

FEDERAL RESERVE BANK  
OF NEW YORK

[Circular No. 7144]  
May 17, 1973 ]

**Changes in Reserve Requirements; Suspension of Interest Rate Ceilings  
on Certain Large Certificates of Deposit**

*To All Member Banks, and Others Concerned,  
in the Second Federal Reserve District:*

Following is the text of a statement issued May 16 by the Board of Governors of the Federal Reserve System:

The Board of Governors of the Federal Reserve System announced today a series of actions designed to curb the rapid expansion in bank credit and help moderate inflationary pressures, and at the same time to assure the availability of credit on a reasonable scale.

The measures will:

1. Impose an 8 per cent marginal reserve requirement (the regular 5 per cent plus a supplemental 3 per cent) on further increases in the total of (a) outstanding certificates of deposit of \$100,000 and over issued by member banks, and (b) outstanding funds obtained by a bank through issuance by an affiliate of obligations subject to the existing reserve requirement on time deposits. The 8 per cent marginal reserve would not apply to banks whose obligations of these types aggregate less than \$10 million.

2. Reduce from 20 per cent to 8 per cent the reserve requirement on certain foreign borrowings of U.S. banks, primarily Euro-dollars, thus affording roughly parallel treatment at present with the marginal reserve requirement on large-denomination certificates of deposit and bank-related commercial paper. The Board also acted to eliminate gradually the reserve-free bases still held by some banks subject to this measure.

3. Suspend the ceilings that apply to the rate of interest commercial banks may pay on certificates of deposit of \$100,000 and over (large CDs) that mature in 90 days or more, effective immediately.

4. At the same time, the Board proposed a regulatory amendment that would apply reserve requirements to funds raised by banks through sales of finance bills (sometimes called working capital acceptances). If adopted, the amendment would subject the amount of finance bills currently outstanding to a 5 per cent reserve requirement. (There is presently no reserve requirement on finance bills.) In addition, under this proposal, finance bills would be part of the total obligations subject to the 8 per cent marginal reserve requirement.

Comment on the finance bills proposal will be received by the Board through June 4.

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For purposes of computing the 8 per cent reserve requirement, a bank would compare its daily average outstanding amount of finance bills, large CDs and bank-related commercial paper to the daily average amount outstanding on the base date—the week ended May 16, 1973, or to \$10 million, whichever is larger. Under the present regulation as amended today, however, marginal reserve requirements will be based on the total amount of large CDs and bank-related commercial paper.

The marginal reserve requirement on large time deposits and covered commercial paper issued by affiliates will apply to the excess of deposits over the base period beginning in the statement week starting June 7. These reserves will have to be held in the week starting June 21.

The actions were taken against the background of an unusually strong expansion in bank credit, stimulated to a considerable extent by increased business spending for capital investment and inventory accumulation. The actions will help the present policy of monetary restraint to moderate this expansion. Recent growth in bank credit to major business corporations has been financed in large part by increases in the issuance of money market-type instruments of the kinds covered by the action taken today by the Board.

Business borrowing from commercial banks increased by about \$15 billion during the first four months of this year. This increase was only partially offset by the reduced use of commercial paper by businesses to obtain funds. Commercial banks obtained funds to meet the demand for a rising volume of business loans largely through the sale of large negotiable CDs, which also increased by about \$15 billion over this period.

#### *Marginal reserve on large denomination CDs*

The new 8 per cent marginal reserve requirement will apply to the total of single-maturity, large-denomination CDs and bank-related commercial paper issued by a member bank beginning Thursday, June 7, to the extent that this volume exceeds the average amount outstanding in the statement week ending Wednesday, May 16. In no case will the marginal reserve apply to an amount outstanding of less than \$10 million.

For example, if a member bank had outstanding a total of \$20 million of large CDs and bank-related commercial paper on average during the week ended May 16, 1973, and increased that amount to \$25 million by the week ended Wednesday, June 13, the bank would be subject to an 8 per cent reserve requirement on the additional \$5 million—or a \$400,000 reserve. Without this change in the regulation, the reserve requirement on the additional \$5 million would be 5 per cent—or \$250,000.

The base for computing the marginal reserve requirement will remain the same for each individual bank—the week ended May 16, 1973 or \$10 million, whichever is greater—regardless of the level of its CD and commercial paper holdings in the future.

Under the lagged reserve system now in effect, a member bank is required to hold reserves during any given week based on the level of its deposits two weeks earlier. Thus, a bank in this instance will be required to hold the 8 per cent marginal reserve during the week of June 21-27, based on the level of its deposits during the week of June 7-13. It will hold the 8 per cent marginal reserve only to the extent that its aggregate total of large CDs and bank-related commercial paper exceeds the total amount outstanding during the week ending today, May 16, 1973.

#### *Euro-dollar reserve requirement*

Last September 7, the Board proposed to reduce its marginal reserve requirement on certain foreign borrowings of U.S. banks, primarily Euro-dollars, from 20 per cent to 10 per cent and to eliminate the reserve-free bases available to banks subject to this reserve requirement. A reserve requirement on Euro-dollar transactions was first imposed in 1969 to moderate short-term dollar flows between the United States and other countries.

Reduction of this reserve requirement to 8 per cent will provide roughly parallel treatment at the present time—so far as reserve requirements are concerned—among Euro-dollars, large CDs and bank-related commercial paper. At some future time, of course, it may be desirable to depart from such parallel treatment.

