Discount window operations
Fed loans assist depository institutions

The objective of the discount window is to assist financial institutions in maintaining their liquidity, according to Jesse Sanders, vice president over the Loan Department of the Dallas Fed. Loans from the Federal Reserve provide depository institutions with cash advances necessary to meet their short-term liquidity needs.

Prior to the passage of the Monetary Control Act of 1980 (MCA), loans were available only to commercial banks which were members of the Fed. MCA directed the Fed to open its discount window to all depository institutions that maintain transaction accounts or nonpersonal time deposits. This change allowed state nonmember banks access to Fed loans.

Savings and loan associations, as well as credit unions, also became eligible to borrow from the Fed. However, these institutions are expected to seek funds from the Federal Home Loan Bank, the National Credit Union Administration's Central Liquidity Facility or similar industry sources, prior to borrowing from the discount window. This treatment is consistent with the Fed's posture of being the "lender of last resort"—that is, depository institutions are expected to seek all other reasonable sources of funds before requesting a loan from the Fed.

The discount rate, the rate of interest charged on loans made by the Fed to depository institutions, is one of the primary tools used by the Federal Reserve System to implement the nation's monetary policy. The lending functions of the Fed are conducted in conjunction with the System's efforts to maintain a sound and efficient financial system.

Historically, the Fed's announcement of a change in the discount rate has been taken as a signal of the direction of monetary policy. The discount rate—currently 5.5 percent—is adjusted from time to time to reflect prevailing economic and money market conditions.

Theoretically, the purpose of the discount window is to extend credit to depository institutions in response to changes in commerce, industry, and agriculture at any given period of time. Loans from the discount window supply reserves to meet the particular (Continued on page 2)
Discount window operations (Cont.)

Credit needs of individual depository institutions.

“Smaller banks tend to have limited sources of liquidity, frequently limited to one or more correspondent banks,” Sanders said. “Large banks may also have access to the nationwide Fed Funds market, the brokered certificate of deposit market and Eurodollars, but these sources are less available to smaller banks throughout the country.”

Loans from the Fed’s discount window are usually one to seven days in length, according to Finlay Higgins, manager of the Loan Department in Dallas. However, loans to institutions with unusual liquidity needs are payable on demand and may be reviewed daily to meet the institution’s business needs.

Loans to smaller banks tend to be extended for a longer period of time. Higgins explained that the turnaround time necessary to correct a liquidity need is usually longer for smaller institutions. “They simply cannot make the adjustment as quickly as the larger institutions; therefore, we allow for that extra time when granting the advance,” he said.

Loans to smaller banks tend to be extended for a longer period of time, the turnaround time necessary to correct a liquidity need is usually longer for smaller institutions.

Higgins added that a request for a loan to buy securities at a higher interest rate than the discount rate (“arbitrage”) or to promote a big loan campaign would generally be denied. “Those types of requests do not meet the criteria or purposes of discount window operations,” Higgins remarked.

Most loan requests to the Dallas Fed are made by phone. Depository institutions must have proper documentation already on file with the Fed before any loan can be granted. When the request is made by an authorized official of the requesting financial institution, Loan Department employees get the reason for the loan and other general information. The loan can then be granted after arrangements to obtain the collateral are made.

The term “discount window” reflects previous procedures for extending credit by discounting commercial and agricultural paper.

“Financial institutions must have collateral of sufficient value to support the loan,” Sanders said. “Government securities, federal agency securities and state and municipal obligations are the major acceptable forms of collateral. If an institution has no such securities available, the Loan Department will consider the pledging of customers’ notes.”

The term “discount window” reflects previous procedures for extending credit by discounting commercial and agricultural paper. The Reserve Bank deducted interest from the face amount of eligible commercial and agricultural paper and credited the net proceeds. At maturity of the commercial and agricultural paper, the borrowing institution would pay the Reserve Bank the face amount. This practice ended, for the most part, in the mid-to-late 1950s, Sander said.

According to Sanders, financial institutions experience a high loan demand and are actively seeking additional customer deposits during periods of rapid economic growth as experienced in the Eleventh District during the 70s and early 80s. At the same time, they generally de-emphasize the purchase of government securities because of comparatively lower rates of return. Therefore, when economic conditions tighten or deposits actually decrease, institutions may find themselves with limited marketable securities as a hedge for liquidity needs.

