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TREASURY TAX AND LOAN ACCOUNTS

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BEFORE THE

**COMMITTEE ON
BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE**

NINETY-FIFTH CONGRESS

FIRST SESSION

ON

H.R. 5675

TO AUTHORIZE THE SECRETARY OF THE TREASURY TO
INVEST PUBLIC MONEYS, AND FOR OTHER PURPOSES

JUNE 6, 1977

Printed for the use of the Committee on Banking,
Housing, and Urban Affairs



U.S. GOVERNMENT PRINTING OFFICE

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WASHINGTON : 1977

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(II)

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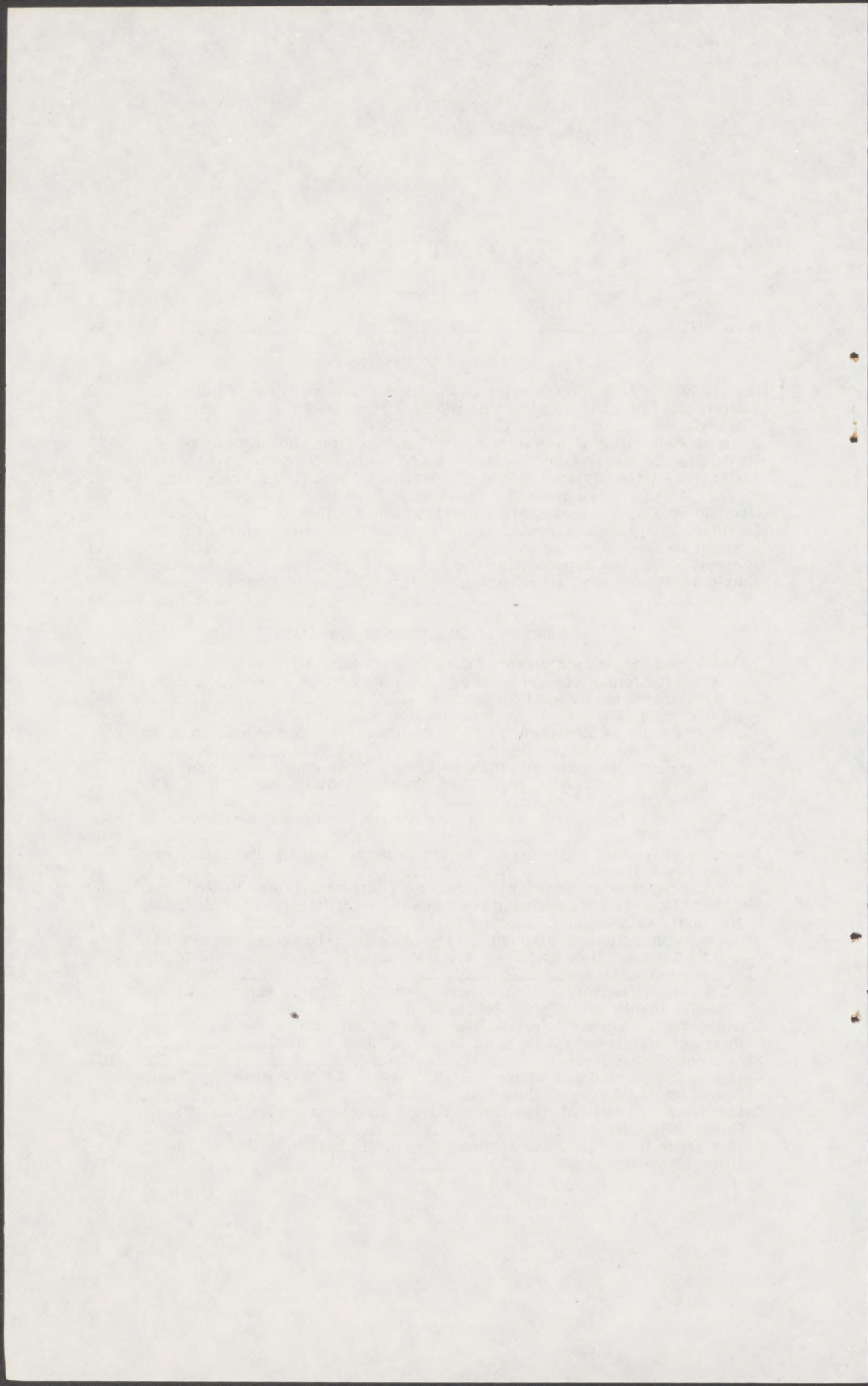
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TREASURY TAX AND LOAN ACCOUNTS

MONDAY, JUNE 6, 1977

UNITED STATES SENATE,
COMMITTEE OF BANKING, HOUSING AND URBAN AFFAIRS,
Washington, D.C.

The committee met at 10 a.m., in room 5302, Dirksen Senate Office Building, Senator William Proxmire, chairman of the committee, presiding.

Present: Senators Proxmire, Lugar and Schmitt.

OPENING STATEMENT OF CHAIRMAN PROXMIRE

The CHAIRMAN. Today the committee is holding hearings on H.R. 5675, a bill to authorize the Secretary of the Treasury to invest public funds in interest-bearing obligations.

The bill addresses a problem which has long been of concern to this committee: the loss of millions of dollars a year in potential Federal revenues that comes from keeping tax deposits in interest-free tax and loan accounts at commercial banks. According to Treasury estimates, the Federal Government stands to gain from \$50 to \$100 million a year in revenues if this legislation is enacted.

