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FACT BOOK
MONETARY IMPROVEMENT
PROGRAM TESTIMONY
9/26/79

from Perry Quick
2/12/80

MONETARY IMPROVEMENT LEGISLATION

TITLE I

EMERGENCY UNIVERSAL RESERVES

1. Universal reserve requirements on transactions and non-personal time deposit accounts, at all depository institutions.

2. Reserve ratios and reservable liabilities same as S. 85, i.e.,

   Transactions balances: 3% ≤ $10 mm.
   12% > $10 mm.

   Non-personal time: 0% ≤ $10 mm.
   3% > $10 mm.

3. Pricing and access same as S. 85, i.e., discount window open to all institutions having transactions accounts; all other services priced competitively.

4. Interest paid on reserves against interest-bearing transactions accounts at maximum of 2 percent below portfolio rate.

TITLE II

PERMANENT VOLUNTARY RESERVE SYSTEM

1. Title II takes effect only when all conditions of Title III are met.

2. Any bank eligible to be a member. Any other institution eligible to be affiliate member if reserve balances held voluntarily.

3. Affiliate members not subject to Federal Reserve supervision.

4. Reserve requirements same as in Title I.

5. Interest paid on all required reserves at portfolio rate, subject to limitations of Title III.

6. Supplemental reserve authority provided as "safety net":

   Up to 5% on all deposits.
   Interest at 1-1/2% below portfolio rate.

7. Access and pricing as in Title I.

TITLE III

TRANSITIONAL CONDITIONS

1. When Regulation Q ceilings on all time and savings deposit rates are lifted, interest may be paid at up to the portfolio rate on reserves held against such deposits.

2. When Regulation Q ceilings on interest-bearing transactions deposits are lifted, interest may be paid at up to the portfolio rate on reserves held against such deposits.

3. When the prohibition of interest on demand deposits and all Regulation Q ceilings are removed, interest may be paid on all reserves at up to the portfolio rate.

4. By January 1, 1982, Board and Treasury to prepare a joint report on possible changes in the income tax paid by depository institutions to ensure that such institutions are paying their fair share.

5. Both Regulation Q and the prohibition of interest on demand deposits are to be phased out by the end of five years from enactment.

6. Voluntary reserve system of Title II will supersede the temporary universal reserve system when

   Interest paid on all reserves, and
   At least 75% of transactions deposits and 60% of total deposits are at members or affiliate members.

7. Universal reserve requirements would be reinstated if, under the voluntary system

   Less than 65% of transactions balances, or 50% of total deposits are at members and affiliate members.

8. Total amount of interest that may be paid on reserves limited:

   Total interest paid on reserves (excluding supplemental balances),
   less income taxes paid on such interest received by the private sector,
   less revenues from service charges may not exceed 6% of the amount the Federal Reserve pays to the Treasury in that year as interest on Federal Reserve notes.

DAV

- please see pages 11-12 re new table on interest payments
- also take a glance at tables re size of reserve base + costs

EMC

The following is offered as a substitute to Title XI of H.R. 4986 ("Depository Institutions Deregulation Act of 1979"). The new Title XI follows:

TITLE XI - MONETARY POLICY IMPROVEMENT ACT OF 1980

DEFINITIONS

Sec. 1101. Section 19(a) of the Federal Reserve Act (12 U.S.C. 461(a)) is amended by adding at the end thereof the following new paragraphs:

"The term 'depository institution' means—

"(1) any insured bank as defined in section 3 of the Federal Deposit Insurance Act;

"(2) any mutual savings bank as defined in section 3 of the Federal Deposit Insurance Act;

"(3) any savings bank as defined in section 3 of the Federal Deposit Insurance Act;

"(4) any insured credit union as defined in section 101 of the Federal Credit Union Act;

"(5) any member as defined in section 2 of the Federal Home Loan Bank Act;

"(6) any insured institution as defined in section 401 of the National Housing Act; and

"(7) for the purpose of section 13 and the fourteenth paragraph of section 16, any association or entity which is wholly owned by or which consists only of institutions referred to in clauses (1) through (6).

"The term 'bank' means any insured or noninsured bank, as defined in section 3 of the Federal Deposit Insurance Act, other than a mutual savings bank or a savings bank as defined in section 3 of the Federal Deposit Insurance Act.

"The term 'transaction account' means a deposit or account on which the depositor or account holder is allowed to make withdrawals by negotiable or transferable instrument, payment orders of withdrawal, or other similar item for the purpose of making payments or transfers to third persons or others. Such term includes demand deposits, negotiable order of withdrawal accounts, savings deposits subject to automatic transfers, and share draft accounts.

"The term 'nonpersonal time deposits' means a time deposit or account representing funds deposited to the credit of, or in which any beneficial interest is held by a depositor who is not a natural person.

"In order to prevent evasions of the reserve requirements imposed by this Act, after consultation with the Board of Directors of the Federal Deposit Insurance Corporation, the Federal Home Loan Bank Board, and the National Credit Union Administration Board, the Board of Governors of the Federal Reserve System is further authorized to determine, by regulation or order, that an account or deposit is a transaction account if such account or deposit may be used to provide funds directly or indirectly for the purpose of making payments or transfers to third persons or others.".

REPORTING REQUIREMENTS

Sec. 1102. Section 11(a) of the Federal Reserve Act (12 U.S.C. 248(a)) is amended—

(1) by inserting "(1)" immediately after "(a)"; and

(2) by adding at the end thereof the following new paragraph:

"(2) To require any depository institution specified in this paragraph to make, at such intervals as the Board may prescribe, such reports of its liabilities and assets as the Board may determine to be necessary or desirable to enable the Board to discharge its responsibility to monitor and control monetary and credit aggregates. Such reports shall be made (A) directly to the Board in the case of member banks and in the case of other depository institutions whose reserve requirements under section 19 of this Act exceed zero, and (B) for all other reports to the Board through the (i) Federal Deposit Insurance Corporation in the case of insured State nonmember banks, savings banks, and mutual savings banks, (ii) National Credit Union Administration Board in the case of insured credit unions, (iii) Federal Home Loan Bank Board in the case of any institution insured by the Federal Savings and Loan Insurance Corporation or which is a member as defined in section 2 of the Federal Home Loan Bank Act, and (iv) such State officer or agency as the Board may designate in the case of any other type of bank, savings and loan association, or credit union. The Board shall endeavor to avoid the imposition of unnecessary burdens on reporting institutions and the duplication of other reporting requirements. Any data provided to any department, agency, or instrumentality of the United States pursuant to other reporting requirements shall be made available to the Board. The Board may classify depository institutions for the purposes of this paragraph and may impose different requirements on each such class.".

RESERVE REQUIREMENTS

Sec. 1103. Section 19(b) of the Federal Reserve Act (12 U.S.C. 461(b)) is amended to read as follows:

"(b)(1) Reserve Requirements.—(A) Each depository institution shall maintain reserves against its transaction accounts as the Board may by regulation prescribe solely for the purpose of implementing monetary policy—

"(i) in the ratio of 3 per centum for that portion of its total transaction accounts of $10,000,000 or less; and

"(ii) in the ratio of 12 per centum, or in such other ratio as the Board may prescribe not greater than 13 per centum and not less than 11 per centum, for that portion of its total transactions accounts in excess of $10,000,000.

"(B) Each depository institution shall maintain reserves against its nonpersonal time deposits as the Board may by regulation prescribe solely for the purpose of implementing monetary policy—

"(i) in the ratio of zero per centum for that portion of its nonpersonal time deposits if $10,000,000 or less; and

"(ii) in the ratio of 3 per centum, or in such other ratio not greater than 12 per centum and not less than zero per centum, for that portion of its nonpersonal time deposits in excess of the $10,000,000.

"(2) WAIVER OF RATIO LIMITS.—Upon a finding by the Board that extraordinary circumstances require such action, the Board, after consultation with the appropriate committees of the Congress, may impose reserve requirements above or below the limits otherwise prescribed by this section for a period not exceeding thirty days, and for further periods not exceeding thirty days each by affirmative action by the Board in each instance. The Board shall promptly transmit to the Congress a report of any exercise of its authority under this paragraph and the reasons for such exercise.

"(3) SUPPLEMENTARY DEPOSIT.--In addition to the requirements of this section, upon an affirmative vote of five or more members of the Board, every depository institution shall maintain with the Federal Reserve Bank of which it is a member or at which it maintains an account or with another institution pursuant to subsection (c)(2) of this section, a supplementary deposit of up to 3 per cent of the total of its transaction accounts and nonpersonal time deposits, or up to 5 per cent of its transaction accounts. The supplementary deposit shall be required only after consultation by the Board with the Boards of Directors of the Federal Deposit Insurance Corporation, the Federal Home Loan Bank Board and the National Credit Union Administration Board and upon a finding by the Board that such deposit is necessary to effectuate the purposes of monetary policy, or for the efficient operation of the payments mechanism. The Board shall promptly transmit to the Congress a report of an exercise of its authority to require supplementary deposits and the reasons for such exercise. The supplementary deposit shall be maintained by the Federal Reserve Banks in an Earnings Participation Account which shall receive earnings to be paid by the Federal Reserve Banks quarterly at a rate equal to the rate earned on the securities portfolio of the Federal Reserve System during the previous calendar quarter. The Board may prescribe rules or regulations concerning the payment of earnings on Earnings Participation Accounts by Federal

Reserve Banks under this section. The Board shall review and determine the need for continued maintenance of supplementary deposits if a supplementary deposit has been required of depository institutions continuously for a one year period and shall promptly transmit a report to the Congress on the continued need for the supplementary deposit.

"(4) PRIVILEGES OF INSTITUTIONS MAINTAINING RESERVES.—During any period that a depository institution is maintaining reserves pursuant to this section, such depository institution shall be entitled to all the privileges of membership in the Federal Reserve System, except that, if it is not otherwise a member, it may not hold stock in, or vote for any director of, a Federal Reserve bank.

"(5) RESERVES RELATED TO FOREIGN OBLIGATIONS OR ASSETS.—Foreign branches, subsidiaries, and international banking facilities of nonmember depository institutions shall maintain reserves to the same extent required by the Board of foreign branches, subsidiaries, and international banking facilities of member banks. In addition to any reserves otherwise required to be maintained pursuant to this subsection, any depository institution shall maintain reserves in such ratios as the Board may prescribe against—

"(A) net balances owed by domestic offices of such depository institution in the United States to its directly related foreign offices and to nonrelated foreign depository institutions,

"(B) loans to United States residents made by overseas offices of such depository institution if such depository institution has one or more offices in the United States, and

"(C) assets (including participations) held by foreign offices of a depository institution in the United States which were acquired from its domestic offices (other than assets representing credit extended to persons not residents of the United States).

"(6) EXEMPTION FOR CERTAIN DEPOSITS.—The requirements imposed by paragraph (1) or under paragraph (3) of this subsection do not apply to deposits payable only outside the States of the United States and the District of Columbia, but nothing in this subsection limits the authority of the Board to impose conditions and requirements on member banks under section 25 of this Act or the authority of the Board under section 7 of the International Banking Act of 1978 (12 U.S.C. 3105).

"(7) DISCOUNT AND BORROWING.—Any depository institution in which transaction accounts are held shall be entitled to the same discount and borrowing privileges as member banks.

"(8) TRANSITIONAL ADJUSTMENTS.—

"(A) Any depository institution required to maintain reserves under this section which was engaged in business on July 1, 1980, but was not a member of the Federal Reserve System on that date, shall maintain reserves against its deposits during the first twelve-month period following the effective date of this paragraph in amounts equal to one-fifth of those otherwise required by this section, during the second such twelve-month period in amounts equal to two-fifths of those otherwise required, and during the third such twelve-month period in amounts equal to three-fifths of those otherwise required.

"(B) With respect to any bank which was a member of the Federal Reserve System on July 1, 1980, the amount of required reserves imposed pursuant to this section on the effective date of this section that exceeds the amount of required reserves maintained by the member institution during the reserve computation period immediately preceding the effective date of such paragraphs may, at the discretion of the Board and in accordance with such rules and regulations as it may adopt, be reduced by 80 per centum during the first year which begins after such effective date, 60 per centum during the second year, and 40 per centum during the third year.

"(C) In order to provide for an orderly transition period, the Board shall implement the reduction in reserve requirements resulting from the amendment of this subsection by the Monetary Policy Improvement Act of 1980 with respect to member banks over a period not greater than sixty months after the effective date of such paragraph.

"(D) Any depository institution which is a member bank on July 1, 1980, and leaves the Federal Reserve System after such date shall continue to be required to maintain reserves against its deposits after the effective date of this section as if it were a member bank.".

FORM OF RESERVES

Sec. 1104. Section 19(c) of the Federal Reserve Act, as amended (12 U.S.C. 461) is amended to read as follows:

"(c) Reserves held by a depository institution to meet the requirements imposed pursuant to subsection (b) of this section shall be in the form of—

"(1) balances maintained for such purposes by such depository institution in the Federal Reserve bank of which it is a member or at which it maintains an account. However, the Board may, by regulation or order, permit depository institutions to maintain all or a portion of their required reserves in the form of vault cash, except that any portion so permitted shall be identical for all depository institutions; and

"(2) balances maintained by a nonmember depository institution in a depository institution that maintains required reserve balances at a Federal Reserve bank, in a Federal home loan bank, or in a central liquidity facility for credit unions, if such depository institution, Federal home loan bank, or central liquidity facility maintains such funds in the form of balances in a Federal Reserve bank of which it is a member or at which it maintains an account. Balances received by a depository institution from another depository institution and used to satisfy the reserve requirement imposed on such depository institution by this section shall not be subject to the reserve requirements of this section imposed on such bank, and shall not be subject to assessment imposed on such bank, pursuant to section 7 of the Federal Deposit Insurance Act.".

INTEREST ON RESERVES

Sec. 1105. Section 19 of the Federal Reserve Act, as amended (12 U.S.C. 461), is amended to add a new subsection to read as follows:

"(L) PAYMENT OF INTEREST ON RESERVES.--(1) Five years after the effective date of the Monetary Policy Improvement Act of 1980, the Board is authorized to pay interest on any reserve balances held against deposits that are not subject to interest rate ceilings. The rate of interest paid on such reserve balances shall not exceed the rate of return on the securities held in the Federal Reserve System Open Market Account.

"(2) Upon the effective date of the repeal of section 1832 of Title 12 of the United States Code, the Board is authorized to pay interest on reserve balances held against interest earning transactions accounts. The rate of interest paid on such reserve balances shall not exceed seventy-five per centum of the ceiling rate of interest payable on such transactions accounts. If no such ceiling rate is in effect, the rate of interest paid on such reserve balances shall not exceed the rate of return on the securities held in the Federal Reserve System Open Market Account.

"(3) Upon the effective date of the repeal of sections 371a and 1828(g) of Title 12 of the United States Code, the Board is authorized to pay interest on the reserve balances held against deposits that are payable on demand. The rate of interest paid on such reserve balances shall not exceed seventy-five per centum of the ceiling rate of interest payable on demand deposits. If no such ceiling rate is in effect, the rate of interest paid on such reserve balances shall not exceed the rate of return on the securities held in the Federal Reserve System Open Market.

"(4) The total annual interest payments authorized by this section (excluding interest payments on supplemental reserve balances held pursuant to section 1103(b)(3)) shall not exceed 10 per centum of the interest earned on the Federal Reserve System Open Market Account.

MISCELLANEOUS AMENDMENTS

Sec. 1106. (a) The first paragraph of section 13 of the Federal Reserve Act (12 U.S.C. 342) is amended as follows:

(1) by inserting after the words "member banks" the words "or other depository institutions";

(2) by inserting after the words "payable upon presentation" the first and third times they appear, the words "or other items";

(3) by inserting after "payable upon presentation within its district," the words "or other items";

(4) by inserting after "nonmember bank or trust company," wherever it appears the words "or other depository institution";

(5) by striking out "sufficient to offset the items in transit held for its account by the Federal Reserve bank" and inserting in lieu thereof the words "in such amount as the Board determines taking into account

items in transit, services provided by the Federal Reserve bank, and other factors as the Board may deem appropriate"; and

(6) by inserting after the words "nonmember bank" after the second colon the words "or other depository institution".

(b)(1) The second paragraph of section 16 of the Federal Reserve Act (12 U.S.C. 412) is amended (1) by adding at the end of the third sentence the following:
", or assets that Federal Reserve Banks may purchase or hold under § 14 of this Act." and (2) by adding at the end thereof the following: "Collateral shall not be required for Federal Reserve notes that are held in the vaults of Federal Reserve banks. "

(2) Section 14(b)(1) of the Federal Reserve Act (12 U.S.C. 355) is amended by inserting after the words " United States" the first time it appears the following:
"and obligations of, or fully guaranteed as to principal and interest by, a foreign government or agency thereof, ".

(c) The thirteenth paragraph of section 16 of the Federal Reserve Act (12 U.S.C. 360) is amended—

(1) by striking out the words "member banks" wherever they appear and inserting in lieu thereof "depository institutions";

(2) by striking out the words "member bank" wherever they appear and inserting in lieu thereof "depository institution"; and

(3) by inserting after "checks" wherever it appears the words "and other items, including negotiable orders of withdrawal and share drafts".

(d) The fourteenth paragraph of section 16 of the Federal Reserve Act (12 U.S.C. 248(o)) is amended by striking out "its member banks" and inserting in lieu thereof "depository institutions".

(e) The first sentence of section 19(c) of the Federal Reserve Act (12 U.S.C. 463) is amended to read as follows: "No member bank shall keep on deposit with any depository institution which is not authorized to have access to Federal Reserve advances under section 10(b) of this Act a sum in excess of 10 per centum of its own paid-up capital and surplus.".

ABOLITION OF PENALTY RATE

Sec. 1107. Section 10(b) of the Federal Reserve Act (12 U.S.C. 347b) is amended by striking out the second sentence of the first paragraph thereof.

PRICING OF SERVICES

Sec. 1108. The Federal Reserve Act is amended by inserting after section 11 the following new section:

"SEC. 11A. (a) Not later than the first day of the sixth calendar month after the date of enactment of the Monetary Policy Improvement Act of 1979, the Board shall publish for public comment a set of pricing principles in accordance with this section and a proposed schedule of fees based upon those principles for Federal Reserve bank services to depository institutions, and not later than the first day of the eighteenth calendar month after the date of enactment of the Monetary Policy Improvement Act of 1980, the Board shall begin implementing a schedule of fees for such services which is based on those principles.

"(b) The services which shall be covered by the schedule of fees under subsection (a) are—

"(1) currency and coin services;

"(2) check clearing and collection services;

"(3) wire transfer services;

"(4) automated clearinghouse services;

"(5) settlement services;

"(6) securities safekeeping services;

"(7) Federal Reserve float; and

"(8) any new services which the Federal Reserve System offers, including but not limited to payment services to effectuate the electronic transfer of funds.

"(c) The schedule of fees prescribed pursuant to this section shall be based on the following principles:

"(1) All Federal Reserve bank services covered by the fee schedule shall be priced explicitly.

"(2) All Federal Reserve bank services covered by the fee schedule shall be available to nonmember depository institutions and such services shall be priced at the same fee schedule applicable to member banks, except that nonmembers shall be subject to any other terms, including a requirement of balances sufficient for clearing purposes, that the Board may determine are applicable to member banks.

"(3) Over the long run, fees shall be established on the basis of all direct and indirect costs actually incurred in providing the Federal Reserve services priced, including interest on items credited prior to actual collection, overhead, and an allocation of imputed costs which takes into account the taxes that would have been paid and the return on capital that would have been provided had the services been furnished by a private business firm, except that the pricing principles shall give due regard to competitive factors and the provision of an adequate level of such services nationwide.

"(4) Interest on items credited prior to collection shall be charged at the current rate applicable in the market for Federal funds.

"(d) The Board shall require reductions in the operating budgets of the Federal Reserve banks commensurate with any actual or projected decline in the volume of services to be provided by such banks. The full amount of any savings so realized shall be paid into the United States Treasury.".

AUTHORITY OF STATE BANK SUPERVISORS

Sec. 1107. Nothing in this Act or in the amendments made by this Act shall be construed in derogation of the authority of any officer or agency of State over any institutions organized or existing under the laws of such State.

EFFECTIVE DATES

Sec. 1110. This Title shall take effect six months after the date of enactment of this Act.

○

APPENDIX B

QUESTIONS FOR MIP TESTIMONY
9/26/79

1. If we had given the Fed this extended control 10 years ago, would the Fed have been able to prevent the dangerous inflation we're now suffering?

2. Won't covering nonmembers and sterilizing their reserves reduce the funds they have available for lending in their communities?

Talking cover, not higher
S+L out of liquidity
Take care of overall availability -

3. If this bill passes, will the Board commit to shift to a reserve aggregate operating procedure?

Wouldn't want to

4. Thrift deposits are not money, why should they be covered for monetary control purposes?

Thrust of bill not to cover,
but there is substitutability

5. Would you favor passage of this bill as part of a reform package that includes eliminating the Fed's supervisory and regulatory functions?

Separate issue

6. Under these bills, the largest banks in the country will reap millions of dollars in increased profits. Do you think that is justified?

Heavy burden –
no transaction
balances

7. Last Sunday on Face the Nation, you answered a question by saying that the Fed had all the tools necessary to conduct monetary policy, yet today you are pressing for extending your control over nonmember banks on the ground you need more tools. How do you explain this conflict?

Bill looking to
future
drive members out

8. The correspondent banking system and private armored carriers can provide virtually all the payments and money services that the Federal Reserve does, and probably more efficiently. If this bill is passed, there will be no need for the Fed to provide services to members. Will you commit to reducing the scale of Federal Reserve Bank services?

if we are
inefficient

9. You have proposed weakening the collateral underpinning of the currency. With inflation running at its current rate, why should we give you authority to print money even more readily?

10. Why shouldn't we continue to rely on a voluntary Federal Reserve System, which has worked so well in the past? Can we construct such a system that would halt attrition? Why wouldn't the Stanton amendment to H.R. 7 do the job?

11. These bills seem directed to short-run monetary control improvements. Mr. Miller and Mr. Burns have both said that short-run fluctuations in money growth are of little significance. Do you need these bills for better long-run control?

Possible Questions by Members of the Senate Banking Committee
on the Reserve Requirement

1. Why is this legislation needed at all? What kind of decline in membership has there been in terms of numbers of banks and amount of deposits, and why does a decline have an adverse effect on monetary policy? Apparently the Board was willing to accept a decline in reserve base coverage to 67.5 percent--why don't we wait rather than push forward with legisla-

2. Suppose the Congress does not choose to pass legislation to pay interest on reserves, what legislation would you suggest? Would the Proxmire bill achieve your objectives? Would the Federal Reserve support the House bill, H.R. 7?

3. Why do you favor a mandatory system requiring banks to keep reserves with the Federal Reserve? Why doesn't this conflict with the concept of the dual banking system? Won't this destroy the dual banking system?

Dual B S will be destroyed if you lose the banks.

4. Why don't we try the voluntary system first and see if it works? That was the judgment of the House and many bankers favor that. Why don't we try it? How much would it cost to ease the burden?

5. Wouldn't the voluntary system work if we reduced reserves substantially and permitted access to the discount window only to members?

6. Wouldn't the voluntary system work if we paid interest on reserves? You are recommending paying interest on reserves. Why can't we devise a bill with interest on reserves but a voluntary system? Why are you so hung up on loss to the Treasury? Isn't our central bank worth more than $300 million?

7. What would be your recommendation for the exemption level in the bill? Suppose we do not adopt the supplemental reserve concept, what would be your recommendation for an exemption level in that context?

8. Would you feel S. 85 was adequate if amended so that there would be no reserves on time deposits? What would be the total of reserves under S. 85 without reserves on time deposits? Wouldn't that suffice for monetary policy?

9. What specifically would call for use of the supplemental reserve? Suppose Congress wanted to write some specific standards into the law as to when the Fed could invoke it, such as when the Fed misses its monetary targets over X number of quarters. Some would be concerned about giving a carte blanche to the Fed. What additional standards would you suggest?

10. Would there be an exemption for the supplemental reserve or would it apply to every single institution? How many reserves would it raise?

11. Why are you concerned about including in this bill credit unions with only $2 billion in share drafts and not concerned about money market mutual funds with some $35 billion in transaction balances?

TO: Board of Governors

DATE: August 9, 1979

FROM: Staff
(Messrs. Axilrod, Brundy,
and Quick)

SUBJECT: H.R. 7

To facilitate Board discussion of H.R. 7 as passed by the House, this memorandum summarizes the main provisions of the bill and reviews their implications for such concerns as membership attrition, monetary control, and balances required for use of Federal Reserve services.

Highlights of Bill

The version of H.R. 7 passed by the House on July 20th is a hybrid bill containing both the provisions of the Reuss-Moorhead-Barnard (R-M-B) version of H.R. 7 and the Stanton amendment.[1/] The Stanton amendment, which goes into effect immediately upon enactment of the bill, continues the existing voluntary system for member banks at substantially reduced reserve ratios. If the voluntary system is not adequate to stop attrition from membership, the R-M-B version of mandatory universal reserve requirements will be triggered.

The Stanton amendment is applicable to members only. Reserve requirements on transactions accounts of member banks are reduced substantially. A 3 percent reserve ratio is imposed on the first $35 million in transactions deposits at a member bank. Above $35 million an 11 percent reserve ratio applies. The Board is permitted to adjust these ratios within a range of 4 to 12 percent (sic). The $35 million breakpoint for the lower reserve ratio is indexed to the rate of growth of total transactions deposits.

[1/] The provisions of H.R. 7 are summarized in Appendix 1.

The Board has authority under the bill to vary reserve requirements on short-term (less than 6 months to maturity) non-personal time deposits in a range of zero to 8 percent, but there is no authority--other than emergency powers--to set reserve requirements on other domestic time and savings deposits. The reserve ratio on short-term non-personal time deposits is initially set at zero. In the House debate, Representative St. Germain, whose amendment reduced that ratio to zero, stated that the ratio should remain at zero unless the Board were 1) to negotiate a Eurodollar reserves agreement with other central banks, and in addition, 2) to find that economic conditions required the imposition of reserve requirements on time deposits.

These reserve requirement provisions from the Stanton amendment are phased in over a three-year period, with 50 percent of the resulting reduction in reserve requirements occurring in the first year and 25 percent in each of the two subsequent years. Access to the discount window is provided at the time of enactment to all institutions having transactions accounts, or short-term non-personal time deposits, whether or not they hold reserves at the Fed. All other services are to be made available to all depository institutions on equal terms, and a price schedule for services is to be published within six months after enactment. In addition, the Stanton amendment contains certain transition provisions designed to make it less attractive to withdraw from the System during the period after enactment.[1]

In the event that the Stanton amendment does not arrest attrition from the System, coverage of deposits by Federal reserve requirements will

[1] For example, the required reserves of a bank that withdraws after enactment will be reduced in three equal annual installments rather than immediately.

continue to decline. When deposits at member banks as a proportion of total deposits at all commercial banks eligible to apply for FDIC insurance drops below 67½ percent, the mandatory provisions of the R-M-B version of H.R. 7 come into effect. At the end of 1978 this trigger ratio was 70.6 percent, down from 71.8 percent at the end of 1977.

The mandatory provisions of H.R. 7 are those of the R-M-B version. They become effective 180 days after the Board determines that the trigger point has been reached. Federal reserve requirements would then apply to transactions accounts at all depository institutions. A $35 million exemption would be provided, indexed at 80 percent of the growth rate of transactions deposits. An 11 percent reserve ratio would be initially imposed above the exemption. For purposes of monetary policy the Board could adjust the reserve ratio within the range of 4 to 12 percent. The reserve requirement provisions for time or savings deposits are the same as under the Stanton amendment.

The provision of the R-M-B version of H.R. 7 permitting all financial assets of the Federal Reserve to count as collateral behind the note issue was struck on the floor of the House. As will be discussed, this raises questions about the feasibility of implementing the reserve requirement reductions.