Traditionally, adjustment credit has accounted for the majority of borrowing in all Fed Districts. Adjustment borrowing tends to be heaviest and more widespread during periods of tight credit. Primarily, adjustment borrowing is used by institutions experiencing an unexpected outflow of volatile funds. Higgins explained that these borrowings are utilized pending an orderly adjustment of the institution’s assets and liabilities.

Extended credit, on the other hand, is divided into three different programs. One program provides seasonal credit for nine months or less to smaller depository institutions lacking access to market funds, while a second type assists depository institutions experiencing special difficulties arising from exceptional circumstances or practices involving that institution. A third type of program is designed to meet the general liquidity needs of a broad range of depository institutions.

The seasonal credit program began in the early 1970s to meet the needs of... (Continued on page 6)
Changes in payments system proposed

The Federal Reserve Board recently issued for comment a series of proposed amendments to its May 17, 1985, Payments System Risk Policy. The policy is designed to reduce and control the payments system risk resulting from the use of large-dollar funds transfer networks, book-entry securities transfer systems, and automated clearing houses (ACHs).

Large-dollar funds transfer networks are an integral part of the payments and clearing mechanism. Participants on these networks incur total overdrafts of more than $80 billion per day.

A daylight overdraft occurs when an institution sends funds over Fedwire, the Federal Reserve’s funds transfer system, in excess of the balance in its account at the Fed, or sends more funds over a private funds transfer network than it has received.

Overdrafts of another $60 billion per day result from book-entry transfers of U.S. Government and agency securities. These overdrafts occur when a depository institution receives and pays for more securities over Fedwire than it has sent and received payment.

The Board’s policy is designed to reduce the domino effect on the banking system—called systemic risk—which might result if a large institution were unable to settle its daylight overdrafts on a private-wire funds transfer system at the close of a day. The policy also attempts to limit potential loss to the Federal Reserve through the failure of depository institutions to settle for daylight overdrafts in their Fed accounts.

The policy seeks to accomplish these objectives by reducing the total volume of daylight overdrafts and the number of depository institutions that rely substantially on them. The principal method is the sender net debit cap, a self-determined limit on the amount of daylight overdrafts at each depository institution.

With respect to book-entry security daylight overdrafts, the Board asked for comment on the following:

• a proposal to give depository institutions an option for dealing with book-entry securities overdrafts. One option is to combine securities daylight overdrafts with other daylight overdrafts (primarily caused by fund transfers) in meeting the overall sender net debit cap.

Proposals affecting ACH include:

• whether to post all entries for ACH debit transactions and checks as of 1 p.m. Eastern time for purposes of calculating daylight overdraft levels.

• whether to grant finality for ACH credit payments of $5,000 and all ACH debit items until the Reserve Banks have actually received the funds.

In connection with these proposals, the Board also requested comment on the concept of charging a fee for daylight overdrafts in accounts at the Federal Reserve that are subject to the net debit cap. The objective of this fee would be to provide an additional incentive for depository institutions and their customers to reduce daylight overdrafts.

Public comment, with deadlines in mid-April, was requested on each of these proposed changes. These proposals were distributed to depository institutions in the Eleventh District in circular 86-112. Persons interested in receiving a copy of the circular may call the Public Affairs Department at 214-651-6289.

Discussing recent trends in banking are Gerald Fronterhouse, chairman of the board at RepublicBank, and Bob Clair, economist at the Dallas Fed. Clair was recently the speaker at a Fed luncheon for financial leaders in the metropole, addressing the topic of bank profitability.
The separate interest and principal components of Treasury STRIPS became eligible as collateral for Treasury Tax & Loan (TT&L) accounts in March, according to Tyrone Gholson, assistant vice president in the Securities Department of the Federal Reserve Bank of Dallas.

The STRIPS program, Separate Trading of Registered Interest and Principal of Securities, was announced by the U.S. Treasury in 1985. STRIPS are selected Treasury securities maintained in book-entry form at a Reserve Bank. These securities are generally new securities with ten or more years of original maturity. They may be stripped into separate principal and interest components or zero-coupon instruments, as direct obligations of the U.S. government.

The Treasury will assign a valuation expressed as a percentage of the maturity value of the component for each outstanding maturity date of a STRIPS component.