As I understand it, the intent of H.R. 5675, which passed the House on April 25, is to give the Federal Government a fair return on its money and also to make the tax and loan accounts system more equitable. Specifically, it would do the following:

1. Permit the Treasury to invest its excess tax and loan account balances in interest-bearing loans to the institution holding the account, or alternatively in U.S. Treasury securities;

2. Allow appropriate compensation to these institutions for the costs of maintaining the tax and loan accounts and for issuing and redeeming U.S. savings bonds;

3. Permit savings and loan associations to participate in the tax and loan account system, on an equal basis with commercial banks, mutual savings banks, and credit unions, which already have this authority; and

4. Cushion the impact on minority banks, by permitting a 5-year phase-in of the investment authority in their case.

Last year the committee reported out an expanded version of this legislation which would have permitted State and local governments to get a fair return as well on their excess cash balances, by allowing direct payments of interest on public demand deposits. Unfortunately, for various reasons—which I'm sure you can understand—that bill died on the Senate floor.

We are still interested in aiding State and local governments to make better use of their funds, perhaps by authorizing public unit NOW accounts. At the same time, however, we recognize that this is a controversial issue. The Treasury Department makes a strong case for acting swiftly on the legislation before us today, H.R. 5675.

Therefore, let us proceed. The committee will hear first from Congressman Mottl who has been an energetic supporter of this legislation since early in the last Congress. I understand this bill passed the House by 384 to 0. It sounds like it's reasonably noncontroversial.

Later on we will hear testimony from the Treasury, the Federal Reserve, and several trade associations affected by the bill.

Congressman Mottl, we are delighted to have you here. Go right ahead, sir.

STATEMENT OF RONALD M. MOTT, REPRESENTATIVE IN CONGRESS FROM THE STATE OF OHIO

Mr. MOTT. Thank you, Mr. Chairman.

It's certainly a pleasure to be back here testifying again on behalf of this measure and I welcome this opportunity to come before you today to speak in support of the legislation that has been a major concern of mine since I entered Congress more than 2 years ago.

When I came to Washington, I was surprised to learn that the Federal Government kept several billion dollars a year on deposit at commercial banking institutions for which the Government did not even receive 1 cent in interest. I learned that this had been the Federal Government's practice since 1917. We were losing approximately \$260 million dollars annually. I wondered how outraged my constituents would be if they knew how many billions of dollars had been lost in revenue over the years because the Federal Government had not had the simple business acumen to put its money into the interest-bearing accounts that they, as a matter of common sense, demanded from their own commercial banks for the use of their money.

The past practice of the Treasury Department in its handling of the tax and loan accounts can only be described as a gross display of fiscal mismanagement of the public revenue. At a time when the Federal deficit has skyrocketed, our taxpayers have the right to demand that the public revenue be managed as efficiently and productively as possible.

President Carter had told the American people that they must make sacrifices, that cutbacks will have to be made in certain service areas. I believe that the American people will accept these sacrifices. But while much attention has been devoted to reducing expenditures, we should also focus our energies on maximizing the utilization of public revenue.

A fitting place to start is H.R. 5675, which would allow the Federal Government to receive interest on the tax and loan accounts the Treasury Department keeps in commercial banks.

The recognition of the need for legislation such as H.R. 5675 and its wide range of support have been demonstrated by its history in the House of Representatives. In the 94th Congress I worked closely with Congressmen Patman, Reuss, and Seiberling for legislation to author-

ize collection of interest from the tax and loan accounts. On December 15, 1975, the House rewarded our efforts by unanimously adopting this legislation by a vote of 391 to 0.

Because of the Senate's failure in the 94th Congress to enact similar legislation, I immediately continued my efforts this January to insure that tax and loan account legislation would become law in this Congress. Working with Chairman Parren Mitchell of the House Monetary Policy Subcommittee, we were successful as H.R. 5675 passed the House on April 25, again unanimously by a vote of 384 to 0.

Thus, tax and loan account legislation has been considered twice by the House, and each time the result has been the same: a unanimous vote that the Treasury Department should have a policy of receiving interest on its tax and loan accounts. It is rare that any type of legislation receives such a universal declaration of support.

With a quick glance at the following figures, I believe that we can see why they should act quickly to consider this legislation.

Because of the scrutiny shown by the 94th Congress the Treasury Department has transferred more tax and loan account funds to interest-bearing Federal Reserve bank accounts. In 1976 the Treasury Department kept an average of \$7.26 billion in Federal Reserve accounts; at a 5 percent rate of interest, this meant an additional \$363 million in revenue during 1976.

Certainly I think David Mosso and his colleagues from the Treasury Department should be complimented for changing this procedure.

This is certainly laudable, but there is currently no law which could prevent a future Secretary of the Treasury from reverting to the unproductive system and depositing all the tax and loan account funds into noninterest bearing accounts. That is one of the reasons why the legislation before us today is needed: to make it known to the Treasury Department that it is the intent of Congress that the Treasury Department has the duty to maximize the utilization of the public revenue.

I know that the Treasury Department would have no objection to this legislation as it is written. It empowers the Secretary of the Treasury with considerable discretion as to how he should invest our country's operating cash. With sound fiscal management policies, he should be able to maximize the effective use of the public revenue.

Mr. Chairman, members of the committee, this legislation must be passed and it must be passed soon. Each day we delay costs the American people several hundred thousand dollars in possible revenue. I have been informed by Mr. Theodore Langlois of the Treasury Department that passage of this legislation would result in approximately \$75 million yearly in additional revenue, over the cost of any services performed for the Treasury Department by the participating banks. Therefore, it is imperative that the Senate act quickly on this legislation and consider it as presently written. No extraneous amendments should be added to this bill that might endanger its prompt passage.

In conclusion, let me say that we have a rare opportunity before us today. It is not often that Congress has the chance to increase Government revenues at no expense to the taxpayer. But by enacting this legislation we can indeed do just that, and, at the same time, set an example for sound, responsible fiscal management of the Nation's revenue.