Appendix 2 presents an analysis of the cost and coverage of the bill using both 1977 and 1978 data. The Stanton amendment provisions, which go into effect on enactment, are shown in column 3 and column 6 of the table. The R-M-B provision, that go into effect after the trigger point has been reached, are shown in columns 2 and 5 of the table. Using 1977 data, the cost to the Treasury of the bill is estimated at roughly $280 million annually when the phase-in of reserve requirement changes,

prices and access has been completed. Reserves at the Federal Reserve Banks are reduced by approximately $20 billion, based on 1977 data. Some 1,450 banks would hold reserves at the Fed under the Stanton provisions, while only about 450 banks would hold balances at the Federal Reserve after the mandatory provisions took effect.

On enactment, when the Stanton amendment becomes effective, the proportion of all transactions balances at banks subject to Federal reserve requirements will be roughly 74 percent, the same as under the current reserve structure.[1] At present, also about 74 percent of all transactions balances are held by banks holding balances at the Federal Reserve. Once the reserve reductions in the Stanton amendment become fully effective the latter ratio will drop to 55 percent. After large nonmember banks were brought under Federal reserve requirements by the triggering of the mandatory provisions, the coverage would be 56 percent.

Implications

Membership attrition. Whether a bank withdraws from membership under the Stanton amendment obviously will depend on its assessment of benefits vs. costs. The net effect on bank earnings of H.R. 7 (including pricing of services) nearly offsets the burden of membership as earlier calculated by the staff. This earlier calculation, however, is not relevant to the present bill because it assumed that access to services and the discount window under a voluntary plan remained limited to members (or to institutions holdings balances equal to member bank required reserves). Under the Stanton provision, by contrast, any depository institution, whether or not a member bank, can obtain the services of the Reserve

[1] The coverage estimates shown are based on deposits and membership for December 1977.

Banks (though the discount window is available only if it has transactions or short-term non-personal time balances). Thus, an institution would be able to withdraw from membership, obtain all the services, and not be required to hold sterile Federal reserves (although the Fed could require the same clearing balances applicable to members as a condition of use of payments services).

With equal access to services by members and nonmembers alike, the burden of membership in effect becomes the total amount of balances at the Fed required to be held above the beyond what are needed for operating or precautionary purposes. Under the Stanton amendment, existing member banks would be required to hold approximately $16 billion in required reserves, of which about $8 billion probably would be held in vault cash for operating purposes and $8 billion as balances at the Fed. It is not likely that banks would voluntarily hold balances of this size at the Fed--and lose about $700 million per year in earnings--unless the System allowed these balances to serve as compensation for services received by the bank. However, it is not clear that permitting payment for services by a credit against reserve balances is consistent with the spirit of discussion surrounding the pricing provisions of H.R. 7. Moreover, such a reserve credit would significantly increase the costs to the Treasury.

On the basis of this analysis, further significant membership attrition might be expected during the voluntary phase of H.R. 7, unless banks believe there are substantial public relations, supervisory, or other technical benefits to membership. The timing with which banks might in practice leave the System depends on a very complicated calculation involving the net gain in earnings from receiving one-third of required reserves per year for three years on withdrawal as compared with the scheduled phase-down of required reserves for existing members. As a rough estimate, under the circumstances, the mandatory phase of H.R. 7 may become effective within

two or three years (unless, to repeat, the bill can be administered in such a way as to permit payment for services by treating reserves as compensating balances).

Once reserve requirements become mandatory, financial calculations about the burden of membership become by and large irrelevant. It seems likely that banks which found it desirable to be a member when holding significant quantities of reserves on voluntary basis will continue to do so when reserve requirements are reduced by two-thirds. Indeed, the state bank supervisors have expressed concern that the H.R. 7 reserve ratios are so low, especially for the smallest banks, that many banks will seek to convert to a national charter to avoid state requirements. Moreover, it is thought that dual examination by the state and by the FDIC is a significant burden that banks will seek to avoid by converting to a national charter.

Monetary control. Although H.R. 7 as passed probably would not make the task of monetary control more difficult, it is not clear that it would improve the ability of the Federal Reserve to control the money supply. If the System seeks to control growth of the aggregates by affecting reserve availability in such a way as to establish a particular interest rate range consistent with that growth rate, it seems unlikely that H.R. 7 would have any effect at all on monetary control.

If the System were to attempt to control an M-1 type monetary aggregate using a reserves target, it is not clear whether monetary control would be facilitated or not. On the one hand, reserve requirements on demand deposits at member banks (or non-exempt banks) would be somewhat more uniform. Thus, the potential complications for monetary control caused by graduated reserve requirement ratios might be reduced.

On the other hand, the large reduction in reserve requirements would increase substantially the number of banks at which vault cash needed for

operations would exceed required reserves. Thus, the proportion of deposits at banks which do not hold reserve balances at the Fed and which are not subject to binding Federal reserve requirements would be increased. Consequently, there would be an increased likelihood of deposit shifts between banks with binding Federal reserve requirements and those banks not bound and whose desired reserve ratios would differ from the stipulated Federal requirement, causing additional variability in the M-1/reserves multiplier. Moreover, the large reduction in required reserves greatly increases the M-1/reserves multiplier, so the effect on the money stock of any change in reserves is amplified. Thus, any errors in projections of reserve availability would introduce more slippage into the monetary control process.

Other effects of the bill on monetary policy would arise from the omission of reserve requirements on time and savings deposits. Zero reserve requirements on time and savings deposits would act to stabilize the M-1/reserves multiplier and thus would improve control of this aggregate under a reserves operating target. However, the System could not--without invoking emergency provisions--use changes in reserve requirements on time deposits to affect the cost of managed liabilities (except on non-personal, short-term time under quite limited conditions). In addition, lack of reserve requirements on any class of time deposits would make it more difficult to control an M-2 type monetary aggregate through an aggregate reserve target.

Adequacy of balances for clearing purposes. Most member banks under the Stanton amendments and most non-exempt banks under the R-M-B provisions will have very small balances at the Federal Reserve, particularly in relation to the services that they are likely to use. As a percent of total deposits at banks with reserves at the Fed, reserve balances will drop from the present 4-1/2 percent to a little over 1 percent; as a percent of demand deposits at those banks, these ratios are 14-1/2 and 3-1/2 percent, respectively. The amount of buffer provided by the reserve balances against the possibility of overdrafts in reserve accounts will be decreased. Increased overdrafts may be the outcome.

Should balances from required reserves prove inadequate in practice, the System would have a number of alternatives, none of which are entirely satisfactory. The Fed could ask for additional clearing balances, but an equitable formula may be difficult to construct. Or banks without adequate balances could be required to settle through those with an adequate balance--which might impose a penalty on some banks. A third possibility would be to require no specific balance for access to clearing services, but to levy a substantial penalty for overdrawing the account.

Collateral. As noted earlier, H.R. 7 no longer has a provision that permits all financial assets held by Federal Reserve Banks to stand behind the Fed's currency liability. As a result, it may not be possible to implement the reserve requirement provisions of H.R. 7 in full. In terms of deposits at the end of 1978, required reserve balances at the Fed would be reduced by about $24 billion. Free note collateral at that time was about $19½ billion; in mid-1979 free note collateral was only $13½ billion. Thus, the reduction in Government security holdings in the Fed portfolio that would accompany the decline in required reserves would probably leave the System without adequate collateral for Federal Reserve notes.

Reporting. As passed, H.R. 7 permits the Fed to obtain asset and liability reports from all depository institutions as needed for monetary policy purposes. Member banks are required to make such reports directly to the Federal Reserve, but other classes of depository institutions are required only to report directly their transactions balances and short-term

non-personal time deposits. All other reports that the Board may require for monetary policy purposes are to be provided through each institution's primary federal or state regulator.

This procedure is likely to be cumbersome both from the point of view of the Board and of the depository institutions that would be required to report to the Board through two channels. Moreover, the delays and communications problem inherent in passing data through the other regulators is likely to make such data of limited value for guiding day-to-day open market operations.

. . . .

While the preceding analysis has focused on certain problem areas, there are a number of clear benefits for the financial system in the bill. All depository institutions with transactions accounts receive access to the discount window. And all depository institutions, whether or not they have transactions accounts, obtain access to System services at a price--which should encourage efficiency in the payments mechanism. Once the mandatory reserve requirement provisions go into effect, there will be no discrimination between classes of institutions with regard to reserve requirements. Also, the Board will obtain authority to set reserves on resources obtained abroad by nonmember depository institutions in the mandatory phase of the bill. Finally, the bill does contain an emergency reserve requirement provision giving the Board authority over all liabilities of all depository institutions, but applicable only after consultation with Congress in extraordinary circumstances for short, renewable periods of time.

Some of these benefits depend on triggering the mandatory provisions, but there is always the risk that Congress may lower the trigger point as the actual coverage ratio approaches it,and pressures from nonmember institutions mount. Other benefits--such as the "level playing field" for

reserve requirements--are achieved without any clear gain for monetary control, except possibly over the long-run.

Finally, it should be noted that the bill does have longer-run implications for the structure of the Federal Reserve System. Once the mandatory provisions become effective, they may in practice appear to conflict with the voluntary nature of membership in the Federal Reserve System. Thus, pressures could develop to modify the structure of the System, perhaps eliminating membership, and questions would be raised in the process about the role of the System in supervisory matters and the role of Reserve Banks and their Boards of Directors in monetary matters.

APPENDIX 1

H.R. 7 As Enacted by The House

Summary of Major Provisions

Sec. 1 Title--Monetary Control Act of 1979.

Sec. 2 Requires all depository institutions to make reports on assets and liabilities as the Board determines necessary to monitor and control monetary and credit aggregates. All member bank reports are to be made directly to the Board as are reports for Category A and B deposits of all nonmember depository institutions. All other reports by nonmembers are to be through the principal supervisor.

Sec. 3 (1) The Board may exercise its authority to define the term "deposit" as applied to required reserves of nonmembers after consultation with the FDIC, FHLBB, and NCUA.

(2) The term "Category A deposit" means all forms of transactional accounts (e.g. NOWs and demand deposits) except deposits subject to six or fewer telephone transfers per month.

(3) The term "Category B deposit" means all nonpersonal time deposits of less than 180 days. Personal time deposits are nonnegotiable, nontransferable deposits of a natural person.

(4) Graduated reserve ratios may be imposed within the ranges provided.

(5) Domestic reserve requirements shall not apply to deposits payable only outside the U.S. However, Eurodollar reserve requirements may be applied on such deposits.

(6) Reserve requirements may be imposed or changed for the sole purpose of implementing monetary policy.

(7) A depository institution that is owned by other institutions and does not do business with the public shall not be required to maintain reserves.

[Numbers (8) through (16) below apply only after the 67.5% trigger is reached as provided by the Stanton Amendment (see (17) through (25) below). However, access to the discount window is immediately available to all institutions with Category A or Category B deposits.]

(8) The Category A and Category B exemptions for 1979 are $35 million and $10 million, respectively, plus 80 percent of the growth of Category A and Category B deposits from December 31, 1977, to June 30, 1978. Thereafter, the exemption is indexed to 80 percent of the growth of deposits.

(9) The principal supervisor determines which institutions will not have deposits above the exemption levels and thus will not be required to maintain reserves.

(10) Category A deposit reserve requirements shall be 11 percent initially, within a range of 4-12 percent. Different reserve ratios may be established for different types of that category of deposits.

(11) Category B deposit reserve requirements shall be 0 percent initially, within a range of 0-8 percent. [The legislative history indicates that Mr. St Germain intended this authority to be used only if (1) there is agreement with the central banks of other industrialized countries to impose Eurodollar reserve requirements equally, and (2) economic conditions

warrant such reserve requirements to control Eurodollar borrowings, after Board consultation with the appropriate Congressional committees.]

(12) Reserves may be imposed on Eurodollar borrowings or nonmember foreign branches, subsidiaries, and IBF's to the same extent that may be imposed on member bank foreign branches subsidiaries and IBF's. The Board may impose reserves on borrowings from, loans to U.S. residents by, and purchases of assets from domestic offices by foreign offices of any depository institution. [But see (23) below.]

(13) Upon a vote of five Board members that extraordinary circumstances exist, after consultation with the appropriate Congressional committees, the Board may impose reserve requirements on all types of liabilities outside the ranges specified elsewhere for 30-day periods. However, the Category A and Category B exemptions cannot be reduced. [But see (24) below.]

(14) A nonmember depository institution maintaining reserves is entitled to all the privileges of membership, except holding stock in or voting for directors of a Reserve Bank.

(15) Any depository institution possessing either Category A or Category B deposits shall be given access to the discount window. The Reserve Banks shall take into consideration the special needs of savings institutions.

(16) Phase-in Provisions

(a) Required reserves of those institutions who were nonmembers on August 1, 1978 are phased in over a 10-year period.

(b) Reserve reductions and increases for member banks on August 1, 1978 are permitted to be phased-in over a 48-month period.

(c) Any institution that was a nonmember on August 1, 1978 that subsequently becomes a member shall meet reserve requirements equal to those of a member bank that is in the process of having its required reserves reduced under (b). [The provision is intended to discourage small nonmembers from switching to national charter to escape State reserve requirements.]

(d) The phase-in for nonmembers in Hawaii begins in five years and extends for ten years thereafter.

Stanton Amendments

(17) Each calendar quarter after enactment the Board shall determine the ratio of total member bank deposits to all bank deposits ("coverage ratio"). The Board must publish this determination in the Federal Register and inform Congress and each member bank of the determination.

(18) Reserve requirements on Category A and B deposits shall apply only to member banks unless the coverage ratio is less than 67.5 percent. When the coverage falls below 67.5 percent, the reserve requirements on Category A and B deposits shall apply to all depository institutions 180 days after the determination is made.

(19) During the period between enactment and the end of 180 days after the date the 67.5 percent figure is determined by the Board, every member bank shall keep reserves against the first $35 million of its Category A deposits initially in the ratio of 3 percent. The Board can increase the ratio up to 12 percent. The $35 million amount is indexed 100 percent to the growth of total Category A deposits of all institutions. Category A deposits in excess of the indexed amount are reservable initially at 11 percent, variable within a range of 4-12 percent. [Category B reserve requirements are at 0 percent in accordance with (11) above.]

(20) During the period between enactment and the end of 180 days after the date the 67.5 percent coverage ratio is determined, the amount of reduced reserves that a member bank maintains shall be phased-down over a three-year period. The phase-down, however, ends 180 days after the 67.5 percent figure is achieved, and the four-year phase-in provision in (16) applies.

(21) Any bank that leaves the System after the date of enactment shall receive a refund of its required reserve balances in three equal annual payments.

(22) Banks that were members on May 24, 1979, that leave the System thereafter shall not be entitled to the ten-year phase-in of reserve requirements that will apply to nonmembers after the 67.5 percent coverage ratio is reached.

(23) Reserves on foreign branches of U.S. banks, subsidiaries and IBF's of nonmembers shall not be permitted until 180 days after the 67.5 percent coverage ratio is determined.

(24) The authority of the Board to impose reserve requirements under extraordinary circumstances (see (13) above) applies only to member banks until 180 days after the 67.5 percent coverage ratio is determined.

(25) The Board shall not approve applications for withdrawals from membership made beginning May 24, 1979, and ending on the date of enactment of the Act. Member banks may withdraw after the date of enactment.

End of
Stanton
Amendments

(26) Reserves are satisfied by maintaining vault cash or reserve balances at a Federal Reserve Bank. Reserves may be passed to the Reserve Bank through a correspondent or a Federal Home Loan Bank.

Sec. 4 Authority of state supervisors over state-chartered depository institutions is unaffected by the Act.

Sec. 5 Eliminates 10(b) penalty rate for Federal Reserve advances on ineligible collateral.

Sec. 6 Requires the Board to prepare and publish for comment a set of pricing principles and proposed fee schedules for virtually all Federal Reserve Bank services within six months after the Act is enacted. The fees shall be based upon these principles:

1. Competitive and explicit pricing.

2. Services to nonmembers and members at same fee schedule; nonmembers may be required to comply with any terms, including holding of clearing balances, that are applicable to members.
3. Long-run prices shall be based on all direct and indirect costs, including imputed costs of capital and taxes, except where the Board finds that the public interest requires a departure from the principle, after giving due regard to competitive factors and to the provision of an adequate level of services nationwide.

Sec. 7 The provision of the Act is effective upon enactment.

APPENDIX 2

ANALYSIS OF MONETARY IMPROVEMENT PROGRAM PLANS

AUGUST 6, 1979

	1977			1978 1/		
PLAN: Exemptions:		35/0	0/0		35/0	0/0
Ratios:						
Transactions		11	3,11 2/		11	3,11 2/
Savings		0	0		0	0
Short-time		0	0		0	0
Long-time		0	0		0	0
	Actual 1977	R-M-B	Stanton	Actual 1978	R-M-B	Stanton
	(1)	(2)	(3)	(4)	(5)	(6)
Reserves (billions)						
Members	27.3	7.2	7.6	31.6	6.9	7.3
Nonmembers	0	.6	0	0	.8	0
Total	27.3	7.8	7.6	31.6	7.7	7.3
Reserves Released	--	19.5	19.7	--	23.9	24.3
Cost of Reserve Requirement Changes (millions) 3/	--	1269	1281	--	1798	1821
Revenue from Service Charges	--	(410)	(410)	--	(410)	(410)
Revenue from Float Charge	--	(247) 4/	(247) 4/	--	(425) 5/	(425) 5/
Net Cost after Taxes	--	275	281	--	433	444
Number of Commercial Banks						
Exempt						
Members	0	5044	0	0	4913	0
Nonmembers	8868	8633	8868	8948	8675	8948
With Required Reserves						
Members	5664	620	5662	5558	645	5555
Nonmembers	0	235	0	0	273	0
With Reserves at Fed						
Members	5587	332	1456	5485	313	1506
Nonmembers	0	117	0	0	123	0
Percent of Total Deposits						
At Banks with Required Reserves	73.1	64.0	73.1	72.3 6/	65.0	72.3
At Banks Holding Balances at Reserve Banks	72.9	53.8	53.1	72.2	52.8	52.6
Percent of Transaction Deposits						
At Banks with Required Reserves	73.7	65.4	73.7	72.3	65.6	72.3
At Banks Holding Balances at Reserve Banks	73.5	55.6	54.5	72.2	53.7	53.1

1/ Imposing reserve requirements on U.S. branches of foreign banks at current levels and then reducing them to the level of the Reuss-Moorhead-Barnard plan would cost an additional $37 million after taxes. Reducing their reserve requirements to the level of the Stanton plan would cost an additional $33 million after taxes. Of the 105 U.S. branches of foreign banks in operation in 1978, 27 would have held reserves at the Fed under R-M-B, while 72 would have held reserves at the Fed under Stanton. With branches covered, the percentage of total deposits at banks with required reserves would be 73.0 for actual 1978, 65.0 for R-M-B, and 72.7 under Stanton. The percentage of total deposits at banks holding reserve balances at the Fed would be 73.0 for actual 1978, 53.1 for R-M-B, and 53.8 for Stanton.

2/ The first $35 million of transactions deposits are reservable at 3 percent, while all transactions deposits above $35 million are reservable at 11 percent.

3/ The figures for 1978 include an estimate of the additional loss in revenue to the Federal Reserve from reduced holdings of vault cash by member banks.

4/ Based on float outstanding of $3.8 billion in December 1977

5/ Based on average float outstanding of $5.8 billion in 1978.

6/ The Stanton trigger ratio was 71.8 percent on December 31, 1977 and 70.6 percent on December 31, 1978. The Reuss-Moorhead-Barnard plan goes into effect when this ratio falls below 67.5 percent.

September 6, 1979

To: Board of Governors

From: Ken Guenther

Attached is Chairman Proxmire's Congressional Record insert introducing the revised Monetary Policy Improvement Act of 1979. This legislation is presently being analyzed and the Board will be supplied with this analysis in the near future.

Attachment

cc: Messrs. Axilrod, Ettin, Brundy, Quick, Petersen, Schwartz, Coyne, Allison, Wallace, Ryan, Kichline and Ms. Hart

SEC. 9. Pursuant to subsection 310(a) of the Congressional Budget Act of 1974, the Committees on Veterans' Affairs shall reduce spending for fiscal year 1980 in reported or enacted laws, bills, and resolutions by $100,000,000 in budget authority and $200,000,000 in outlays and are instructed to report promptly, in accordance with section 310 of such Act, recommendations for changes in new budget authority for fiscal year 1980, budget authority initially provided for prior fiscal years, and new spending authority which is to become effective during fiscal year 1980 contained in reported or enacted laws, bills, and resolutions within the jurisdictions of those committees sufficient to accomplish the reduction required by this section.

SEC. 10. Pursuant to section 300 and 310 of the Congressional Budget Act of 1974, the committees specified in sections 3 to 9 herein shall report the recommendations required by this resolution not later than September 25, 1979, or ten days after Congress completes action on this resolution, whichever first occurs.

AMENDMENTS SUBMITTED FOR PRINTING

MONETARY POLICY IMPROVEMENT ACT OF 1979—S. 85

AMENDMENT NO. 398

(Ordered to be printed and referred to the Committee on Banking, Housing, and Urban Affairs)

Mr. PROXMIRE (for himself, Mr. BURDICK, and Mr. BUMPERS) submitted an amendment intended to be proposed by them jointly, to S. 85, a bill to amend the Federal Reserve Act to provide for maintenance of reserves in order to facilitate the implementation of monetary policy, to promote competitive equality among depository institutions, to require the imposition of service charges for services by Federal Reserve banks, and for other purposes.

Mr. PROXMIRE. Mr. President, I am today introducing an amendment to S. 85, the Monetary Policy Improvement Act of 1979, which incorporates many of the ideas that have been talked about during the course of extensive hearings on the so-called Fed membership problem, during meetings on this subject by various groups within the banking community, and during the evolution of H.R. 7 through the House of Representatives. This amendment is being offered as a substitute for the original text of S. 85 and will be considered by the Banking Committee along with H.R. 7 at hearings that have been scheduled for September 26 and 27, 1979.

This issue has been before the Congress for a considerable time and if no consensus can be reached during this session it will be an ongoing issue until it is resolved. To call it the Fed membership issue is incorrect for the issue goes far beyond the problem of the continued erosion of membership in the Federal Reserve System. That is, of course, the problem which brought the broader issues out into the open. But, in my view, and in the view of former Chairman G. William Miller, membership in the central bank is not essential. The evolution of banking and the financial markets in the past 30 years has been dramatic, and it is time to consider needed and fundamental reforms in the Federal Reserve System to make it truly our Nation's central bank unencumbered by worries about membership.

The primary responsibility of the Federal Reserve today is the conduct of monetary policy, a function that was not even envisioned in 1913 when the Congress passed the Federal Reserve Act. In fact, the most important monetary policy committee within the Federal Reserve, the Federal Open Market Committee, was not created until 1933. And since then the importance of monetary policy to the well-being of the Nation has expanded dramatically. If the Congress is to continue to depend on the Federal Reserve to manage our money and credit needs, it is the Congress responsibility to make sure that the Fed has both the necessary tools and a broad base within the financial system from which those tools can be used. The continued reduction of the proportion of deposits covered by reserve requirements could weaken the Fed's ability to implement monetary policy.

The innovativeness of the financial system has developed an expanded payments mechanism which goes far beyond that of 1913, 1933, or even 1970. Our basic money supply used to be composed of only currency, coin, and demand deposits at banks—checking accounts. But, in recent years, our means of payments have expanded to include negotiable order of withdrawal accounts (NOW's), credit union share drafts, telephone transfer and billpayer accounts, remote service units, automatic transfer accounts, and others. If control of the money supply is important to this economy, and there is almost nobody that says it is not, then the Federal Reserve must be in a position to use its policy tools to the growth of currency, demand deposits and the new types of money, regardless of whether those components of money are deposits at member banks, nonmember banks, credit unions, mutual savings banks, or savings and loan associations.

Mr. President, important and beneficial changes are needed if the Federal Reserve System is to continue to remain strong and effective. I have tried to incorporate these into the legislation I am submitting today. The broad objectives which are sought by this legislation are:

First, to insure on a permanent basis that the Federal Reserve has the ability to control money and credit in a rapidly changing financial environment;

Second, to promote greater competitive equality among financial institutions;

Third, to provide for changes in the reserve requirement structure that provide for a lower, more uniform, and more equitable structure while at the same time providing the necessary cover to strengthen the ability of the Fed to control both money and credit;

Fourth, to enhance the safety and soundness of the banking system by providing direct access to the Federal Reserve's discount window for all depository institutions offering transaction accounts based on need, not affiliation;

Fifth, to improve the efficiency of the payments mechanism by the establishment of a system of fees for Federal Reserve services, now offered without charge, by encouraging faster clearing and less float, and by providing access to Federal Reserve services to all depository institutions at the same price;

Sixth, to free the Federal Reserve Board from any overbearing concern it may have that its decisions with regard to issues of monetary policy, or supervision and regulation of banks or bank holding companies may adversely affect membership in the Federal Reserve System and, therefore, weaken its ability to act; and

Seventh, to accomplish the above objectives in a manner that provides the maximum benefit at a reasonable and justifiable cost to the U.S. Treasury and the American taxpayers.

Mr. President, on July 18, 1979 the Banking Leadership Conference of the American Bankers Association issued a consensus statement in which it affirmed the importance of preserving the strength, independence, and monetary effectiveness of the Federal Reserve. The statement also indicated that the ABA would be willing to support legislation which established reserve requirements set by the Federal Reserve on all transactions accounts offered by any and all financial intermediaries, with some allowance for size considerations. This structure has been called the level-playing field because all depositories would be treated in the same manner. The legislation that I am introducing today satisfies those requirements.

SUMMARY OF MAIN FEATURES

Reserve requirements: All depository institutions would be required to hold reserves against their transaction accounts and nonpersonal time deposits. There would be no reserve requirements against personal time and savings deposits. For transaction accounts the reserve requirement would be 3 percent on the first $5 million and 12 percent on such accounts in excess of $5 million. The Federal Reserve Board would be given the authority to vary the reserve ratio on accounts above $5 million within a range of 11 to 13 percent solely for the purpose of implementing monetary policy. For nonpersonal time deposits the reserve requirement would be zero percent on the first $5 million and 6 percent on such deposits above $5 million. The Board would have the authority to vary the reserve ratio on such deposits in excess of $5 million within a range of 0 to 12 percent, again solely for the purpose of implementing monetary policy. The Board would also be given flexibility to impose reserve requirements above or below the prescribed limits in extraordinary circumstances for a period of 30 days.

This simplified and lower reserve requirement structure would permit a reduction in reserves maintained by member banks at the Federal Reserve banks of more than $10 billion, while total reserves of the banking system would be reduced by about $7 billion. At the same time the proportion of total bank deposits held at those banks subject to reserve requirements would be increased from 72 percent to approximately 87 percent. The number of banks holding reserves would increase from 5,062, total number of members banks, to 6,872.

Reporting requirements: The Federal

Reserve Board would be authorized to require periodic reporting of liabilities and assets from all depository institutions whose reserve requirements are greater than zero as may be necessary or desirable to enable the Board to monitor and control the monetary and credit aggregates. Institutions not subject to reserve requirements would provide such reports to their respective supervisory agencies.

Discount window: Any depository institution in which transaction accounts are held would be entitled to access to the Federal Reserve's discount window on the same terms and conditions as member banks.

Federal Reserve services: The Federal Reserve would be required to publish for public comment a set of pricing principles and a proposed schedule of fees based on those principles for services offered by Federal Reserve banks to depository institutions within 6 months after enactment of the legislation. The Board would also be required to put into effect a schedule of fees for such services within 18 months after the date of enactment of the legislation.

All Federal Reserve services covered by the fee schedule would be made available to nonmember depository institutions at the same fee applicable to member banks.

The fees are to be established on the basis of all direct and indirect costs actually incurred including overhead and an allocated or imputed cost for taxes and the rate of return on capital that would have applied if such services were provided by private business firms, except where the Board determines that it is necessary to depart from this principle in order to prevent a serious and long lasting impairment of the Nation's payments system.

