

Voice

of
the Federal Reserve Bank of Dallas
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The Deregulation and Monetary Control Act of 1980

The Depository Institutions Deregulation and Monetary Control Act of 1980 was signed into law March 31, 1980. Described by some as the most significant piece of legislation since the 1930's, the act includes a number of major provisions, several of which may have considerable impact on the structure and performance of financial institutions.

The act provides for the phasing out of interest rate ceilings on time and savings deposits, a feature of banking regulation since the Depression in the 1930's. With the elimination of rate ceilings, the higher ceilings that have been authorized for savings and loan associations than for commercial banks would disappear. The act acknowledges that interest rate ceilings have become outdated and, in an inflationary environment, have caused substantial shifts of financial resources from depository institutions to money market instruments.

Another part of the act authorizes all depository financial institutions to offer negotiable order of withdrawal (NOW) accounts, commonly referred to as interest-bearing checking accounts. These had previously been authorized only in the New England States, New York, and New Jersey. Commercial banks had been authorized to make automatic transfers from savings to checking accounts, but this has not been used widely. Thus, the act authorizes thrift institutions across the nation to participate directly in the payments mechanism by providing third-party payment services.

These two features of the Deregulation and Monetary Control Act will increase financial alternatives available to most households and may significantly

increase competition among financial institutions. The act will influence the evolution of financial institutions in other ways as well. Certainly, the spread of electronic banking allowed by the new legislation will be a significant development, as will the pricing of Federal Reserve services.

Key features of the act

The act is developed in nine parts, or titles. Some major provisions of the titles are given below.

- **Title I** requires all depository institutions to hold reserves against transaction accounts and nonpersonal time deposits, gives all depository institutions access to Federal Reserve services on a fee basis, and extends access to the Fed's discount window to all depository institutions subject to reserve requirements.

- **Title II** provides for the orderly phaseout, as rapidly as economic conditions warrant and within a six-year period, of interest rate ceilings on deposits and accounts. The Depository Institutions Deregulation Committee was created to achieve this goal, at which time the committee will cease to exist and rates would thereafter be determined by market forces. The committee is to try to provide depositors with a market rate of return on their savings with due regard for the safety and soundness of depository institutions.

- **Title III** authorizes all depository institutions to offer NOW accounts, effective December 31, 1980, to individuals and to organizations operated primarily for nonprofit purposes. It also authorizes savings and loan associations to operate

remote service units, allows credit unions to make mortgage loans to cooperatives, increases the loan rate ceiling for Federal credit unions from 12 percent to 15 percent, and increases Federal insurance on deposits from \$40,000 to \$100,000.

- **Title IV** authorizes new investment opportunities for federally chartered savings and loan associations and expands their authority to make real estate, acquisition, development, and construction loans. These associations also may engage in credit-card operations, exercise trust powers, and issue mutual capital certificates with fixed or variable dividend rates. Federal mutual savings banks may make commercial, corporate, and business loans and are authorized to accept demand deposits in connection with a commercial, corporate, or business loan relationship.

- **Title V** preempts state usury laws regarding residential loans, mortgages, and credit sales or advances unless reinstated by April 1, 1983, and preempts state usury laws on business and agricultural loans of \$25,000 or more, such preemption to expire April 1, 1983, unless overridden by state legislatures. A ceiling of 5 percent over the Federal Reserve discount rate is imposed for such business and agricultural loans.

- **Title VI** simplifies the truth-in-lending requirements of Regulation Z in an attempt to increase consumer understanding and facilitate procedural matters for creditors.

- **Title VII** authorizes amendments to the national banking laws relating to the authority of national banks and the operations of the Comptroller of the Currency.

- **Title VIII** requires that regulations of the Federal financial regulatory agencies be reviewed periodically and revised, when necessary, to ensure that they are as simple and clear as possible, achieve legislative goals, and do not impose any unnecessary burden on financial institutions or consumers.

- **Title IX** prohibited the approval before July 1, 1980, of any applications relating to the takeover of domestic financial institutions by foreign concerns, except under specified circumstances.

Since the enactment of the Depository Institutions Deregulation and Monetary Control Act, the Board of Governors of the Federal Reserve System has issued proposals and revised regulations to implement the new law, and the Depository Institutions Deregulation Committee has issued various proposals for comment and announced several mea-

asures. The actions of the Federal Reserve Board have included major revisions of Regulations A and D and the publication of a proposed pricing schedule for Federal Reserve services.

Regulation A

The revised Regulation A, effective September 1, 1980, implements the Title I provision that all depository institutions subject to reserve requirements have access to the Federal Reserve's discount window. Nonmember banks and nonbank depository institutions maintaining transaction accounts or nonpersonal time deposits now have access to the loan facilities of Federal Reserve banks on the same basis as member banks.