Thank you.

The CHAIRMAN. Congressman Mottl, you gave the committee a lot of help last year in your efforts to expand the scope of this legislation and include authority for direct interest on demand deposits of State and local governments. I realize that you're interested now—and you state good reason for it—in getting swift action on this particular bill. As you point out, we lose hundreds of thousands of dollars every week if we don't get it.

However, if we have a separate bill, would you still support the principle of getting a fair return for State and local governments on their cash balances if this is done in the context of another bill perhaps the forthcoming public unit NOW accounts legislation?

Mr. MOTTl. I would be most enthusiastic to support such legislation. I had the pleasure of working with you, Senator Proxmire, on that concept and I think it's a great idea that you came up with to maximize the revenues for State and local governments by securing interest on demand deposits. It's unbelievable to me to see that this money is not securing interest for the residents of the State and local governments. Also, as an auxiliary concept—I think you came up with this idea and I applaud it and we introduced legislation on the same date in our respective bodies—that this could be a potential for much corruption by treasurers in the city governments and also State governments throughout the United States because they have the discretion where to deposit these demand deposit funds with banks and lending institutions. I think not only for the additional billion dollars in additional revenues for the State and local governments and their taxpayers, but it also prevents any possible corruption. I think it's just a great idea and I would be delighted to be able to assist the great Senator from Wisconsin in this legislation.

The CHAIRMAN. In using the authority granted under H.R. 5675, Treasury has said that it will set interest rates in relation to prevailing market conditions, but there's nothing in the legislation to indicate what interest rates should be charged or even set a minimum.

Now that raises the question that perhaps a future administration could allow low interest rates and give the banks more of a break than we would intend. Do you believe that this legislation should contain a specific requirement that interest rates charged should be set at market levels?

Mr. MOTTl. I would defer to the wisdom of the chairman of this committee. If he felt there should be a minimum amount, I would be delighted to support that concept.

The CHAIRMAN. I wouldn't want to specify a figure. I think obviously we can't determine that by statute. But I was thinking of language that would provide an interest rate to be required to be charged at the market level.

Mr. MOTTl. I think that would be an excellent amendment. I'm sure that the House would be enthusiastic in its support of that effort.

The CHAIRMAN. Mr. Mottl, thank you very, very much. You deserve a world of credit for this. You are the person who's pushed it hard. You have had great success in the House with this and we haven't been able to move it in the Senate the way you have, but I think this year if we don't encumber it we should be able to move it through

rapidly. I don't believe any member of this committee or any Member of the Senate is likely to oppose this legislation. Thanks to your efforts, it should move and move rapidly.

Mr. MOTT. Well, thank you, Mr. Chairman.

The CHAIRMAN. You can tell your constituents you have saved your salary many, many times over every day. If this bill is enacted into law, your salary would have been saved many times over.

Mr. MOTT. Well, that's very kind of you, Mr. Chairman. I certainly appreciate those nice remarks and before I leave, if I could have submitted into the record my colleagues' testimony—that is, of subcommittee chairman Parren J. Mitchell and also John F. Seiberling—they both worked very hard and diligently on this.

The CHAIRMAN. I know they both wanted to be here. Congressman Seiberling was ill and Congressman Mitchell couldn't be here and we'll be happy to have their testimony printed in full in the record.

[Complete statements and a copy of H.R. 5675 follow:]

Statement of

Parren J. Mitchell
Representative from Maryland

Senator Proxmire and other members of this distinguished committee, I am delighted to have this opportunity to make a statement in support of H.R. 5675. We in the House passed this legislation overwhelmingly on April 25. The vote was 384 to 0 with one abstention.

Let me now review briefly the three major issues which this legislation involves. The first is the proposed investment authority; the second is the inclusion of saving and loan associations in the TT&L system. The third concerns minority-owned banks.

The investment authority granted in Section 1 of H.R. 5675 is long overdue. Consider, for instance, that in the 1964-1976 period, average annual TT&L balances, on which no interest was earned, totalled \$54.4 billion. (See Table 1). Applying the average federal funds rate of 5.93% for the 1964-1976 period (see Table 2) to the \$54.4 billion, the gross amount of interest income lost to the Treasury during the last 13 years is estimated to be \$3.2 billion. Even after deducting a generous Treasury estimate of \$64 million per year as compensation to the banks for free services they provided the Treasury in connection with the TT&L accounts, we find that taxpayers have foregone earnings of approximately \$2.4 billion during these 13 years.

A 1974 Treasury study confirms that in past years hundreds of millions of dollars in net revenues have been foregone annually. The Treasury study points out that in 1972 the earnings to banks from Tax and Loan balances exceeded the expenses of handling these accounts by \$170 million.

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Table 1Average Annual Treasury Tax & Loan Account Balances

(Billions of Dollars)

<u>Year</u>	<u>Average Balance</u>
1964	\$4,747
1965	5,431
1966	4,324
1967	3,775
1968	4,191
1969	4,329
1970	4,022
1971	5,146
1972	5,648
1973	5,644
1974	3,913
1975	1,853
1976	1,394
	\$54,417

Table 2Average Annual Federal Funds Rate1964-1976

<u>Year</u>	<u>Rate</u>
1964	3.49%
1965	4.06
1966	5.09
1967	4.22
1968	5.64
1969	8.18
1970	7.18
1971	4.67
1972	4.42
1973	8.69
1974	10.55
1975	5.86
1976	5.05

Average 13-year period Federal funds rate 5.93%

-more-

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In recent years, TT&L balances have been reduced significantly so that they currently comprise only 20% of Treasury's total operating cash. Nonetheless, taxpayers are still foregoing millions of dollars in net revenues every year. Section 1 of H.R. 5675 permits the Treasury to capture these revenues.

