Research Department
Federal Reserve
Bank of
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FRBSF Weekly Letter

Membership II—The Proposals

Over the past decade, the Federal Reserve System has experienced an accelerating withdrawal of member banks and a consequent decline in the amount of banking-system deposits under its direct control. To correct this situation, the Board of Governors this month released a proposal to reduce the burden on Federal Reserve member banks and simultaneously move toward competitive equality among financial institutions generally. Last week we discussed the background to this problem, and in this article we summarize the Fed's specific proposals. These proposals encompass four separate areas—universal reserve requirements, pricing of Federal Reserve services, access to Fed services, and interest on member-bank reserves.

Universal reserve requirements
Under the proposed "Reserve Requirements Act of 1978," the Board of Governors would have the authority to impose uniform reserve requirements on transactions accounts at all depository institutions, whether or not they are members of the Federal Reserve System. "Transactions accounts" include commercial-bank demand deposits, thrift-institution NOW accounts (negotiables orders of withdrawal), credit-union share drafts, and all other deposit accounts on which "negotiable or transferable" instruments may be drawn for the purpose of making payments. The authority thus would cover all Federally insured depository institutions—commercial banks, mutual-savings banks, savings-and-loan associations, and credit unions—insofar as they offer such transactions accounts.

Under the Act, the statutory range for reserve requirements would remain at the present 7 to 22 percent for demand deposits. The range for all other transactions accounts, such as NOW's and share-drafts, would be established at 3 to 12 percent. Also, the bottom end of the range for member-bank time and savings accounts (other than transactions accounts) would be reduced from the present 3 percent to ½ percent, while the top end would remain at 10 percent. Initially, the first $5 million of transactions balances would not be subject to reserve requirements, although the Board would have the authority to impose reserve requirements on them in the range of 0 to 7 percent. Reserves would have to be held in the form of either vault cash or balances at a Federal Reserve Bank.

Additionally, the Board proposes to simplify and lower the reserve requirements applied to demand deposits of less than $600 million by amendment to its Regulation D. Currently, reserve requirements are graduated according to bank deposit size, ranging in five steps from 7 percent to 16¼ percent.

At the end of a two-phase transition period, the reserve requirement would be 7 percent against the first $200 million in demand deposits and 10

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percent against demand deposits in the $200-600 million range. Above $600 million, the current requirement of 16¼ percent would remain in effect. Today, in contrast, the 7-percent requirement applies only to the first $2 million in deposits, whereas a bank with demand deposits of as little as $100 million faces a marginal requirement of 12¾ percent.

Pricing of services

In another major move, the Federal Reserve proposes to "unbundle" its services and to begin pricing them individually, as a means of promoting economic efficiency and competitive equity. The pricing system would be established in accordance with three general principles:

1) Separate prices would be established for each service category and class of work processed on a per item basis;

2) Separate prices would be established for different geographic areas (typically the area served by a Federal Reserve Bank, Branch or other service facility), but all users in the same pricing zone would pay the same price for a given service; and

3) The Fed would maintain some basic level of service nationwide, and it would adjust its operating policies and prices to maintain competitiveness and to assure that basic level of service.

However, the Fed does not contemplate imposing charges for the governmental functions it performs, such as bank examinations, monetary policy and the issuance and destruction of Federal Reserve Notes.

In the first phase of the implementation period, the Fed would impose charges for payments services, such as check processing, check transportation, and automated clearinghouse (ACH) services. In the second phase, it would impose charges for all other priced services, such as shipping coin and currency to member banks, transferring and settling reserve balances, and handling the purchase, sale, safekeeping and clearing of securities.

Several guidelines would govern the pricing of payments services. First, charges for check services would be imposed on depositing institutions. Charges for interoffice items deposited locally could include both a local processing charge and a uniform national charge. For automated clearinghouse items, charges could be imposed either on the ACH association or on the individual institution using the service. These ACH charges would be set at levels that would encourage use — that is, ACH services could continue to be subsidized until "mature volumes" are reached.