The depository institutions are still expected to rely on other reasonably available sources of funds before turning to the Federal Reserve banks for credit. These sources include special industry lenders, such as the Federal home loan banks, the Central Liquidity Facility of the National Credit Union Administration, and corporate central credit unions. The final revision of Regulation A was modified slightly from the June proposal to allow temporary advances on short notice to institutions experiencing immediate cash or reserve needs when timely access to their special industry lenders is not available. These advances would be repayable when access to the usual lender is again available, usually the next business day.

According to revised Regulation A, credit is available under two major programs: short-term adjustment credit and extended credit. Short-term adjustment credit, which in the past has accounted for most Federal Reserve lending, is available to help depository institutions meet temporary needs for funds. This type of credit is also available for longer periods—up to a few weeks—to help cushion more persistent outflows of funds pending an orderly adjustment of the institution's assets and liabilities.

Extended credit includes "seasonal" credit, which can provide a prearranged line of credit to smaller depository institutions that lack access to national money markets to help offset the effects of a drain on funds at the same time every year. This type of credit is designed to accommodate seasonal needs for extra funds that arise from expected patterns of movement in deposits and loans. In addition to seasonal credit, "other" extended credit can be made available to assist institutions facing special problems of either a local or

a widespread nature.

Extensions of any type of credit from Federal Reserve banks will be in the form of secured advances at the discount rate, although a surcharge over the basic rate is provided for in certain circumstances. And prior to the extension of credit to any eligible institution, the necessary loan documentation must be on file with the Federal Reserve Bank.

Regulation D

The Board of Governors also adopted a revision of Regulation D, under which reserve requirements will apply to all depository institutions offering transaction accounts or nonpersonal time deposits. The reporting of deposits subject to reserve requirements will begin October 30, unless reporting for the institution has been deferred to a later date, and the actual maintenance of reserves will begin November 13.

The initial reserve requirements are as follows:

- 3 percent on the first \$25 million of transaction accounts.
- 12 percent on transaction account amounts over \$25 million.
- 3 percent on nonpersonal time deposits with original maturities of less than four years.
- 3 percent on Eurocurrency liabilities.

Regulation D defines transaction accounts as demand deposits, NOW accounts, ATS accounts (savings accounts subject to automatic transfers), share draft accounts, accounts permitting telephone or preauthorized transfers to third parties, and accounts permitting third-party payments through automated teller machines or remote service units. Three telephone or preauthorized transfers a month are permitted before an account is subject to reserve requirements. An account that permits more than three transfers a month is subject to reserve requirements even if it is not actively used. Transfers in connection with a loan made by the institution holding the deposit do not make an account subject to reserve requirements.

Nonpersonal time deposits are defined as transferable time deposits or time deposits held by a depositor that is not an individual or sole proprietor. For transitional purposes, all time deposits issued to individuals before October 1, 1980, will be considered personal time deposits. After that date, a personal time deposit must have a legend indicating that the instrument is not transferable. Individual Retirement Accounts, Keogh accounts,

and deposits held by trustees for natural persons are personal time deposits and are not subject to reserve requirements.

In addition to transaction accounts and nonpersonal time deposits, Regulation D imposes reserve requirements on commercial paper, credit union certificates of indebtedness, ineligible acceptances, due bills remaining uncollateralized by similar securities within three days, and mortgage-backed bonds with original maturities of less than four years. Generally, such items with original maturities of less than 14 days will be considered transaction accounts, and those with original maturities of more than 14 days will be considered nonpersonal time deposits.

Reserves may be held as vault cash or as balances with Federal Reserve banks. Nonmember institutions may choose to hold reserves directly with a Federal Reserve Bank or indirectly through pass-through arrangements. Pass-through correspondents may be a Federal home loan bank, the National Credit Union Administration Central Liquidity Facility, or a depository institution holding reserve balances with a Federal Reserve Bank. Where reserve balances of a nonmember institution are zero or small, it may be necessary for the institution to maintain clearing balances with a Federal Reserve Bank in order to utilize Federal Reserve services involving debits to the reserve account.

Regulation D provides for a gradual phase-in of the required reserves of depository institutions. Nonmember depository institutions will phase in their reserve requirements over an eight-year period beginning November 1980. Member banks will phase down their required reserves to the lower level provided in the act over a period of approximately 3½ years from September 1, 1980, with the actual phase-down beginning with the reserve maintenance period starting November 13, 1980. New banks, new members, new agencies and branches of foreign banks, and new Edge corporations will phase in reserve requirements over a 24-month period. There will be no phase-in period for reserve requirements on NOW accounts for depository institutions outside states where NOW accounts are currently permitted.

Pricing Federal Reserve services

The Board of Governors has proposed for public comment a schedule of fees for Federal Reserve Bank services to financial institutions, including a statement of the principles upon which the pro-

posed charges are based. In addition, the Board announced a series of measures to reduce Federal Reserve float and a preliminary plan to price remaining float beginning in mid-1982. The Board's proposed pricing of services and its endeavors to eliminate Federal Reserve float are in response to objectives of the act and are meant to offset the loss in revenue to the U. S. Treasury that will occur as a result of the lower average reserve requirements set by the act and to serve as a means of encouraging competitive and efficient provision of services.