In sum, the advantages of the investment authority granted in Section 1 of H.R. 5675 are three-fold:

1. It will promote efficient government cash management practices and at the same time enable Treasury to earn \$50-\$100 million of net revenues annually, as Treasury testified before my Subcommittee on Domestic Monetary Policy.
2. It permits equitable compensation to depository institutions for services they render to the Treasury. Under the new system, depositories will be compensated for services which they now render free of charge. Compensable services will include maintaining TT&L accounts, processing federal tax deposits, and issuing and redeeming U.S. savings bonds.
3. Finally, but by no means of little importance, by allowing Treasury to use accounts in commercial banks as their working balances rather than shifting cash in and out of Federal Reserve banks, as in recent years, this legislation will insulate bank reserves from volatile transfers of funds between the public and the Treasury, thereby, facilitating the smooth conduct of monetary policy.

It is, thus, amply clear that the investment authority granted in H.R. 5675 is in the public interest -- in the interest of equitable treatment of depository institutions, increased potential revenues to

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the Government, and smoother money management. Now let me turn to the second major issue which this legislation involves; that is, inclusion of S&Ls in the TT&L system.

One of the greatest inequities of our current tax and loan collection system is the exclusion of savings and loan associations as depository institutions. H.R. 5675 would correct this situation. Section 2 of the bill authorizes federally insured S&Ls, as well as those insured by states and corporations chartered by states, to act as public depositories and members of the TT&L system.

The U.S. League of Savings Associations, in a statement submitted for the House record, has endorsed this legislation, and in regard to Section 2, stated that "Tax and loan accounts can potentially help moderate the economic swings which affect deposit flows to savings associations and consequently funds available for mortgage lending. Skillful management can no doubt utilize tax and loan deposits to keep funds flowing to home borrowers in times of slack savings performance."

Several other reasons mentioned in the Banking Committee's report on H.R. 5675 indicate further why S&Ls should be brought into the TT&L system. Briefly, these reasons include:

1. Thrift institutions such as mutual savings banks are already in the system.
2. Federally chartered credit unions were made eligible to act as depositories under 12 U.S.C. 1767.
3. Those S&Ls that issue savings bonds are not currently compensated for their services because they are not members of the TT&L system.

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4. Nearly all of the services performed for Treasury by commercial banks are also provided by S&Ls.

5. S&Ls already have the authority to and do make short-term investments.

6. Under the proposed new system, S&Ls would be treated equally with other depositary institutions.

7. In order to receive TT&L deposits, eligible S&Ls would have to pledge collateral. If individual S&Ls cannot pledge collateral, they cannot receive these funds. This, therefore, covers the issue of assurances on the financial condition of eligible S&Ls.

Clearly, these interests are important to all of us; and in this regard, I strongly urge your support of Section 2 of H.R. 5675.

Finally, let me turn to the question of the impact of the investment authority granted in H.R.5675 on the nation's 83 minority-owned banks. In testimony before the Domestic Monetary Policy Subcommittee on March 9, representatives of the National Bankers Association, while supporting this legislation, emphasized that without a program to soften the immediate impact of the proposed payment of interest on TT&L deposits on minority-owned banks, recent efforts which they have made to strengthen their development by attracting hitherto interest-free TT&L deposits would be undermined. Treasury's position on this potentially adverse impact buttresses the NBA's concerns. Our hearings record shows that Treasury favors establishing "special demand deposit" balances in minority-owned banks which would be based on the average TT&L balance in such banks during a selected base year. These special deposits would be available to the minority-owned banks on an interest-free basis.

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However, over a five-year period, special deposits would be decreased by 20% annually and thereby phased out. Both Treasury and the NBA agree that this method will adequately cushion the immediate impact of the proposed TT&L investment authority embodied in H.R. 5675.

Both the Banking, Finance and Urban Affairs, and the Ways and Means Committees' reports on the bill expressly approve of the implementation of "special demand deposit" balances for minority-owned banks. As Fiscal Assistant Secretary of the Treasury David Mosso stated before my Subcommittee on Domestic Monetary Policy, and the Ways and Means Committee, such a procedure could not be adopted by the Department "without a clear indication in the law or legislative history that such an arrangement reflects the intent of Congress." So far, the legislative history on H.R. 5675 without reservation supports the adoption of the five-year phase-out program for minority-owned banks. I urge your attention to this question and support of the five-year phase-out program.

With respect to small banks, Treasury has agreed to adjust its investment and call procedures in consideration of the relative inaccessibility of small banks to money markets.

In conclusion, let me affirm that our legislative history is intended to prevent the viability of minority-owned and small banks being undermined by implementation of the investment authority in H.R. 5675, which as has been amply documented, will generate annual net revenues of \$50-\$100 million to the Treasury, provide for more equitable compensation to institutions now providing services free to the Treasury, and finally facilitate the smooth conduct of monetary policy.

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TESTIMONY OF CONGRESSMAN JOHN F. SEIBERLING BEFORE THE SENATE BANKING, HOUSING, AND URBAN AFFAIRS COMMITTEE ON HR 5675, TO REFORM THE FEDERAL TAX AND LOAN ACCOUNT SYSTEM,

JUNE 6, 1977.

Mr. Chairman, I am pleased to testify this morning before the Senate Banking Committee on legislation to reform the tax and loan account system. As you know, legislation for this purpose, which I introduced in the 94th Congress with more than 100 cosponsors, received the unanimous approval of the House in 1975 and again this year. It is indeed an idea whose time has come, and I speak for many Members of the House when I express my appreciation to you for your work on this issue, and for the prompt attention which the Banking Committee has given to it.