Access to services
As part of its overall plan, the Federal Reserve proposes to offer more depository institutions access to its services. Initially, all nonmember depository institutions with third-party payments powers would be given access to Fed payments services on the same terms now available to nonmember banks. They could deposit intra-regional checks and drafts at Fed regional check-processing centers (RCPC's), but they would be required to settle through the reserve account of a member bank. When prices are imposed, they would pay the same charge as a member bank.

Once the program is fully established, the Fed expects to provide nonmember institutions full access to payments and other operational services, under several conditions. Nonmembers would be required to maintain clearing balances equivalent to member-bank reserve balances, and they would receive compensation on those balances equivalent to that paid on member-bank required reserves.

Interest on reserves
Payment of interest on required-reserve balances would be an important part of the Fed's total package. The proposed "Interest on Reserves Act of 1978" would recognize the Fed's need to pay interest on member-bank reserve balances "within appropriate limits." The legislation would limit aggregate interest on reserve payments to no more than 7 percent of the System's net earnings, excluding revenues from the new pricing system as well as the expense of paying interest on reserves.

The Fed proposes to implement the payment of interest in two phases concurrent with the pricing of services. Initially, interest would be paid on all required-reserve balances at the rate of 2 percent. In the second phase, interest payments would be increased on the first $25 million of reserves only, to a rate equal to ½ percentage point below the return on the Federal Reserve's securities portfolio. In 1977, this formula would have yielded roughly a 6-percent return.

The Federal Reserve plan to reduce the membership burden would affect U.S. Treasury revenues, because the Fed pays over to the Treasury most of the net earnings which it receives from securities holdings and loans to member banks. During the first three years of the proposed new program, there could be a cumulative net reduction in Treasury revenues on the order of $575 million. To maintain Treasury revenues during this transition period, the Fed proposes to transfer an equivalent amount from its surplus to the Treasury.

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BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 7/12/78	Change from 7/5/78	Change from year ago Dollars	Change from year ago Percent
Loans (gross, adjusted) and investments*	113,634	− 932	+ 14,767	+ 14.94
Loans (gross, adjusted) — total	91,689	− 941	+ 15,847	+ 20.89
Security loans	1,821	− 1,222	− 269	− 12.87
Commercial and industrial	27,823	− 36	+ 4,097	+ 17.27
Real estate	31,036	+ 143	+ 6,374	+ 25.85
Consumer instalment	16,412	+ 33	+ 3,640	+ 28.50
U.S. Treasury securities	8,081	− 68	− 765	− 8.65
Other securities	13,864	+ 77	− 315	− 2.22
Deposits (less cash items) — total*	111,499	− 1,290	+ 13,431	+ 13.70
Demand deposits (adjusted)	31,308	− 302	+ 2,614	+ 9.11
U.S. Government deposits	415	− 49	+ 72	+ 20.99
Time deposits — total*	77,951	− 332	+ 10,776	+ 16.04
States and political subdivisions	6,535	− 30	+ 872	+ 15.40
Savings deposits	31,633	− 145	− 286	− 0.90
Other time deposits‡	36,849	+ 138	+ 9,369	+ 34.09
Large negotiable CD's	17,767	− 542	+ 7,466	+ 72.48

Weekly Averages of Daily Figures	Week ended 7/12/78	Week ended 7/5/78	Comparable year-ago period
Member Bank Reserve Position			
Excess Reserves(+)/Deficiency (−)	− 44	+ 78	+ 23
Borrowings	34	44	3
Net free(+)/Net borrowed (−)	− 78	34	+ 20
Federal Funds—Seven Large Banks			
Interbank Federal fund transactions			
Net purchases (+)/Net sales(−)	+ 205	− 1608	+ 897
Transactions with U.S. security dealers			
Net loans (+)/Net borrowings (−)	+ 43	+ 324	+ 345

*Includes items not shown separately. ‡Individuals, partnerships and corporations.

Editorial comments may be addressed to the editor (William Burke) or to the author. . . .
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