The four principles that serve as the basis for Federal Reserve fees are:

1. All Federal Reserve services listed under the fee schedule are to be priced explicitly.
2. Nonmember depository institutions are to be charged the same prices as member banks and may be subject to other terms, such as clearing balances, that apply to member banks.
3. Over the long run, the fees are to be based on all direct and indirect costs actually incurred in providing the services.
4. Interest on float shall be charged at the current market rate for Federal funds.

In addition to the basic pricing principles, the Board set forth further principles as a means of encouraging competition and an adequate level of services nationwide.

5. Over the long run, the fee schedule should recover total costs for all priced services.

6. The schedule should be structured so that it avoids disruptions in services and facilitates an orderly transition to pricing.

7. Schedules and services should be flexibly administered to respond to changes in market conditions and demands for the services.

8. Incentives may be provided to improve the efficiency and capacity of the payments system and to induce desirable longer-run changes in it.

Fees will be charged the party originating a transaction and will be for the following services:

1. Currency and coin transportation and coin wrapping.
2. Check clearing and collection.
3. Wire transfer of funds.
4. The use of Federal Reserve automated clearinghouse (ACH) facilities.
5. Net settlement of debits and credits affecting accounts held by the Federal Reserve.
6. Book entry, safekeeping, and other services connected with the purchase or sale of government

securities.

7. The receipt, collection, and crediting of accounts of depository institutions in connection with municipal and corporate securities—usually referred to as noncash collection.

8. Federal Reserve float.

9. Any new services the Federal Reserve System offers.

The following is the schedule of effective dates the Board has proposed for pricing services:

Service	Pricing effective
Wire transfer	January 1981
Net settlement.....	January 1981
Check clearing and collection	April 1981
Automated clearinghouse.....	April 1981
Currency and coin.....	July 1981
Securities services.....	October 1981
Noncash collection.....	October 1981
Float	
Phase I.....	In progress
Phase II.....	September 1981
Phase III.....	Mid-1982

Float reduction

The Monetary Control Act calls for reducing and, if possible, eliminating Federal Reserve float (funds paid on checks or other noncash items prior to collection from the payee banks). In order to accomplish this, the Board has proposed a three-phase plan. Phase I calls for improvements in Federal Reserve System operations involving check clearing and collection. Already under way as part of this phase are measures to improve the Federal Reserve's Interdistrict Transportation System for moving checks.

Phase II involves modification of schedules for making funds available to institutions that have presented checks for clearance. Any float remaining after the implementation of Phases I and II would be charged for explicitly. The charges would be computed at the prevailing Federal funds rate and would be reflected in the fees for all check collection services.

Comments on the proposed fee schedules and pricing principles must be received by October 31, 1980; should refer to Docket No. R-0324; and should be addressed to Theodore E. Allison, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, D.C. 20551.

Regulatory Changes Bring New Challenge to S&L's, Other Depository Institutions

By Bronwyn Brock

In the past 15 years, residential construction experienced four substantial declines in sales, production, and employment. These recessions in the housing industry were directly related to disintermediation at savings and loan associations (S&L's)—the largest source of mortgage funds—and at other lenders of long-term mortgage funds. *Disintermediation* is the shift of funds from depository financial institutions to open market investments during periods of rising interest rates as holders of liquid financial assets attempt to maximize their returns. A similar phenomenon affects insurance companies as policyholders borrow policy reserves at contracted interest rates.

Regulators of financial institutions have been attempting to design policies that would moderate disintermediation since savings and loan deposits first showed sensitivity to short-term market yields in 1965. The inability of thrift institutions to continue to attract substantial amounts of funds during periods of high or rapidly rising interest rates causes a reduced flow of mortgage credit and contributes to an increase in mortgage rates. When this happens, home sales decline, builders' inventories of newly completed homes rise, and housing starts are reduced. As housing

starts decline, unemployment rises in the construction industry as well as in related industries, such as lumber, insulation, textiles, furniture, and appliances.

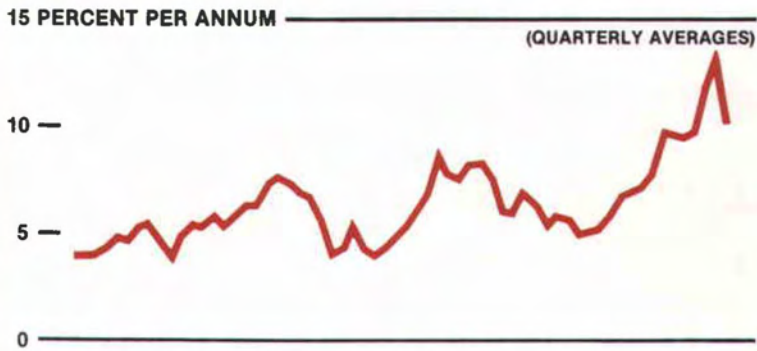
Periods of disintermediation

The year 1965 marked a turning point for the savings and loan industry. The preceding years had been characterized by fast and stable growth of deposits at savings and loan associations. The years since have been marked by greater instability of savings deposit inflows.