Not many people know what initially happens to the tax money that is withheld from their paychecks. I'm sure it would come as a shock to many to learn that it goes into account in commercial banks, where it sits without earning a penny of interest while the banks reap profits on it from the interest they charge.

The primary purpose of the tax and loan account system is to provide an efficient tax collection mechanism for the Treasury, and to minimize the potentially disruptive effect of Treasury cash operations on the banking system and the nation's economy. It has performed this useful function ever since it was set up in 1917. Ostensibly, the government has allowed banks to hold these accounts without paying interest to compensate them for various banking services they perform for the government. There is no longer any question that banks are being overcompensated for their services. Treasury now recognizes that fact, and has drawn down the balances in the tax and loan accounts substantially and placed them in Federal Reserve Banks. However, this system is unacceptable to the Federal Reserve Board on a permanent basis, because it tends to complicate the Federal Reserve's monetary policy.

The bill before the Committee would restore equity to the tax and loan account

Rep. John Seiberling

HR 5675

June 6, 1977

system by providing the taxpayer a return on his tax deposits and allowing banks to use surplus tax and loan account funds. It would give the Treasury authority to invest these surplus funds on a daily basis in interest-bearing obligations of depositories maintaining tax and loan accounts. In effect, banks would borrow this money from the Treasury each day. The bill will not require the Secretary to reinvest the money, since this could place a real burden on small commercial banks which handle tax and loan accounts as a service to their customers and the Treasury. I would hope that the Treasury will use this new authority in a prudent manner where small banks are concerned. The bill would give the Treasury the flexibility necessary to negotiate the terms and conditions of tax and loan accounts, consistent with good cash management and the maximum return on public funds. The Committee will, of course, have an opportunity through its oversight function to determine whether the Treasury's handling of these accounts is being done in a way that is fair to both the taxpayers and the banks which will be providing services to the Treasury.

In conclusion, Mr. Chairman, I want to commend the Committee for holding hearings on this issue. Although the Treasury has taken action to minimum the loss of tax dollars through tax and loan accounts, this issue still warrants congressional action. The present tax and loan account system has cost the taxpayer millions of dollars in lost revenues. It is high time to put the government's handling of tax funds on a more businesslike basis. I urge the Committee to approve effective legislation for this purpose.

Thank you.

95TH CONGRESS
1ST SESSION

H. R. 5675

IN THE SENATE OF THE UNITED STATES

APRIL 26 (legislative day, FEBRUARY 21), 1977

Read twice and referred jointly, by unanimous consent, to the Committees on
Banking, Housing, and Urban Affairs and Finance

AN ACT

To authorize the Secretary of the Treasury to invest public
moneys, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That the Secretary of the Treasury is authorized, for cash
4 management purposes, to invest any portion of the Treasury's
5 operating cash for periods of up to ninety days in (1) obliga-
6 tions of depositaries maintaining Treasury tax and loan ac-
7 counts secured by a pledge of collateral acceptable to the
8 Secretary of the Treasury as security for tax and loan
9 accounts, and (2) obligations of the United States and of
10 agencies of the United States: *Provided*, That the authority
11 granted under this section shall not be construed as requiring

1 the Secretary of the Treasury to invest any or all of the cash
2 balance held in any particular account: *Provided further,*
3 That the authority granted under this section shall not be
4 construed as permitting the Secretary of the Treasury to
5 require the sale of such obligations by any particular person,
6 dealer, or financial institution.

7 SEC. 2. (a) Section 5(k) of the Home Owners' Loan
8 Act of 1933 (12 U.S.C. 1464(k)) is amended by adding
9 after "Bank" in the first sentence thereof the following:
10 "shall be a depository of public money and" and by striking
11 the period at the end thereof and inserting the following:
12 ", including services in connection with the collection of taxes
13 and other obligations owed the United States, and the Secre-
14 tary of the Treasury is hereby authorized to deposit public
15 money, in any such Federal savings and loan association or
16 member of a Federal home loan bank, and shall prescribe
17 such regulations as may be necessary to carry out the pur-
18 poses of this subsection."

19 (b) Section 402(d) of the National Housing Act
20 (12 U.S.C. 1725(d)) is amended by adding the following
21 at the end thereof: "Insured institutions shall be depositories
22 of public money and may be employed as fiscal agents of the
23 United States. The Secretary of the Treasury is authorized
24 to deposit public money in each insured institution, and shall
25 prescribe such regulations as may be necessary to enable such

1 institutions to become depositaries of public money and fiscal
2 agents of the United States. Each insured institution shall
3 perform all such reasonable duties as depositary of public
4 money and fiscal agent of the United States as may be
5 required of it including services in connection with the collec-
6 tion of taxes and other obligations owed the United States.”.

7 (c) Banks, savings banks, and savings and loan, build-
8 ing and loan, and homestead associations (including coopera-
9 tive banks) created under the laws of any State and the
10 deposits or accounts of which are insured by a State or
11 agency thereof or corporation chartered pursuant to the laws
12 of any State may be depositaries of public money and may
13 be employed as fiscal agents of the United States. The Secre-
14 tary of the Treasury is authorized to deposit public money in
15 any such institution, and shall prescribe such regulations as
16 may be necessary to enable such institutions to become
17 depositaries of public money and fiscal agents of the United
18 States. Each such institution shall perform all such reasonable
19 duties as depositary of public money and fiscal agent of the
20 United States as may be required of it including services in
21 connection with the collection of taxes and other obligations
22 owed the United States.

23 SEC. 3. (a) Subsection (c) of section 6302 of the In-
24 ternal Revenue Code of 1954 (relating to use of Govern-
25 ment depositaries) is amended—

1 (1) by striking out "or trust companies" and in-
2 serting in lieu thereof ", trust companies, or domestic
3 building and loan associations"; and

4 (2) by striking out "and trust companies" and
5 inserting in lieu thereof ", trust companies, and domestic
6 building and loan associations".