For collateral value purposes, STRIPS components with less than one year to maturity will be accepted at face value. STRIPS components with more than one year to maturity will be accepted on the basis of a valuation rate calculated by the Treasury every three months.

In order to determine the component value, the Treasury will use the “lost bond program” method. The “lost bond program” is used to find the present value of a zero-coupon instrument that is consistent with a given par value yield curve. This method is the same used for valuing STRIPS components for broker reporting purposes in Internal Revenue Service Publication 1212.

The U.S. Treasury Department distributes valuation rates to the Federal Reserve banks for use in revaluing the STRIPS components held for collateral. Upon revaluation the Federal Reserve banks will notify affected financial institutions as to the amount of over- or under-collateralization.

Creation of zero-coupon securities has benefited the Treasury by broadening the appeal of Treasury securities. The popularity of stripped Treasury securities has been a major development in the government security market because of increased attractiveness among prospective investors.

Questions concerning the use of STRIPS components as collateral for TT&L accounts should be directed to the Securities Department at 214-651-6360.

December UBPR released

The December 1986 Uniform Bank Performance Report (UBPR) has been released to all insured commercial banks and is available for sale to the general public. The December edition is identical in format to the September 1986 edition.

The quarterly UBPR is designed for use by Bank examiners, financial analysts and bank managers. It provides information for both summary and in-depth analysis of a commercial bank's financial performance and trends.

All copies of individual bank UBPRs are $30 per report for the general public. UBPR User’s Guides may be obtained for $15 each. December 1986 and prior State Average Reports are also available for $30 per copy and Peer Group Reports are $50 per copy.

Persons interested in ordering the reports or obtaining additional information on them should call the Federal Financial Institutions Examination Council at 1-800-843-1669, or send a check payable to the Council at UBPR, Department 4320, Chicago, IL 60673.

System pays Treasury $17.8 billion

If you like big numbers, then you'll love this story. Following are a few of the more interesting and illustrative excerpts from the Federal Reserve System’s 1986 “income statement”.

System earnings consist primarily of interest earned on securities held and traded for monetary policy purposes, fees earned through the provision of priced financial services and interest earned on loans to financial institutions. These revenues are returned to the U.S. Treasury once the System's operating expenses are deducted, a statutory six percent dividend is paid to member banks on their Federal Reserve stock and additional accounting gymnastics have been performed.

Here's the fun . . .

. . . the Federal Reserve turned over $17.8 billion to the Treasury during 1986.

. . . it cost $181 million for the System to have new Federal Reserve notes printed by the Bureau of Engraving and Printing.

. . . the System reflected a special gain of $1.981 million due to the annual revaluation of foreign denominated assets such as currency and securities maintained at the New York Fed in its operations with foreign central banks.

. . . the Federal Reserve Banks earned $630 million through the provision of priced financial services to commercial banks and others.

. . . the statutory dividend to member banks amounted to $110 million.

. . . the Reserve Banks were assessed $97 million to recover the operating expenses of the Board of Governors and its staff in Washington, D.C.

. . . the System increased the amount of its own capital and surplus by $92 million.

. . . the 12 Federal Reserve Banks and 25 branches operating expenses totaled $1.156 billion.

Now, aren't you glad you read the whole story?
The board of directors of the Federal Reserve Bank of Dallas and its Branch offices have announced the following:

Admiral Bobby R. Inman, chairman and chief executive officer of Westmark Systems, Inc., in Austin, has been designated chairman of the Head Office board by the Board of Governors of the Federal Reserve System. Inman succeeds Robert D. Rogers, president and chief executive officer of Texas Industries, Inc., in Dallas.

Hugh G. Robinson, president of Cityplace Development Corporation, Dallas, has been designated deputy chairman of the Head Office board.

Robert G. Greer, chairman of the board of Tanglewood Bank, Houston, was elected by Federal Reserve member banks to serve as a Head Office director.

Gary E. Wood, finance professor and director of governmental relations at Baylor University, Waco, was elected by member banks to serve as a Head Office director.

Leo E. Linbeck, Jr., chairman and chief executive officer of Linbeck Construction Corporation, Houston, was appointed by the Board of Governors of the Federal Reserve System to serve as a Head Office director.

In addition, Gerald W. Fronerthouse, chairman of the board and chief executive officer of RepublicBank Corporation, Dallas, has been appointed by the Board of Governors to serve as the Dallas Fed's member of the Federal Advisory Committee for 1987. Each of the 12 Federal Reserve Banks has a representative on the council, which meets at least four times per year to discuss economic and banking matters and to make recommendations regarding the activities of the Federal Reserve System.