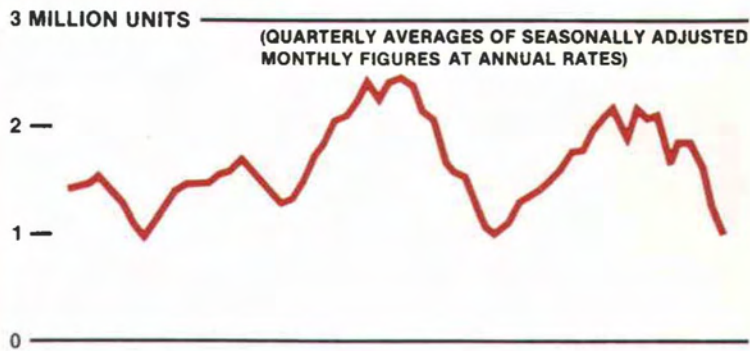
Monetary policy was tightened in 1966, 1969-70, and 1973-74 (as in the first quarter of 1980) to slow an overheated economy and an accelerating rate of inflation. Each time, the yields on short-term open market securities rose sharply. Depositors at S&L's responded to these higher money market yields by withdrawing substantial portions of their savings deposits for reinvestment in such items as U.S. Treasury bills. Each period of disintermediation was characterized by a peak-to-trough decline of at least 26 percent in the annual rate of housing starts, due largely to the reduced availability and high cost of mortgage funds.

Interest rate peaks in 1966, 1969, 1973-74, and 1980 have been accompanied by significant declines in housing starts . . .

SIX-MONTH TREASURY BILLS



PRIVATE HOUSING STARTS



FEDERALLY INSURED SAVINGS AND LOAN ASSOCIATIONS



SOURCES: Board of Governors, Federal Reserve System.
Federal Home Loan Bank Board.
U.S. Department of Commerce.

Regulators' efforts to offset disintermediation

Federal regulators of the nation's depository institutions have authorized the issuance of new types of liabilities in recent years, in addition to authorizing higher yields on passbook and certificate accounts, to enable these financial intermediaries to continue to attract funds during periods of high interest rates. In 1973, a new four-year \$1,000-minimum-balance certificate was authorized on which there was no rate ceiling. The response to this instrument, which came to be known as the "wild card" certificate, quickly disrupted the balance between deposits at commercial banks and deposits at savings and loan associations.

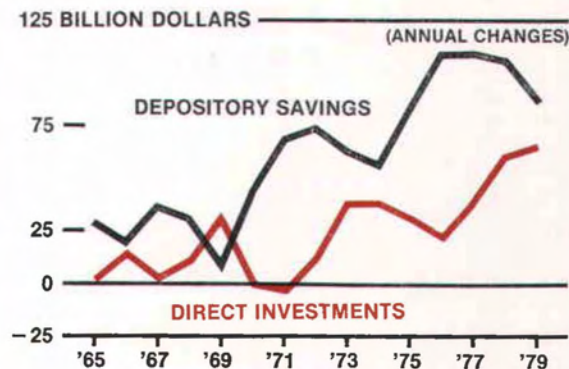
Rate wars waged in several major cities. Commercial banks, because of their more quickly maturing assets, were able to offer higher yields than savings and loan associations and swiftly gained depositors. The result of the disruptive experiment was congressional legislation requiring the Federal regulatory agencies to set maximum rate ceilings on certificate accounts with balances of less than \$100,000. The rate wars were ended, but depository financial institutions, with interest rate ceilings on deposits, were still exposed to the competition of money market instruments.

The second offering of the financial intermediaries in competition with open market investments was the money market certificate, first available in June 1978. This certificate was designed to moderate deposit outflows during periods of high market interest rates.

Withdrawals of funds during peaks in market interest rates typically were from passbook accounts rather than certificate accounts, because of the withdrawal penalties associated with the latter. And disintermediation usually occurred for accounts with high average balances, as most of the funds were used to purchase Treasury bills, which had minimum denominations of \$10,000. Finally, the funds withdrawn from accounts at depository institutions during interest rate peaks were removed for periods of only six to nine months.

The money market certificate was designed to counter these characteristics of disintermediation. The result was a certificate with a minimum denomination of \$10,000, a maturity of six months, and a rate ceiling pegged to the going yield on six-month Treasury bills. Savings and loan associations were authorized to offer a yield on money market certificates a quarter of a point above that

... as households shifted funds into open market investments in response to higher yields



SOURCE: Board of Governors, Federal Reserve System.