7 (b) Subsection (e) of section 7502 of the Internal
8 Revenue Code of 1954 (relating to mailing of deposits) is
9 amended by striking out "or trust company" each time it
10 appears and inserting in lieu thereof ", trust company, or
11 domestic building and loan association".

12 (c) The amendments made by this section shall apply
13 to amounts deposited after the date of the enactment of
14 this Act.

Passed the House of Representatives April 25, 1977.

Attest: EDMUND L. HENSHAW, JR.,

Clerk.

The CHAIRMAN. I would like to ask Mr. David Mosso, Fiscal Assistant Secretary, Department of the Treasury; and Mr. Charles Partee, member of the Board of Governors of the Federal Reserve System, if they would come forward together so we could have them as a panel. Mr. Mosso, you have a rather substantial statement, a very helpful statement, with fine documentation and exhibits. We will have the entire statement printed in full in the record. If you would like to abbreviate it or summarize it we would be grateful.

**STATEMENT OF DAVID MOSSO, FISCAL ASSISTANT SECRETARY,
DEPARTMENT OF THE TREASURY**

Mr. Mosso. Thank you, Mr. Chairman. I would like to summarize it and just hit the highlights.

[Complete statement follows:]

FOR RELEASE UPON DELIVERY

Expected at 10:00 A.M.

June 6, 1977

STATEMENT OF DAVID MOSSO
FISCAL ASSISTANT SECRETARY OF THE TREASURY
BEFORE THE SENATE COMMITTEE ON BANKING,
HOUSING AND URBAN AFFAIRS ON H.R. 5675

Mr. Chairman, I am happy to appear before this Committee to present the Treasury Department's views on H.R. 5675 which would authorize the Treasury to invest, for cash management purposes, in obligations of Treasury tax and loan depositaries and in obligations of the United States. The bill also provides expanded authority for the Treasury to use savings and loan associations as depositaries.

For the past two and one-half years the Treasury has actively sought authority to invest its operating cash on a short-term basis. We fully support the bill under consideration.

Need for Investment Authority

H.R. 5675 would give the Treasury an option already generally available to state and local governments, to corporations, and to other institutions -- the option to invest temporarily excess operating cash. The Treasury has no present authority to invest surplus cash except in time deposits, and the 30-day minimum maturity for such deposits makes that course impracticable.

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A Treasury study completed in 1974 concluded that the Government was losing some \$260 million of potential earnings annually on tax and loan accounts. As a result of that study, the Treasury proposed legislation to permit the direct investment of operating balances. As an interim procedure pending enactment of the proposed investment authority, the Treasury adopted a stop-gap, indirect way of recouping some of the potential earnings on its balances.

Indirectly, earnings are achieved (1) by keeping as much cash as is feasible in the Federal Reserve Banks where it is invested by those banks in the normal course of their operations and returned to the Treasury in the form of Federal Reserve System earnings, and (2) through the imputed value of services provided by commercial banks maintaining tax and loan accounts (those services consist of handling tax deposits and issuing and redeeming savings bonds).

Exhibit 1 shows the change that has taken place, since this policy was adopted in 1974, in the distribution of cash between the Treasury tax and loan accounts at commercial banks and the Treasury accounts at Federal Reserve Banks. Before 1974, an average of about 80 percent of Treasury operating cash was held in tax and loan accounts and 20 percent in Federal Reserve Banks. Since 1974, the proportion has just about reversed.

Indirect Earnings Procedures

Let me explain what the present procedures have gained for the Treasury by way of indirect earnings.

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During calendar year 1976, Treasury operating cash balances averaged \$8.8 billion, consisting of \$7.3 billion at the twelve Federal Reserve Banks and \$1.5 billion at 14,000 commercial banks in tax and loan accounts.

Indirect earnings generated by Treasury balances at Federal Reserve Banks during 1976 are estimated to be \$365 million. This is based upon a rate of 5 percent, the average rate during 1976 on repurchase agreements which are the principal instruments of Federal Reserve open market operations.

Indirect earnings on tax and loan balances at commercial banks in 1976 were \$64 million, the estimated value of services rendered by banks without a fee. This translates to a rate of 4.2 percent when computed on balances as recorded on the books of the Treasury. However, there is estimated to be an average of over \$1.0 billion of tax deposit advices in transit, for more than the normal one-day delivery time, between commercial banks and Federal Reserve Banks. When that is figured into the calculation, the rate of return on tax and loan balances is reduced to about 2.3 percent.

Disadvantages of Current Procedures

Now let me explain what the Government is giving up because of the absence of the investment authority.

The first consequence is that we have lost a significant monetary tool. The present stop-gap cash management procedures have subverted one of the basic purposes of the tax and loan

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account system -- to insulate the nation's monetary system from the impact of irregular Treasury cash flows.

Treasury cash flows affect the level of bank reserves to the extent that the Treasury balance at the Federal Reserve Banks changes -- an increase in the Treasury balance lowers bank reserves and a decrease raises reserves. The original objective of the tax and loan system was to keep a small, stable Federal Reserve balance and to let the volatile swings in Treasury cash flows fall in the tax and loan balance. This eliminated the whipsawing effect on bank reserves of fluctuating Treasury cash flows. Current procedures have transferred those fluctuations directly to the Federal Reserve balance and, therefore, to bank reserves.

To minimize the disruptive effects of these induced swings in bank reserves, the Federal Reserve is forced to compensate through open market operations. Exhibit 2 shows, by quarter, swings in Treasury operating cash since 1970. As you can see, before 1974 the amplitude of fluctuations was concentrated mostly in the tax and loan accounts. After 1974, it has been concentrated in the Federal Reserve balance.