In addition to the Head Office announcements, changes to the Branch boards of directors have also been released as follows:

**El Paso Branch**

David L. Stone, president of the Portales National Bank in Portales, New Mexico, has been reappointed by the Head Office board to serve another term as a director for the El Paso Branch board.

Humberto M. Sambrano, partner with Urban General Contractors, Inc., in El Paso, has been appointed by the Head Office to serve as a director for the El Paso Branch board.

John R. Sibley, president of Delaware Mountain Enterprises in Carlsbad, New Mexico, was reappointed by the Board of Governors to serve as a director for the El Paso Branch board.

**Houston Branch**

Jenard M. Gross, chairman of the board and chief executive officer of United Savings Association of Texas, Houston, has been appointed by the Head Office board to serve as a director for the Houston Branch board.

Walter M. Mischer, Jr., president of the Mischer Corporation in Houston, has been reappointed by the Board of Governors to serve another term as director for the Houston Branch board.

Gilbert D. Gaedcke, chief executive officer and chairman of the board of Gaedcke Equipment Company, Houston, has been appointed by the Board of Governors to serve as director for the Houston Branch board.

**San Antonio Branch**

C. Ivan Wilson, chairman of the board and chief executive officer of First City Bank of Corpus Christi, has been reappointed by the Head Office board to serve another term as director for the San Antonio Branch board.

Patricia Patterson Lebermann, president of Patterson Investments, Inc., has been appointed by the Board of Governors to serve as a director for the San Antonio Branch board.

Nine directors serve on the Dallas Office board and seven directors serve on each of the three branch office boards. Each board meets monthly to discuss matters of importance to the Eleventh District's economy as well as to the nation's. All directors serve three year terms. Head Office directors are either elected by Eleventh District member banks or are appointed by the Board of Governors of the Federal Reserve System. Branch office directors are either appointed by the Federal Reserve Bank of Dallas directors or by the Board of Governors.
Discount window operations (Cont.)

small banks with limited access to funds in national money markets. These banks frequently had difficulty serving their local customers. Since the smaller institutions were unable to borrow funds in the money markets, they found it necessary to accumulate a greater amount of liquid assets throughout the year to meet their seasonal demand. This practice limited the amount of credit available to their customers.

The seasonal credit program gives banks an assurance of access to borrowed funds during normal peak seasons. This accessibility keeps them from having to carry the increased liquid assets during other times of the year. As a result, more funds are available for loans in the local community throughout the year.

Sanders explained that banks must establish their seasonal line with the Fed before being eligible for this credit program. The seasonal line is based on the bank's projected available funds for the next 12 months as compared with its actual needs for the same time frames in previous years. He added that many smaller banks in the District are eligible for the program.

According to Sanders, the program was partially designed to aid smaller banks with a large number of agricultural loans due to their seasonal cash demands. For example, farmers tend to borrow funds and use their own deposits for planting costs and have little, if any, cash flow until the crop is harvested and sold. The seasonal loan provides an operating cushion for those financial institutions.

The Fed also offers a temporary simplified seasonal credit program to small and mid-sized agricultural banks experiencing unusually strong loan demands. Under the temporary program, which was created in response to farmers' request for special assistance due to the downturn in agricultural prices, qualifying banks may borrow at the discount window to fund half of their loan growth in excess of 2 percent over a base level.

In addition to seasonal credit, extended credit may be provided when exceptional circumstances or practices adversely affect the liquidity of an individual institution. These circumstances may include the closing of a major industrial plant in a local community, a natural disaster, or an overall downturn in economic activity.

The key in determining an institution's eligibility for extended credit is the Reserve Bank's judgment that extending credit is in the public interest for an orderly resolution of the problem. The repayment plan usually includes special monitoring to insure fulfillment of the agreement, repayment of the loan as conditions permit and restraint on the institution's lending activity.

"Extended credit is also provided to meet liquidity problems of depository institutions, including those with longer-term asset portfolios which are experiencing difficulties in adjusting to changing market conditions such as disintermediation," Higgins said. Although some commercial banks have such portfolios, they are more common to thrifts that have invested a large portion of their funds in long-term residential mortgages.

