

FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 7289]
[December 7, 1973]

REGULATIONS D AND Q

— Reduction in Marginal Reserve Requirement
on Large-Denomination Certificates of Deposit

— Rules Governing Use of NOW Accounts in
Massachusetts and New Hampshire

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

Following are the texts of statements issued today by the Board of Governors of the Federal Reserve System, relating to amendments to its Regulations D and Q:

Regulation D — Reduction in marginal reserve requirement

The Board of Governors of the Federal Reserve System today announced a reduction from 11 per cent to 8 per cent in its marginal reserve requirement on large denomination certificates of deposit (CDs). This action — which will reduce the costs to banks of accommodating the credit needs of their customers — was taken in recognition of the moderation in bank credit growth achieved over recent months.

The announced reduction will take effect on deposits in the week beginning next Thursday, December 13, and will reduce required reserves two weeks later, when there is a seasonal need to provide reserves to the banking system. The net effect of the Board's action will be to reduce by about \$375 million the reserves required to support member bank deposits.

A marginal reserve requirement (the regular 5 per cent plus a supplemental 3 per cent) was first announced by the Board on May 16 as part of a series of actions designed to curb a rapid expansion in bank credit and help moderate inflationary pressures. An additional 3 per cent marginal reserve was announced by the Board on September 7, thus raising the total reserve requirement on affected deposits to 11 per cent.

In recent months, the rate of growth in bank credit has moderated, and the outstanding amount of large denomination CDs has dropped substantially. Business loan expansion at banks has been at a much slower pace than earlier this year, and extensions of other forms of bank credit have also slowed.

The marginal reserve requirement applies to increases (beyond the amount outstanding in the week ended May 16) in the total of (a) time deposits in denominations of \$100,000 and over and (b) bank-related commercial paper and finance bills with a maturity of 30 days or more. In no case does the supplemental reserve apply to banks whose obligations of these types total less than \$10 million.

The Board said the action also affects certain nonmember State banks and U.S. agencies and branches of foreign banks which have been voluntarily holding marginal reserves on large CDs at the request of the Board. The special marginal reserve held by these institutions will now be reduced from 6 per cent to 3 per cent. The Board expressed its appreciation to the nonmember institutions for their continued cooperation.

Regulation Q — Use of NOW accounts

The Board of Governors of the Federal Reserve System today issued an amendment to its Regulation Q — governing payment of interest on deposits — under which customers of member banks in Massachusetts and New Hampshire may write negotiable orders of withdrawal (NOWs) against interest-bearing savings accounts.

The amendment, effective January 1, 1974, was adopted pursuant to new legislation permitting all depository institutions in the two States to allow customers to write NOWs — which function as checks — on savings accounts. The customary type of check may be written only against non-interest-paying demand deposits.

The new rules for the use of NOWs by savings depositors in Federal Reserve member banks in Massachusetts and New Hampshire are:

- Maximum interest payable on NOW accounts is 5 percent.
- NOW accounts may be owned only by natural persons (or fiduciary accounts for individuals) and non-profit associations eligible to maintain savings accounts.
- To avoid unfair competition for deposits with institutions in neighboring states, advertising and solicitation of NOW account deposits should be directed toward residents of Massachusetts and New Hampshire. In this connection, member banks are requested to offer NOW accounts only to permanent or temporary residents of Massachusetts and New Hampshire, persons who work in those States, and current customers.
- The number of negotiable orders of withdrawal that may be processed against an individual NOW account may not exceed 150 per year.

The Board's rules governing the use of NOWs in the two States were formulated following careful consideration of the history of the legislation and of all comment received on a tentative statement of proposed policies issued by the Board on September 14. The Board also consulted with the other Federal regulatory agencies through the Inter-Agency Coordinating Committee. The Federal Deposit Insurance Corporation and the Federal Home Loan Bank Board are also issuing regulations covering institutions under their jurisdiction in Massachusetts and New Hampshire.

The new rules do not require the imposition of service charges by member banks on NOW transactions. But the Board suggested that each individual bank charge a fee for transactions if its earnings from NOW accounts do not fully cover the cost of establishing and servicing such accounts.

NOW drafts will continue to be cleared, for all depository institutions, by the Federal Reserve Bank of Boston through member banks.