The Board also decided to phase out the reserve-free bases available to banks subject to this marginal reserve requirement. Bases will be reduced by 10 per cent in each four week computation period beginning with the period starting July 5. This schedule will result in elimination of the bases in the computation period beginning March 14, 1974.



### *Suspension of large CD ceilings*

The Board suspended interest rate ceilings on large CDs maturing in 90 days or more, in order to permit member commercial banks to maintain a balanced structure of deposits. Ceilings previously had been suspended on CDs issued for 30-89 days, and had ranged from 6¾ per cent to 7½ per cent on longer-maturity deposits of \$100,000 and over. Because of recent advances in market rates, the ceiling rates on longer maturity deposits now practically preclude banks from using long-term CDs and the great bulk of large CDs being issued mature in less than 90 days. Ceilings on large CDs with maturities of less than 90 days were suspended in June of 1970.

Interest rate ceilings will remain in place on all other types of bank deposits, including passbook accounts and consumer-type certificates of deposit (those of less than \$100,000).

### *Proposed amendment on finance bills*

The proposed amendment would apply reserve requirements against funds obtained by the bank for use in its banking business through sale of bankers acceptances that are not eligible for discount at a Federal Reserve Bank. The traditional type of bank acceptances which apply to specific transactions in goods would continue to be exempt from reserve requirements and eligible for discount by a Federal Reserve Bank. Under the proposal, the Board would treat the sale of finance bills as equivalent to deposits subject to reserve requirements. At present, about \$1.1 billion in such bills are outstanding. Under the proposal, funds received by a bank would be treated as a deposit if the member bank (1) makes an acceptance that is not eligible for discount at a Federal Reserve Bank, (2) then sells the acceptance, and (3) uses the proceeds in its banking business.

In a related matter, the Board said only acceptances eligible for discount at a Federal Reserve Bank would be subject to limitations on amounts outstanding set forth in Section 13 of the Federal Reserve Act.

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The Board urged all banks to observe the spirit, as well as the letter, of the the Board's actions in a concerted effort to curb bank credit expansion and to moderate inflationary pressures. In this connection, the attached letter is being sent to about 190 of the largest nonmember banks, seeking their assistance and cooperation in ensuring the effectiveness of this program.

Following is the letter to large nonmember banks:

Dear Sir:

I earnestly seek your assistance and cooperation in ensuring that actions taken by the Federal Reserve System today in the interest of a healthy national economy can effectively accomplish this objective.

The Board of Governors of the Federal Reserve System has taken two actions that affect large time certificates of deposit issued by member banks. One action is to suspend maximum interest rate ceilings on such deposits with maturities of more than 89 days; the ceiling rate on deposits of 30-89 day maturity had been suspended since June 27, 1970. The Federal Deposit Insurance Corporation has taken a similar action with respect to insured banks that are not members of the Federal Reserve System. With market interest rates relatively high, the suspension of ceilings across the board will enable banks to compete in all maturity sectors of the short-term market and thereby permit them to establish a balanced maturity structure for outstanding large certificates of deposit.

The other action taken by the Federal Reserve Board has been to impose a marginal reserve requirement on the total of funds raised from the issuance of (1) single-maturity time deposits of \$100,000 or more, (2) deposits represented by certain commercial paper obligations such as promissory notes, acknowledgements of advances, and due bills, and (3) funds obtained by the bank from obligations issued by affiliates and subsidiaries of the bank. The board has also published for comment a proposal to establish reserve requirements, including marginal reserve requirements, on funds obtained from the sale of finance bills (also termed ineligible acceptances), the proceeds of which are used by the bank.

The marginal reserve requirement action means that member banks must maintain additional reserves equal to 3 per cent of any growth in the total of deposits and liabilities specified above in excess of a base amount. The base for computing the marginal reserve will be the amount outstanding in the week ended May 16, 1973, or \$10 million, whichever is greater. Thus, for a member bank the reserve requirement applicable to the excess of such deposits above the base level would generally be 8 per cent—the continuing 5 per cent requirement on large denomination time deposits and other similar domestic money market instruments, plus the marginal 3 per cent requirement.

The reserve requirement action was taken by the Board in an effort to restrain bank credit growth as part of the Nation's anti-inflationary program. The effectiveness of this proposal in the essential task of combating inflation would be enhanced if it applied generally throughout the banking community. Accordingly, I very much hope you will see fit to conform to the additional 3 per cent marginal requirement as described above. A copy of the Federal Reserve notice implementing the marginal reserve is attached for your information and guidance.

For a nonmember bank, the additional marginal reserve should be maintained with a member of the Federal Reserve System of your choosing. The member bank receiving the deposit will be expected to re-deposit these balances with its Federal Reserve Bank. Operating procedures will be provided by the Federal Reserve Bank and your designated correspondent.

I assure you that the request I am now making of you will be withdrawn at the earliest possible time consistent with the national interest. Your cooperation can play a significant role in restraining inflation and in returning the economy to a more normal course.

I look forward to receiving your response.

Sincerely yours,  
Arthur F. Burns

Copies of amendments to the Board of Governors' regulations, reflecting the actions announced in the above statement, will be sent to you shortly; in addition, instructional material and forms relating to the new marginal reserve requirements will soon be sent to banks maintaining reserve accounts with this Bank. Comments on the finance bills proposal should be submitted by June 4, and may be sent to our Regulations and Bank Analysis Department.

Additional copies of this circular will be furnished upon request.

Alfred Hayes,  
*President.*