVERSEAS ASSETS OF MEMBER BANKS DROP

An abrupt change in the pattern of growth in the assets of foreign branches of member banks was reported by the Federal Reserve at the end of August. The combined assets of the overseas branches of member banks decreased during 1983 by $2.5 billion (0.6 percent) to a total of $388.5 billion. In addition, combined assets, excluding claims on other foreign branches of the same bank, also dropped by 0.6 percent from the comparable prior year-end level of $341.3 billion on December 31, 1982.

Before 1982, the assets of foreign branches had grown at an annual rate exceeding 20 percent in the 1970s and by about 10 percent in 1980 and 1981. The Fed said that the recent decline reflects three developments: 1) a general decline in international trade and finance during 1982; 2) the higher exchange rate value of the U.S. dollar, which lowered the dollar value of foreign branch assets denominated in foreign currencies; and 3) the emergence of domestic international banking facilities (IBFs) authorized by the Board beginning in December 1981, that may have served as substitutes for foreign branches for many purposes.

Reports on condition filed at the end of the year with the Comptroller of the Currency and the Federal Reserve System yielded the information on foreign branch assets. The reports also showed that, at year-end 1982, 162 member banks operated 900 branches in foreign countries and overseas territories. This meant a net increase of 59 branches during the year. The reports of condition reflect all assets and liabilities of overseas branches of member banks.

FOR PUBLIC COMMENT

ACH Fee Schedule: The Federal Reserve is proposing a revised and restructured fee schedule for automated clearinghouse services and is requesting public comment by November 7, 1983 (Docket R-0482). The Board also is requesting comment on a number of proposed enhancements for Federal Reserve ACH services and on the reduction and pricing of float generated in connection with ACH transactions.

The Federal Reserve expects to implement the proposed fee schedule in December 1983. The revised fees would recover 60 percent of the actual cost of providing ACH services, including a private sector adjustment factor. The current fee schedule is aimed at recovering 40 percent of ACH costs.

For further information, and the complete Federal Reserve notice, please contact Robert O'Donoghue, AVP, Electronic Payments, at (415) 974-2135.

Regulation J—Collection of Checks and other Items: The Federal Reserve Board is proposing to amend Regulation J to permit Reserve Banks to charge for checks that would be presented for collection to a bank or other depository institution that is closed on a weekday during which the Reserve Bank is open. The Board requested comment by October 14, 1983 (Docket R-0481).

The proposed amendment would affect institutions that (1) choose to close on a weekday as permitted by state law, or that (2) are closed on a "nonstandard" holiday (a state or local holiday) during which the Reserve Bank is open for business. Such closing may result in Federal Reserve float, which the Fed proposes to eliminate by charging accounts of the closed institutions for the checks that would have been presented had the institution been open, or, at the option of the closed institution, charge for the value of the float associated with such checks.

Copies of the Board's notice are available from the Corporate Services Department at (415) 974-2752. For further information, please contact Bob Mulford in our Law Department at (415) 974-2256.

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DID BANK CAPITAL RISK RISE IN THE 1970s?

The accelerating inflation and volatile interest rates, growing federal deficits, and widespread deregulation that marked the past decade have dramatically altered the financial and economic environment in which banks must operate. Yet Jack H. Beebe, Vice President of Banking Studies at the S.F. Fed, finds that market perceptions of the riskiness of bank capital—both debt and equity—did not change significantly for large banks.

In an article entitled "Bank Capital Risk in the Post-1979 Monetary and Regulatory Environment" in the Bank's Summer 1983 *Economic Review*, Beebe cites as potential factors affecting bank capital risk, rapidly rising inflation and interest rates, the change in October 1979 in the Federal Reserve's short-term operating procedure for influencing money, the imminent legislation to deregulate banks, credit controls imposed in the period from March–July of 1980, and the prospect of chronic federal deficits.

To study the effects of these forces, Beebe compared actual market measures of bank capital risk—both for bank debt and bank equity—for the two periods before and after October 1979.

With regard to debt risk, Beebe found that the risk premia for Moody's Baa corporate bonds and for an equally weighted index of fifteen bank debt issues, both relative to Aaa corporate issues, were about the same throughout the 1974–79 period. After 1979, the risk premium on bank bonds declined relative to that on corporate Baa's. On the basis of this and other evidence, Beebe concludes that "bank debt issues have not been viewed as becoming more risky in the post-1979 period."

Using the standard deviation of equity returns over each of the periods as a measure of equity risk, Beebe found that equity risk declined between the two periods and that the decline was greatest for the largest banks, even in comparison to the Standard and Poor 500.

Finally, Beebe calculated the sensitivity of bank stocks to the market price of risky assets (as measured by the S&P 500) in the two periods to see whether banks' ability to manage risk deteriorated after 1979. His results indicate that the sensitivity of bank equity returns to non-diversifiable, or market-related risk, declined in the post-1979 period compared to the earlier period especially for banks in the $10 billion-plus group. Beebe concludes that large banks at least were able through active portfolio management to cope successfully with the potentially riskier post-1979 environment.

S.F. FED'S CASH ITEMS COLLECTION SERVICES

A revised version of Circular 1 outlining the services offered by the Federal Reserve Bank of San Francisco to depository institutions within the Twelfth Federal Reserve District is available from the Check Officer at each local Reserve Office. The revised circular became effective August 1, 1983 and supersedes the previous Circular 1 dated July 1, 1982.

Together with subpart A of Regulation J and the S.F. Fed's time schedules, the new circular applies to the handling of all checks and other cash items accepted by the S.F. Fed for collection, and all bank drafts and other forms of payment the S.F. Fed receives for such items. The circular also contains instructions to paying and collecting banks for handling and paying checks and other cash items contained in cash letters received from this Bank. It is binding on the sender, on each collecting bank, paying bank and nonbank payor to which the S.F. Fed or a subsequent collecting bank presents or sends a cash item, and on other parties interested in the item, including the owner.

The only substantive changes in the revised Circular 1 are in the new Credit Availability Schedules for each of the San Francisco Reserve Bank's branches.