Eleventh District loan operations were centralized in January of this year, with all loan requests directed to the Dallas office rather than the three branches. Sanders said centralization of loan activities is a current trend within the Fed System.

"We realize that the Fed is the ultimate resource to meet the liquidity needs of financial institutions," Sanders said. "While monetary policy is the big picture for the Fed, there are always instances where local demands are not following the overall banking industry. Therefore, loan operations must also meet the individual needs of the financial institutions in the local communities throughout the District."

Examining high-speed check sorting equipment operating at the Dallas Fed are Ren Gao Lian, Bao Zhen Zhang and Jian Lin Wang. They visited the Bank as part of a business exchange program between metropolex companies and China.

Enjoying food and friendship at a Dallas Fed reception are Adolf Latuhamallo and Akman Aga. The event was held to honor a group of 10 visitors from Bank Indonesia participating in a four week computer training program at the Fed.
Following is a listing of recent System speeches and statements, Eleventh District circulars, and pamphlets and brochures which currently are available from the Federal Reserve Bank of Dallas.

To place an order please circle the number of the item you wish to receive, fill out the address information at the bottom of the page, enclose a check or money order if applicable, and mail the entire page to:

NOW AVAILABLE
Public Affairs Department
Federal Reserve Bank of Dallas
Station K
Dallas, Texas 75222

System Speeches and Statements


Eleventh District Circulars


Pamphlets, Brochures and Reports


30. Selected Interest Rates. 86/87 updates of weekly, monthly and annual interest rate histories of Treasury bill auctions, Treasury constant maturities, Fed funds, and prime.


32. Trade-Weighted Value of the Dollar. Monthly statistical release of the X-131 Nominal Dollar Exchange Rate Index and the X-101 Real Dollar Index recently established by the Federal Reserve Bank of Dallas. The X-131 compares the value of the dollar to all 131 U.S. trading partners. The RX-101 compares the purchasing power of the dollar to the 101 U.S. trading partners who have consumer price indexes. $48/annual subscription.

33. Truth in Lending, Regulation Z, Annual Percentage Rate Tables and Factor Tables for Irregular Transactions. $4/Two-volume set.

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Address __________________________________________

City, State __________________________________________________________________________ Zip Code __________________________

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News Briefs

New council members announced

Four new members have been appointed to the Advisory Council of Financial Institutions of the Federal Reserve Bank of Dallas. They are Clyde N. Choate, president, Enserch Federal Credit Union, Dallas; Bookman Peters, chairman of the board and chief executive officer, First City National Bank, Bryan, TX; Ben Land, president, Family Federal Savings and Loan Association, Shreveport, LA and Walter E. Johnson, president, Allied Bank of Texas, Houston.

The 12-member advisory council was founded in 1985 to provide improved communication between financial institutions and the Federal Reserve. It meets with the Bank's senior management twice yearly. At its most recent meeting in mid-January, the topics of discussion included the regional economic outlook and the impact of interstate banking and limited branch banking. The council is chaired by A.W. Riter, Jr., chairman of the board and chief executive officer, InterFirst Bank Tyler, Tyler, TX.

Other council members, who were reappointed for 1987, are James A. Altick, Central Bank, Monroe, LA; John H. Dalton, Freedom Capital Corporation, San Antonio; Lowell Smith, Jr., First State Bank, Rio Vista, TX; William E. Brady, Denton Savings Association, Denton, TX; Kenneth L. Burgess, First State Bank, Abilene, TX; Garry Owen, First Federal Savings, Roswell, NM and H.O. Bursum, III, First State Bank, Socorro, NM.

The Dallas Fed also has an Advisory Council of Small Business and Agriculture. Similar councils have been established by other Federal Reserve banks elsewhere in the country.

Proceedings available

Copies of the proceedings of the 1985 Conference on Energy and the Southwest Economy, sponsored by the Federal Reserve Bank of Dallas, are now available.

The volume contains the twelve conference papers presented by several outstanding economists.

The book also contains the text of the luncheon address by Admiral Bobby R. Inman, USN (Ret.), on the diversification of the Texas economy.

Copies may be ordered by sending a check or money order for $10.00 per copy to: Symposium, Public Affairs Department, Federal Reserve Bank of Dallas, Station K, Dallas, TX 75222. Checks should be made payable to the Federal Reserve Bank of Dallas.