Research Department
Federal Reserve
Bank of
San Francisco

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FRBSF Weekly Letter

ATS—Promises and Problems

Consumers next week will have a new tool available for more efficient cash management. Under amendment to the Federal Reserve's Regulation Q, banks will then be able to institute preauthorized transfers of funds from consumers' savings accounts to their demand-deposit accounts. Since it is stated in broad terms, the amendment gives member banks wide latitude in designing automatic-transfer (ATS) services. Therefore, banks' pricing and marketing strategies will be determined by competitive factors and income considerations rather than by administrative dictums. Even so, as consumers respond by reducing their checking balances, the new ATS system could adversely affect bank income—at least during the transition period.

Implementation of this banking innovation also could pose problems for the monetary authority. The demand-deposit component of M_1 (currency plus demand deposits) will grow more slowly under this new regulation. Hence, the Federal Reserve may find it more difficult to target the M_1 money-supply measure in relation to desired GNP growth.

The regulation

In March 1976, the Fed's Board of Governors first issued a proposal of this type, designed to permit the automatic transfer of funds from an individual's savings account to his or her checking account to cover checks drawn or to ensure a minimum checking-account balance. After several revisions of the original proposal, the Fed announced this May that it would permit such a plan to go into effect on November 1. The Board said that automatic transfers "would provide significant benefits to the public in the form of an additional convenient savings-deposit withdrawal service," and that they "should also increase the efficiency of the Federal Reserve's check-clearing operations by reducing the number of return items processed by the System."

The amendment applies only to individual customers of Fed member banks—not to businesses, partnerships, or governmental units. (The FDIC also has adopted an ATS regulation for non-member banks.) The authorization requires banks and customers to make written arrangements in advance—provided they both want to participate in such a service. Banks offering an automatic-transfer plan must notify depositors that they reserve the right to require not less than 30 days' notice of withdrawal from savings accounts, although there is no interest-forfeiture provision (as originally proposed). The Board has told banks to indicate clearly that the service involves two separate accounts (checking and savings), and it has encouraged them to develop automatic-transfer charges to reflect the cost of providing such a service to depositors.

Implementation

Most banks may eventually offer automatic-transfer services, but only a few have announced detailed plans to date. These plans differ widely, depending on both size and geographic location of banks. Variations also reflect an individual bank's aggressiveness in the consumer-banking market,

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as well as the degree of competition among financial institutions in different market areas.

Most automatic-transfer plans announced to date are tied to savings accounts at the ceiling interest rate of 5 percent. Many plans are based on a concept of zero-balance checking—that is, no minimum balance in the checking account. The bank transfers funds from the consumer's savings account to the checking account to cover checks when they are presented for collection.

Pricing schedules generally consist of a monthly maintenance fee (ranging from $2 to $5 per month) plus transaction charges (ranging from 10 to 25 cents or more per transaction). Some banks apply a sliding price scale based on the minimum amount held in the depositor's savings balance. All but a few banks are offering free ATS service to those maintaining a specified minimum savings balance. The required level ranges from $300 to $5,000, with many large Western banks at $2,000 but with some Eastern banks at the upper end of the range.

A number of banks are offering a preauthorized overdraft plan as well as a zero-balance checking account plan. (A few banks are offering only an overdraft plan.) Under the overdraft plan, a charge of 50 cents to $1 is assessed each time a transfer is made from an individual's savings account to cover a checking-account overdraft.

Income effect

In their pricing policy, banks are trying to recover the full cost of ATS services, which are estimated at about $60 per year on the average checking account. Even so, the impact of ATS might reduce 1979 net income by 5 to 10 cents a share, partly because consumers will be shifting funds from demand balances to savings, and thereby increasing the percentage of interest-bearing deposits to total deposits. However, some of that expected adverse impact would reflect non-recurring start-up costs of transfer services—such as computer reprogramming, staff training and marketing.

At the same time, many banks are taking advantage of the opportunity presented by their detailed ATS-cost analyses to review all of their existing schedules of charges and fees on regular checking accounts. In this way, they are developing fee schedules which reflect costs more accurately. For example, some banks that had been offering free checking have reinstituted charges on accounts below a specified minimum balance.

Cash-management impact

With inflation worsening, consumers have found it increasingly necessary to improve their daily cash-management practices. Many of the bank services which aid corporate or government treasurers in reducing non-earning balances have not been available to the individual bank depositor. But now, the services offered under ATS plans provide consumers with a major breakthrough in this area.