A second consequence of our inability to invest directly is that our stop-gap procedures have caused confusion and uncertainty in the money markets, put unnecessary pressures on the Government securities market, and made it considerably more difficult for the Federal Reserve System to achieve its monetary

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objectives. Although there is no way to measure the impact, it is clear that a toll has been exacted in the form of higher interest rates, higher transaction costs, and a generally adverse impact on the nation's economy.

A third consequence is that the method of compensation for services performed for the Treasury by commercial banks is inequitable to individual banks. These compensable services are the processing of tax deposits and the issue and redemption of savings bonds. Although the Treasury attempts to keep bank costs and benefits in an equitable relationship on an aggregate basis, it is impossible under current procedures to compensate each bank in direct proportion to the volume of services it provides to the Treasury. Some banks may make excessive profits while others may lose money. In addition, non-bank providers of services are inequitably treated. While commercial banks receive compensation through tax and loan accounts for handling savings bonds on behalf of the Treasury, other institutions, such as savings and loan associations, do not receive compensation for this service because they do not have tax and loan accounts.

A fourth consequence is that the present indirect manner of generating earnings fails to achieve maximum realizable earnings. This is because:

- (1) It is impossible under all market conditions to transfer money from the tax and loan accounts into Treasury

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accounts at the Federal Reserve as fast as might be desirable for earnings purposes without being unduly disruptive of Federal Reserve monetary policy. At times, the Treasury must ease off on transfers, leaving more money in tax and loan accounts than would otherwise be the case.

(2) There is no way at the present time to tap the earnings potential of tax deposits for which advices are in transit between the commercial banks and the Federal Reserve Banks. In the absence of investment authority, the in-transit balance cannot be converted to an earning asset.

(3) Finally, a reduction of the level of tax and loan account balances to the break-even point (where the total earnings value of the balances would equal the total value of services rendered) would push many banks into a net loss position with respect to tax and loan accounts. The hardest hit would be those banks that provide the most services to the Treasury relative to the size of their tax and loan balances. They would tend to drop out of the system. That would jeopardize another major purpose of the tax and loan system -- to provide a simple and efficient tax collection mechanism, convenient for the taxpayer and expeditious for the Treasury.

For the foregoing reasons of monetary policy, equity, and operational feasibility, we estimate that between \$50 and \$100 million of net earnings are being lost per year.

Investment Authority

The investment authority embodied in H.R. 5675 would

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authorize the Secretary of the Treasury to invest Treasury operating cash directly with each tax and loan depository. This would be in lieu of calling the balances immediately into the Federal Reserve Banks and, together with the payment of fees for services, would solve the basic problems inherent in the present system. The Treasury already has authority to pay fees for the services involved and has requested appropriations for that purpose contingent upon enactment of investment authority.

H.R. 5675 would also permit the Treasury to invest directly in Government securities if, at times, that would be more advantageous than direct investment with tax and loan depositories. On occasions when cash management, debt management, and monetary policy objectives were conducive, the Treasury could exercise this authority and use excess operating cash to purchase Treasury securities in the market.

Impact on Minority Banks

Mr. Chairman, the Treasury has one concern about the immediate effect of the proposed legislation. That is the disproportionate impact it would have on banks in the minority bank deposit program. We are proposing a transitional arrangement whereby we would stretch out the impact on minority banks over a five year period. We do not feel, however, that we could adopt such a procedure without a clear indication in the law or the legislative history that such an arrangement reflects the intent of the Congress. The report of the House Committee

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on Banking, Finance and Urban Affairs on H.R. 5675 endorses the Treasury's proposed transitional arrangement.

Interest-Bearing Public Unit Accounts

In requesting my testimony, you specifically asked for my views on the question of direct payment of interest on public demand accounts or, alternatively, public unit NOW accounts as a means of providing a fair return to the Federal Government and to State and local governments on deposits held in demand accounts.

As you know, our basic reservation about the concept of interest on public unit accounts is that it is an inseparable part of a sensitive and potentially controversial issue. The investment authority embodied in H.R. 5675, on the other hand, is completely non-controversial. We do not think that the two proposals should be joined.

As a separate issue, the matter of permitting payment of interest on public unit accounts is being considered by the Administration along with other financial institutions issues. A position has not yet been firmed up; therefore, I cannot answer your question from an administration policy point of view.

I can, however, offer an assessment strictly in terms of potential cash management impact, apart from the other potential impacts that have to be considered in arriving at a policy position.

Strictly as a cash management tool, the payment of interest

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on public demand deposits is very unlikely to be as advantageous for the Federal Government as the investment authority in H.R. 5675. If, for example, the Congress were to provide for a ceiling on rates, as is presently the case with NOW accounts in the New England States, the Treasury would have difficulty in balancing rates, fees, deposit levels and other variables in a way that would achieve maximum earnings with equity to individual banks. H.R. 5675 gives the Treasury the ability to set rates in relation to prevailing market conditions, and to determine fees and other factors with the flexibility that is essential if we are to realize the full earnings potential of Treasury balances while dealing with nearly 20,000 institutions with fairness and administrative simplicity.

I cannot speak authoritatively about the impact on State and local governments, but my impression is that interest-bearing accounts would provide additional net revenues for at least some of them who are not in a position to obtain the equivalent of interest through services performed by the banks. From that standpoint alone, interest-bearing accounts would be beneficial to some State and local governments. I cannot assess, however, the trade-off that might be exacted through other changes in the financial system.

Concluding Remarks

In order to keep my opening remarks brief this morning, the details of the minority bank transitional arrangement, a number

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of technical comments on H.R. 5675, and a fuller explanation of the tax and loan system have been incorporated into a separate statement which with your permission, Mr. Chairman, I will submit for the record as Exhibit 3.