In cooperation with the other regulatory agencies, the Board — through the Federal Reserve Bank of Boston — is establishing a system for monitoring, on a monthly basis, the use and activity in NOW accounts. The purpose is to generate timely information on public use and acceptance of such accounts and to uncover any institutional weaknesses that may arise from excessive promotional schemes and activities.

The Board has written the chairmen and ranking minority members of the committees and subcommittees that considered the recent NOW account legislation, to inform them of the reasons underlying the Board's action. Following are excerpts from those letters:

The Board has predicated its actions on the belief that the basic purpose of the NOW account experiment is to make money transfers a feature of savings accounts owned by individuals. The primary, but not exclusive, beneficiaries of this policy would be those who do not have checking accounts but keep their funds in a savings account in a commercial bank, a mutual savings bank, a savings and loan association or other thrift institution. The Board does not believe that NOW accounts should be made so available and attractive as to result in the wholesale conversion of demand deposits into such accounts.

In formulating its rules, the Board has given close attention to comment it received on its tentative proposals published September 14, just before the new legislation went into effect. The Board has considered the views of the other Federal regulatory agencies concerned, and of the banking officials in the two States in which Congress authorized the experiment in making check-like withdrawals from interest-bearing deposits.

The Board has also sought to be guided by the legislative history of PL 93-100 permitting NOW transfers from savings accounts. This legislative history indicates that the NOW account experiment was meant by Congress to be confined to Massachusetts and New Hampshire. Consequently, the Board is requesting member banks in Massachusetts and New Hampshire to limit the ownership of NOW accounts to permanent or temporary residents of those States, to persons who work in the two States and to current customers. Similarly, the Board has limited direct solicitation of NOW account deposits by member banks to the two States concerned.

The legislative history also implies that eligible holders should be limited to natural persons. Savings accounts at commercial banks are limited to individuals, to fiduciary accounts for the benefit of individuals, and to certain non-profit associations. The Board has concluded that confining the use of NOW accounts at member banks to those who have savings accounts at those banks carries out the intent of Congress. The Board does not believe that Congress intended for corporations and State and local governments to have access to NOW accounts, and it sees no present reason for permitting such access.

The Board believes that all depository institutions offering this service should be permitted to pay the same rates of interest on the deposits supporting NOW accounts.

In its publication of September 14 soliciting comment on tentative proposals for the use of NOW accounts, the Board implied concern over the possibility that NOW accounts might be offered as a loss leader for attracting deposits. In the interest of maintaining sound banking, institutions in these two States should avoid predatory competition implicit in loss leader promotion.

The Board suggests that fees should be charged where the costs of maintaining and servicing NOW accounts, including the interest paid to the holder of the account, are not fully covered by the bank's earnings on the deposits supporting the account. One reason for this concern is the fact that savings accounts at all the depository institutions in Massachusetts and New Hampshire are small on the average — less than \$250 — and that the large majority of all savings accounts in the two States is under \$1,000. Thus, a bank's opportunities for earnings on such accounts are limited. When one keeps in mind the interest paid to holders of such accounts, the costs of setting up accounts and the servicing of transactions, it is clear that unless fees are charged for NOW transfers many, if not most, such accounts would be operated at a loss to the institution offering them. This would tend to undermine the viability of the experiment by undermining the earning capacity and ultimately the soundness of institutions caught in a competitive bind. The Board is reluctant to deal with this possibility by fixing the money equivalent of the costs of handling a funds transfer in a NOW account, since this will vary from institution to institution or customer to customer, or even from transaction to transaction. The best solution, therefore, appears to be for an individual bank to charge fees in the light of its own knowledge of the relation of its costs to its earnings on NOW accounts.

The NOW account may become the vehicle for wholesale conversion of checking accounts to NOW accounts unless some limitation is imposed upon the use of NOW transfers. The Board has therefore set a twelve month limit of 150 such transfers per account. The NOW account should be of particular benefit to that segment of the public that does not maintain checking accounts, and, therefore, does not make large numbers of payments in some form other than currency. The limit of 150 transfers per year, consequently, seems appropriate at the outset to serve that segment of the public that the Board expects will derive the primary benefit from the NOW account.

Copies of amendments to Regulations D and Q, reflecting these changes, will be sent to you shortly.

ALFRED HAYES,
President.