Unfortunately, ATS zero-balance plans provide a useful cash-management tool only for individuals who maintain large balances — specifically, those whose 5-percent interest income (less income-tax effect) offsets ATS fees and charges. Under the pricing system adopted for many plans, this break-even point would require a minimum balance of around $1,200. (As noted above, bank costs approximate $60 per account, which is the equivalent of 5-percent interest on $1,200.) Of course, ATS is even more advantageous for consumers who can maintain the minimum savings balance required for free services — $2,000 at many large Western banks. But the overdraft provisions under the amended Reg Q could help other depositors who have lower demand balances.

From a cash-management standpoint, the important aspect is not the automatic transfer of funds from savings to checking, but rather the reverse movement — immediate transfer of funds deposited in the checking account to the savings account. Funds which the depositor formerly held in a checking account, both to cover checks and to provide a "cushion" for unexpected cash demands, will now be automatically transferred to a 5-percent interest-bearing savings account.

For large depositors, this new facility for reducing the amount of non-earning idle balances to zero represents a forward step in cash management. For other depositors who cannot meet the minimum-balance requirement for free services, ATS still may provide an advantage, depending on how ATS fees and charges measure up against charges on a regular checking account. Individual consumers will need a sharp pencil (or calculator) to assess the cash-management possibilities of ATS for their specific circumstances.

Policy problems

As individuals shift funds from checking accounts to savings accounts under automatic-transfer plans, the demand-deposit component of the M_1 money supply will grow more slowly than it otherwise would have done. This will create uncertainties for the Federal Open Market Committee in estimating and interpreting M_1 growth, and in setting targets for this monetary aggregate that are consistent with desired GNP growth. However, this is not a new type of problem for the Federal Reserve, since many recent financial innovations have affected money-supply behavior and made money-demand functions difficult to estimate.

In an attempt to monitor this latest innovation, the Board of Governors has asked member banks to maintain data on those funds transferred via the automatic-transfer service. Specifically included were the total amount of savings deposits subject to automatic transfer, the total amount of savings funds actually transferred, the number of such automatic transfers, and the interest forfeiture or other charges imposed by the banks. But even with this assistance, conducting monetary policy could be difficult in the transition period, just as it was during those earlier periods when corporations and governmental units accomplished their own significant improvements in cash-management practices.

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BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 10/11/78	Change from 10/4/78	Change from year ago Dollar	Percent
Loans (gross, adjusted) and investments*	119,038	+ 76	+ 17,279	+ 16.98
Loans (gross, adjusted) — total	96,065	+ 189	+ 16,710	+ 21.06
Security loans	1,951	− 51	− 17	− 0.86
Commercial and industrial	28,183	+ 158	+ 3,952	+ 16.31
Real estate	33,436	+ 176	+ 7,457	+ 28.70
Consumer instalment	17,845	+ 26	+ 3,970	+ 28.61
U.S. Treasury securities	8,576	− 459	+ 923	+ 12.06
Other securities	14,397	+ 346	− 354	− 2.40
Deposits (less cash items) — total*	114,531	+ 183	+ 13,979	+ 13.90
Demand deposits (adjusted)	32,926	+ 1,344	+ 3,337	+ 11.28
U.S. Government deposits	362	− 245	+ 57	+ 18.69
Time deposits — total*	79,338	− 888	+ 10,835	+ 15.82
States and political subdivisions	6,420	− 35	+ 1,162	+ 22.10
Savings deposits	31,898	− 169	+ 33	+ 0.10
Other time deposits‡	38,218	− 325	+ 9,139	+ 31.43
Large negotiable CD's	18,154	− 717	+ 6,781	+ 59.62

Weekly Averages of Daily Figures	Week ended 10/11/78	Week ended 10/4/78	Comparable year-ago period
Member Bank Reserve Position			
Excess Reserves(+)/Deficiency (−)	+ 77	− 57	+ 118
Borrowings	36	42	107
Net free(+)/Net borrowed (−)	+ 41	− 99	+ 11
Federal Funds—Seven Large Banks			
Interbank Federal fund transactions Net purchases (+)/Net sales(−)	+ 1,263	− 243	+ 277
Transactions with U.S. security dealers Net loans (+)/Net borrowings (−)	+ 111	+ 555	+ 480

*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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