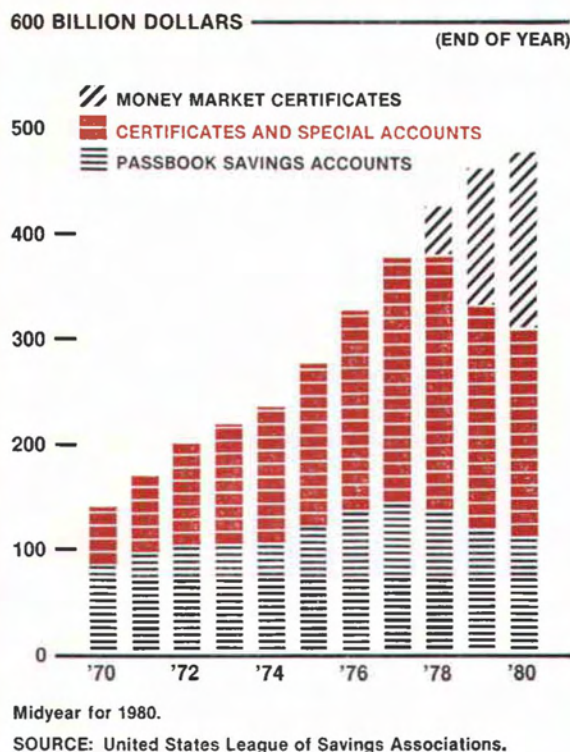
offered by commercial banks in order to preserve their advantage in attracting depositors' funds. While it was recognized that these certificates would increase the cost of funds for S&L's, the higher costs were recognized as temporary. The revenues locked in by the availability of funds for mortgages during periods of high interest rates were expected to swell revenues of S&L's in subsequent years.

The test

The most recent bout of high interest rates occurred in the first quarter of this year. The economy, which had expanded sluggishly throughout 1979, showed renewed growth in the first two months of 1980. The inflation rate surged as well, reflecting the impact of both price increases by the Organization of Petroleum Exporting Countries in 1979 and rising mortgage rates. From January to mid-March, bond prices fell as much as 15 percent.

The turbulence of the bond markets and the subsequent postponement of new issues resulted in sharply increased credit demands in commercial paper markets, as well as at commercial banks. Vigorous bidding for short-term funds pushed short-term interest rates to unprecedented levels. The yield on six-month Treasury bills peaked in March, averaging 15.1 percent—over 560 basis points above the year-earlier level and 325 basis points above the level for January this year.

Money market certificates have accounted for an increasing share of deposits at S&L's since their introduction in 1978



This time, money market certificates were important in maintaining the flow of funds into savings and loan associations. New savings received (savings inflows net of interest) fell to \$1.6 billion, the smallest first-quarter inflow in 10 years. But money market certificate accounts, increasing 28 percent from the fourth quarter of 1979, rose to \$162.4 billion. The proportion of total deposits at S&L's accounted for by money market certificates grew from 28 percent in that quarter to 35 percent in the first quarter of 1980. Passbook account balances were eroded as in past periods of disintermediation, however, as these and the funds in low-yield certificate accounts were diverted to money market certificates. While such certificates were effective in attracting deposits to S&L's in this period of high interest rates, the resulting record mortgage rates that lenders charged to cover the cost of these high-priced funds eliminated many prospective home buyers from the market for

mortgage loans.

As rates on mortgage loans climbed to new highs, total loans closed by S&L's in the first quarter of this year fell 37 percent from the preceding quarter to \$13.9 billion, or 53 percent below the peak of \$29.4 billion in the second quarter of 1979, resulting in the smallest first-quarter lending volume since 1976. The level of housing starts, which had declined to an annual rate of almost 1.6 million units in the last quarter of 1979, dropped 21 percent to an annual rate of less than 1.3 million units in the first quarter of 1980. Although S&L's currently have ample liquidity and mortgage rates have declined from the first quarter's high levels, home sales remain slack as consumers' incomes continue to be eroded by inflation.

Outlook for S&L's

Adjustments of the regulatory and legislative environment of depository intermediaries continue to facilitate the access of savings and loan associations and other financial institutions to the available supply of funds. The passage of the Depository Institutions Deregulation and Monetary Control Act of 1980 marks the beginning of a new era for the U.S. financial system, one that will be characterized by greater competition among all types of depository institutions and greater dependence on market-determined interest rates. The general thrust of the provisions in the act is to put financial institutions on a more equal basis with respect to the types of investments offered to the public as well as the investment opportunities of which the institutions may avail themselves.

An important part of the act concerns the phase-out of interest rate ceilings on time and savings deposits within six years. Regulatory agencies have been required to set interest rate ceilings on savings deposits for commercial banks since 1933 and for savings and loan associations since 1966. Enabling depository institutions to compete for funds by paying market rates of interest is expected not only to provide households with a new incentive to save but also to end the discrimination against small savers in the form of below-market yields for those with less than \$100,000. The phase-out of interest rate regulation also means an end to the irregular flows of credit to the housing industry due to disintermediation during periods of high market interest rates.