One of the services that the Federal Reserve provides—Federal Reserve float—arises from the clearing of checks and other paper items. The Fed is attempting to reduce the level of float by operational means and is studying possible changes in rules for clearing that may be needed to further reduce float. The legislation would require that any float remaining after such reductions be charged for at the current rate of interest applicable in the market for Federal funds.

Treasury revenues: The legislation would affect the revenues of the Federal Reserve System and ultimately the Treasury and, therefore, the budget deficit in a number of ways. First, the revised reserve requirement structure would reduce reserve requirements for member banks by $10.2 billion. This would increase member banks earnings and cost the Treasury approximately $660 million in pretax revenues. Second, the application of reserve requirements to insured and noninsured nonmember banks will result in an increase of reserves of $3.3 billion and an increase in pretax revenues to the Treasury of $213.4 million. Third, the mandate to begin charging for Federal Reserve services would produce an additional $410 million in pretax revenues to the Treasury at current service levels. Fourth, assuming reduction of float to end-of-year 1977 levels, the Federal Reserve would collect an additional $247 million in fees for the remaining float.

The combined effect of these changes would result in a pretax revenue gain to the Treasury of $210 million. However, these net gains in revenue to the Treasury would be subject to offsetting taxes against increased earnings and write-offs against increased expenses. The Treasury has estimated that the revenue loss would be at a 55-percent rate. Therefore, the net revenue gains to the Treasury would be approximately $116 million. This is a net gain in revenue, not a loss as would be the case with all other proposals. The revenue loss to the Treasury after taking into consideration of the amount to be recaptured by taxes of H.R. 7 is over $300 million and could be much more, perhaps more than $1 billion, depending on how the pricing of Federal Reserve services is handled. Given the President's commitment to hold down the deficit and to balance the budget, we must be mindful of the effects that this legislation will have on Treasury revenues. In our inflationary environment, with the CPI increasing at 13 percent, the use of Treasury revenues to provide additional revenues for the banks, will be extremely difficult to justify to the voters of the Nation.

Mr. President, I had an opportunity to meet with Chairman Volcker yesterday to discuss the Fed membership legislation. Several different approaches were the subject of our meeting, including some new ideas that Chairman Volcker has put forth. He will be discussing this issue with various groups over the next 2 or 3 weeks prior to our committee hearings on September 26 and 27.

Mr. President, I ask unanimous consent that the text of my amendment and the section-by-section analysis of the amendment be included in the RECORD.

There being no objection, the amendment and analysis were ordered to be printed in the RECORD, as follows:

AMENDMENT NO. 398

Strike out all after the enacting clause and insert in lieu thereof the following: That this Act may be cited as the "Monetary Policy Improvement Act of 1979".

DEFINITIONS

SEC. 2. Section 19(a) of the Federal Reserve Act (12 U.S.C. 461(a)) is amended by adding at the end thereof the following new paragraphs:

"The term 'depository institution' means—

"(1) any insured bank as defined in section 3 of the Federal Deposit Insurance Act;

"(2) any mutual savings bank as defined in section 3 of the federal Deposit Insurance Act;

"(3) any savings bank as defined in section 3 of the Federal Deposit Insurance Act;

"(4) any insured credit union as defined in section 101 of the Federal Credit Union Act;

"(5) any member as defined in section 2 of the Federal Home Loan Bank Act;

"(6) any insured institution as defined in section 401 of the National Housing Act; and

"(7) for the purpose of section 13 and the fourteenth paragraph of section 16, any association or entity which is wholly owned by or which consists only of institutions referred to in clauses (1) through (6).

"The term 'bank' means any insured or noninsured bank, as defined in section 3 of the Federal Deposit Insurance Act, other than a mutual savings bank or a savings bank as defined in section 3 of the Federal Deposit Insurance Act.

"The term 'transaction account' means a deposit or account on which the depositor or account holder is allowed to make withdrawals by negotiable or transferable instrument, payment orders of withdrawal, or other similar item for the purpose of making payments or transfers to third persons or others. Such term includes demand deposits, negotiable order of withdrawal accounts, savings deposits subject to automatic transfers, and share draft accounts.

"The term 'nonpersonal time deposits' means a time deposit or account representing funds deposited to the credit of, or in which any beneficial interest is held by a depositor who is not a natural person.

"In order to prevent evasions of the reserve requirements imposed by this Act, after consultation with the Board of Directors of the Federal Deposit Insurance Corporation, the Federal Home Loan Bank Board, and the National Credit Union Administration Board, the Board of Governors of the Federal Reserve System is further authorized to determine, by regulation or order, that an account or deposit is a transaction account if such account or deposit may be used to provide funds directly or indirectly for the purpose of making payments or transfers to third persons or others.".

REPORTING REQUIREMENTS

SEC. 3 Section 11(a) of the Federal Reserve Act (12 U.S.C. 248(a)) is amended—

(1) by inserting "(1)" immediately after "(a)"; and

(2) by adding at the end thereof the following new paragraph:

"(2) To require any depository institution specified in this paragraph to make, at such intervals as the Board may prescribe, such reports of its liabilities and assets as the Board may determine to be necessary or desirable to enable the Board to discharge its responsibility to monitor and control monetary and credit aggregates. Such reports shall be made (A) directly to the Board in the case of member banks and in the case of other depository institutions whose reserve requirements under section 19 of this Act exceed zero, and (B) for all other reports to the Board through the (i) Federal Deposit Insurance Corporation in the case of insured State nonmember banks, savings banks, and mutual savings banks, (ii) National Credit Union Administration Board in the case of insured credit unions, (iii) Federal Home Loan Bank Board in the case of any institution insured by the Federal Savings and Loan Insurance Corporation or which is a member as defined in section 2 of the Federal Home Loan Bank Act, and (iv) such State officer or agency as the Board may designate in the case of any other type of bank, savings and loan association, or credit union. The Board shall endeavor to avoid the imposition of unnecessary burdens on reporting institutions and the duplication of other reporting requirements. Any data provided to any department, agency, or instrumentality of the United States pursuant to other reporting reouirements shall be made available to the Poard. The Board may classify depositorv institutions for the purposes of this paragraph and mav impose different requirements on each such class.".

RESERVE REQUIREMENTS

SEC. 4. Section 19(b) of the Federal Reserve Act (12 U.S.C. 461(b)) is amended to read as follows:

"(b)(1) RESERVE REQUIREMENTS.—(A) Each depository institution shall maintain reserves against its transaction accounts as the Board may by regulation prescribe solely for the purpose of implementing monetary policy—

"(i) in the ratio of 3 per centum for that portion of its total transaction accounts of $5,000,000 or less; and

"(ii) in the ratio of 12 per centum, or in such other ratio as the Board may prescribe not greater than 13 per centum and not less than 11 per centum, for that portion of its total transactions accounts in excess of $5,-000,000.

"(B) Each depository institution shall maintain reserves against its nonpersonal; time deposits as the Board may by regulation prescribe solely for the purpose of implementing monetary policy—

"(i) in the ratio of 0 per centum for that portion of its nonpersonal time deposits if $5,000,000 or less; and

"(ii) in the ratio of 6 per centum, or in such other ratio not greater than 12 per centum and not less than 0 per centum, for that portion of its nonpersonal time deposits in excess of the $5,000,000.

"(2) WAIVER OF RATIO LIMITS.—Upon a finding by the Board that extraordinary circumstances require such action, the Board, after consultation with the appropriate committees of the Congress, may impose reserve requirements above or below the limits otherwise prescribed by this section for a period not exceeding thirty days, and for further periods not exceeding thirty days each by affirmative action by the Board in each instance. The Board shall promptly transmit to the Congress a report of any exercise of its authority under this paragraph and the reasons for such exercise.

"(3) PRIVILEGES OF INSTITUTIONS MAINTAINING RESERVES.—During any period that a depository institution is maintaining reserves pursuant to this section, such depository institution shall be entitled to all the privileges of membership in the Federal Reserve System, except that, if it is not otherwise a member, it may not hold stock in, or vote for any director of, a Federal Reserve bank.

"(4) RESERVES RELATED TO FOREIGN OBLIGATIONS OR ASSETS.—Foreign branches, subsidiaries, and international banking facilities of nonmember depository institutions shall maintain reserves to the same extent required by the Board of foreign branches, subsidiaries, and international banking facilities of member banks. In addition to any reserves otherwise required to be maintained pursuant to this subsection, any depository institution shall maintain reserves in such ratios as the Board may prescribe against—

"(A) net balances owed by domestic offices of such depository institution in the United States to its directly related foreign offices and to nonrelated foreign depository institutions,

"(B) loans to United States residents made by overseas offices of such depository institution if such depository institution has one or more offices in the United States, and

"(C) assets (including participations) held by foreign offices of a depository institution in the United States which were acquired from its domestic offices (other than assets representing credit extended to persons not residents of the United States).

"(5) EXEMPTION FOR CERTAIN DEPOSITS.—The requirements imposed by paragraph (1) of this subsection do not apply to deposits payable only outside the States of the United States and the District of Columbia, but nothing in this subsection limits the authority of the Board to impose conditions and requirements on member banks under section 25 of this Act or the authority of the Board under section 7 of the International Banking Act of 1978 (12 U.S.C. 3105).

"(6) DISCOUNT AND BORROWING.—Any depository institution in which transaction accounts are held shall be entitled to the same discount and borrowing privileges as member banks.

"(7) TRANSITIONAL ADJUSTMENTS.—

"(A) Any depository institution required to maintain reserves under this section which was engaged in business on July 1, 1979, but was not a member of the Federal Reserve System on that date, shall maintain reserves against its deposits during the first twelve-month period following the effective date of this paragraph in amounts equal to one-fourth of those otherwise required by this section, during the second such twelve-month period in amounts equal to one-half of those otherwise required, and during the third such twelve-month period in amounts equal to three-fourths of those otherwise required.

"(B) With respect to any bank which was a member of the Federal Reserve System on July 1, 1979, the amount of required reserves imposed pursuant to this section on the effective date of this section that exceeds the amount of required reserves maintained by the member institution during the reserve computation period immediately preceding the effective date of such paragraphs may, at the discretion of the Board and in accordance with such rules and regulations as it may adopt, be reduced by 75 per centum during the first year which begins after such effective date, 50 per centum during the second year, and 25 per centum during the third year.

"(C) In order to provide for an orderly transition period, the Board shall implement the reduction in reserve requirements resulting from the amendment of this subsection by the Monetary Policy Improvement Act of 1979 with respect to member banks over a period not greater than 48 months after the effective date of such paragraph.

"(D) Any depository institution which is a member bank on July 1, 1979, and leaves the Federal Reserve System after such date shall continue to be required to maintain reserves against its deposits after the effective date of this section as if it were a member bank.".

FORM OF RESERVES

SEC. 5. Section 19(c) of the Federal Reserve Act, as amended (12 U.S.C. 461) is amended to read as follows:

"(c) Reserves held by a depository institution to meet the requirements imposed pursuant to subsection (b) of this section shall be in the form of—

"(1) balances maintained for such purposes by such depository institution in the Federal Reserve bank of which it is a member or at which it maintains an account. However, the Board may, by regulation or order, permit depository institutions to maintain all or a portion of their required reserves in the form of vault cash, except that any portion so permitted shall be identical for all depository institutions; and

"(2) balances maintained by a nonmember depository institution in a depository institution that maintains required reserve balances at a Federal Reserve bank, in a Federal home loan bank, or in a central liquidity facility for credit unions, if such depository institution, Federal home loan bank, or central liquidity facility maintains such funds in the form of balances in a Federal Reserve bank of which it is a member or at which it maintains an account. Balances received by a depository institution from another depository institution and used to satisfy the reserve requirement imposed on such depository institution by this section shall not be subject to the reserve requirements of this section imposed on such bank, and shall not be subject to assessment imposed on such bank, pursuant to section 7 of the Federal Deposit Insurance Act.".

MISCELLANEOUS AMENDMENTS

SEC. 6. (a) The first paragraph of section 13 of the Federal Reserve Act (12 U.S.C. 342) is amended as follows:

(1) by inserting after the words "member banks" the words "or other depository institutions";

(2) by inserting after the words "payable upon presentation" the first and third times they appear, the words "or other items";

(3) by inserting after "payable upon presentation within its district," the words "or other items";

(4) by inserting after "nonmember bank or trust company," wherever it appears the words "or other depository institution";

(5) by striking out "sufficient to offset the items in transit held for its account by the Federal Reserve bank" and inserting in lieu thereof the words "in such amount as the Board determines taking into account items in transit, services provided by the Federal Reserve bank, and other factors as the Board may deem appropriate"; and

(6) by inserting after the words "nonmember bank" after the second colon the words "or other depository institution".

(b) The second paragraph of section 16 of the Federal Reserve Act (12 U.S.C. 412) is amended to read as follows:

"Each Federal Reserve bank shall maintain with the local Federal Reserve agent collateral in the form of financial assets in an amount not less than the amount of Federal Reserve notes issued by such bank and outstanding. Collateral shall not be required for Federal Reserve notes that are held in the vaults of Federal Reserve banks. The Federal Reserve agent shall each day notify the Board of Governors of the Federal Reserve System of all issues and withdrawals of Federal Reserve notes to and by the Federal Reserve bank to which he is accredited. The Board of Governors may at any time call upon a Federal Reserve bank for additional security to protect the Federal Reserve notes issued by it.".

(c) The thirteenth paragraph of section 16 of the Federal Reserve Act (12 U.S.C. 360) is amended—

(1) by striking out the words "member banks" wherever they appear and inserting in lieu thereof "depository institutions";

(2) by striking out the words "member bank" wherever they appear and inserting in lieu thereof "depository institution"; and

(3) by inserting after "checks" wherever it appears the words "and other items, including negotiable orders of withdrawal and share drafts".

(d) The fourteenth paragraph of section 16 of the Federal Reserve Act (12 U.S.C. 248 (o)) is amended by striking out "its member banks" and inserting in lieu thereof "depository institutiôns".

(e) The first sentence of section 19(e) of the Federal Reserve Act (12 U.S.C. 463) is amended to read as follows: "No member bank shall keep or deposit with any depository institution which is not authorized to have access to Federal Reserve advances under section 10(b) of this Act a sum in excess of 10 per centum of its own paid-up capital and surplus.".

ABOLITION OF PENALTY RATE

SEC. 7. Section 10(b) of the Federal Reserve Act (12 U.S.C. 347b) is amended by striking out the second sentence of the first paragraph thereof.

PRICING OF SERVICES

SEC. 8. The Federal Reserve Act is amended by inserting after section 11 the following new section:

"SEC. 11A. (a) Not later than the first day of the sixth calendar month after the date of enactment of the Monetary Policy Improvement Act of 1979, the Board shall publish for public comment a set of pricing principles in accordance with this section and a proposed schedule of fees based upon those principles for Federal Reserve bank services to depository institutions, and not later than the first day of the eighteenth calendar month after the date of enactment of the Monetary Policy Improvement Act of 1979, the Board shall put into effect a schedule of fees for such services which is based on those principles.

"(b) The services which shall be covered by the schedule of fees under subsection (a) are—

"(1) currency and coin services;

"(2) check clearing and collection services;

"(3) wire transfer services;

"(4) automated clearinghouse services;

"(5) settlement services;

"(6) securities safekeeping services;

"(7) Federal Reserve float; and

"(8) any new services which the Federal Reserve system offers, including but not limited to payment services to effectuate the electronic transfer of funds.

"(c) The schedule of fees prescribed pursuant to this section shall be based on the following principles:

"(1) All Federal Reserve bank services covered by the fee schedule shall be priced explicitly.

"(2) All Federal Reserve bank services covered by the fee schedule shall be available to nonmember depository institutions and such services shall be priced at the same fee schedule applicable to member banks, except that nonmembers shall be subject to any other terms, including a requirement of balances sufficient for clearing purposes, that the Board may determine are applicable to member banks.

"(3) Over the long run, fees shall be established on the basis of all direct and indirect costs actually incurred in providing the Federal Reserve services priced, including interest on items credited prior to actual collection, overhead, and an allocation of imputed costs which takes into account the taxes that would have been paid and the return on capital that would have been provided had the services been furnished by a private business firm, except that the pricing principles shall give due regard to competitive factors and the provision of an adequate level of such services nationwide.

"(4) Interest on items credited prior to collection shall be charged at the current rate applicable in the market for Federal funds.

"(d) The Board shall require reductions in the operating budgets of the Federal Reserve banks commensurate with any actual or projected decline in the volume of services to be provided by such banks. The full amount of any savings so realized shall be paid into the United States Treasury.".

AUTHORITY OF STATE BANK SUPERVISORS

SEC. 9. Nothing in the this Act or in the amendments made by this Act shall be construed in derogation of the authority of any officer or agency of State over any institutions organized or existing under the laws of such State.

EFFECTIVE DATES

SEC. 10. This Act shall take effect on the date of enactment, except that the amendments made by sections 4 and 5 of this Act shall take effect on the first day of the sixth month which begins after the date of enactment of this Act.

SECTION-BY-SECTION ANALYSIS

Section 1. Title. Title of the bill is the "Monetary Policy Improvement Act of 1979".

Section 2. Definitions. Defines the terms "depository institution", "bank", "transaction account", and "nonpersonal time deposits". The section also gives the Federal Reserve 'Board the authority to determine whether an account or deposit is a transaction account after consultation with the Federal Deposit Insurance Corporation, the Federal Home Loan Bank Board, and the National Credit Union Administration Board.

Section 3. Reporting Requirements. Gives the Federal Reserve Board the authority to collect reports of liabilities and assets from depository institutions as may be necessary or desirable to enable the Board to discharge its responsibility to monitor and control monetary and credit aggregates.

Section 4. Reserve Requirements. This section establishes rules pertaining to reserves to be held against deposits held by depository institutions.

Every depository institution would have reserve requirements against its transaction accounts of less than $5,000,000 in a ratio of 3% and in excess of $5,000,000 in a ratio of 12%, or within a range of 11% to 13%, as determined by the Board for the purpose of implementing monetary policy. Also, every depository institution would have reserve requirements against its nonpersonal time deposits in excess of $5,000,000 in a ratio of 6%, or within a range of 0% to 12%

The Board would be given the authority to impose reserve requirements outside statutory limits for a period of 30 days in extraordinary circumstances. The exercise of this authority would require the Board to report the reasons for such actions from the Congress.

Any depository institution maintaining reserves would be entitled to all the privileges of membership in the Federal Reserve System, except nonmembers could not hold stock in or vote for directors of a Federal Reserve Bank.

The Board's authority to apply reserve requirements against foreign obligations or assets of member banks is classified and such authority as extended to nonmember depository institutions. Reserves could be prescribed against net balances owed by domestic offices to foreign offices, loans to U.S. residents made by overseas offices, and assets held by foreign offices of a U.S. depository institution acquired from its domestic offices.

The authority of the Board to impose conditions and requirements in member banks under Section 25 of the Federal Reserve Act and section 7 of the International Banking Act of 1978 is not limited by this Act.

Any depository institution in which transaction accounts are held would have access to the discount window on the same basis as member banks.

There would be a four-year phase-in of reserve requirements for any depository institution that was not a member as of July 1, 1979. Similarly, any member bank as of July 1, 1979 with an increase in reserve requirements imposed pursuant to this legislation would have a four-year phase-in of the additional requirements.

The reduction of reserve requirements for member banks would be made over a four-year period.

A nonmember depository institution, organized under state law, with the principal offices of which are outside the continental limit of the U.S. would not be required to hold reserves against its deposits until six years after the enactment of the legislation, and then the reserve requirements would be phased-in over an additional 10 years.

Any bank which is a member bank as of July 1, 1979 and leaves the Federal Reserve System would continue to be required to maintain reserves as if it were a member.

Section 5. Form of Reserves. The reserves held by a depository institution to meet its reserve requirements would be required to be held as (1) balances for that purpose at a Federal Reserve bank, (2) vault cash, or (3) balances maintained by a nonmember depository institution in a depository institution that maintains required reserve balances at a Federal Reserve bank, in a Federal Home Loan bank, or in a central liquidity facility for credit unions, provided such balances are maintained in the form of balances with a Federal Reserve bank.

Section 6. Miscellaneous Amendments. This section amends the Federal Reserve Act to permit the Federal Reserve bank to accept deposits and to clear checks or similar instruments received from nonmember depository institutions. It also amends the collateral requirements for Federal Reserve notes.

Section 7. Abolition of Penalty Rate. Eliminates the penalty rate on advances to member banks.

Section 8. Pricing of Services. This section requires that the Federal Reserve Board publish for comment a set of pricing principals for Federal Reserve services within six months after the date of enactment of the legislation. The Board would also be required to put a fee schedule into effect within 18 months after the date of enactment.

The services to be priced include currency and coin, check clearing and collection, wire transfers, ACH services, settlement, securities safekeeping, and Federal Reserve float with float to be valued at the Federal funds rate.

This section specifies a set of principals on which prices are to be based. It also indicates that if adherence to the pricing principals for system services results in an increase in the performance of such service by the private sector the Board would make commensurate reductions in system expenditures for the provision of such services.

Section 9. Authority of State Bank Supervisors. This section provides that nothing in the bill is to be construed in derogation of the authority of any state bank supervisor over any institution it supervises by state law.

Section 10. Effective Dates. The new reserve requirement included in Section 4 and 5 takes effect on the first day of the sixth calendar month after enactment. All other sections take effect on the date of enactment.

Mr. PROXMIRE. Mr. President, I ask unanimous consent that the Senator from North Dakota (Mr. BURDICK) and the Senator from Arkansas (Mr. BUMPERS) be added as cosponsors to the amendment.

The PRESIDING OFFICER. Without objection, it is so ordered.

NOTICES OF HEARINGS

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

● Mr. HARRY F. BYRD, JR. Mr. President, I wish to announce that the Subcommittee on Taxation and Debt Management of the Committee on Finance will hold a hearing on extension of the temporary limit on the public debt has been scheduled. The Honorable William G. Miller, Secretary of the Treasury, Mr. James T. McIntyre, Director of the Office of Management and Budget, and Alice M. Rivlin, Director of the Congressional Budget Office, will testify on the public debt at 2 p.m., Tuesday, September 11, 1979, in room 2221, Dirksen Senate Office Building.

The temporary debt limit of $836 billion which the Congress enacted in February of 1979 is due to expire on September 30.

By law, the budget is required to be in balance by fiscal year 1981.

The hearings will give Congress an opportunity to review the work of the Office of Management and Budget in preparing a balanced budget and implementing the requirements established by prior debt ceiling legislation.

The subcommittee would be pleased to receive written testimony from those persons or organizations who wish to submit statements for the record. Statements submitted for inclusion in the record should be typewritten, not more than 25 double-spaced pages in length and mailed with five copies by October 1, 1979, to Michael Stern, staff director, Committee on Finance, room 2227, Dirksen Senate Office Building, Washington, D.C.●

SUBCOMMITTEE ON ENERGY REGULATION

● Mr. JOHNSTON. Mr. President, I wish to announce that the Subcommittee on Energy Regulation of the Committee on Energy and Natural Resources will hold

Monetary Improvement Program

A Comparison of Proposals Before Congress

Major Provisions	H.R. 7 Introduced January 15 by Rep. Henry S. Reuss	H.R. 7 as modified January 24 by testimony of Federal Reserve Board Chairman G. William Miller		S.85 Introdued January 18 by Sen. William Proxmire
Universal Reserve Requirements Ranges	8-10% on transaction accounts including automatic transfer and NOW accounts (9.5% initially) 3-8% on short-term time deposits (8% initially) 1-3% on savings deposits (3% initially) 1-3% on long-term time deposits (1% initially)	Same as H.R. 7		12-14% on transaction deposits (13% initially) 4-8% on short-term time deposits (6% initially) 1-5% on savings deposits (3% initially) 1/2-2% on long-term time deposits (1% initially)
Institutions covered	Commercial banks for all categories; thrift institutions for transaction accounts only.	Coverage same as H.R. 7		Coverage essentially same as H.R. 7
Exemption Levels	$50 million of transaction deposits and $50 million of total time and savings deposits	Same as H.R. 7 (See Earnings Participation Account below)		$40 million of transaction deposits and $40 million of total time and savings deposits
Indexation	Exemption level indexed by Federal Reserve each year to maintain constant the percentage of deposits at institutions with reservable deposits	No Indexation		No Indexation
Earnings Participation Account (EPA)	Not included	The first $10 million of transaction deposits and the first $10 million of other deposits would be excluded. An EPA would be held against deposits exempted by H.R. 7 from reserve requirements. The size of the EPA for each category of deposits would be the amount of deposits between $10 million and $50 million multiplied by the reserve ratio that would apply. The return on the account would be equal to the average return on the Federal Reserve portfolio (about 6.75% last year).		Not included
Phase in of Reserve Requirements	Reductions for member banks phased in over two years. Increases phased in over 4 years	Same as H.R. 7		Essentially the same as H.R. 7
Pricing of Federal Reserve Services	By July 1, 1979, Board must publish for comment a set of pricing principles and proposed fee schedule	Same as H.R. 7		By July 1, 1979, Board must publish for comment a set of pricing principles and fee schedule; fees must go into effect by July 1, 1980
Access to Services	Services covered by fee schedule available to all depository institutions	Same as H.R. 7		Services covered by fee schedule available to all depository institutions
Access to Discount Window	For all institutions with transaction accounts	Same as H.R. 7		For all commercial banks and thrift institutions having reservable deposits but Board can request a certification of solvency from FDIC for non-member banks
Institutions Affected				
Member Banks	Non-Earning	Non-Earning	Including EPA	Non-Earning
Covered (Holding Balances at Fed)	424	424	2091	516
Exempt (Not Holding Fed Balances)	5240	5240	3573	5048
Non-Member Banks				
Covered	232	232	1541	280
Exempt	8722	8722	7413	8674
Thrift Institutions Covered	0	0	0	0
Credit Unions Covered	0	0	0	0
Reserve Coverage	71% of total bank deposits	94% of total bank deposits		75% of total bank deposits
Total Reserve Reductions	$12.2 billion	$6.3 billion		$8.4 billion
Net Cost to Treasury	$173 million; declining in future because loss from attrition avoided.	$173 million; declining in future because loss from attrition avoided		$60 million; declining in future because loss from attrition avoided

Decline in Membership in the Federal Reserve System

	Number of Member Banks	Percent of Deposits
1945	6884	86.3
1950	6873	85.7
1955	6543	85.2
1960	6174	84.0
1965	6221	82.9
1970	5767	80.1
1975	5787	75.1
1976	5758	73.8
1977	5664	71.8
1978	5593	70.8

From testimony of G. William Miller, Chairman of the Federal Reserve Board, before the House Banking Committee, January 24, 1979

"It is essential that the Federal Reserve maintain adequate control over the monetary aggregates if the nation is to succeed in its efforts to curb inflation, sustain economic growth, and maintain the value of the dollar in international exchange markets. The attrition in deposits subject to reserve requirements set by the Federal Reserve weakens the linkage between member bank reserves and the monetary aggregates. . ."

Board of Governors of the Federal Reserve System
Washington, D.C. 20551
February 9, 1979

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date August 6, 1979

To Chairman Volcker

Subject: H.R. 7: Monetary Improvement Bill

From Nancy Teeters N.H.T.

I find H.R. 7 as passed by the House acceptable primarily as a device to bring the proposal to serious consideration in the Senate. Features that I would like to see changed are:

Reserves should be mandatory, with no or a very small exemption, on transaction accounts

NOW or ATS accounts would be considered transaction accounts

The trigger mechanism embodied in the Stanton amendment should be removed

A somewhat wider range on the level of reserve requirements would be desirable

Even if the initial reserve requirement is set at 12 percent, the permissible range should allow us to raise as well as lower reserves

If the range were 8 to 16 percent we could again use required reserves as a policy instrument

The compromise in the reserves behind savings and time deposits is acceptable. My primary concern was to achieve evenhanded treatment among the various financial institutions for the transaction accounts. It would be desirable to have a range of reserve requirements for policy purposes, even if initially the reserves were set at zero.