The act also authorizes additional activities for depository institutions, both to improve financial

services to consumers and to enable the institutions to attract and retain funds in competition with the money and capital markets. Depository financial institutions will be permitted to offer negotiable order of withdrawal (NOW) accounts and other interest-earning transaction accounts. In addition, S&L's are authorized to invest up to 20 percent of their assets in consumer loans, commercial paper, and corporate debt securities. They may also invest in shares or certificates of open-end investment companies registered with the Securities and Exchange Commission if the company's portfolio is restricted to investments that S&L's may make directly. The associations' authority to make real estate loans is expanded by removing any geographical lending restriction, by replacing the existing \$75,000 loan limit with a 90-percent loan-to-value limit, and by removing the first-lien restriction on residential real estate loans. Their authority to make acquisition, development, and construction loans is also expanded.

Federally chartered savings and loan associations are authorized to offer credit-card services and to exercise trust and fiduciary powers. The act also makes it easier for state S&L's to convert to Federal charters, and under regulations of the Federal Home Loan Bank Board, mutual S&L's are authorized to expand their capital bases with the issuance of mutual capital certificates.

To oversee the phaseout of ceilings on interest rates payable on deposits and accounts at depository institutions, the act established the Depository Institutions Deregulation Committee comprising the Secretary of the Treasury, the Chairman of the Board of Governors of the Federal Reserve System, the Chairman of the Board of Directors of the Federal Deposit Insurance Corporation, the Chairman of the Federal Home Loan Bank Board, and the Chairman of the National Credit Union Administration Board, as voting members, and the Comptroller of the Currency, as a nonvoting member.

The Deregulation Committee is vested with all the statutory authority of the Federal Reserve Act, the FDIC Act, and the Federal Home Loan Bank Act to oversee the transition from regulated rates of interest payable on deposits and accounts at depository institutions to rates of return consistent with market yields. The committee is charged with the responsibility to oversee this transition with all due regard for the safety and soundness of depository institutions. During the six-year

phaseout period, each committee member is to make an annual report to the Congress on the economic viability of these institutions.

The act also called for the President to establish an interagency task force composed of the Secretary of the Treasury, the Secretary of Housing and Urban Development, and representatives of the Federal Home Loan Bank Board, the Board of Governors of the Federal Reserve System, the Board of Directors of the Federal Deposit Insurance Corporation, the Comptroller of the Currency, and the National Credit Union Administration Board. The task force was called upon to conduct a study and make recommendations to Congress by June 30, 1980, on the options available for improving the balance of asset and liability maturities in the thrift portfolio structure, on the options available to increase the ability of thrifts to pay market yields during periods of rapid inflation and high interest rates, and on the options available through the Federal Home Loan Bank System and other Federal agencies to assist thrift institutions in times of economic difficulty. Finally, as of March 31, 1980, the insurance on accounts at federally insured banks, savings and loan associations, and credit unions was increased from \$40,000 to \$100,000.

The cumulative effect of this legislative package represents a congressional effort to increase reliance on the forces of the marketplace to determine the most appropriate uses among the nation's credit needs. There has been some concern that the removal of Regulation Q will end the protection of the flow of funds to housing via the nation's savings and loan associations, the largest source of mortgage funds. Actually, the legislation is intended to improve the consistency of the flow of funds to S&L's by allowing them to compete more effectively for funds when interest rates are rising. Depository intermediaries, to remain economically viable in the 1980's, must offer a competitive array of services to the public as well as pay interest on deposits at levels consistent with market yields.

“Fed Quotes”

Brief Excerpts from Recent Federal Reserve Speeches, Statements, Publications, Etc.

“We must not be timid in setting our goals for inflation. It would be a mistake to take as our goal merely the prevention of any further increase in the underlying inflation rate. If we tell the public that inflation rates above 10 percent are unacceptable, but that anything less is satisfactory, businesses and consumers may well begin to borrow and spend in ways that make a higher rate of inflation virtually inevitable.

“Our goal must be much tougher. It must be to bring the underlying inflation rate down even as the economy moves from recession to higher levels of economic activity.

“This is a very ambitious goal. During each and every economic recovery during the postwar period, the underlying inflation rate has always risen. Moreover, with the passage of time, inflationary expectations have worsened substantially: mechanisms to index wages, social security benefits and other income payments to prices have become more widespread; shocks to prices from the food and energy sectors have become more common; and for other reasons, also, the inflationary bias in the U.S. economy has increased. Nonetheless, despite these difficulties, history during the forthcoming economic recovery must be stood on its head. The hard core inflation rate must be brought down.”

“In today’s economy, any fresh impetus to inflation—whether it comes from rising OPEC prices, a food shortage, a productivity disaster, or a mistake in economic policy—tends to worsen the long-term trend of inflation. Using monetary policy actively as a countercyclical device, in the way we once did, is extremely risky because mistakes are inevitable, and they tend to aggravate the long-term inflation problem. This does not mean that the dials of monetary policy should be set on automatic pilot. It does mean, however, that to have any real hope of ultimately regaining price stability, the principal focus of monetary policy now must at all times be to find and pursue the course of action most likely to bring down the long-term rate of inflation.