What the implications of a mandatory reserve requirement would be for membership in the System are not clear. Obviously, the incentives to leave the System are greatly reduced. The only remaining differentials between members and nonmembers would be ownership of stock in the District banks and which agency was responsible for bank examination. The major disadvantage of owning Federal Reserve stock is the six percent dividend. Our General Counsel has recently interpreted the six percent figure that is in the statute as a "minimum," an interpretation that I gathered is a departure from previous positions. It may be possible to pay rates of return closer to those available in the market in the future. With examination council, differences between regulatory agencies in examination procedures are rapidly disappearing. Selection of an examination agency should not be a factor.

On balance, if the rate of return on the stock remains at six percent, we might lose a few members. However, with mandatory reserves, we pick up members, simply for the prestige associated with membership. I have not heard of a bank leaving the System for reasons other than those associated with the cost of membership. If the cost factor disappears, it seems to me likely that former members will rejoin.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

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OFFICE OF THE CHAIRMAN

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date July 31, 1979

To Distribution

Subject: Effects of H.R. 7

From James Brundy JmB

The attached table contains cost and coverage estimates for H.R. 7 based on 1977 and on 1978 year-end data. Because H.R. 7 as passed by the House contains two approaches to solving the membership problem--the Stanton Amendment and the Reuss-Moorhead-Barnard plan--the table shows the effects of both approaches. The Stanton Amendment is analyzed in columns (3) and (6) and the Reuss-Moorhead-Barnard version, which would be triggered only if coverage of total deposits fell below 67.5 percent, in columns (2) and (5).

The rate of return on the System portfolio used to calculate the cost of reserves released and of float was 6.5 percent for 1977 and 7.33 percent for 1978. Reserves on December 31, 1978 would have been $5.7 billion higher than on the same date in 1977, and the estimated reserve release is much larger.

The estimates for 1977 do not include reserves on U.S. branches of foreign banks, but they are included for 1978. This change in treatment reflects enactment during 1978 of the International Banking Act. It is assumed that branches have reserve requirements that are the same as member banks. Therefore, in spite of an increase of about $180 million in the value of float recouped, the cost of the plans is substantially (about $175 million) higher when calculated using December 31, 1978 data.

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ANALYSIS OF MONETARY IMPROVEMENT PROGRAM PLANS JULY 31, 1979

		1977			1978 1/	
PLAN: Exemptions:		35/0	0/0		35/0	0/0
Ratios:						
Transactions		11	3,11 2/		11	3,11 2/
Savings		0	0		0	0
Short-time		0	0		0	0
Long-time	Actual	0	0	Actual	0	0
	1977	R-M-B	Stanton	1978	R-M-B	Stanton
	(1)	(2)	(3)	(4)	(5)	(6)
Reserves (billions)						
Members	27.3	7.2	7.6	31.6	6.9	7.3
Nonmembers	0	.6	0	0	.8	0
Foreign Bank Branches	n.a.	n.a.	n.a.	1.4	.3	.4
Total	27.3	7.8	7.6	33.0	8.0	7.7
Reserves Released	--	19.5	19.7	--	25.0	25.3
Cost of Reserve Requirement Changes (millions) 6/	--	1269	1281	--	1879	1894
Revenue from Service Charges	--	(410)	(410)	--	(410)	(410)
Revenue from Float Charge	--	(247) 3/	(247) 3/	--	(425) 4/	(425) 4/ annualized
Net Cost after Taxes	--	275	281	--	470	477
Number of Commercial Banks						
Exempt						
Members	0	5044	0	0	4913	0
Nonmembers	8868	8633	8868	8948	8675	8948
Foreign Bank Branches	n.a.	n.a.	n.a.	0	77	0
With Required Reserves						
Members	5664	620	5662	5558	645	5555
Nonmembers	0	235	0	0	273	0
Foreign Bank Branches	n.a.	n.a.	n.a.	105	28	85
With Reserves at Fed						
Members	5587	332	1456	5485	313	1506
Nonmembers	0	117	0	0	123	0
Foreign Bank Branches	n.a.	n.a.	n.a.	101	27	72
Percent of Total Deposits						
At Banks with Required Reserves	73.1	64 0	73.1	73.0	65.0 5/	72.7
At Banks Holding Balances at Reserve Banks	72.9	53.8	53.1	72.9	53.1	53 8
Percent of Transaction Deposits						
At Banks with Required Reserves	73.7	65.4	73.7	72.8	66 0	72.5
At Banks Holding Balances at Reserve Banks	73.5	55.6	54.5	72.7	54.3	53.2

1 The results for 1977 and 1978 are not comparable because foreign bank branches were excluded for 1977.

2/ The first $35 million of transactions deposits are reservable at 3 percent, while all transactions deposits above $35 million are reservable at 11 percent.

3/ Based on float outstanding of $3.8 billion in December of 1977.

4/ Based on average float outstanding of $5.8 in 1978.

5/ The Stanton trigger ratio was 70.6 percent of December 31, 1978. The Reuss-Moorhead-Barnard plan goes into effect when this ratio falls below 67.5 percent.

6/ The figures for 1978 include an estimate of the additional loss in revenue to the Federal Reserve from reduced holdings of vault cash by member banks.

CHAIRMAN VOLCKER

#3

For Consideration at a Board Session

8/13

TO: Board of Governors

DATE: August 9, 1979

FROM: Staff
(Messrs. Axilrod, Brundy,
and Quick)

SUBJECT: H.R. 7

To facilitate Board discussion of H.R. 7 as passed by the House, this memorandum summarizes the main provisions of the bill and reviews their implications for such concerns as membership attrition, monetary control, and balances required for use of Federal Reserve services.

Highlights of Bill

The version of H.R. 7 passed by the House on July 20th is a hybrid bill containing both the provisions of the Reuss-Moorhead-Barnard (R-M-B) version of H.R. 7 and the Stanton amendment.[1] The Stanton amendment, which goes into effect immediately upon enactment of the bill, continues the existing voluntary system for member banks at substantially reduced reserve ratios. If the voluntary system is not adequate to stop attrition from membership, the R-M-B version of mandatory universal reserve requirements will be triggered.

The Stanton amendment is applicable to members only. Reserve requirements on transactions accounts of member banks are reduced substantially. A 3 percent reserve ratio is imposed on the first $35 million in transactions deposits at a member bank. Above $35 million an 11 percent reserve ratio applies. The Board is permitted to adjust these ratios within a range of 4 to 12 percent (sic). The $35 million breakpoint for the lower reserve ratio is indexed to the rate of growth of total transactions deposits.

[1] The provisions of H.R. 7 are summarized in Appendix 1.

The Board has authority under the bill to vary reserve requirements on short-term (less than 6 months to maturity) non-personal time deposits in a range of zero to 8 percent, but there is no authority--other than emergency powers--to set reserve requirements on other domestic time and savings deposits. The reserve ratio on short-term non-personal time deposits is initially set at zero. In the House debate, Representative St. Germain, whose amendment reduced that ratio to zero, stated that the ratio should remain at zero unless the Board were 1) to negotiate a Eurodollar reserves agreement with other central banks, and in addition, 2) to find that economic conditions required the imposition of reserve requirements on time deposits.

These reserve requirement provisions from the Stanton amendment are phased in over a three-year period, with 50 percent of the resulting reduction in reserve requirements occurring in the first year and 25 percent in each of the two subsequent years. Access to the discount window is provided at the time of enactment to all institutions having transactions accounts, or short-term non-personal time deposits, whether or not they hold reserves at the Fed. All other services are to be made available to all depository institutions on equal terms, and a price schedule for services is to be published within six months after enactment. In addition, the Stanton amendment contains certain transition provisions designed to make it less attractive to withdraw from the System during the period after enactment.[1/]

In the event that the Stanton amendment does not arrest attrition from the System, coverage of deposits by Federal reserve requirements will

[1/] For example, the required reserves of a bank that withdraws after enactment will be reduced in three equal annual installments rather than immediately.

continue to decline. When deposits at member banks as a proportion of total deposits at all commercial banks eligible to apply for FDIC insurance drops below 67½ percent, the mandatory provisions of the R-M-B version of H.R. 7 come into effect. At the end of 1978 this trigger ratio was 70.6 percent, down from 71.8 percent at the end of 1977.

The mandatory provisions of H.R. 7 are those of the R-M-B version. They become effective 180 days after the Board determines that the trigger point has been reached. Federal reserve requirements would then apply to transactions accounts at all depository institutions. A $35 million exemption would be provided, indexed at 80 percent of the growth rate of transactions deposits. An 11 percent reserve ratio would be initially imposed above the exemption. For purposes of monetary policy the Board could adjust the reserve ratio within the range of 4 to 12 percent. The reserve requirement provisions for time or savings deposits are the same as under the Stanton amendment.

The provision of the R-M-B version of H.R. 7 permitting all financial assets of the Federal Reserve to count as collateral behind the note issue was struck on the floor of the House. As will be discussed, this raises questions about the feasibility of implementing the reserve requirement reductions.

Appendix 2 presents an analysis of the cost and coverage of the bill using both 1977 and 1978 data. The Stanton amendment provisions, which go into effect on enactment, are shown in column 3 and column 6 of the table. The R-M-B provision, that go into effect after the trigger point has been reached, are shown in columns 2 and 5 of the table. Using 1977 data, the cost to the Treasury of the bill is estimated at roughly $280 million annually when the phase-in of reserve requirement changes,

prices and access has been completed. Reserves at the Federal Reserve Banks are reduced by approximately $20 billion, based on 1977 data. Some 1,450 banks would hold reserves at the Fed under the Stanton provisions, while only about 450 banks would hold balances at the Federal Reserve after the mandatory provisions took effect.

On enactment, when the Stanton amendment becomes effective, the proportion of all transactions balances at banks subject to Federal reserve requirements will be roughly 74 percent, the same as under the current reserve structure.[1/] At present, also about 74 percent of all transactions balances are held by banks holding balances at the Federal Reserve. Once the reserve reductions in the Stanton amendment become fully effective the latter ratio will drop to 55 percent. After large nonmember banks were brought under Federal reserve requirements by the triggering of the mandatory provisions, the coverage would be 56 percent.

Implications

Membership attrition. Whether a bank withdraws from membership under the Stanton amendment obviously will depend on its assessment of benefits vs. costs. The net effect on bank earnings of H.R. 7 (including pricing of services) nearly offsets the burden of membership as earlier calculated by the staff. This earlier calculation, however, is not relevant to the present bill because it assumed that access to services and the discount window under a voluntary plan remained limited to members (or to institutions holdings balances equal to member bank required reserves). Under the Stanton provision, by contrast, any depository institution, whether or not a member bank, can obtain the services of the Reserve

[1/] The coverage estimates shown are based on deposits and membership for December 1977.

Banks (though the discount window is available only if it has transactions or short-term non-personal time balances). Thus, an institution would be able to withdraw from membership, obtain all the services, and not be required to hold sterile Federal reserves (although the Fed could require the same clearing balances applicable to members as a condition of use of payments services).

With equal access to services by members and nonmembers alike, the burden of membership in effect becomes the total amount of balances at the Fed required to be held above the beyond what are needed for operating or precautionary purposes. Under the Stanton amendment, existing member banks would be required to hold approximately $16 billion in required reserves, of which about $8 billion probably would be held in vault cash for operating purposes and $8 billion as balances at the Fed. It is not likely that banks would voluntarily hold balances of this size at the Fed--and lose about $700 million per year in earnings--unless the System allowed these balances to serve as compensation for services received by the bank. However, it is not clear that permitting payment for services by a credit against reserve balances is consistent with the spirit of discussion surrounding the pricing provisions of H.R. 7. Moreover, such a reserve credit would significantly increase the costs to the Treasury.

On the basis of this analysis, further significant membership attrition might be expected during the voluntary phase of H.R. 7, unless banks believe there are substantial public relations, supervisory, or other technical benefits to membership. The timing with which banks might in practice leave the System depends on a very complicated calculation involving the net gain in earnings from receiving one-third of required reserves per year for three years on withdrawal as compared with the scheduled phase-down of required reserves for existing members. As a rough estimate, under the circumstances, the mandatory phase of H.R. 7 may become effective within

two or three years (unless, to repeat, the bill can be administered in such a way as to permit payment for services by treating reserves as compensating balances).

Once reserve requirements become mandatory, financial calculations about the burden of membership become by and large irrelevant. It seems likely that banks which found it desirable to be a member when holding significant quantities of reserves on voluntary basis will continue to do so when reserve requirements are reduced by two-thirds. Indeed, the state bank supervisors have expressed concern that the H.R. 7 reserve ratios are so low, especially for the smallest banks, that many banks will seek to convert to a national charter to avoid state requirements. Moreover, it is thought that dual examination by the state and by the FDIC is a significant burden that banks will seek to avoid by converting to a national charter.

Monetary control. Although H.R. 7 as passed probably would not make the task of monetary control more difficult, it is not clear that it would improve the ability of the Federal Reserve to control the money supply. If the System seeks to control growth of the aggregates by affecting reserve availability in such a way as to establish a particular interest rate range consistent with that growth rate, it seems unlikely that H.R. 7 would have any effect at all on monetary control.

If the System were to attempt to control an M-1 type monetary aggregate using a reserves target, it is not clear whether monetary control would be facilitated or not. On the one hand, reserve requirements on demand deposits at member banks (or non-exempt banks) would be somewhat more uniform. Thus, the potential complications for monetary control caused by graduated reserve requirement ratios might be reduced.

On the other hand, the large reduction in reserve requirements would increase substantially the number of banks at which vault cash needed for

operations would exceed required reserves. Thus, the proportion of deposits at banks which do not hold reserve balances at the Fed and which are not subject to binding Federal reserve requirements would be increased. Consequently, there would be an increased likelihood of deposit shifts between banks with binding Federal reserve requirements and those banks not bound and whose desired reserve ratios would differ from the stipulated Federal requirement, causing additional variability in the M-1/reserves multiplier. Moreover, the large reduction in required reserves greatly increases the M-1/reserves multiplier, so the effect on the money stock of any change in reserves is amplified. Thus, any errors in projections of reserve availability would introduce more slippage into the monetary control process.

Other effects of the bill on monetary policy would arise from the omission of reserve requirements on time and savings deposits. Zero reserve requirements on time and savings deposits would act to stabilize the M-1/reserves multiplier and thus would improve control of this aggregate under a reserves operating target. However, the System could not--without invoking emergency provisions--use changes in reserve requirements on time deposits to affect the cost of managed liabilities (except on non-personal, short-term time under quite limited conditions). In addition, lack of reserve requirements on any class of time deposits would make it more difficult to control an M-2 type monetary aggregate through an aggregate reserve target.

Adequacy of balances for clearing purposes. Most member banks under the Stanton amendments and most non-exempt banks under the R-M-B provisions will have very small balances at the Federal Reserve, particularly in relation to the services that they are likely to use. As a percent of total deposits at banks with reserves at the Fed, reserve balances will drop from the present 4-1/2 percent to a little over 1 percent; as a percent of demand deposits at those banks, these ratios are 14-1/2 and 3-1/2 percent, respectively. The amount of buffer provided by the reserve balances against the possibility of overdrafts in reserve accounts will be decreased. Increased overdrafts may be the outcome.

Should balances from required reserves prove inadequate in practice, the System would have a number of alternatives, none of which are entirely satisfactory. The Fed could ask for additional clearing balances, but an equitable formula may be difficult to construct. Or banks without adequate balances could be required to settle through those with an adequate balance--which might impose a penalty on some banks. A third possibility would be to require no specific balance for access to clearing services, but to levy a substantial penalty for overdrawing the account.

Collateral. As noted earlier, H.R. 7 no longer has a provision that permits all financial assets held by Federal Reserve Banks to stand behind the Fed's currency liability. As a result, it may not be possible to implement the reserve requirement provisions of H.R. 7 in full. In terms of deposits at the end of 1978, required reserve balances at the Fed would be reduced by about $24 billion. Free note collateral at that time was about $19½ billion; in mid-1979 free note collateral was only $13½ billion. Thus, the reduction in Government security holdings in the Fed portfolio that would accompany the decline in required reserves would probably leave the System without adequate collateral for Federal Reserve notes.

currency

Reporting. As passed, H.R. 7 permits the Fed to obtain asset and liability reports from all depository institutions as needed for monetary policy purposes. Member banks are required to make such reports directly to the Federal Reserve, but other classes of depository institutions are required only to report directly their transactions balances and short-term

non-personal time deposits. All other reports that the Board may require for monetary policy purposes are to be provided through each institution's primary federal or state regulator.

This procedure is likely to be cumbersome both from the point of view of the Board and of the depository institutions that would be required to report to the Board through two channels. Moreover, the delays and communications problem inherent in passing data through the other regulators is likely to make such data of limited value for guiding day-to-day open market operations.

. . . .

While the preceding analysis has focused on certain problem areas, there are a number of clear benefits for the financial system in the bill. All depository institutions with transactions accounts receive access to the discount window. And all depository institutions, whether or not they have transactions accounts, obtain access to System services at a price--which should encourage efficiency in the payments mechanism. Once the mandatory reserve requirement provisions go into effect, there will be no discrimination between classes of institutions with regard to reserve requirements. Also, the Board will obtain authority to set reserves on resources obtained abroad by nonmember depository institutions in the mandatory phase of the bill. Finally, the bill does contain an emergency reserve requirement provision giving the Board authority over all liabilities of all depository institutions, but applicable only after consultation with Congress in extraordinary circumstances for short, renewable periods of time.

Some of these benefits depend on triggering the mandatory provisions, but there is always the risk that Congress may lower the trigger point as the actual coverage ratio approaches it,and pressures from nonmember institutions mount. Other benefits--such as the "level playing field" for

reserve requirements--are achieved without any clear gain for monetary control, except possibly over the long-run.

Finally, it should be noted that the bill does have longer-run implications for the structure of the Federal Reserve System. Once the mandatory provisions become effective, they may in practice appear to conflict with the voluntary nature of membership in the Federal Reserve System. Thus, pressures could develop to modify the structure of the System, perhaps eliminating membership, and questions would be raised in the process about the role of the System in supervisory matters and the role of Reserve Banks and their Boards of Directors in monetary matters.

APPENDIX 1

H.R. 7 As Enacted by The House

Summary of Major Provisions

Sec. 1 Title--Monetary Control Act of 1979.

Sec. 2 Requires all depository institutions to make reports on assets and liabilities as the Board determines necessary to monitor and control monetary and credit aggregates. All member bank reports are to be made directly to the Board as are reports for Category A and B deposits of all nonmember depository institutions. All other reports by nonmembers are to be through the principal supervisor.

Sec. 3 (1) The Board may exercise its authority to define the term "deposit" as applied to required reserves of nonmembers after consultation with the FDIC, FHLBB, and NCUA.

(2) The term "Category A deposit" means all forms of transactional accounts (e.g. NOWs and demand deposits) except deposits subject to six or fewer telephone transfers per month.

(3) The term "Category B deposit" means all nonpersonal time deposits of less than 180 days. Personal time deposits are nonnegotiable, nontransferable deposits of a natural person.

(4) Graduated reserve ratios may be imposed within the ranges provided.

(5) Domestic reserve requirements shall not apply to deposits payable only outside the U.S. However, Eurodollar reserve requirements may be applied on such deposits.

(6) Reserve requirements may be imposed or changed for the sole purpose of implementing monetary policy.

(7) A depository institution that is owned by other institutions and does not do business with the public shall not be required to maintain reserves.

[Numbers (8) through (16) below apply only after the 67.5% trigger is reached as provided by the Stanton Amendment (see (17) through (25) below). However, access to the discount window is immediately available to all institutions with Category A or Category B deposits.]

(8) The Category A and Category B exemptions for 1979 are $35 million and $10 million, respectively, plus 80 percent of the growth of Category A and Category B deposits from December 31, 1977, to June 30, 1978. Thereafter, the exemption is indexed to 80 percent of the growth of deposits.

(9) The principal supervisor determines which institutions will not have deposits above the exemption levels and thus will not be required to maintain reserves.

(10) Category A deposit reserve requirements shall be 11 percent initially, within a range of 4-12 percent. Different reserve ratios may be established for different types of that category of deposits.

(11) Category B deposit reserve requirements shall be 0 percent initially, within a range of 0-8 percent. [The legislative history indicates that Mr. St Germain intended this authority to be used only if (1) there is agreement with the central banks of other industrialized countries to impose Eurodollar reserve requirements equally, and (2) economic conditions

warrant such reserve requirements to control Eurodollar borrowings, after Board consultation with the appropriate Congressional committees.]

(12) Reserves may be imposed on Eurodollar borrowings or nonmember foreign branches, subsidiaries, and IBF's to the same extent that may be imposed on member bank foreign branches subsidiaries and IBF's. The Board may impose reserves on borrowings from, loans to U.S. residents by, and purchases of assets from domestic offices by foreign offices of any depository institution. [But see (23) below.]

(13) Upon a vote of five Board members that extraordinary circumstances exist, after consultation with the appropriate Congressional committees, the Board may impose reserve requirements on all types of liabilities outside the ranges specified elsewhere for 30-day periods. However, the Category A and Category B exemptions cannot be reduced. [But see (24) below.]

(14) A nonmember depository institution maintaining reserves is entitled to all the privileges of membership, except holding stock in or voting for directors of a Reserve Bank.

(15) Any depository institution possessing either Category A or Category B deposits shall be given access to the discount window. The Reserve Banks shall take into consideration the special needs of savings institutions.

(16) Phase-in Provisions

(a) Required reserves of those institutions who were nonmembers on August 1, 1978 are phased in over a 10-year period.

(b) Reserve reductions and increases for member banks on August 1, 1978 are permitted to be phased-in over a 48-month period.

(c) Any institution that was a nonmember on August 1, 1978 that subsequently becomes a member shall meet reserve requirements equal to those of a member bank that is in the process of having its required reserves reduced under (b). [The provision is intended to discourage small nonmembers from switching to national charter to escape State reserve requirements.]

(d) The phase-in for nonmembers in Hawaii begins in five years and extends for ten years thereafter.

Stanton Amendments

(17) Each calendar quarter after enactment the Board shall determine the ratio of total member bank deposits to all bank deposits ("coverage ratio"). The Board must publish this determination in the Federal Register and inform Congress and each member bank of the determination.

(18) Reserve requirements on Category A and B deposits shall apply only to member banks unless the coverage ratio is less than 67.5 percent. When the coverage falls below 67.5 percent, the reserve requirements on Category A and B deposits shall apply to all depository institutions 180 days after the determination is made.

(19) During the period between enactment and the end of 180 days after the date the 67.5 percent figure is determined by the Board, every member bank shall keep reserves against the first $35 million of its Category A deposits initially in the ratio of 3 percent. The Board can increase the ratio up to 12 percent. The $35 million amount is indexed 100 percent to the growth of total Category A deposits of all institutions. Category A deposits in excess of the indexed amount are reservable initially at 11 percent, variable within a range of 4-12 percent. [Category B reserve requirements are at 0 percent in accordance with (11) above.]

(20) During the period between enactment and the end of 180 days after the date the 67.5 percent coverage ratio is determined, the amount of reduced reserves that a member bank maintains shall be phased-down over a three-year period. The phase-down, however, ends 180 days after the 67.5 percent figure is achieved, and the four-year phase-in provision in (16) applies.

(21) Any bank that leaves the System after the date of enactment shall receive a refund of its required reserve balances in three equal annual payments.

(22) Banks that were members on May 24, 1979, that leave the System thereafter shall not be entitled to the ten-year phase-in of reserve requirements that will apply to nonmembers after the 67.5 percent coverage ratio is reached.

(23) Reserves on foreign branches of U.S. banks, subsidiaries and IBF's of nonmembers shall not be permitted until 180 days after the 67.5 percent coverage ratio is determined.

(24) The authority of the Board to impose reserve requirements under extraordinary circumstances (see (13) above) applies only to member banks until 180 days after the 67.5 percent coverage ratio is determined.

(25) The Board shall not approve applications for withdrawals from membership made beginning May 24, 1979, and ending on the date of enactment of the Act. Member banks may withdraw after the date of enactment.

End of
Stanton
Amendments

(26) Reserves are satisfied by maintaining vault cash or reserve balances at a Federal Reserve Bank. Reserves may be passed to the Reserve Bank through a correspondent or a Federal Home Loan Bank.

Sec. 4 Authority of state supervisors over state-chartered depository institutions is unaffected by the Act.

Sec. 5 Eliminates 10(b) penalty rate for Federal Reserve advances on ineligible collateral.

Sec. 6 Requires the Board to prepare and publish for comment a set of pricing principles and proposed fee schedules for virtually all Federal Reserve Bank services within six months after the Act is enacted. The fees shall be based upon these principles:

1. Competitive and explicit pricing.

2. Services to nonmembers and members at same fee schedule; nonmembers may be required to comply with any terms, including holding of clearing balances, that are applicable to members.

3. Long-run prices shall be based on all direct and indirect costs, including imputed costs of capital and taxes, except where the Board finds that the public interest requires a departure from the principle, after giving due regard to competitive factors and to the provision of an adequate level of services nationwide.

Sec. 7 The provisions of the Act are effective upon enactment.

APPENDIX 2

ANALYSIS OF MONETARY IMPROVEMENT PROGRAM PLANS

AUGUST 6, 1979

		1977			1978 1/	
Exemptions:		35/0	0/0		35/0	0/0
Ratios:						
Transactions		11	3,11 2/		11	3,11 2/
PLAN: Savings		0	0		0	0
Short-time		0	0		0	0
Long-time	Actual	0	0	Actual	0	0
	1977	R-M-B	Stanton	1978	R-M-B	Stanton
	(1)	(2)	(3)	(4)	(5)	(6)
Reserves (billions)						
Members	27.3	7.2	7.6	31.6	6.9	7.3
Nonmembers	0	.6	0	0	.8	0
Total	27.3	7.8	7.6	31.6	7.7	7.3
Reserves Released	--	19.5	19.7	--	23.9	24.3
Cost of Reserve Requirement Changes (millions) 3/	--	1269	1281	--	1798	1821
Revenue from Service Charges	--	(410)	(410)	--	(410)	(410)
Revenue from Float Charge	--	(247) 4/	(247) 4/	--	(425) 5/	(425) 5/
Net Cost after Taxes	--	275	281	--	433	444
Number of Commercial Banks						
Exempt						
Members	0	5044	0	0	4913	0
Nonmembers	8868	8633	8868	8948	8675	8948
With Required Reserves						
Members	5664	620	5662	5558	645	5555
Nonmembers	0	235	0	0	273	0
With Reserves at Fed						
Members	5587	332	1456	5485	313	1506
Nonmembers	0	117	0	0	123	0
Percent of Total Deposits						
At Banks with Required Reserves	73.1	64.0	73.1	72.3 6/	65.0	72.3
At Banks Holding Balances at Reserve Banks	72.9	53.8	53.1	72.2	52.8	52.6
Percent of Transaction Deposits						
At Banks with Required Reserves	73.7	65.4	73.7	72.3	65.6	72.3
At Banks Holding Balances at Reserve Banks	73.5	55 6	54.5	72.2	53.7	53.1

1/ Imposing reserve requirements on U.S. branches of foreign banks at current levels and then reducing them to the level of the Reuss-Moorhead-Barnard plan would cost an additional $37 million after taxes. Reducing their reserve requirements to the level of the Stanton plan would cost an additional $33 million after taxes. Of the 105 U.S. branches of foreign banks in operation in 1978, 27 would have held reserves at the Fed under R-M-B, while 72 would have held reserves at the Fed under Stanton. With branches covered, the percentage of total deposits at banks with required reserves would be 73.0 for actual 1978, 65.0 for R-M-B, and 72.7 under Stanton. The percentage of total deposits at banks holding reserve balances at the Fed would be 73.0 for actual 1978, 53.1 for R-M-B, and 53.8 for Stanton.

2/ The first $35 million of transactions deposits are reservable at 3 percent, while all transactions deposits above $35 million are reservable at 11 percent.

3/ The figures for 1978 include an estimate of the additional loss in revenue to the Federal Reserve from reduced holdings of vault cash by member banks.

4/ Based on float outstanding of $3.8 billion in December 1977

5/ Based on average float outstanding of $5.8 billion in 1978.

6/ The Stanton trigger ratio was 71.8 percent on December 31, 1977 and 70.6 percent on December 31, 1978. The Reuss-Moorhead-Barnard plan goes into effect when this ratio falls below 67.5 percent.

H.R. 7 As Enacted by The House

Sec. 1 Title--Monetary Control Act of 1979.

Sec. 2 Requires all depository institutions to make reports on assets and liabilities as the Board determines necessary to monitor and control monetary and credit aggregates. All member bank reports are to be made directly to the Board as are reports for Category A and B deposits of all nonmember depository institutions. All other reports by nonmembers are to be through the principal supervisor.

Sec. 3(a) The Board may exercise its authority to define the term "deposit as applied to required reserves of nonmembers after consultation with the FDIC, FHLBB, and NCUA.

(b)(1) The term "Category A deposit" means all forms of transactional accounts (e.g. NOWs and demand deposits) except deposits subject to six or fewer telephone transfers per month.

(2) The term "Category B deposit" means all nonpersonal time deposits of less than 180 days. Personal time deposits are nonnegotiable, nontransferable deposits of a natural person.

(3) Graduated reserve ratios may be imposed within the ranges provided.

(4) Domestic reserve requirements shall not apply to deposits payable only outside the U.S. However, Eurodollar reserve requirements may be applied on such deposits.

(5) Reserve requirements may be imposed or changed for the sole purpose of implementing monetary policy.

(6) A depository institution that is owned by other institutions and does not do business with the public shall not be required to maintain reserves.

[Sections (7) through (15) below apply only after the 67.5% trigger is reached as provided by the Stanton Amendment (see (16) through (24) below). However, access to the discount window is immediately available to all institutions with Category A deposits.]

(7) The Category A and Category B exemptions for 1979 are $35 million for each category plus 80 percent of the growth of Category A and Category B deposits from December 31, 1977, to June 30, 1978. Thereafter, the exemption is indexed to 80 percent of the growth of deposits.

(8) The principal supervisor determines which institutions will not have deposits above the exemption levels and thus will not be required to maintain reserves.

(9) Category A deposit reserve requirements shall be 11 percent initially, within a range of 4-12 percent. Different reserve ratios may be established for different types of that category of deposits.

(10) Category B deposit reserve requirements shall be 0 percent initially, within a range of 0-8 percent. [The legislative history indicates that Mr. St Germain intended this authority to be used only if (1) there is agreement with the central banks of other industrialized countries to impose Eurodollar reserve requirements equally, and (2) economic conditions warrant such reserve requirements to control Eurodollar borrowings, after Board consultation with the appropriate Congressional committees.]

(11) Reserves may be imposed on Eurodollar borrowings on nonmember foreign branches, subsidiaries, and IBF's to the same extent that may be imposed on member bank foreign branches subsidiaries and IBF's. [But see (22) below.]

(12) Upon a vote of five Board members that extraordinary circumstances exist, after consultation with the appropriate Congressional committees, the Board may impose reserve requirements on all types of liabilities outside the ranges specified elsewhere for 30-day periods. [But see (23) below.]

(13) A nonmember depository institution maintaining reserves is entitled to all the privileges of membership, except holding stock in or voting for directors of a Reserve Bank.

(14) Any depository institution possessing Category A deposits shall be given access to the discount window. The Reserve Banks shall take into consideration the special needs of savings institutions.

(15) Phase-in Provisions

(a) Required reserves of those institutions who were nonmembers on August 1, 1978 are phased in over a 10-year period.

(b) Reserve reductions and increases for banks that were members on August 1, 1978 are permitted to be phase-in over a 48-month period.

(c) Any institution that was a nonmember on August 1, 1978 that subsequently becomes a member shall meet reserve requirements equal to those of a member bank that is in the process of having its required reserves reduced under (b). [The provision is intended to discourage small nonmembers from switching to national charter to escape State reserve requirements.]

(d) The phase-in for nonmembers in Hawaii begins in five years and extends for ten years thereafter.

Stanton Amendments

(16) Each calendar quarter after enactment the Board shall determine the ratio of total member bank deposits to all bank deposits ("coverage ratio"). The Board must publish this determination in the Federal Register and inform Congress and each member bank of the determination.

(17) Reserve requirements on Category A and B deposits shall apply only to member banks unless the coverage ratio is less than 67.5 percent. When the coverage falls below 67.5 percent, the reserve requirements on Category A and B deposits shall apply to all depository institutions 180 days after the determination is made.

(18) During the period between enactment and the end of 180 days after the date the 67.5 percent figure is determined by the Board, every member bank shall keep reserves against the first $35 million of its Category A deposits initially in the ratio of 3 percent. The Board can increase the ratio up to 12 percent. The $35 million amount is indexed

100 percent to the growth of total Category A deposits of all institutions. Category A deposits in excess of the indexed amount are reservable initially at 11 percent, within a range of 4-12 percent. [Category B reserve requirements are at 0 percent in accordance with (10) above.]

(19) During the period between enactment and the end of 180 days after the date the 67.5 percent coverage ratio is determined, the amount of reduced reserves that a member bank maintains shall be phased-down over a three-year period. The phase-down, however, ends 180 days after the 67.5 percent figure is achieved, and the four-year phase-in provision in (15) applies.

(20) Any bank that leaves the System after the date of enactment shall receive a refund of its required reserve balances in three equal annual payments.

(21) Banks that were members on May 24, 1979, that leave the System thereafter shall not be entitled to the ten-year phase-in of reserve requirements that will apply to nonmembers after the 67.5 percent coverage ratio is reached.

(22) Reserves on foreign branches of U.S. banks, subsidiaries and IBF's of nonmembers shall not be permitted until 180 days after the 67.5 percent coverage ratio is determined.

(23) The authority of the Board to impose reserve requirements under extraordinary circumstances (see (12) above) applies only to member banks until 180 days after the 67.5 percent coverage ratio is determined.

End of Stanton Amendments

(24) The Board shall not approve applications for withdrawals from membership made beginning May 24, 1979, and ending on the date of enactment of the Act. Member banks may withdraw after the date of enactment.

(25) Reserves are satisfied by maintaining vault cash or reserve balances at a Federal Reserve Bank. Reserves may be passed to the Reserve Bank through a correspondent or a Federal Home Loan Bank.

Sec. 4 Authority of state supervisors over state-chartered depository institutions is unaffected by the Act.

Sec. 5 Eliminates 10(b) penalty rate for Federal Reserve advances on ineligible collateral.

Sec. 6 Requires the Board to prepare and publish for comment a set of pricing principles and proposed fee schedules for virtually all Federal Reserve Bank services within six months after the Act is enacted. The fees shall be based upon these principles:

1. Competitive and explicit pricing.
2. Services to nonmembers and members at same fee schedule; nonmembers may be required to comply with any terms, including holding of clearing balances, that are applicable to members.
3. Long-run prices shall be based on all direct and indirect costs, including imputed costs of capital and taxes, except where the Board finds that the public interest requires a departure from the principle, after giving due regard to competitive factors and to the provision of an adequate level of services nationwide.

Sec. 7 The Act is effective upon enactment.

H.R. 7 as Passed by the House

1. Reporting Requirements

Gives the Board authority to require from any depository institution reports of assets and liabilities as are necessary for the purposes of monetary policy.

2. Initial Voluntary Reserve Requirement System

Reduces reserves on transactions accounts at member banks as follows:

transaction accounts -- a 3 per cent reserve ratio on the first $35 million of transaction accounts

-- an 11 per cent reserve ratio (or within the ranges of 4-12) on transaction account deposits above $35 million

Time & Savings accounts -- no reserves on time and savings accounts except that there is a reserve ratio of 0-8 on short-term (less than 180 days) nonpersonal or personal negotiable time deposits. But the initial ratio is 0 and it cannot be increased unless there is international agreement on the need to control Eurodollar borrowings via the imposition of reserve requirements and consultation with Congress.

3. Trigger Mechanism

Provides that a mandatory reserve requirement system is triggered if the ratio of the amount of total deposits held by all member banks to the amount of total deposits at all banks becomes less than 67.5 per cent.

4. Mandatory Reserve Requirements

-- Applies to all depository institutions.
-- Imposes reserve requirements as follows:

on transaction accounts -- no reserves on the first $35 million of transaction accounts

-- an 11 per cent reserve ratio (or within the range of 4-12) on transaction account deposits over $35 million

5. Services

-- Provides prices for Federal Reserve services.

-- All services covered by the fee schedule are to be available to non-member depository institutions at the same fees and terms as to member banks.

6. Discount Window

There is some confusion as a result of Floor amendments but it appears that before the trigger mechanism is reached access to the discount window will be limited to member banks. After the trigger mechanism is reached, the discount window is available to all institutions with transaction accounts.

MIP PLAN RUN ON JULY 23, 1979

		Current	(H.R. 7)[4]	Bill Passed on July 20, 1979
PLAN:	Exemptions:		35/10	0/0
	Ratios:			
	Transactions		11	3,11[3]
	Savings		0	0
	Short-time		3[2]	0
	Long-time		0	0
Reserves (billions)				
Members		27.3	8.4	7.6
Nonmembers		0	.7	0
Total		27.3	9.1	7.6
Reserves Released		--	18.2	19.7
Cost of Reserve Requirement Changes (millions)		--	1187	1281
Revenue from Service Changes		--	(410)	(410)
Net Cost before Taxes		--	777	871
Net Cost after Taxes (No Float Adjustment)		--	349	392
Revenue from Float Charge (Net of Tax)[1]		--	(111)	(111)
Net Cost after Taxes (With Float Adjustment)		--	238	281
Number of Commercial Banks				
Exempt				
Members		0	4954	0
Nonmembers		8868	8599	8868
With Required Reserves				
Members		5664	710	5664
Nonmembers		0	269	0
With Reserves at Fed				
Members		5587	348	1456
Nonmembers		0	126	0
Percent of Total Deposits At Banks with Required Reserves		71.8	65.4	71.8
Percent of Transaction Deposits At Banks with Required Reserves		73.0	66.6	73.0

Requested By:

[1] Based on float outstanding of $3.8 billion in December of 1977. Average float for the year 1977 was $3.6 billion, and for the year 1978, $5.8 billion.

[2] Only non-individual time deposits are reservable.

[3] The first $35 million of transactions deposits has a 3 percent reserve requirement, while all transactions deposits above $35 million are reservable at 11 percent.

[4] This version of H.R. 7 was passed out of the House Banking Committee.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date July 24, 1979

To Distribution

From James Brundy

Subject: Passage of H.R.7 by the House of Representatives

As most of you probably already know, H.R.7 (the membership bill) was passed by the House of Representatives on July 20, 1979, by a vote of 340-20. The bill as passed by the House was substantially different from the bill that was reported to the House by the Banking Committee. The major difference that may not be obvious from the attached daily report is that the House-passed version applies to member banks only until such time as less than 67.5% of total deposits are held at banks with Federal reserve requirements. In this event, a version similar to that reported by the House Banking Committee would come into effect. At the end of 1978, 71% of total deposits were held at member banks (institutions with Federal reserve requirements), and the ratio has been decreasing about one percentage point per year.

MIP PLANS RUN ON JULY 24, 1979

PLAN: Exemptions:		35/10	0/0	0/5	5/5
Ratios:					
Transactions		11	3,11[4]	4,12[6]	12
Savings		0	0	0	0
Short-time		3[2]	0	6[2]	6[2]
Long-time		0	0	0	0
	Current	(H.R. 7)[3]	(H.R.7)[5]		
Reserves (billions)					
Members	27.3	8.4	7.6	14.2	13.7
Nonmembers	0	.7	0	2.9	2.4
Total	27.3	9.1	7.6	17.1	16.1
Reserves Released	--	18.2	19.7	10.2	11.2
Cost of Reserve Requirement Changes (millions)	--	1187	1281	663	729
Revenue from Service Changes	--	(410)	(410)	(410)	(410)
Net Cost before Taxes	--	777	871	253	319
Net Cost after Taxes (No Float Adjustment)	--	349	392	114	143
Revenue from Float Charge (Net of Tax)[1]	--	(111)	(111)	(111)	(111)
Net Cost after Taxes (With Float Adjustment)	--	238	281	3	32
Number of Commercial Banks					
Exempt					
Members	0	4954	0	2	2086
Nonmembers	8868	8599	8868	110	5611
With Required Reserves					
Members	5664	710	5664	5662	3578
Nonmembers	0	269	0	8758	3257
With Reserves at Fed					
Members	5587	348	1456	3726	2252
Nonmembers	0	126	0	4353	1602
Percent of Total Deposits At Banks with Required Reserves	71.8	65.4	71.8	100	91.5
Percent of Transaction Deposits At Banks with Required Reserves	73.0	66.6	73.0	100	92.6
Requested By:				Roberts	ABA

[1] Based on float outstanding of $3.8 billion in December of 1977. Average float for the year 1977 was $3.6 billion, and for the year 1978, $5.8 billion.

[2] Only non-individual time deposits are reservable.

[3] As passed by the House Banking Committee.

[4] The first $35 million of transactions deposits are reservable at 3%, while all transactions deposits above $35 million are reservable at 11%.

[5] As passed by the House of Representatives on July 20, 1979.

[6] The first $35 million of transactions deposits are reservable at 4%, while all transactions deposits above $35 million are reservable at 12%.

EVOLUTION OF HOUSE BANKING COMMITTEE RESERVE REQUIREMENT PROPOSALS

	Current System	H.R. 14072 9/14/78	H.R. 7 1/15/79	Son of H.R. 7 4/12/79	Grandson of H.R. 7 5/22/79	Stanton Amendment	H.R. 7 as Passed By the House 7/20/79	
							Voluntary System	Mandatory System, if triggered
1) Number of banks subject to reserve requirements	5664	Unknown	1526	2302	1015	5,664	5,664	1015
2) Number of banks holding reserves at Fed	5664	800	656	699	510	1,648	1,648	510
3) Exemptions	0	a) $50M demand & savings b) $50M time	a) $50M demand & savings b) $50M time	a) $35M transactions b) $35M time & savings	a) $35M transactions b) $10M non-personal short time	a) none b) none	a) none b) none	a) $35M transactions b) $10M non-personal short time
4) Indexing		full	full	partial	partial	full	full	partial
5) Reserve Ratios (initial ratios in parenthesis)								
Transactions	7-16¼%	6-8% (7)	8-10% (9.5)	4-8% (7)	4-12% (11)	4-12% (3) under $35M 4-12% (11) over $35M	4-12% (3) under $35M 4-12% (11) over $35M	4-12% (11)
Savings	3%		1-3% (3)	0-3% (1)	N/A	N/A	N/A	N/A
Short Time	3-6	1-6% (6)	3-8% (8)	4-8% (7)	N/A on consumer 0-8% (3) on non-personal	N/A on consumer 0-8% on non-personal	N/A on consumer 0-8% (0) on non-personal	N/A on consumer 0-8% (0) on non-personal
Long Time	1-2½%	1-3% (1)	1-3% (1)	0-3% (1)	N/A	N/A	N/A	N/A
6) Coverage of Thrifts								
Transaction Deposits	no	no	yes	yes	yes	no	no	yes
Time and Savings Deposits	no	no	no	no	yes	no	no	yes
7) Reduction in non-earning reserves at the Fed								
Members		$14.5B	$13.9B	$18.5B	$18.9B	$18.4B	$18.4B	$18.9B
Non-members		-1.3B	-1.7B	- .8B	-0.9B	none	none	- 0.9B

July 18, 1979

CONSENSUS STATEMENT -- BANKING LEADERSHIP CONFERENCE

The members of the Banking Leadership Conference, anticipating further legislative action in the House of Representatives and later in the Senate on the Federal Reserve issue, affirmed the importance of preserving the strength, independence and monetary effectiveness of our nation's central bank. The bankers concluded that the practical legislative goal for the banking community is the following:

- For monetary policy purposes, the Federal Reserve should be authorized to impose reserve requirements on transaction accounts offered by any and all financial intermediaries. Reserve requirements set by the Federal Reserve should apply to transaction account deposits only.
- Recognizing that allowance of size considerations among financial intermediaries may facilitate resolution of the issue, these reserve requirements could be structured to apply a lower reserve ratio to each intermediary's net transaction account deposits below a certain level, with a higher reserve ratio on net transaction deposits above that level.
- Recognizing the cost factors inherent in interest-bearing transaction account balances, a lower reserve rate should be established for such accounts than the level established for non-interest-bearing transaction account balances.

* * * * * * * * * * *

Recognizing that the House of Representatives will vote on H.R. 7 this week, and that the two major options which will be put before the House will be H.R. 7 and the Freedom of Choice Amendment, the members of the Banking Leadership Conference voted strong support of the Freedom of Choice Amendment as a much superior alternative to H.R. 7.

Preservation of the opportunity to retain the voluntary relationship between banks and the Federal Reserve System, which would be accomplished by the Freedom of Choice Amendment, is essential until such time as the legislative process presents the option of achieving bankers' ultimate legislative goal of true competitive equality.

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American Bankers Association. *Capital*, No. 418, July 24, 1979.

TO: Board of Governors
FROM: Staff
(Messrs. Axilrod, Brundy, and Quick)

DATE: August 8, 1979
SUBJECT: H.R. 7

To facilitate Board discussion of H.R. 7 as passed by the House, this memorandum summarizes the main provisions of the bill and reviews their implications for such concerns as membership attrition, monetary control, and balances required for use of Federal Reserve services.

Highlights of Bill

The version of H.R. 7 passed by the House on July 20th is a hybrid bill containing both the provisions of the Reuss-Moorhead-Barnard (R-M-B) version of H.R. 7 and the Stanton amendment.[1/] The Stanton amendment, which goes into effect immediately upon enactment of the bill, continues the existing voluntary system for member banks at substantially reduced reserve ratios. If the voluntary system were not adequate to stop attrition from membership, the R-M-B version of mandatory universal uniform reserve requirements would be triggered.

The Stanton amendment is applicable to members only. Reserve requirements on transactions accounts of member banks are reduced substantially. A 3 percent reserve ratio is imposed on the first $35 million in transactions deposits at a member bank. Above $35 million an 11 percent reserve ratio applies. The Board is permitted to adjust these ratios within a range of 4 to 12 percent (sic). The $35 million breakpoint for the lower reserve ratio is indexed to the rate of growth of total transactions deposits.

[1/] The provisions of H.R. 7 are summarized in Appendix 1.

The Board has authority under the bill to vary reserve requirements on short-term (less than 6 months to maturity) non-personal time deposits in a range of zero to 8 percent, but there is no authority--other than emergency powers--to set reserve requirements on other domestic time and savings deposits. The reserve ratio on short-term non-personal time is initially set at zero. In the House debate, Representative St. Germain, whose amendment reduced that ratio to zero, stated that the ratio should remain at zero unless the Board were 1) to negotiate a Eurodollar reserves agreement with other central banks, and in addition, 2) to find that economic conditions required the imposition of reserve requirements on time deposits.

These reserve requirement provisions from the Stanton amendment are phased in over a three-year period, with 50 percent of the resulting reduction in reserve requirements occurring in the first year and 25 percent in each of the two subsequent years. Access to the discount window is provided at the time of enactment to all institutions having transactions accounts, whether or not they hold reserves at the Fed. All other services are to be made available to all depository institutions on equal terms, and a price schedule for services is to be published within six months after enactment. In addition, the Stanton amendment contains certain transition provisions designed to make it less attractive to withdraw from the System during the period after enactment.[1]

In the event that the Stanton amendment does not arrest attrition from the System, coverage of deposits by Federal reserve requirements will

[1] For example, the required reserves of a bank that withdraws after enactment will be reduced in three equal annual installments rather than immediately.

continue to decline. When deposits at member banks as a proportion of total deposits at all commercial banks eligible to apply for FDIC insurance drops below 67½ percent, the mandatory provisions of the R-M-B version of H.R. 7 come into effect. At the end of 1978 this trigger ratio was 70.6 percent, down from 71.8 percent at the end of 1977.

The mandatory provisions of H.R. 7 are those of the R-M-B version. They become effective 180 days after the Board determines that the trigger point has been reached. Federal reserve requirements would then apply to transactions accounts at all depository institutions, A $35 million exemption would be provided, indexed at 80 percent of the growth rate of transactions deposits. An 11 percent reserve ratio would be initially imposed above the exemption. For purposes of monetary policy the Board could adjust the reserve ratio within the range of 4 to 12 percent. The reserve requirement provisions for time or savings deposits are the same as under the Stanton amendment.

The provision of the R-M-B version of H.R. 7 permitting all financial assets of the Federal Reserve to count as collateral behind the note issue was struck on the floor of the House. As will be discussed, this raises questions about the feasibility of implementing the reserve requirement reductions.

Appendix 2 presents an analysis of the cost and coverage of the bill using both 1977 and 1978 data. The Stanton amendment provisions, which go into effect on enactment, are shown in column 3 and column 6 of the table. The R-M-B provision, that go into effect after the trigger point has been reached, are shown in columns 2 and 5 of the table. Using 1977 data, the cost to the Treasury of the bill is estimated at roughly $280 million annually when the phase-in of reserve requirement changes,

prices and access has been completed. Reserves at the Federal Reserve Banks are reduced by approximately $20 billion, based on 1977 data. Some 1,450 banks would hold reserves at the Fed under the Stanton provisions, while only about 450 banks would hold balances at the Federal Reserve after the mandatory provisions took effect.

On enactment, when the Stanton amendment becomes effective, the proportion of all transactions balances at banks subject to Federal reserve requirements will be roughly 74 percent, the same as under the current reserve structure.[1/] At present, also about 74 percent of all transactions balances are held by banks holdings balances at the Federal Reserve. Once, the reserve reductions in the Stanton amendment become fully effective the latter ratio will drop to 55 percent. After large nonmember banks were brought under Federal reserve requirements by the triggering of the mandatory provisions, the coverage would be 56 percent.

Implications

Membership attrition. Whether a bank withdraws from membership under the Stanton amendment obviously will depend on its assessment of benefits vs. costs. The net effect on bank earnings of H.R. 7 (including pricing of services) nearly offsets the burden of membership as earlier calculated by the staff. This earlier calculation, however, is not relevant to the present bill because it assumed that access to services and the discount window under a voluntary plan remained limited to members (or to institutions holdings balances equal to member bank required reserves). Under the Stanton provision, by contrast, any depository institution, whether or not a member bank, can obtain the services of the Reserve

[1/] The coverage estimates shown are based on deposits and membership for December 1977.

Banks (though the discount window is available only if it has transactions balances). Thus, an institution would be able to withdraw from membership, obtain all the services, and not be required to hold sterile Federal reserves (although the Fed could require clearing balances for use of payments services).

With equal access to services by members and nonmembers alike, the burden of membership in effect becomes the total amount of balances at the Fed required to be held above the beyond what are needed for operating or precautionary purposes. Under the Stanton amendment, existing member banks would be required to hold approximately $16 billion in required reserves, of which about $8 billion probably would be held in vault cash for operating purposes and $8 billion as balances at the Fed. It is not likely that banks would voluntarily hold balances of this size at the Fed--and lose about $700 million per year in earnings--unless the System allowed these balances to serve as compensation for services received by the bank. However, it is not clear that permitting payment for services by a credit against reserve balances is consistent with the spirit of discussion surrounding the pricing provisions of H.R. 7. Moreover, such a reserve credit would significantly increase the costs to the Treasury.

On the basis of this analysis, further significant membership attrition might be expected during the voluntary phase of H.R. 7, unless banks believe there are substantial public relations, supervisory, or other technical benefits to membership. The timing with which banks might in practice leave the System depends on a very complicated calculation involving the net gain in earnings from receiving one-third of required reserves per year for three years on withdrawal as compared with the scheduled phase-down of required reserves for existing members. As a rough estimate, under the circumstances, the mandatory phase of H.R. 7 may become effective within

two or three years (unless, to repeat, the bill can be administered in such a way as to permit payment for services by treating reserves as compensating balances).

Once reserve requirements become mandatory, financial calculations about the burden of membership become by and large irrelevant. It seems likely that banks which found it desirable to be a member when holding significant quantities of reserves on voluntary basis will continue to do so when reserve requirements are reduced by two-thirds. Indeed, the state bank supervisors have expressed concern that the H.R. 7 reserve ratios are so low, especially for the smallest banks, that many banks will seek to convert to a national charter to avoid state requirements. Moreover, it is thought that dual examination by the state and by the FDIC is a significant burden that banks will seek to avoid by converting to a national charter.

Monetary control. Although H.R. 7 as passed probably would not make the task of monetary control more difficult, it is not clear that it would improve the ability of the Federal Reserve to control the money supply. If the System seeks to control growth of the aggregates by affecting reserve availability in such a way as to establish a particular interest rate range consistent with that growth rate, it seems unlikely that H.R. 7 would have any effect at all on monetary control.

If the System were to attempt to control an M-1 type monetary aggregate using a reserves target, it is not clear whether monetary control would be facilitated or not. On the one hand, reserve requirements on demand deposits at member banks (or non-exempt banks) would be somewhat more uniform. Thus, the potential complications for monetary control caused by graduated reserve requirement ratios might be reduced.

On the other hand, the large reduction in reserve requirements would increase substantially the number of banks at which vault cash needed for

operations would exceed required reserves. Thus, the proportion of deposits at banks which do not hold reserve balances at the Fed and which are not subject to binding Federal reserve requirements would be increased. Consequently, there would be an increased likelihood of deposit shifts between banks with binding Federal reserve requirements and those banks not bound and whose desired reserve ratios would differ from the stipulated Federal requirement. Thus, it is probable that additional variability in the reserves multiplier could be introduced into the monetary control process from this source.

Other effects of the bill on monetary policy would arise from the omission of reserve requirements on time and savings deposits. Zero reserve requirements on time and savings deposits would act to stabilize the M-1 reserves ratio and thus would improve control of this aggregate under a reserves target. However, the System could not--without invoking emergency provisions--use changes in reserve requirements on time deposits to affect the cost of managed liabilities (except on non-personal, short-term time under quite limited conditions). In addition, lack of reserve requirements on any class of time deposits would make it more difficult to control an M-2 type monetary aggregate through an aggregate reserve target.

Adequacy of balances for clearing purposes. Most member banks under the Stanton amendments and most non-exempt banks under the R-M-B provisions will have very small balances at the Federal Reserve, particularly in relation to the services that they are likely to use. As a percent of total deposits, reserve balances at the Fed would drop from the present 4½ percent to a little over 1 percent; as a percent of demand deposits, these ratios are 14½ and 3½ percent, respectively. The amount of buffer provided by the reserve balances against the possibility of overdrafts in reserve accounts will be decreased. Increased overdrafts may be the outcome.

Should balances from required reserves prove inadequate in practice, the System would have a number of alternatives, none of which are entirely satisfactory. The Fed could ask for additional clearing balances, but an equitable formula may be difficult to construct. Or banks without adequate balances could be required to settle through those with an adequate balance--which might impose a penalty on some banks. A third possibility would be to require no specific balance for access to clearing services, but to levy a substantial penalty for overdrawing the account.

Collateral. As noted earlier, H.R. 7 no longer has a provision that permits all financial assets held by Federal Reserve Banks to stand behind the Fed's currency liability. As a result, it may not be possible to implement the reserve requirement provisions of H.R. 7 in full. In terms of deposits at the end of 1978, required reserve balances at the Fed would be reduced by about $24 billion. Free note collateral at that time was about $19½ billion; in mid-1979 free note collateral was only $13½ billion. Thus, the reduction in Government security holdings in the Fed portfolio that would accompany the decline in required reserves would probably leave the System without adequate collateral for Federal Reserve notes.

Reporting. As passed, H.R. 7 permits the Fed to obtain asset and liability reports from all depository institutions as needed for monetary policy purposes. Member banks are required to make such reports directly to the Federal Reserve, but other classes of depository institutions are required only to report directly their transactions balances and short-term

non-personal time deposits. All other reports that the Board may require for monetary policy purposes are to be provided through each institution's primary federal or state regulator.