“The differences in developments affecting financial markets and the real economy that stem from such a course of policy will probably be less evident during periods of recession than during the early phases of economic recovery. Historically, monetary policy has not moved dramatically toward stimulus when the economy headed into recession. Simply holding to a fairly steady course of policy has resulted in substantial declines in interest rates because of weakening credit demands. But during the earlier phase of economic recoveries, growth in supplies of money and credit has often begun to accelerate because the Federal Reserve did not let credit markets tighten sufficiently while unemployment and excess capacity were still relatively high. That is the mistake we must be particularly careful to avoid when the current recession bottoms out and recovery begins again.”

Lyle E. Gramley, Member, Board of Governors of the Federal Reserve System (At a joint meeting of the Board of Directors of the Federal Reserve Bank of Kansas City and its Denver Branch Board of Directors, Denver, Colorado, July 17, 1980)

"For all the developing consensus on the need for 'supply side' tax reduction, and I happen to share in that consensus, some time seems to me necessary to explore the implications of the competing proposals and to reduce them to an explicit detailed program for action.

"I have emphasized the need to achieve not only productivity improvement, but also a lower trend of costs and wages. Despite its importance, I have seen relatively little discussion in the current context of how tax reduction plans might be brought to bear more directly on the question of wage and price increases.

"The continuing sensitivity of financial markets, domestic and international, to inflationary fears is a fact of life. It adds point and force to these observations and questions.

"Tax and budgetary programs leading to the anticipation of excessive deficits and more inflation can be virtually as damaging as the reality in driving interest rates higher at home and the dollar lower abroad.

"I believe it is obvious from these remarks that a convincing case for tax reduction can be made only when the crucial questions are resolved, questions that are not resolved today. The appropriate time for decision seems to me late this year or early 1981."

Paul A. Volcker, Chairman, Board of Governors of the Federal Reserve System (Before the Committee on Banking, Finance and Urban Affairs, U.S. House of Representatives, July 23, 1980)

"While the recent easing of financial pressures helps provide an environment conducive to growth, we should not be misled. A resurgence of inflationary pressures, or policies that would seem to lead to that result, would not be consistent with maintenance of present—much less lower—interest rates, receptive bond markets, and improving mortgage availability. We in the Federal Reserve believe the kind of commitment we have made to reduce monetary growth over time is a key element in providing assurance that the inflationary process will be wound down."

Paul A. Volcker, Chairman, Board of Governors of the Federal Reserve System (Before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, July 22, 1980)

Regulatory Briefs and Announcements

Mandatory Effective Date Deferred for New APR Rules

The Board of Governors of the Federal Reserve System has delayed the date on which new methods of calculating and disclosing the annual percentage rate on consumer loans under Regulation Z (Truth in Lending) become mandatory.

In January the Board adopted annual percentage rate (APR) amendments to Regulation Z that were to become mandatory October 1, 1980. For the most part, the amendments would provide greater flexibility and protection to creditors in calculating and disclosing the rate.

After these amendments were adopted, the Truth in Lending Simplification and Reform Act was enacted, and the Board has recently proposed a revised Regulation Z to implement the act. The proposed regulation contains rules for calculating and disclosing the annual percentage rate on consumer loans that are similar to those adopted by the Board in January. The new rules will become effective April 1, 1981, and will become mandatory April 1, 1982.

Creditors may wish to comply with the APR changes when the new rules take effect next year, or earlier, but are not required to do so until April 1, 1982. Deferral of the mandatory effective date does not affect creditors that have already made APR changes conforming to the amendments adopted in January.

Regulation Q Penalty Suspended for Emergency Areas in Texas

The Federal Reserve Board has granted a temporary suspension of the Regulation Q penalty for early withdrawal of time deposits from member banks for depositors affected by Hurricane Allen.

The temporary lifting of the early-withdrawal penalty will affect depositors suffering property losses in the Texas counties of Cameron, Nueces, Willacy, Kleberg, San Patricio, Jim Wells, Aransas, Hidalgo, and Brooks. The waiver of the penalty will be in effect until 12:00 midnight, February 15, 1981.

Under the waiver, a member bank is permitted to pay a time deposit before maturity without imposing the penalty as long as the depositor can show that a property loss has been suffered in the emergency area. The bank should receive from the depositor a signed statement describing the loss, and the statement should be approved and certified by an officer of the bank.

Any questions regarding Regulation Q may be directed to Consumer Affairs, Bank Supervision and Regulations Department, Federal Reserve Bank of Dallas, (214) 651-6169.

Amended Regulation T Expands Lending Powers of Brokers and Dealers

The Federal Reserve Board has announced approval of an amendment to Regulation T (Credit by Brokers and Dealers) to allow brokers and dealers to lend on mutual fund shares.

Under the amendment, brokers and dealers can extend and maintain credit only on fully paid-for mutual fund shares. A broker-dealer would be prohibited under provisions of the Securities Exchange Act and existing rules of the Securities and Exchange Commission from giving credit on the initial purchase of mutual fund shares.

The amendment is effective November 3, 1980.

Bank Holding Companies Allowed to Establish Services Subsidiaries

The Federal Reserve Board has issued a final interpretation of Regulation Y (Bank Holding Companies and Change in Bank Control), effective August 11, 1980. This interpretation permits a bank holding company to establish, without the Board's prior approval, an operations subsidiary to perform services for the bank holding company and its banking and nonbanking subsidiaries that could be executed directly by a division or department of the holding company itself.

New nonmember bank

Bank of Cypress Trails, Houston, Texas, a newly organized nonmember bank located in the territory served by the Houston Branch of the Federal Reserve Bank of Dallas, opened for business August 4, 1980.

New member banks

City National Bank, Weslaco, Texas, a newly organized institution located in the territory served by the San Antonio Branch of the Federal Reserve Bank of Dallas, opened for business August 1, 1980, as a member of the Federal Reserve System. The new member bank opened with capital of \$1,000,000 and surplus of \$1,000,000. The officers are: Rodolfo Margo, M.D., Chairman of the Board; W. Kenneth Hearn, President; Frank N. Trevino, Vice President and Cashier; Linda Gray, Assistant Cashier; and Lily Escalon, Assistant Cashier.

First City National Bank, Carlsbad, New Mexico, a newly organized institution located in the territory served by the El Paso Branch of the Federal Reserve Bank of Dallas, opened for business August 11, 1980, as a member of the Federal Reserve System. The new member bank opened with capital of \$1,000,000 and surplus of \$1,000,000. The officers are: Reed H. Chittim, Chairman of the Board; Stanley E. Newman, President; Jim R. Hobbs, Vice President and Cashier; Ruthie Loy, Assistant Vice President; Joan Stone, Operations Officer; and Bari Cogburn, Assistant Cashier.

American National Bank, Abilene, Texas, a newly organized institution located in the territory served by the Head Office of the Federal Reserve Bank of Dallas, opened for business August 25, 1980, as a member of the Federal Reserve System. The new member bank opened with capital of \$1,000,000 and surplus of \$1,000,000. The officers are: Fred Lee Hughes, Chairman of the Board; John M. Stroud, President and Chief Executive Officer; and David Runnels, Vice President and Cashier.

Alvin National Bank, Alvin, Texas, a newly organized institution located in the territory served by the Houston Branch of the Federal Reserve Bank of Dallas, opened for business August 26, 1980, as a member of the Federal Reserve System. The new member bank opened with capital of \$750,000 and surplus of \$750,000. The officers are: Brian W. Garrison, Chairman of the Board; Shirley H. Burwell, President; and Tolbert N. Newman, Vice President and Cashier.

Now Available

Recently issued Federal Reserve circulars, speeches, statements to Congress, publications, etc., may be obtained by contacting the Bank and Public Information Department, Federal Reserve Bank of Dallas, Station K, Dallas, Texas 75222, unless indicated otherwise.

Circulars

Interpretation of Regulation Y—Bank Holding Companies and Change in Bank Control: Disposition of Property Acquired in Satisfaction of Debts Previously Contracted. 3 pp. Circular No. 80-151 (August 5, 1980).

A Reminder Concerning Attempts to Perpetrate Fraudulent Transfers of Funds. 1 p. Circular No. 80-152 (August 6, 1980).

Amendment to Regulation Z [Truth in Lending]. 1 p. Circular No. 80-153 (August 7, 1980).

Policy Regarding Assessment of Civil Money Penalties. 4 pp. Circular No. 80-156 (August 11, 1980).

Interpretation of Regulation Y—Bank Holding Companies and Change in Bank Control: Bank Holding Companies—Operations Subsidiaries. 2 pp. Circular No. 80-157 (August 14, 1980).

Revised Regulation A—"Extensions of Credit by Federal Reserve Banks": Access to the Discount Window by Depository Institutions. 12 pp. Circular No. 80-160 (August 21, 1980).

Election of Directors—Nomination Procedures. 16 pp. Circular No. 80-161 (August 19, 1980).

Regulation Q [Interest on Deposits]: Temporary Suspension of Early Withdrawal Penalty [For depositors affected by Hurricane Allen]. 1 p. Circular No. 80-162 (August 21, 1980).

Amendment to Regulation T—Credit by Brokers and Dealers. 5 pp. Circular No. 80-163 (August 28, 1980).

Amendments to Rules Regarding Delegation of Authority. 2 pp. Circular No. 80-164 (August 28, 1980).

Cross-Zone Presentment of Cash Letters. 1 p. Circular No. 80-165 (August 28, 1980).

Speeches and Statements

Statement by **Paul A. Volcker** before the **Committee on Banking, Housing, and Urban Affairs**, U.S. Senate. 14 pp., including attachments. August 5, 1980.

Remarks of **Frederick H. Schultz** before the **Commonwealth Club of California**, San Francisco, California. 15 pp. August 15, 1980.

Pamphlets, Brochures, and Reports

By the Way. Prepared by the Federal Reserve Subcommittee on Communications of the Committee on Communications and Payments. (A pamphlet to help banks reduce the chance of fraud, particularly in funds and securities transfer) 15 pp. May 1980.