This procedure is likely to be cumbersome both from the point of view of the Board and of the depository institutions that would be required to report to the Board through two channels. Moreover, the delays and communications problem inherent in passing data through the other regulators is likely to make such data of limited value for guiding day-to-day open market operations.

. . . .

While the preceding analysis has focused on certain problem areas, there are a number of clear benefits for the financial system in the bill. All depository institutions with transactions accounts receive access to the discount window. And all depository institutions, whether or not they have transactions accounts, obtain access to System services at a price--which should encourage efficiency in the payments mechanism. Once the mandatory reserve requirement provisions go into effect, there will be no discrimination between classes of institutions with regard to reserve requirements. Also, the Board will obtain authority to set reserves on resources obtained abroad by nonmember depository institutions in the mandatory phase of the bill. Finally, the bill does contain an emergency reserve requirement provision giving the Board authority over all liabilities of all depository institutions, but applicable only after consultation with Congress in extraordinary circumstances for short, renewable periods of time.

Some of these benefits depend on triggering the mandatory provisions, but there is always the risk that Congress may lower the trigger point as the actual coverage ratio approaches it,and pressures from nonmember institutions mount. Other benefits--such as the "level playing field" for

reserve requirements--are achieved without any clear gain for monetary control, except possibly over the long-run.

Finally, it should be noted that the bill does have longer-run implications for the structure of the Federal Reserve System. Once the mandatory provisions become effective, they may in practice appear to conflict with the voluntary nature of membership in the Federal Reserve System. Thus, pressures could develop to modify the structure of the System, perhaps eliminating membership, and questions would be raised in the process about the role of the System in supervisory matters and the role of Reserve Banks and their Boards of Directors in monetary matters.

Quick

AUGUST 7, 1979

ANALYSIS OF MONETARY IMPROVEMENT PROGRAM PLANS

		1977		
PLAN: Exemptions:		35/0	0/0	0/5
Ratios:				
Transactions		11	3,11 1/	3,12 2/
Savings		0	0	0
Short-time		0	0	6 3/
Long-time	Actual	0	0	0
	1977	R-M-B	Stanton	Senate Staff
Reserves (billions)				
Members	27.3	7.2	7.6	17.2
Nonmembers	0	.6	0	3.3
Total	27.3	7.8	7.6	20.5
Reserves Released	--	19.5	19.7	6.8
Cost of Reserve Requirement Changes (millions)	--	1269	1281	446
Revenue from Service Charges	--	(410)	(410)	(410)
Revenue from Float Charge	--	(247) 4/	(247) 4/	(247) 4/
Net Cost after Taxes (55 percent marginal rate)	--	275	281	(95)
Number of Commercial Banks				
Exempt				
Members	0	5044	0	0
Nonmembers	8868	8633	8868	0
With Required Reserves				
Members	5664	620	5664	5664
Nonmembers	0	235	0	8868
With Reserves at Fed				
Members	5587	332	1456	3382
Nonmembers	0	117	0	3467
Percent of Total Deposits				
At Banks with Required Reserves 5/	73.1	64.0	73.1	100
At Banks Holding Balances at Reserve Banks	72.9	53.8	53.1	86.7
Percent of Transaction Deposits				
At Banks with Required Reserves	73.7	65.4	73.7	100
At Banks holding Balances at Reserve Banks	73.5	55.6	54.5	88.5
Requested By:				(ROBERTS)

1/ The first $35 million of transactions deposits are reservable at 3 percent, while all transactions deposits above $35 million are reservable at 11 percent.

2/ The first $5 million of transactions deposits are reservable at 3 percent, while all transactions deposits above $5 million are reservable at 12 percent.

3/ All corporate time deposits are reservable at 6 percent.

4/ Based on float outstanding of $3.8 billion in December of 1977.

5/ The Stanton trigger ratio was 71.8 percent of December 31, 1977 because deposits of branches of foreign banks were included in the denominator. The Reuss-Moorhead-Barnard plan goes into effect when this ratio falls below 67.5 percent.

ANALYSIS OF MONETARY IMPROVEMENT PROGRAM PLANS
AUGUST 6, 1979

		1977			1978 1/	
PLAN: Exemptions:		35/0	0/0		35/0	0/0
Ratios:						
Transactions		11	3,11 2/		11	3,11 2/
Savings		0	0		0	0
Short-time		0	0		0	0
Long-time	Actual	0	0	Actual	0	0
	1977	R-M-B	Stanton	1978	R-M-B	Stanton
	(1)	(2)	(3)	(4)	(5)	(6)
Reserves (billions)						
Members	27.3	7.2	7.6	31.6	6.9	7.3
Nonmembers	0	.6	0	0	.8	0
Total	27.3	7.8	7.6	31.6	7.7	7.3
Reserves Released	--	19.5	19.7	--	23.9	24.3
Cost of Reserve Requirement Changes (millions) 3/	--	1269	1281	--	1798	1821
Revenue from Service Charges	--	(410)	(410)	--	(410)	(410)
Revenue from Float Charge	--	(247) 4/	(247) 4/	--	(425) 5/	(425) 5/
Net Cost after Taxes	--	275	281	--	433	444
Number of Commercial Banks						
Exempt						
Members	0	5044	0	0	4913	0
Nonmembers	8868	8633	8868	8948	8675	8948
With Required Reserves						
Members	5664	620	5662	5558	645	5555
Nonmembers	0	235	0	0	273	0
With Reserves at Fed						
Members	5587	332	1456	5485	313	1506
Nonmembers	0	117	0	0	123	0
Percent of Total Deposits						
At Banks with Required Reserves	73.1	64.0	73.1	72.3 6/	65.0	72.3
At Banks Holding Balances at Reserve Banks	72.9	53.8	53.1	72.2	52.8	52.6
Percent of Transaction Deposits						
At Banks with Required Reserves	73.7	65.4	73.7	72.3	65.6	72.3
At Banks Holding Balances at Reserve Banks	73.5	55.6	54.5	72.2	53.7	53.1

1/ Imposing reserve requirements on U.S. branches of foreign banks at current levels and then reducing them to the level of the Reuss-Moorhead-Barnard plan would cost an additional $37 million after taxes. Reducing their reserve requirements to the level of the Stanton plan would cost an additional $33 million after taxes. Of the 105 U.S. branches of foreign banks in operation in 1978, 27 would have held reserves at the Fed under R-M-B, while 72 would have held reserves at the Fed under Stanton. With branches covered, the percentage of total deposits at banks with required reserves would be 73.0 for actual 1978, 65.0 for R-M-B, and 72.7 under Stanton. The percentage of total deposits at banks holding reserve balances at the Fed would be 73.0 for actual 1978, 53.1 for R-M-B, and 53.8 for Stanton.

2/ The first $35 million of transactions deposits are reservable at 3 percent, while all transactions deposits above $35 million are reservable at 11 percent.

3/ The figures for 1978 include an estimate of the additional loss in revenue to the Federal Reserve from reduced holdings of vault cash by member banks.

4/ Based on float outstanding of $3.8 billion in December 1977

5/ Based on average float outstanding of $5.8 billion in 1978.

6/ The Stanton trigger ratio was 71.8 percent on December 31, 1977 and 70.6 percent on December 31, 1978. The Reuss-Moorhead-Barnard plan goes into effect when this ratio falls below 67.5 percent.

D. Services – no question of objection
 have flexibility

E. Collateral

F. Phase-in

G. Revenue – different methods of calculating.
 Will lose members.

Conclusion.

A. Treatment of transaction balances

11 or 12% — upper limit at 12

Exemptions — 35 or 0

important issue to be resolved

Philosophically 0 — not important for monetary policy.

Graduate requirement (vault cash)

B. Time + savings.

S&L base 6% requirement on non-personal.

Question practicality.

Commercial paper, Eurodollars, Money Market funds.

But do need stand-by —

For cyclical reasons

To protect definition

C. Monetary control + reserve base

5,500, 30 billion, 70%

450 7-8 billion, 54%

Long argument — must be prepared for all eventualities

Have practical approach, solve by standby supplementary

Pay interest

2% on all

Pass through — don't need direct contact or supervision by Fed over S&L — don't look to homogenization of all institutions.

Understanding in industry

Budget & deficit
Revenue

1

1. Willingness of FR. to accept
2. Improvement
Touching upon all the points

I Welcome opportunity — Won't read statement, but concentrate on a few crucial points

II Issue that since has been around for some time.
Echo Mr Reuss's comments — time has come to deal with it.

Common ground evolved — Essential points in place — major controversies resolved in long debate.

Lower cost than [illegible] to [illegible]

III Central is ~~a~~ effective conduct of monetary policy over a long period of years. Basic legislation to shape future of Federal Reserve.

A. Also important we achieve result in a fair & equitable manner.

~~Unity of~~

First question — Voluntary or mandatory.

Voluntary — have lived with, philosophically attractive — but costly — and doubtful can ~~get~~ keep pace with innovation

Therefore testimony mainly on mandatory portion of HR 7585
RR, a kind of tax — reconcile that tax with needs of monetary policy, recognizing tax drives business to other channels.

Both bills have in common building blocks
- ~~RR and commercial~~ or same treatment of competing institutions
- Focus on transaction balances
- Open access & pricing
- Voluntary membership.

Widely supported by institutions
Some differences —
Need to protect reserve base

For release on delivery
September 26, 10:00 AM (E.D.T.)

Statement by

Paul A. Volcker

Chairman, Board of Governors of the Federal Reserve System

before the

Committee on Banking, Housing, and Urban Affairs

United States Senate

September 26, 1979

I am pleased to be here today to testify on several bills designed to assure the capacity of the Federal Reserve to conduct effective monetary policy over the years ahead. Each of these bills aims to achieve that objective in a manner consistent with fair and equitable ground rules for financial institutions competing in providing depository services to the public.

The issues involved are old ones. There have been many proposals to deal with the so-called Federal Reserve membership problem and to restructure Federal reserve requirements through the years, going back in my personal experience on the Commission on Money and Credit twenty years ago. The matter has been under active, and sometimes contentious, consideration in the Congress for more than three years, as the need has become more evident. Financial innovations, shifting competitive patterns, strong inflationary pressures and related high interest rates have all exacerbated existing competitive inequities, have led to declines in membership in the Federal Reserve, and ultimately threaten our ability to conduct effective monetary policy.

Now, it is time to act. Moreover, it is possible to act with a minimum of controversy and maximum effectiveness.

I reach that conclusion in large part because of the substantial progress that has been made in the past year, through hearings and debate in the Congress and through discussions among interested parties, in achieving a consensus on the essential elements of a solution. As I will discuss later, that solution can be reached within acceptable limits of cost to the Treasury; indeed, failure to act would also cost revenues, and in cumulating amounts as attrition of Federal Reserve membership continues. Those issues which remain are being addressed by virtually all parties in a constructive atmosphere, with awareness of the central need to maintain a strong Federal Reserve, equipped with adequate tools to do its job.

It is my judgment, and that of many others, that only expeditious handling of this legislation can forestall a new wave of withdrawals from Federal Reserve membership. Many banks understandably have been willing to carry the burden of voluntary membership only so long as they felt that legislation could be foreseen that would provide more equitable competitive conditions. Failure to act now will not make the issue go away; we would only be forced to return to it in still more urgent, and potentially more contentious and divisive, circumstances.

All the legislative proposals need to be judged first of all against the central objective: We need to strengthen our ability to implement monetary policy in a variety of possible circumstances -- not just in the immediate future, but for decades ahead. This legislation would provide the most important structural change in the Federal Reserve since its foundation; once passed, it will not be lightly amended. As we look ahead in that long perspective, effective monetary control will significantly benefit from broad coverage of competing depository institutions and a reserve base sufficient to support and transmit the effects of Federal Reserve monetary actions through the financial system.

At the same time, we need to work toward evenhanded treatment of all depository institutions insofar as they compete directly and bear a reserve burden. It is not only a matter of fairness. Evenhanded treatment, including broader access to System services, rationally priced, can bring about greater efficiency and more effective competition in financial markets. We should also assure that institutions bearing the implicit cost of reserves do not gradually lose, for that reason, business to others, thus narrowing the scope of Federal Reserve control.

The manner in which reserves are presently applied is the source of our present problem. Members of the Federal Reserve System are currently subject to a special burden -- from their point of view, the equivalent of a special tax -- because they must maintain substantial levels of reserves in non-interest bearing balances at Federal Reserve Banks. Nonmember commercial banks or other depository institutions -- even when their business overlaps -- have no comparable requirement. Member banks receive some offset to this burden due to their access to System services, but all studies that have been made indicate the value of these services is, for the bulk of members, not sufficient to compensate for the earnings foregone on required sterile balances. In these circumstances, members leave the System, narrowing our base of control.

The specific bills before you originating with members of this committee have very different points of departure in dealing with these issues. S. 85, proposed by Chairman Proxmire, would place mandatory reserve requirements on all depository institutions, at the same time opening access to Federal Reserve services to all depository institutions. S. 353, proposed by Senator Tower, would instead preserve a fully voluntary system, but would attempt to remove the burden of membership by mandating that all balances held with the Federal Reserve to meet such requirements earn interest at nearly a market rate; access to System services would remain restricted to members and other depository institutions voluntarily maintaining reserves. The legislation passed by the House, H.R. 7, is a hybrid, initiating a mandatory reserve structure and open access to services if a revised voluntary structure fails to stem membership attrition.

This threshold question -- mandatory against voluntary -- has been at the center of much past debate. The voluntary approach has always had a certain appeal to me and others -- it is the way the Federal Reserve has operated, and I suspect it has helped encourage professionalism and efficiency within the Federal Reserve.

I would not want to see those attributes lost. But a purely voluntary approach toward reserve requirements does not seem to be practicable or possible at this time. The cost of eliminating the burden of reserves -- as would be necessary in a voluntary system -- would be relatively high -- apparently higher than the Administration or the Congress would find tolerable. Full pricing and open access to our services -- a key consideration to many in Congress and elsewhere -- would not be feasible. Consequently, I believe it is more fruitful to concentrate attention on the mandatory approaches to reserves: S. 85, and the basic provisions of H.R. 7. That is consistent with the preferred position of the Federal Reserve Board over a long period of time.

These two bills have consistent common elements. Those common elements, with one important exception, provide an appropriate framework for speedy resolution of the remaining issues.

-- To the extent reserves are required, both bills would apply them on a consistent basis against comparable deposits or other accounts in competing depository institutions.

-- The reserve structure would focus mainly on transactions balances, the central element in the money supply and monetary control.

-- Access to Federal Reserve services would be open to all depository institutions, and the Federal Reserve would be expected to recover the full cost of those services from pricing.

-- Voluntary membership in the Federal Reserve System, which would continue to have implications for certain supervisory and regulatory matters and for election of Federal Reserve Bank directors, would remain.

My own understanding is that these basic, common approaches have wide support among affected institutions. What remains to be done is to reconcile remaining differences and to provide assurance that the Federal Reserve will in fact have an adequate base of reserves in all foreseeable circumstances for the effective conduct of monetary policy.

The Treatment of Transactions Balances

Both bills would extend reserve coverage of transactions balances to all established depository institutions. The change is clearly consistent with the emergence of transactions accounts at thrift institutions, the growth of which can be expected to accelerate as the powers of those institutions to operate such accounts are enlarged. Such coverage assures, first, that larger and larger portions of the basic money supply of the nation will not escape direct Federal Reserve influence; and second, that future competition in markets for transactions deposits will be conducted without one institution or another enjoying an unfair competitive advantage. I would note in that connection that financial technology does not stand still, and the definition of a transactions balance -- in principle, an account from which payments to third parties can be made -- is critical. For instance, we can now observe burgeoning growth of money market mutual funds, many of which now offer facilities for transfer by draft, raising the question of whether such funds do not perform the economic function of a transactions account.

Providing the Federal Reserve has authority to define transactions balances, I believe concentrating the focus of reserve requirements on those accounts is appropriate. They are, together with currency, the most active element in the nation's money supply. However, we need to remember that non-interest bearing reserves do have the characteristic of a tax on those deposits; a high tax will discourage use of transactions accounts over time relative to other outlets for liquid funds, lead to innovations in payment mechanisms outside the perimeter of the definition of defined transactions accounts, and promote the growth of money substitutes entirely outside the traditional domestic banking system, gradually impairing the base upon which the Federal Reserve operates. For that reason we should be wary of setting the requirement too high. The 12 percent ratio initially set in S. 85 is slightly higher than the 11 percent of H.R. 7. Even if the initial ratio were to be set as high as provided in S. 85 in the interests of preserving Treasury revenue, I believe that should also be the top of the permissible range, as already specified in the House bill.

An important difference in the two bills lies in exemption levels. In S. 85, the reserve requirement would apply to all transactions deposits regardless of the aggregate size of the balances in an institution, although the reserve ratio is set at only 3 percent for the first $5 million of such deposits. In H.R. 7 the first $35 million of transactions deposits in an institution are exempt from reserve requirements, and that exemption would be ratcheted upward as deposits grow. The universal, virtually uniform ratio of S. 85 seems to us in the Federal Reserve more congenial to the basic thrust of both bills toward placing competing institutions on an equal footing. In practice, monetary control would not be significantly impaired by exemption of a very small amount of transactions balances for each institution. However, at some point, an exemption does have adverse implications for the reserve base and effective monetary control.

This Committee and the Congress will need to resolve this practical and philosophical question about the exemption level; a requirement graduated downward for small balances is one obvious possibility. I would emphasize that most institutions holding relatively small amounts of transactions balances -- for commercial banks up to $10 to $15 million -- will in practice be able to use cash held in their vaults to satisfy the requirements of S. 85 without cost; a more smoothly graduated reserve ratio would in practice exempt even more.

Treatment of Time and Savings Deposits

Both bills would exempt all savings and personal time accounts from reserve requirements. Because of the strong competition from other savings outlets outside the banking system, that approach is strongly and understandably urged by both banking and thrift institutions and is acceptable to the Federal Reserve. Both bills also provide authority to apply such reserves against nonpersonal time deposits, but there are important differences.

S. 85 seems to envisage a more or less permanent requirement on nonpersonal time deposits, starting at the substantial initial level of 6 percent. Such a permanent requirement poses an important substantive problem. Competition for funds flowing into nonpersonal time deposits is intense and growing. The competitive handicap for covered institutions would be significant, as it is today, when the commercial paper market, the Eurodollar market, and money market funds are growing rapidly. A substantial permanent reserve requirement would also place new burdens on thrift institutions.

For these reasons, the more practicable and desirable approach would be to maintain limited authority for the use of reserve requirements on short-term nonpersonal time deposits on a standby basis as seemed to be contemplated by H.R. 7. The circumstances for use should be exceptional, but not so extreme as stated by a colloquy on the House floor which would confine such use only to circumstances in which other countries agreed with the U.S. to impose parallel requirements on Eurodollars. For instance, there may be occasions when such authority would be extremely useful to restrain excessively rapid growth near-money and of bank credit, particularly by large institutions. Moreover, the borderline between a transactions balance and a very short-time deposit may become so fuzzy as to suggest more equal reserve treatment.

The Question of Monetary Control and the Reserve Base

The key problem I have with the reserve structure specified in H.R. 7 or in S. 85 (assuming, in the latter case, no initial requirement on time deposits) concerns the volume and distribution of reserve balances that would be held in Federal Reserve Banks. It is these balances, and only these balances, that provide the "fulcrum" for the efficient conduct of monetary policy.

A few numbers will give you a sense of the potential problem. Today, some 5,600 banks hold about $30 billion of reserves at the Federal Reserve Banks, and those banks account for some 70 percent of all commercial bank deposits. Under H.R. 7, only 450 banks would keep any required reserves with the Federal Reserve; reserve balances would total only about $7-1/2 billion; and those 450 banks, while the largest in the country, would account for only 54 percent of total commercial bank deposits.

While S. 85 would provide much higher coverage, it would achieve that result in large part by extending substantial reserves to time deposits. That arrangement, as I have just noted, would create other serious problems if contemplated as permanent.

Viewed in another light, the ratio of reserve balances at the Federal Reserve Banks to the total of deposits at all commercial banks would drop to well below 1 percent under H.R. 7, and to about 1-1/2 percent under S. 85 (without time deposits reserves). These percentages are uncomfortably low, even on operational grounds, considering the enormous volume of clearings that go through the Federal Reserve Banks every day. Large and erratic day-to-day fluctuations in such operational factors as currency in circulation or "float" arising from check clearings could, with a relatively low reserve base, have magnified effects on the money supply and weaken monetary control.

I know that the Committee has already heard theoretical debates about whether reserve requirements are essential at all to the conduct of monetary policy -- indeed I have engaged in such theorizing myself. But we in the Federal Reserve have the practical responsibility of operating monetary policy, and you will properly hold us accountable. We are not interested in committing ourselves to the conduct of monetary policy on the basis of untested and controversial theorizing.

In that connection, foreign experience has often been cited, including the fact that some industrial countries do not impose legal reserve requirements. A few of those countries approach monetary control either by keeping their banks continuously in debt to the central banks, and maintaining close control over the level of indebtedness as a method of control, or by relying heavily on direct, quantitative controls on bank liabilities on assets. Both methods are foreign to our experience and traditions. Other leading countries, whether by statute, convention, or tradition, de facto maintain a significantly higher proportion of total commercial bank deposits in central bank balances than would be provided by the transactions account requirements of either H.R. 7 or S. 85.

We cannot be certain precisely how large reserve balances need to be to assure effective monetary control and a well functioning banking system. I feel quite sure we can do with a smaller reserve base than we now have. It is conceivable that the reserve requirements implicit in a modified S. 85 or in H.R. 7 may be sufficient, but I have grave doubts. Under H.R. 7, 97 percent of the nation's banks would either be exempt entirely or hold more than enough reserves in the form of vault cash to meet their requirements. Some technically covered banks would voluntarily wish to hold more reserves than required, and that uncertain "excess," differing from bank to bank and varying over time, would loosen the relationship between reserves and deposits. As a consequence, the ability of the Federal Reserve to control deposits by adjusting the reserve base could deteriorate, perhaps severely.

I have discussed both with members of this Committee and with representative industry leaders a practical approach for dealing with this problem. This approach would provide the Federal Reserve with the assurance we need that reserve balances will be adequate for monetary control and to support the nation's depository system, while not significantly adding to costs of banks and other depository institutions, disturbing competitive relationships among them, or draining revenue from the Treasury.

More specifically, I propose adding a provision to the legislation for standby authority to the Board to call for "supplementary deposits" to be held at Reserve Banks by all depository institutions up to a specified maximum. The Federal Reserve would be required to provide banks with a market yield on those deposits, the formula for which should be fixed in law to be comparable to the yields on U.S. Government securities. One simple way of providing such a return would be to provide that the supplementary deposits be invested in earnings participation certificates in the Federal Reserve's own portfolio of U.S. Government and agency securities.

I would not expect this authority to be used unless the Federal Reserve found that, in practice, monetary policy could not be effectively implemented with the reserve balances required under the other provisions of the legislation. Consequently, the authority should be viewed as an "insurance policy" or "safety net," to be used only in the event experience demonstrates the need for a larger reserve base than would be produced by other provisions of the bill. Thus, the percentage of deposits to be held as supplementary deposits probably would change infrequently, if at all, over time, if the authority were used at all.

As further assurance that the supplementary deposits would not be introduced lightly, I would suggest that the Board not be permitted to call for such deposits unless five members of the Board vote affirmatively, a report is issued to this

Committee, and the determination by the Board is renewed at, say, 2 year intervals.

Arrangements would be made for nonmember banks and thrift institutions to respond to a call for supplementary deposits by dealing through established banking correspondents. The law should, for instance, specify that such supplemental deposits could be held with the Federal Home Loan Banks, in the case of their member institutions, or the Central Liquidity Facility of the credit unions. The thrift institutions could, in turn, be permitted to count these deposits toward meeting their existing liquidity requirements, but the deposits would be "passed through" to the Federal Reserve Banks so the funds could become part of the reserve base. Possible arrangements of this kind have been reviewed with, and in principle are supported by, the Federal Home Loan Bank Board and the National Credit Union Administration Board.

It would make relatively little difference from the standpoint of monetary control whether these supplementary deposits are determined as a percentage of transactions balances or of all deposits held at institutions. The maximum percentage requirement would, of course, have to be judged against the base of deposits to which it applied. For instance, a limit as low as 2 percent would be adequate if the base were to be total deposits, transactions and time. If transactions balances alone are covered -- which account for only about 20 percent of the whole -- the upper limits would need to be proportionately higher, depending on exemptions and the level of requirements determined elsewhere in the legislation, to assure an equivalent reserve base. We would be glad to work with the Committee in developing precise legislative language to meet the need in the way best suited to all interests.

I would emphasize the receipt of earnings on the supplementary deposits at a market rate will, over time, mean that institutions should suffer very little, if any, loss in earnings from any call for such balances. If earnings are determined by the return in the Federal Reserve portfolio, those earnings will reflect a mix of long- and short-term securities. Yield fluctuations would be less volatile than the yield on shorter-term securities alone because the portfolio yield varies less over time than does, say, the 3-month bill rate. In years of relatively high short-term rates, banks would be able to earn more by investing in the market short-term, but the reverse is likely to be true in years of relatively low short-term rates.

I must also emphasize a call for supplementary deposits would have no effect on Treasury revenues. In effect, the Federal Reserve would simply add to existing security holdings to match the increased liabilities to banks and other depository institutions incurred from supplementary deposits held at Reserve Banks. These new security purchases would provide the income to be transferred to the banks. And, the banks would pay taxes to the Treasury in about the same amount as if there had been no supplementary deposits.

Provision and Charge for Services

Both S. 85 and H.R. 7 provide broadened access to System services, including the discount window, and a mandate to charge for those services at prices adequate to cover costs, including imputed capital costs and taxes. In principle, these provisions are acceptable to the Federal Reserve. Intelligently implemented, we believe this approach can contribute to the efficiency, competition, and safety of the financial system. I would emphasize, however, that open access and pricing is practicable only after reserve requirements are restructured and applied to all depository institutions if we are to avoid exacerbating the cost burdens now placed on member banks.

Substantial progress has been made within the Federal Reserve toward developing pricing policies and schedules for Reserve Bank services. Those efforts will be pursued with vigor. I should note that in this process, a number of difficult technical and policy problems -- problems familiar to those engaged in the pricing of other public services where there is an obligation not only to cover costs but to maintain a minimum service level -- are apparent. For that reason, I would urge that the legislative language not unduly limit our flexibility in pricing particular services, while retaining the goal of full cost coverage.

Open access and pricing of System services likely will induce major changes in existing banking relationships. It may have differential effects on large and small, or city and rural, institutions. Moving too precipitously to put this new system into place could cause disruptions in banking markets. Consequently, I would urge that the pricing provision allow some flexibility in timing and implementation. Moreover, it should be clear that the Federal Reserve need not precisely match costs and revenues for every service. Indeed, the Board questions whether a charge for the receipt and disbursement of currency is appropriate at all. The Government might normally be expected to provide that service, and in any event, the Treasury already earns some $7 billion per year from the provision of currency through securities held by the Federal Reserve as collateral.

Collateral for Federal Reserve Notes

A technical problem regarding collateral against Federal Reserve notes does arise in the bill. Under existing law, currency issued by the Federal Reserve must be secured by certain assets of the Federal Reserve specified in the Federal Reserve Act. If no changes were to be made in this requirement, the reserve reductions implied by the bills before you could be technically unworkable for they might result in insufficient amounts of government securities and other eligible financial assets to meet the collateral requirements against these notes. In mid-1979, for instance, collateral in excess of currency was only $13 billion. In terms of deposits outstanding at that time, balances at Federal Reserve Banks would be reduced about $24 billion under H.R. 7 and roughly $14 billion under S. 85

without the reserve requirement on time deposits. The reduction in government security holdings in the Fed portfolio that would have to accompany the decline in reserve requirements would leave the System with too few eligible securities to meet the legal collateral requirements.

S. 85 would meet this collateral problem by permitting all financial assets held by Federal Reserve Banks to stand behind the Federal Reserve's currency liability and by eliminating the requirement to collateralize notes remaining in the vaults of Federal Reserve Banks. This approach, while clearly meeting the need, was rejected by the House apparently on the grounds that it might open the way to the Federal Reserve acquiring a broader range of assets. To meet that objection, assets eligible for collateralizing currency might be confined to certain enumerated market-type assets that may already be held by the Federal Reserve.

I would suggest adding to the present list only assets acquired abroad arising from time to time out of our foreign currency operations -- a relatively small but fluctuating amount -- while removing the requirement for collateral against notes held by the Federal Reserve itself. In that connection, the Federal Reserve Act already permits us to hold foreign bank deposits and bills of exchange; it would be helpful to us operationally if short-term foreign government securities could be added to our authorized holdings -- an omission at the time of the original Federal Reserve Act when such securities were not widely available.

The Phase-in

S. 85 and H.R. 7 differ substantially in phase-in time for the application of reserves to transaction balances of nonmember institutions: 4 years for the former, 10 years for the latter. The Board feels the S. 85 approach -- which itself provides considerable time, is more in keeping with the purposes of the legislation, particularly for institutions newly entering or rapidly expanding transaction account business. At the same time, we are aware that this Committee and the Congress may be in a better position to appraise the equities of particular situations and develop an appropriate compromise.

Effect on Treasury Revenue

There is understandable sensitivity to the implication for Treasury revenue from alternative monetary improvement plans, particularly in these inflationary times when the budget is under pressure. An attachment to this statement shows the revenue input from H.R. 7 and S. 85. As can be seen, the bill acceptable to the House had a cost of around $300 million, using 1977 data. S. 85 would not cost the Treasury any revenue, but at the cost of increasing the reserve burden of many depository institutions. Without a reserve requirement on time deposits, as I have suggested, the revenue loss would be significantly smaller than in the House bill.

I would emphasize these calculations are artificial because, contrary to all expectations,they assume no revenue loss from rapid attrition of Federal Reserve membership, if no bill is passed. The net drain on Treasury revenues from H.R. 7 or

S.85 as modified would be quite moderate, if there were any drain at all, after account is taken of the losses that would be incurred by the Treasury due to that attrition. Indeed, the modification I have proposed to S. 85 would probably still leave the Treasury with a net gain in revenue over a reasonable period of time. Moreover, I would also note that the Federal Reserve has indicated its willingness to transfer to the Treasury part of its $1 billion surplus to cover revenue losses during the transition period.

Conclusion

This Committee has before it, in S. 85 and H.R. 7, nearly all of the essential elements of constructive legislation. I hope you will agree that the major new provision I have proposed today -- standby authority for "supplementary deposits" -- is a useful and possibly essential "insurance policy" for monetary policy. I do not believe it should be controversial.

Consequently, the way seems to me clear for promptly enacting legislation with the following main features:

> First, reserve requirements should be placed on transactions balances at all depository institutions. Both S. 85 and H.R. 7 adopt this principle; what remains is only satisfactory resolution of exemption levels and the price level of the requirement.
>
> Second, to assure an adequate reserve base for monetary control and to support the nation's depository

system, legislation should provide an insurance policy in the form of standby authority for "supplementary deposits" at Federal Reserve Banks, with those deposits earning a market rate of return.

Third, initial reserve ratios on nonpersonal time deposits should be set at zero, as in H.R. 7, but with the understanding that the Federal Reserve would have some flexibility to apply reserves to short-term nonpersonal time deposits if needed to "protect" the dividing line between transactions and time accounts or for cyclical purposes. There should be no reserves on personal or long-term time deposits.

Finally, there should be full pricing and open access to Federal Reserve services, with adequate flexibility, in timing and application, to minimize the risk of disruptions in banking markets and to protect the availability of a basic level of payments services to all institutions.

In passing through the lobby of the Federal Reserve Building recently, I read again a quotation from Woodrow Wilson on the wall referring to the original Federal Reserve Act:

> "We shall deal with our economic system as it is and as it may be modified, not as it might be if we had a clean sheet of paper to write upon, and step-by-step we shall make it what it should be."

A constructive blending of S. 85 and H.R. 7, combined with the safety valve I have requested, can take a big step toward developing a reserve structure as it should be. The basic issue is preserving a strong and effective central bank able to discharge its responsibilities for monetary policy. The questions have been long debated, and I sense a convergence of views. Now, this Committee has the chance to bring the long process to the edge of conclusion. I urge you to seize that chance.

* * * * * *

APPENDIX A

RESERVE COVERAGE AND TREASURY REVENUE EFFECTS OF MONETARY IMPROVEMENT PROGRAM PROPOSALS

(Based on December 1977 deposits; does not include effect on Treasury revenue of halting membership attrition)

	Exemptions:		35/0	35/0[a]	5/5	5/0
	Ratios:					
	Transactions		11	3,11	3,12	3,12
PLAN:	Savings		0	0	0	0
	Nonpersonal Time		0	0	6	0
	Other Time		0	0	0	0
			H.R. 7	H.R. 7		
		Actual	Mandatory	Voluntary		
		1977	Plan	Plan	S. 85	Mod. 85
Reserves (billions)						
Members		27.3	7.2	7.6	17.2	11.4
Nonmembers		0	.6	0	3.5[b]	2.5
Total		27.3	7.8	7.6	20.7	13.9
Reserves Released		--	19.5	19.7	6.8	13.4
Cost of Reserve Requirement Changes (millions)[c]		--	1307	1315	428	874
Revenue from Service Charges		--	(410)	(410)	(410)	(410)
Revenue from Float Charge[d]		--	(247)	(247)	(247)	(247)
Net Cost after Taxes (55 percent marginal rate)[e]		--	293	296	-99	103
Number of Commercial Banks						
Exempt						
Members		0	5044	0	2	2
Nonmembers		8868	8633	8868	109	110
With Required Reserves						
Members		5664	620	5664	5662	5662
Nonmembers		0	235	0	8759	8758
With Reserves at Fed						
Members		5587	332	1456	3382	3279
Nonmembers		0	117	0	3467	3403
Percent of Total Deposits						
At Banks holding balances at Reserve Banks		72.9	53.8	53.1	86.7	84.7
Percent of Transactions Deposits						
At Banks holding balances at Reserve Banks		73.5	55.6	54.5	88.5	87.0

[a] Members only.

[b] Includes $300 million of reserve balances of thrifts.

[c] Includes vault cash shift for members.

[d] Based on float outstanding of $3.8 billion in December of 1977.

[e] Cost estimate does not include offsetting benefit of halting membership attrition which would result in a loss of Treasury revenues of about $200 million annually by 1985, assuming attrition at midway between that experienced in the nation and that in New England during 1974-1978.

September 25, 1979

Comparison of S.85, H.R. 7, and S.353 (Tower Bill)

	S.85	H. R.7	S.353
Title:	Monetary Policy Improvement Act of 1979	Monetary Control Act of 1979	Federal Reserve Modernization Act of 1979
Reporting:	Authorizes the Board to require reports from all depository institutions. The Board can receive reports on all assets and liabilities directly from member banks and others whose reserve requirements exceed zero and indirectly through the primary supervisor for all others. The Board can require reports as are "necessary or desirable" to control or monitor monetary or credit aggregates. (sec. 3)	H.R. 7 enables the Board to obtain reports directly from nonmembers only on reservable liabilities. All other reports from nonmembers can be obtained only indirectly. Only reports "necessary" to control or monitor monetary or credit aggregates are authorized. (sec. 2)	H. R. 7 enables the Board to reports directly from nonmembers only on reservable liabilities. All other reports from nonmembers can be obtained only indirectly. Only reports "necessary" to control or monitor monetary or credit aggregates are authorized. (sec. 2)
Coverage:	Covers insured commercial banks, savings banks, S&L's, and credit unions. (sec. 2)	H.R. 7 covers insured and noninsured depository institutions. (sec. 3)	Covers member banks only; Nonmembers may put up reserves voluntarily. (sec. 3)
Definitions:	(1) A transaction account is defined as a deposit that can be withdrawn by a negotiable or transferable instrument, payment orders of withdrawal or other similar item for the purpose of making transfers to third parties or others. While NOWs, share drafts and automatic transfers are covered, the bill is silent concerning coverage of telephone transfers. However, it appears that the language can be read to include most, if not all, telephone transfers. However, it appears that the language can be read to include most, if not all, telephone transfers that are used to make payments. (sec. 2)	H.R. 7 provides a substantially similar definition of transaction account, but specifically exempts accounts subject to six or fewer telephone transfers per month. (sec. 2)	S. 353 applies reserve requirements to demand deposits. (sec. 3)

	S. 85	H.R. 7	S. 353
	(2) Nonpersonal time deposits of all maturities are covered. (sec. 2) (3) Authorizes the Board, after consultation with other agencies, to determine an account to be a transaction account. (sec. 2)	(2) H.R. 7 covers only nonpersonal time deposits with initial maturities of less that 180 days. (sec.3) (3) H.R. 7 authorizes the Board, after consultation with the other agencies, to define the term "deposit" for all institutions. (sec. 3)	(2) S. 353 applies reserve requirements to time deposits of less that 180 days and savings deposits. (sec. 3) (3) S. 353 does not affect the Board's present broad authority to define terms.
Reserve Requirements:	(sec. 3)	(sec. 3) Pre 67.5% Trigger	(sec. 3)
	Covers all depository institutions.	Covers only member banks	Covers only member banks. Nonmembers may put up reserves voluntarily.
	Transaction accounts: Up to $5 million--3% Over $5 million--12% initially, within a range of 11-13%	Transaction accounts: Up to $35 million--3% initially, within a range of up to 12 %. (Indexed at 100%) Over $35 million--11% initially, within a range of 4-12%	Demand Deposits 3-10%
	Nonpersonal time deposits: Up to $5 million--0% Over $5 million--6% initially, within a range of 0-12 %	Nonpersonal time deposits (short-term): 0% initially, within a range of 0-8%	Time (short-term) and savings deposits 1-7%

S.85 H.R. 7 S.353

Post 67.5% Trigger

Covers all depository institutions:

Transaction accounts:

$35 million exemption.--0% indexed at 80% of growth of transaction balances

Above Exemption level.-- 11% initially, within a range of 4-12%

Nonpersonal time deposits (short-term):

$10 million exemption.-- indexed at 80% of growth of short term nonpersonal time deposits

Above exemption level.-- 0% initially, within a range of 0-8%

[Legislative history: a positive reserve requirement is to be imposed only after agreement is reached on Eurodollar reserve requirements]

	S. 85	H.R. 7	S. 353
Extraordinary Circumstances:	Under extraordinary circumstances, the Board can impose higher or lower reserve requirements outside the ranges specified above on depository institutions for 30 day periods after consultation with the appropriate Committees of Congress. (sec. 4)	H.R. 7 is similar, except H.R. 7 requires a finding of extraordinary circumstances by at least five Board members and permits reserves on all liabilities. (sec. 3)	No similar provision.
Privileges of Membership:	Institutions maintaining reserves are entitled to all privileges of membership except holding Federal Reserve stock or voting for directors. (sec. 4)	H.R. 7 is similar. (sec. 3)	No similar provision
Eurodollar Reserve Requirements:	Authorizes the Board to impose reserve requirements on foreign branches, subsidiaries, and IBF's of nonmember depository institutions to the same extent required to members. (sec. 4)	H.R. 7 is similar. (sec. 3)	No similar provision.
Foreign Deposits:	Deposits payable outside the U.S. are not subject to domestic reserve requirements (Eurodollar reserve requirements, however, can be imposed). (sec. 4)	H.R. 7 is similar. (sec. 3)	No similar provision.
	The bill does not affect the ability of the Board to impose conditions on foreign branches of member banks under §25 of the Federal Reserve Act or on U.S. branches or agencies of foreign banks under the International Banking Act.	H.R. 7 is similar. (sec. 3)	No similar provision.

	S.85	H.R. 7	S.353
Discount Window:	Any depository institution with transactionaccounts shall be entitled to the same discount window access as member banks. However, under the "Privileges of Membership" provision, access to the discount window would be available to any institution maintaining reserves, which includes thrift institutions that possess only nonpersonal time deposits. (sec. 4)	H.R. 7 provides discount window privileges to institutions with transaction or short-term nonpersonal time deposits and requires the Board to take into account the special needs of thrifts. (sec. 3)	Except on an emergency basis, the discount window is not available to anyone that does not maintain reserve requirements. (sec. 3)
Phase-in of Reserve Requirements:	(1) For nonmembers on July 1, 1979 provides for a 4 year phase-in of reserve requirements. (sec. 4)	H.R. 7 provides for a 10 year phase-in for nonmembers as of August 1, 1978 and a 15 year phase in for nonmembers in Hawaii. (sec. 4)	Provides a 4-year phase-in.
	(2) For members as of July 1, 1979 authorizes the Board to hase-in the change in reserve requirements over 4 years. (sec. 4)	H.R. 7 is similar. (sec. 3)	Provides a 4-year phase-in.
	(3) A nonmember that was a member on July 1, 1979 must maintain reserves as if it were a member bank. (sec. 4)	H.R. 7 provides that the phase-in provisions do not apply to nonmembers that were members as of May 24, 1979 and a member leaving after the date of enactment shall receive a refund of reserve balances in three equal annual payments. H.R. 7 also prohibits the approval of an application for withdrawal from membership filed between May 24, 1979, and the date of enactment. (sec. 3)	No similar provision.
Form of Reserves:	Reserves can be held in the form of: 1) vault cash (or that proportion permitted by the Board), 2) balances held at Federal Reserve Banks, or 3) balances held at a Federal Home Loan Bank, central liquidity facility or at a depository institution maintaining reserve balances with a Reserve Bank provided the balances are passed through to the Reserve Bank. (sec. 5)	H.R. 7 is similar, however H.R. 7 does not provide for the pass through of reserves by a central liquidity facility. (sec. 3)	Reserves can be held in the form of vault cash and balances at Reserve banks. (sec. 3)

	S. 85	H.R. 7	S. 353
Interest on Reserves:	No provision	No provision	Provides for a investment of reserve balances (less vault cash) in an Earnings Participation Account that earns interest at a rate of 1/2% below the System's portfolio.
Clearing Services:	Provides technical amendments to the clearing services provisions of the Federal Reserve Act and authorizes the Board to require a clearing balance of nonmembers "insuch amount as the Board determines taking into account items in transit, services provided by the Federal Reserve bank, and other factors as the Board may deem appropriate." (sec. 6)	H.R. 7 has similar language concerning requiring clearing balances from nonmembers. (sec. 6)	No similar provision.
Federal Reserve Note Collateral:	Authorizes use of all financial assets to collateralize Federal Reserve notes and provides that notes in Reserve Bank vaults need not be collateralized. (sec. 6)	A similar provision in H.R. 7 was struck on the House floor.	No similar provision
Deposits with Nonmembers:	Permits members to maintain a deposit in excess of 10% of its capital with a nonmember that has access to the discount window. (sec. 6)	No similar provision in H.R. 7.	No similar provision.
Penalty Rate:	Eliminates the required 1/2% penalty rate of § 10(b) advances on ineligible collateral. (sec. 7)	H.R. 7 is similar. (sec. 5)	No similar provision.
Pricing:	(sec. 8) 1) requires pulbication of pricing principles and fee schedule six months after enactment.	(sec. 6) H. R. 7 is similar.	No similar provision.
	2) Requires implementation of fee schedule within 1 8 months after enactment.	No similar provision in H.R. 7.	No similar provision.

	S.85	H.R. 7	S.353
	3) Services covered include currency and coin, check collection, wire transfer, settlement, ACH, float, safekeeping, and all new services offered.	H.R. 7 is similar.	No similarprovision.
	4) Requires explicit pricing: services are to be made available to members and nonmembers on same terms, including a requirement for sufficient clearing balances.	H.R. 7 is similar	No Federal Reserve services are to be made available to nonmembers unless reserves are held by such nonmember. (However, services obtained indirectly through correspondents are not affected).
	5) Over the long run fees shall be based on direct and indirect costs, including imputed costs of capital and taxes, except that the principles shall give due regard to competitive factors and the provision of an adequate level of services nationwide.	H.R. 7 is similar except H.R. 7 provides that a departure from the principle is permitted where the Board determines that the public interest requires so after giving due regard to competitive factors and the provision of an adequate level of services nationwide.	
	6) Float is to be priced based upon the Federal funds rate.	No similar provision in H.R. 7.	
	7) Federal Reserve Bank operating budgets are to be reduced commensurate with any actualor projected decline due to pricing in the folume of services, provided such savings are to be passed on to the Treasury.	No similar provision in H.R. 7.	
Effective Date:	Reserve requirement provision is effective six months after enactment. Remaining provisions are effective upon enactment.	H.R. 7 is effective upon enactment.	S.353 is effective 90 days after enactment.

COSTS/COVERAGE

Corrected
September 21, 1979

ANALYSIS OF MONETARY IMPROVEMENT PROGRAM PLANS

PLAN:						
Exemptions:						
Ratios:		35/0	35/0[a]	5/5	5/0	0/0[a]
Transactions		11	3,11	3,12	3,12	7
Savings		0	0	0	0	3
Nonpersonal Time		0	0	6	0	6[b]
Other Time	Actual	0	0	0	0	0
	1977	R-M-B	Stanton	S.85	Mod. 85	S. 353
Reserves (billions)						
Members	27.3	7.2	7.6	17.2	11.4	13.7
Nonmembers	0	.6	0	3.5[c]	2.5	0
Total	27.3	7.8	7.6	20.7	13.9	13.7
Reserves Released	--	19.5	19.7	6.8	13.4	13.6
Cost of Reserve Requirement Changes (millions)[d]	--	1307	1315	428	874	1710[e]
Revenue from Service Charges	--	(410)	(410)	(410)	(410)	(410)
Revenue from Float Charge[f]	--	(247)	(247)	(247)	(247)	0[g]
Net Cost after Taxes (55 percent marginal rate)	--	293	296	-99	103	585
Number of Commercial Banks						
Exempt						
Members	0	5044	0	2	2	0
Nonmembers	8868	8633	8868	109	110	8868
With Required Reserves						
Members	5664	620	5664	5562	5562	5562
Nonmembers	0	235	0	8759	8758	0
With Reserves at Fed						
Members	5587	332	1456	3382	3279	5448
Nonmembers	0	117	0	3467	3403	0
Percent of Total Deposits						
At Banks with Required Reserves	73.1	64.0	73.1[h]	100.0	100.0	73.1
At Banks Holding Balances at Reserve Banks	72.9	53.8	53.1	86.7	84.7	71.9
Percent of Transactions Deposits						
At Banks with Required Reserves	73.7	65.4	73.7	100.0	100.0	73.7
At Banks Holding Balances at Reserve Banks	73.5	55.6	54.5	88.5	87.0	72.6

[a] Members only.

[b] Short maturity time deposits.

[c] Includes $300 million of reserve balances of thrifts.

[d] Includes vault cash shift for members.

Includes payment of 6 percent interest on remaining balances at Fed.

Based on float outstanding of $3.8 billion in December of 1977.

[g] The Stanton trigger ratio was 71.8 as deposits of branches of foreign banks were included in denominator. R-M-B plan goes into effect when this ratio falls below 67.5.

[h] When S. 353 was introduced there was no agreement to price float.

August 22, 1979

NEW TRANCHES ON TRANSACTIONS BALANCES

				9	7
		1977			
PLAN: Exemptions:		35/0	10,35/0	10,25/0	35/0
Ratios:					
Transactions		11	0,7,11	0,6,11	2,11
Savings		0	0	0	0
Nonpersonal time		0	0	0	0
Other time	Actual	0	0	0	0
	1977	R-M-B			
Reserves (billions)					
Members	27.3	7.2	7.9	8.1	7.4
Nonmembers	0	.6	1.0	1.0	.7
Total	27.3	7.8	8.9	9.1	8.1
Reserves Released	--	19.5	18.4	18.2	19.2
Cost of Reserve Requirement Changes (millions)	--	1307	1228	1217	1284
Revenue from Service Charges	--	(410)	(410)	(410)	(410)
Revenue from Float Charge	--	(247)	(247)	(247)	(247)
Net Cost after Taxes (55 percent marginal rate)	--	293	257	252	282
Number of Commercial Banks					
Exempt					
Members	0	5044	3571	3571	0
Nonmembers	8868	8633	7444	7444	110
With Required Reserves					
Members	5664	620	2093	2093	5664
Nonmembers	0	235	1424	1424	8758
With Reserves at Fed					
Members	5587	332	700	670	781
Nonmembers	0	117	394	377	784
Percent of Total Deposits					
At Banks with Required Reserves	73.1	64.0	82.0	82.0	100
At Banks holding Balances at Reserve Banks	72.9	53.8	62.2	62.3	57.5
Percent of Transaction Deposits					
At Banks with Required Reserves	73.7	65.4	83.5	83.5	100
At Banks holding Balances at Reserve Banks	73.5	55.6	64.5	64.6	59.6

All Depository Institutions
Reservable Balances
($ billions, December 1977)

Exemption of:	Transactions	Savings	Nonpersonal Time	Other Time	All
0	257.0	439.6	159.9	465.6	1322.1
5	203.0	369.9	120.4	392.6	1085.9
10	178.3	330.4	108.8	351.1	968.3
15	164.2	303.6	102.2	322.6	892.6
25	147.4	266.7	93.9	282.6	790.6
35	137.1	241.5	88.2	254.9	721.7
Memo: Updated Deposit Estimates (No Exemption)					
June 1978	262.4	448.7	174.0	501.4	1386.5
December 1978	271.5	446.2	190.7	549.7	1458.1

Number of Depository Institutions with Deposits
Above Selected Levels of Transactions Balances
(Based on December 1977 Deposits)

	CBs	MSBs	S&Ls	CUs
0	14,422	408	186	1,007
5	6,832	88	20	n.a.
10	3,517	40	10	7
15	2,258	21	n.a.	4
20	1,535	12	n.a.	2
25	1,259	8	n.a.	1
30	1,057	5	n.a.	0
35	855	0	0	0

Transactions Balances at Selected Depository Institutions
($ Billions, Not Seasonally Adjusted)

	Demand Deposits		ATS	NOWs [a]		
Year-End	CBs	MSBs		CBs	MSBs & S&Ls	CU Share Drafts
1975	228.8	0.2	0	0.4	0.5	0
1976	240.5	0.5	0	1.3	0.8	0.1
1977	258.1	0.7	0	1.9	1.1	0.4
1978	272.2	1.0	2.8	2.5	1.3	0.7
1979-July	270.9	1.0	6.7	4.4	1.4	0.9

[a] Figures include NOW accounts in New York State, which were essentially zero at the end of 1978. By the end of July 1979, CBs in New York had $2.0 billion in NOWs and thrifts had about $0.2 billion.

Estimated Loss in Treasury Revenues From Attrition Continuing After 1979[1] ($ millions)

	If Member Bank Share of Deposits Drops 1.2 Percentage Points Per Year[2]	If Member Bank Share of Deposits Drops 3 Percentage Points Per Year[3]
1980	14.8	37.0
1981	29.7	74.3
1982	44.5	111.3
1983	59.3	148.3
1984	74.2	185.5
1985	89.0	222.5

[1] Based on reported reserves at Fed of $30 billion, with no adjustment for any vault cash reductions from change from member to nonmember status. Earnings calculated using return of 6.5 percent and an average marginal tax rate of 55 percent.

[2] Estimated average annual decline for the nation, 1974-1978.

[3] Assumes member bank attrition would accelerate to midway between that of New England and that of the nation during the 1974-78 period.

Rates of Return on the System's Portfolio and Selected Interest Rates
(quarterly averages; annual effective rate

	System Open Market Account 1/	Federal funds 2/	3-month Treasury bill 3/
1970--QI	6.55	9.05	7.58
QII	6.73	8.30	7.00
QIII	6.89	7.02	6.63
QIV	6.73	5.80	5.58
1971--QI	6.77	3.98	3.97
QII	5.68	4.70	4.41
QIII	5.82	5.69	5.21
QIV	5.78	4.92	4.38
1972--QI	5.45	3.65	3.55
QII	5.33	4.45	3.90
QIII	5.46	4.92	4.37
QIV	5.69	5.32	5.05
1973--QI	5.85	6.84	5.95
QII	6.31	8.22	6.92
QIII	6.88	11.28	8.81
QIV	7.35	10.66	7.90
1974--QI	7.09	9.89	8.03
QII	7.35	12.05	8.62
QIII	7.67	13.03	8.66
QIV	7.85	9.93	7.75
1975--QI	7.35	6.58	6.00
QII	7.00	5.62	5.62
QIII	7.14	6.43	6.63
QIV	7.18	5.62	5.87
1976--QI	7.03	4.99	5.11
QII	6.91	5.40	5.37
QIII	6.99	5.47	5.36
QIV	6.93	5.03	4.85
1977--QI	6.62	4.81	4.81
QII	6.59	5.36	5.03
QIII	6.72	6.06	5.73
QIV	6.95	6.80	6.39
1978--QI	7.09	7.06	6.70
QII	7.31	7.66	6.79
QIII	7.69	8.52	7.69
QIV	7.80	10.20	9.08
1979--QI	8.25	10.74	9.98
QII	8.76	10.85	9.97

	System Open Market Account 1/	Federal funds 2/	3-month Treasury bill 3/
1965--QI	3.94	4.08	4.02
QII	4.02	4.19	4.01
QIII	4.06	4.19	4.00
QIV	4.12	4.30	4.32
1966--QI	4.17	4.70	4.79
QII	4.41	5.10	4.76
QIII	4.68	5.62	5.25
QIV	4.85	5.80	5.42
1967--QI	4.84	4.99	4.68
QII	4.74	4.12	3.78
QIII	4.70	4.01	4.46
QIV	4.91	4.30	4.94
1968--QI	5.08	4.96	5.25
QII	5.23	6.24	5.76
QIII	5.46	6.21	5.41
QIV	5.56	6.17	5.83
1969--QI	5.68	6.87	6.37
QII	5.93	8.79	6.48
QIII	6.11	9.51	7.38
QIV	6.52	9.47	7.74

1/ Quarterly rate of return, converted to an anual effective rate. Rate of return equals earnings on System's holdings of Government and agency securities (including earnings on repurchase agreements and profits and losses from sales of Government securities) divided by book value of those holdings (quarterly average of daily figures).

2/ Effective federal fund rate, converted to an annual effective rate.

3/ 3-month Treasury bill rate (market yield on a bank discount basis), converted to an annual effective rate.

Deposits and Released Reserve Balances
(December 1977)

	Reserves at Fed ($ millions)		Earnings on Released Reserves ($ millions)	Service Charges ($ millions)	Earnings Gain Before Float Charge ($ millions)	Charge for Float ($ millions)	Net Earnings Gain ($ millions)
	Current	H.R. 7					
Bank of America	1,714	456	81.8	10.9	70.9	6.6	64.3
Citibank	897	448	29.2	5.8	23.4	3.5	19.9
Chase Manhattan	831	421	26.7	6.2	20.5	3.7	16.8
Manufacturers Hanover	623	338	18.5	7.5	11.0	4.5	6.5
Morgan Guaranty	424	348	4.9	2.7	2.2	1.6	0.6
Chemical Bank	611	301	20.2	5.9	14.3	3.6	10.7
Continental Illinois	398	152	16.0	6.1	9.9	3.7	6.2
Bankers Trust	252	82	11.1	3.5	7.6	2.1	5.5
First National of Chicago	416	115	19.6	4.6	15.0	2.8	6.0
Security Pacific	477	153	21.1	4.5	16.6	2.0	14.6

September 25, 1979

ATTRITION

Table

Change in the Number of Member Banks as a Result of On-going Banks Joining and Withdrawing from the Federal Reserve System, 1960-79[1]

Year	Joining			Withdrawing			Net Change		
	National	State Member	Total	National	State Member	Total	National	State Member	Total
1960	6	7	13	-9[2]	-25	-34	-3	-18	-21
1961	5	4	9	-1	-16	-17	4	-12	-8
1962	8	5	13	-6	-26	-32	2	-21	-19
1963	18	3	21	-13	-22	-35	5	-19	-14
1964	19	4	23	-5	-19	-24	14	-15	-1
1965	12[2]	1	13	-7	-22	-29	5	-21	-16
1966	10	4	14	-7	-32	-39	3	-28	-25
1967	7	1	8	-5	-21	-26	2	-20	-18
1968	6	3	9	-12	-40	-52	-6	-37	-43
1969	9	1	10	-28	-41	-69	-19	-40	-59
1970	5	0	5	-39	-38	-77	-34	-38	-72
1971	7	4	11	-21	-20	-41	-14	-16	-30
1972	12	6	18	-22	-36	-58	-10	-30	-40
1973	8	4	12	-21	-28	-49	-13	-24	-37
1974	8	9	17	-20	-28	-48	-12	-19	-31
1975	8	4	12	-10	-32	-42	-2	-28	-30
1976	8	10	18	-23	-23	-46	-15	-13	-28
1977	5	5	10	-43	-26	-69	-38	-21	-59
1978	3	11	14	-62	-37	-99	-59	-26	-85
1979[3]	0	4	4	-27	-14	-41	-27	-10	-37
Total	164	90	254	-381	-546	-927	-217	-456	-673

[1] *De novo* banks, bank closures, and merging banks are excluded from these figures.

[2] Figure taken from summary table published by FDIC. Detailed listing of banks by name indicated one bank less than summary figure shown.

[3] Data through June 1979.

SOURCE: FDIC, *Annual Reports*, 1960-77, and *Changes Among Operating Banks and Branches*, 1960-78. Data for 1979 compiled from records at the Federal Reserve Board.

Table 2

Deposits Acquired by the Member Sector As a Result of Banks Joining and Withdrawing from the Federal Reserve System, 1960-79 1/2/

	Joining			Withdrawing			Net Change		
Year	National ($mil)	State Member ($mil)	Total ($mil)	National ($mil)	State Member ($mil)	Total ($mil)	National ($mil)	State Member ($mil)	Total ($mil)
1960	--	--	--	--	--	--	--	--	--
1961	56.6	10.7	67.3	-1.7	-98.6	-100.3	54.9	-87.9	-33.0
1962	168.8	49.9	218.7	-30.9	-357.7	-388.6	137.9	-307.8	-169.9
1963	97.3	19.8	117.1	-143.8	-138.1	-281.9	-46.5	-118.3	-164.8
1964	181.7	84.7	266.4	-34.0	-232.7	-266.7	147.7	-148.0	-.3
1965	59.2	35.6	94.8	-61.4	-320.3	-381.7	-2.2	-284.7	-286.9
1966	225.2	56.5	281.7	-67.5	-432.9	-500.4	157.7	-376.4	-218.7
1967	72.4	16.3	88.7	-15.7	-380.1	-395.8	56.7	-363.8	-307.1
1968	83.2	64.7	147.9	-65.6	-399.2	-464.8	17.6	-334.5	-316.9
1969	49.3	1.6	50.9	-1,046.7	-616.2	-1,662.9	-997.4	-614.6	-1,612.0
1970	103.3	-0-	103.3	-558.7	-393.7	-952.4	-455.4	-393.7	-849.1
1971	52.4	139.5	191.9	-400.0	-263.2	-663.2	-347.6	-123.7	-471.3
1972	132.2	406.8	539.0	-563.1	-1,302.9	-1,866.0	-430.9	-896.1	-1,327.0
1973	117.7	106.0	223.7	-498.6	-1,392.1	-1,890.7	-380.9	-1,286.1	-1,667.0
1974	125.6	627.0	752.6	-1,640.5	-1,349.1	-2,989.6	-1,514.9	-722.1	-2,237.0
1975	140.5	191.4	331.9	-239.9	-728.1	-968.0	-99.4	-536.7	-636.1
1976	254.4	439.7	694.1	-1,100.0	-953.2	-2,053.2	-845.6	-513.5	-1,359.1
1977	71.0	202.8	273.8	-2,433.5	-2,049.6	-4,483.1	-2,362.5	-1,846.8	-4,209.3
1978	107.1	448.3	555.4	-3,170.7	-2,418.0	-5,588.7	-3,063.6	-1,969.7	-5,033.3
1979 3/	0.0	33.2	33.2	-1,754.1	- 595.6	-2,349.7	-1,754.1	- 562.4	-2,316.5
Total	2,097.9	2,934.5	5,032.4	-13,826.4	-14,421.3	-28,247.7	-11,728.5	-11,486.8	-23,215.3

1/ Deposit data correspond to bank data in Table 1.

2/ Deposit data are based on total deposit size as of year-end prior to the year in which a bank changed its charter-membership class. In five instances the banks changed their charter-membership class later in the same year in which they were organized; hence, deposit data were not available. Deposit data were also unavailable for those banks that changed their charter-membership class in 1960.

3/ Data through June 1979.

SOURCE: Deposit data from Reports of Condition (Call Reports).

Table 3

Number of Commercial Banks[1] Withdrawing from
the Federal Reserve System, 1968-79
(Banks Grouped by Deposit Size Class as of the
Beginning of Each Year)

Deposit Size Class ($ millions)	1968	1969	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979[2]
0-2	5	3	7	3	3	1	1	1		2	4	
2-5	18	18	27	8	11	4	2	10	1	4	5	2
5-10	17	21	15	11	11	15	5	7	9	11	14	3
10-25	8	16	16	11	21	12	18	9	13	19	25	12
25-50	3	4	10	5	5	7	9	10	13	13	23	11
50-100	1	3	2	3	2	5	3	5	5	5	18	7
100-500		4			5	5	10		5	15	9	6
500-1000											1	
Total	52	69	77	41	58	49	48	42	46	69	99	41
Ave. Size Bank ($ mil. deposits)	8.9	24.1	12.4	16.2	32.2	38.6	62.3	23.0	44.6	65.0	56.5	57.3

[1] Includes both national banks and state member banks.

[2] Data through June 1979.

SOURCE: FDIC, Changes Among Operating Banks and Branches, 1968-78, and records at the Federal Reserve Board.

Table 4

Number of Commercial Banks[1] Joining
the Federal Reserve System, 1968-79
(Banks Grouped by Deposit Size Class as of the
Beginning of Each Year)

Deposit Size Class ($ millions)	1968	1969	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979[3]
0-2	1	2	1	3[2]	1	2[2]	2		1[2]	1[2]		2[4]
2-5	3	4		1	2	1	2	3	2	2	1	2
5-10		2	2	1	7	3	5	3	3	4	1	
10-25	3	2		4	3	2	3	2	6	2	5	
25-50	2		1	1	3	4	3	2	1		1	
50-100			1	1	1		1	1	2		5	
100-500					1		1	1	3	1	1	
500+												
Total	9	10	5	11	18	12	17	12	18	10	14	4
Ave. Size Bank ($ mil. deposits)	16.4	5.1	20.7	17.4	29.9	18.6	44.3	27.7	38.6	27.4	39.7	8.3

[1] Includes both national banks and state member banks.

[2] Includes one bank which joined the System later in the same year in which it was organized.

[3] Data through June 1979.

[4] Includes one bank which was organized in 1978 but for which year-end 1978 deposit data are unavailable.

SOURCE: FDIC, Changes Among Operating Banks and Branches, 1968-78, and records at the Federal Reserve Board.

Estimated Loss in Treasury Revenues from Attrition in Federal Reserve Membership
1973 - 1978

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Year	Commercial Bank Total Deposits	Actual Member Bank Deposits	Member Bank Deposits if 1972 Proportion Maintained	Difference (3)-(2)	Amount by Which Fed Security Holdings are Lower 1/	Amount by Which Fed Earnings are Lower 2/	Amount by Which Treasury Revenues are Lower 3/
	($ billion)	($ billion)	($ billion)	($ billion)	($ million)	($ million)	($ million)
1972	616.8	482.5	482.5	--	--	--	--
1973	682.4	527.2	533.8	6.6	271	17.4	9.6
1974	748.2	575.8	585.3	9.5	355	25.9	14.3
1975	786.5	591.0	615.3	24.3	838	57.7	31.7
1976	838.2	618.9	655.6	36.7	1171	78.3	43.0
1977	900.2	652.3	710.5	58.2	1862	122.0	67.1
1978	1005.8	716.3	786.8	70.5	2256	165.0	90.9

1/ Column (4) times average reserve requirement against all deposits for member banks with deposits less than $100 million in each year less average nonmember bank holdings of vault cash. Latter amount is subtracted from average reserve requirements because even if a member bank were to withdraw from the System, it would have to maintain vault cash equal to that of an average nonmember. Since the Fed holds securities against Federal Reserve notes, System earnings would only be reduced by the amount of reserve balances withdrawn plus excess cash held by members over and above that of nonmembers.

2/ Column (5) times the average rate of return on System portfolio in each year.

3/ Column (6) times .55. Latter figure assumes the average marginal tax rate against banks is 35 per cent and an additional 10 per cent in tax revenue is collected from dividends. Thus, of each dollar reduction in System payment, an estimated 45 cents is returned to the Treasury through higher taxes and 55 cents is lost.

Estimated Loss in Treasury Revenues From Attrition Continuing After 1979[1] ($ millions)

	If Member Bank Share of Deposits Drops 1.2 Percentage Points Per Year[2]	If Member Bank Share of Deposits Drops 3 Percentage Points Per Year[3]
1980	14.8	37.0
1981	29.7	74.3
1982	44.5	111.3
1983	59.3	148.3
1984	74.2	185.5
1985	89.0	222.5

[1] Based on reported reserves at Fed of $30 billion, with no adjustment for any vault cash reductions from change from member to nonmember status. Earnings calculated using return of 6.5 percent and an average marginal tax rate of 55 percent.

[2] Estimated average annual decline for the nation, 1974-1978.

[3] Assumes member bank attrition would accelerate to midway between that of New England and that of the nation during the 1974-78 period.

FOREIGN

Larry Promisel
August 29, 1979

RATIOS OF RESERVE BALANCES AT CENTRAL BANKS TO TOTAL DEPOSIT LIABILITIES

COUNTRY	RATIO	NOTES
ITALY	.149	Average 1978Q4; interest is paid on central bank balances; reserves can be held in other forms, as well.
GERMANY	.078	Average 1979Q2; ratio of reserve balances at Bundesbank to all deposits against which reserves are required; central bank balances do not bear interest.
UNITED STATES	.048	Average 1979Q2; ratio of reserves with Federal Reserve Banks to total deposit liabilities of member banks; reserves do not bear interest.
CANADA	.044	Average 1979H1; ratio of Chartered Banks' balances at Bank of Canada to their total deposit liabilities (including Government of Canada deposits); central bank balances do not bear interest.
FRANCE	.024	Average January-February 1979; central bank balances do not bear interest.
SWEDEN	.016	End-April 1979.
UNITED KINGDOM	.008	Mid-May 1979; ratio of balances (other than Special and Supplementary deposits) at Bank of England to total sterling deposits of banking system; only London Clearing Banks are required to maintain balances at Bank of England, equal to 1-1/2 percent of their eligible liabilities (these balances do not bear interest); all banks must observe liquid asset ratios. Note: if Special and Supplementary deposits were included, ratio would be .016.
JAPAN	less than .015 but more than .0025	In May 1979 the ratio of all financial institutions' deposits at Bank of Japan to total deposit liabilities was .015; however, the numerator includes many items that are not reserves against deposits. The smallest reserve ratio, which is applicable to deposits of less than ¥500 billion, is .0025; central bank balances do not bear interest.

RATIOS OF RESERVE BALANCES AT CENTRAL BANKS TO TOTAL DEPOSIT LIABILITIES

COUNTRY	RATIO	NOTES
BELGIUM	less than .001	
NETHERLANDS	less than .001	

Footnotes

* Cash Reserve Requirements whenever applicable.

1/ Actual requirements vary according to size of bank and term of time deposit. Reserve requirements only on net foreign liabilities.

2/ The 20% maximum applies to deposits with a maturity of one month or less. Reserve restrictions were imposed on October 1978. There exists a 100% marginal primary reserve requirement on credits beyond same threshold. Bank holdings of secondary reserves as a ratio of total liabilities is frozen at some base period.

3/ New Bank Act may be in effect by end of 1979. Reserve requirements, in general, will be slightly lower. Foreign-currency deposits used domestically will be treated slightly differently from domestic-currency deposits. The minimum required ratio for secondary reserves is uniform -- currently 5 per cent for all Canadian dollar deposit liabilities.

4/ Maximum reserve requirements are not statutory. They are fixed by National Credit Council and Banque de France is free to set requirements below ceiling. The first FF15 million is subject to ½ the actual reserve requirement shown.

5/ Actual reserve requirements on demand and time deposits increase with size of commercial banks. There exists a 50% marginal reserve requirement on non-resident yen deposits (above February 1978 level).

6/ Maximum apply to deposits in excess of 15 million guilders. Secondary reserve requirements are 10.5% for short-term deposit liabilities and 6% for long-term deposit liabilities.

7/ There exists separate "liquidity" requirements. The maximum liquidity ratio (LR) is 50% and the minimum is 0%. The actual LR is 23-24% for small banks to 45% for large savings banks. For commercial banks, the actual LR ranges from 26-50% (depending on size of bank).

8/ The actual reserve requirements were dropped to 0% on February 1977 for foreign deposits and on November 1974 for domestic deposits. Maximum reserve requirements are higher for time deposits than savings deposits.

9/ Reserve requirements for London Clearing Banks are 1½% for the actual and minimum. Reserve requirements on net position of foreign-currency deposits only. Most of reserve requirements held in various public debt securities.

The Primary* Reserve Requirements In The Leading Industrial Countries

a: legal maximum b: requirements in force as of January 1, 1979 c: legal minimum

		Demand Deposits		Savings and Other Time Deposits	
		Domestic	Foreign	Domestic	Foreign
Austria[1/]	(a.	15%	15%	15%	15%
	(b.	5-9%	5-9%	4½-7%	4½-7%
	(c.	0%	0%	0%	0%
Belgium[2/]	(a.	20%	20%	7%	7%
	(b.	0%	0%	0%	0%
	(c.	0%	0%	0%	0%
Canada[3/]	(a.	12%	12%	4%	4%
	(b.	12%	12%	4%	4%
	(c.	12%	12%	4%	4%
France[4/]	(a.	25%	100%	25%	100%
	(b.	4%	0%	0%	0%
	(c.	0%	0%	0%	0%
Germany	(a.	30%	100%	10-20%	100%
	(b.	14%	14%	6.2-9.8%	6.2-9.8%
	(c.	0%	0%	0%	0%
Italy	(a.	20%	20%	20%	20%
	(b.	15.8%	15.8%	15.8%	15.8%
	(c.	10%	10%	10%	10%
Japan[5/]	(a.	20%	100%	20%	100%
	(b.	0.25-2.5%	0.25%	0.125-1.625%	0.25%
	(c.	0%	0%	0%	0%
Netherlands[6/]	(a.	15%	15%	15%	15%
	(b.	0%	0%	0%	0%
	(c.	0%	0%	0%	0%
Sweden[7/]	(a.	15%	15%	15%	15%
	(b.	2%	2%	2%	2%
	(c.	0%	0%	0%	0%
Switzerland[8/]	(a.	40%	40%	0-30%	0-30%
	(b.	0%	0%	0%	0%
	(c.	0%	0%	0%	0%
United Kingdom[9/]	(a.	-	-	-	-
	(b.	12½%	12½%	12½%	12½%
	(c.	12½%	12½%	12½%	12½%

January 1979

Checklist of Monetary Powers and Practices of Foreign Central Banks

	(1) Mandatory "Membership" of Commercial Banks	(2) Universal Reserve Requirements	(3) Interest on Reserves or Reserves Held in Interest-Bearing Assets	(4) Access to Discount Window	(5) Major Monetary Policy Instruments
Canada	Yes Mandatory for Chartered Banks (which account for 65 per cent of deposits), and Quebec Savings Banks (a commercial bank). Not mandatory for other deposit-accepting institutions ("near banks").	Yes Reserve requirements uniform for all Chartered Banks. Different requirements for Quebec Savings Banks and "near banks".	Yes Chartered banks required to maintain non-interest bearing cash reserves; however, secondary reserve requirements may be satisfied by interest-bearing assets. "Near banks" required to hold some proportion of their assets in liquid (interest-bearing) form.	Access restricted to chartered banks and Quebec Savings Banks.	--Open market operations is major instrument; --"moral suasion" has large role; --discount window used as a signal to market; --primary reserve requirements may not be varied; --direct controls not used.
France	Yes All banks controlled by the Bank of France.	Yes Reserve requirements uniform for all banks; sometimes apply different ratios for residents and non-resident accounts. Requirements differ according to type of deposit. Also, requirements on bank assets differ by type of bank.	No All reserves held in non-interest bearing form.	All commercial banks and certain other financial institutions have access.	--Credit ceiling is major instrument (norms for credit expansion posted for all banks, and differ according to size of banks); --reserve requirements and discount window of secondary importance.
Germany	Yes All deposit-taking institutions are subject to Bundesbank regulatory instruments, and can use credit facilities.	Yes Reserve requirements differ according to the size of the bank and the type of deposit.	No All reserves held in non-interest bearing form.	Access theoretically can be tied to conditions such as credit ceilings; however, this has never been done.	--Changes in reserve requirements and the use of rediscount quotas are major instruments; --open market operations not large, but frequently used; --changes in the discount rate, the use of foreign exchange regulations, capital controls and "moral suasion" used occasionally.
Italy	Yes All banks are controlled by the Bank of Italy.	Yes Since 1975 there are universal reserve requirements for increases in deposit liabilities.	Yes Existing holdings of some assets other than central bank balances count as reserves, but increases in required reserves all take form of (interest-bearing) deposits at the Bank of Italy.	All commercial banks have access to discount window.	--Open market operations is the major instrument; --direct control over credit expansion important; --changes in the discount rate often used but small effect; --regulation of banks foreign position occasionally used; --changes in reserve requirements rarely used.
Japan	No Banks are not required to establish a correspondent relationship with the Bank of Japan. However, all commercial banks are controlled by the Bank of Japan.	Yes There are higher reserve requirements for large city banks; lower, for smaller banks.	No Required reserves are exclusively non-interest bearing current-account deposits at the Bank of Japan; vault cash is not counted as a reserve.	Financial institutions seeking access to the Bank of Japan's borrowing facilities must satisfy certain requirements -- including sound financial standing and significant size. Large city banks are the principal borrowers.	--Central bank lending, primarily via rationing of credit to banks, is major instrument; --open market operations, mainly on long-term government securities; --changes in reserve requirements have been used in recent years; --"window guidance", a form of "moral suasion", has diminished in importance recently.
Switzerland	All commercial banks subject to central bank control.	Yes All commercial banks subject to reserve requirements that vary with the size of the bank.	No All reserves held in non-interest bearing form.	All commercial banks have access to discount window.	--Open market operations, via currency swaps and sterilization bonds, is the major instrument; --credit controls, such as negative interest rates on foreign deposits and bans on foreign purchases of Swiss securities, are less frequently used; --changes in discount rates and reserve requirements of minor importance.
United Kingdom	No No formal relationship between Bank of England and commercial banks. In practice an informal relationship exists.	Yes London Clearing Banks (LCB), which account for about one-half of total deposits, must keep 1-1/2 per. cent of eligible liabilities at the Bank of England. All banks (including LCB) must have 12-1/2 per cent of eligible liabilities in "liquid assets".	Yes The 1-1/2 per cent LCB requirement does not bear interest; however, all other required reserves take the form of liquid (interest-bearing) assets.	Banks have access to discount window through the Discount houses.	--Open market operations, via trading of bonds and treasury bills, is major instrument; --variations in the Minimum Lending Rate at which the Bank of England lends to Discount houses frequently used; --reserve requirements affected by special deposits and supplementary special deposits ("the corset") occasionally used; --"moral suasion" also has a role.

Prepared by Federal Reserve Board Staff

MONEY MARKET
MUTUAL FUNDS

Notes on Money Market Mutual Fund Tables

Table 1

a. MMMFs were first offered in 1974 and grew rapidly through early 1975. Octstanding shares did not decline when interest rates fell in 1975 and 1976.

b. Outstanding shares of MMMFs have tripled since year-end, reaching nearly $34.0 billion on September 12.

c. Fund managers have channelled most of the cash inflows into domestic and Eurodollar CDs and commercial paper.

Table 2

At year-end 1978 about half of MMMF shares were held by institutions, with most of the institutional total in bank trust accounts or pension and related funds.

Table 3

a. A disproportionate share of money fund growth this year has occurred in stockbroker sponsored funds.

b. The average size of general purpose and stockbroker sponsored funds is around $19,000.

Transactions

a. All funds offer wire transfer facilities, and most offer check writing privileges which usually required minimum checks of $500.

b. Conversation with industry representatives suggest that thus far accounts have had a very low level of checking activity. Volume of redemptions relative to assets suggest a level of activity similar to a savings account.

Table 1
Assets, Portfolio Composition, Average Maturity, and Average Yield
of Money Market Mutual Funds
(dollar amounts in billions)

End of Period	Number of Funds	Total Net Assets	Portfolio Composition								Average Maturity 1/ (days)	Averate Yield 2/ (percent)
			U.S.									
			Treas.	Other	RPs	CDs	Euro CDs	Commercial Paper	BAs	Other		
1975	33	3.6	0.9	n.a.	n.a.	2.1	--	0.4	--	0.2	93	n.a.
1976	39	3.7	0.9	0.3	n.a.	1.5	--	0.9	--	0.1	94	4.7
1977	46	4.0	0.4	0.3	0.3	1.7	0.2	1.0	0.1	0.1	75	5.7
1978-Q1	46	5.4	0.5	0.6	0.2	2.4	0.3	1.2	0.1	0.1	77	6.2
Q2	46	6.8	0.4	0.7	0.3	3.0	0.2	1.8	0.4	0.1	67	6.5
Q3	49	8.2	0.2	0.9	0.3	3.7	0.3	2.2	0.5	0.1	66	7.3
Q4	49	11.0	0.4	1.0	0.4	4.8	0.5	2.9	0.8	0.1	48	9.3
1979-Jan.	54	13.2	0.4	1.1	0.4	5.6	0.8	3.6	1.0	0.3	41	9.8
Feb.	55	15.5	0.2	2.1	0.7	6.3	1.1	3.8	1.1	0.2	51	9.6
Mar.	56	17.7	0.3	2.0	0.7	6.3	1.4	5.1	1.6	0.3	49	9.6
Apr.	56	20.0	0.3	2.5	0.5	6.8	1.7	5.8	2.3	0.2	47	9.4
May	60	23.2	1.2	2.1	1.2	7.0	2.1	6.2	3.3	0.1	49	9.5
June	62	26.0	1.5	2.1	0.6	7.8	2.6	7.8	3.1	0.4	50	9.7
July	63	30.2	0.9	2.4	0.8	9.9	3.1	9.8	2.9	0.4	53	9.4
Aug.	68	32.7	0.6	2.4	1.0	12.1	3.7	9.1	3.4	0.4	46	9.7
Sep. 12	68	33.9	2.4	2.7	0.9	12.1	3.5	10.2	3.6	0.2	50	9.8

1/ 30-day average weighted by assets.
2/ 30-day average.
n.a. - not available.

Source: Donoghue's Money Fund Report.

Table 2
Ownership of Money Market Mutual Funds
December 31, 1978

	Total Assets in billions of dollars	Percent of Total Assets	Average Account Size
Total	10.86	100	23,215
Individual	4.94	45	15,544
Institutional	5.92	55	40,375
Fiduciary	3.07	28	38,499
Business	.61	6	46,793
Employee Plans	.45	4	18,494
Pension	.14	1	24,412
Profit Sharing	.14	1	28,317
IRA and Keogh	.17	2	12,451
Insurance Companies	.41	4	34,713
Other	1.38	13	79,660

Note: Classification by Individual or Institutional made on basis of nearly complete coverage. Classification by type of institution made on basis of 56 percent coverage of institutional accounts.

Source: Investment Company Institute Estimates.

Table 3
Money Market Mutual Fund Assets
by Type of Fund

	General Purpose	Stockbroker/ Gen'l. Purpose	Institutions Only	Total
Assets, billions of dollars				
December 1978	3.8	3.6	3.3	10.7
Sept. 12, 1979	9.4	16.4	8.1	33.9
Percent of total assets				
December 1978	35.5	33.6	30.8	100.0
Sept. 12, 1979	27.7	48.4	23.9	100.0
Number of accounts				
December 1978	189,297	216,852	60,088	466,237
July 1979	423,067	725,097	104,311	1,252,475
Average account size, thousands of dollars				
July 1979	19.5	19.1	77.6	24.1

Source: Donoghue's Money Fund Report.

ISSUES

ISSUES REGARDING MONETARY CONTROL

- Theoretically, Federal control the money stock without any reserve requirements.
  - Control could be based on more active use of discount window or open market intervention similar to current operating procedure.
  - However, relationship is not stable in the short run so that there would be too much slippage in monetary control.
- Higher reserve balances and greater coverage more important under reserves aggregate operating procedure.
  - Under current balances and coverage, monetary control is about as precise under federal funds procedure as under reserve aggregate procedure.
  - With increased coverage, reserves aggregate procedure would be superior to federal funds procedure.
- Under reserve operating procedure, higher reserve balances and greater bank coverage improve short-run monetary control.
  - Based on M-1/reserves multiplier relationship.
  - Higher reserves reduce size of multiplier, thus ameliorate impact of errors in provision of reserves.
  - Greater coverage increases proportion of deposits at same reserve requirement and reduces excess reserves in banking system, thus making multiplier more stable.
  - Paying interest on required reserve balances (or special supplementary deposits) would not affect multiplier relationship.

o Exact amount of required reserves necessary for monetary policy is uncertain

-- Reserve ratio should be high enough to make reserve requirements binding at most banks.

-- Based on statistics for nonmember banks, Board staff estimate that using modified S.85 structure, the special supplementary deposit ratio would have to be 4 to 5 percent on all transactions balances in order to put 80 percent of transactions balances at banks with binding reserve requirements.

--- Such a reserve structure would yield about $20 to $25 billion in reserves at the Fed.

o Required reserve balances of nonmembers should be held at other regulatory institutions only if these regulators pass through these reserves to the Fed.

-- Fed must have control over total reserves availability in system.

-- If other regulators have independent control they can offset our monetary policy actions.

PRICING ISSUES IN S. 85

- Add public interest criterion to section 11A(b)(3).
  - Need additional flexibility.
  - Allow Board to preserve efficient effective payments mechanism.
- Drop requirement that prices be fully implemented within 18 months.
  - Replace with requirement to begin in 18 months.
  - May need longer time to avoid disruption to correspondent banking system.
  - Reserve Banks must construct an accounts receivable facility that they don't now have.
  - Allow time for orderly change.
  - Suggest time comparable to 4-year phasing of reserve requirements.
- Do not require pricing of all new services.
  - Only new payments services should be priced.
  - Congressional objectives can be accomplished without requiring pricing of non-payments services, e.g., publications.
  - Prices intended to promote private sector. If private sector can't provide the service, no purpose served by charges.
- Unreasonable to require reductions in operating budgets of Reserve Banks commensurate with volume declines.
  - Impossible to do. Not all costs variable in short-run.
  - Could restrict ability of Fed to serve public interest by adapting to changes in marketplace.

-- Could make it impossible to continue to promote efficient effective payments mechanism.

-- For example, suppose items left to Fed after pricing were high unit cost. Expenses could not decrease as rapidly as volume.

-- Impossible to tell what amount to return to Treasury would be.

o Impact of Fed charging on correspondent banking.

-- Greater opportunity to compete.

-- Promote explicit pricing of correspondent services.

-- Should have minor cost and profit impact on banking system.

-- Create an alternative provider of services for depository institutions now non-member.