However, I would like to make one technical comment. Section 2(c) of H.R. 5675 would permit the Secretary of the Treasury to designate banks and savings and loan associations which are insured by a state or an agency thereof, or by a corporation chartered pursuant to the laws of any State, to act as depositories of public money and as fiscal agents of the United States. The Treasury has not had an opportunity to research adequately the significance of the expansion of eligibility to these institutions. Federal insurance provides for loss recoupment through large premium reserves and stand-by borrowing authority, and for loss prevention through regulations and periodic examination. We are not aware of the details of the several non-Federal insurance arrangements and do not know if they provide comparable protection. We do not object to being given the authority to use institutions that are not covered by Federal insurance, but the Congress should be aware that the Treasury would not expect to exercise such authority automatically without imposing regulatory safeguards. We would use institutions covered by a particular insurance plan only after satisfying ourselves that the risks were within reasonable bounds.

In conclusion, Mr. Chairman, the Treasury fully supports the enactment of investment authority as in H.R. 5675. That

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authority is vitally needed and I urge its prompt passage. The bill passed the House by a vote of 384 to 0, convincing evidence that both its objective and method have wide support. Enactment of the authority to invest excess operating cash would not only give the Treasury a cash management tool that most institutions already have -- and in this regard, it breaks no new ground -- but it would also enable the Treasury to cease its disruptive influence on the money markets and to forestall the loss of significant earnings.

That concludes my statement, Mr. Chairman. I will be happy to answer questions.

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EXHIBIT 1

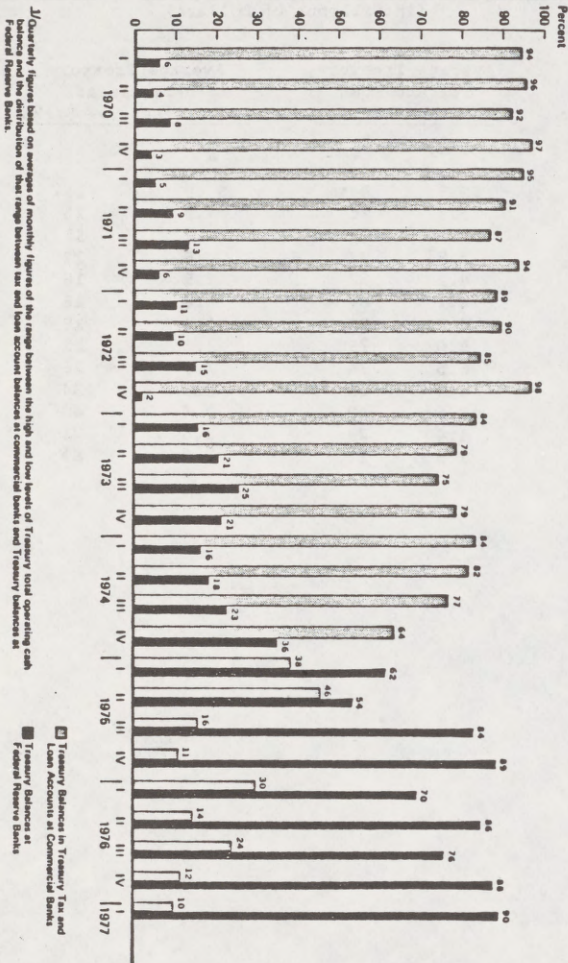
DISTRIBUTION OF TREASURY OPERATING CASH BETWEEN TAX AND LOAN
ACCOUNTS AND TREASURY ACCOUNTS AT FEDERAL RESERVE BANKS
(In Billions of Dollars)

<u>Calendar Year</u>	<u>Average Treasury Tax and Loan Account Balances</u>		<u>Average Treasury Balances at Federal Reserve Banks</u>		<u>Total</u>
1964	\$4.9	84½	\$.9	16½	\$5.8
1965	5.3	85	.9	15	6.2
1966	3.9	85	.7	15	4.6
1967	3.9	83	.8	17	4.7
1968	4.2	82	.9	18	5.1
1969	4.1	84	.8	16	4.9
1970	4.9	82	1.1	18	6.0
1971	5.0	79	1.3	21	6.3
1972	5.5	74	1.9	26	7.4
1973	4.9	66	2.5	34	7.4
1974	3.6	60	2.4	40	6.0
1975	1.4	29	3.4	71	4.8
1976	1.5	17	7.3	83	8.8

EXHIBIT 2

Range Between Highs and Lows in
Treasury Tax and Loan Account Balances at Commercial Banks
and Treasury Balances at Federal Reserve Banks by Quarter 1/

Exhibit 2



THE TAX AND LOAN SYSTEM -- THE NEED FOR INVESTMENT AUTHORITY
AND TECHNICAL COMMENTS ON H.R. 5675

Background

There are approximately 14,000 banks throughout the country which maintain Treasury tax and loan accounts. In FY 1976, over \$228 billion, approximately 70 percent of the Government's gross budget receipts, was collected through the tax and loan account system.

The tax and loan account system has two essential purposes: to insulate the nation's monetary system from the whipsawing impact of irregular Treasury cash flows, and to provide a simple and efficient tax collection mechanism. A corollary of the first purpose is that tax deposits remain in local communities until such time as the funds are needed at Federal Reserve Banks to cover the Government's disbursements.

In brief, the system functions as follows: As taxes are deposited by business firms at local banks, the funds are transferred on each bank's books from the taxpayer's account to the Treasury's tax and loan account. The Treasury then calls the tax and loan balances as it needs funds in its accounts at Federal Reserve Banks to cover disbursements. The flow of collections into the Federal Reserve Banks can be regulated vis-a-vis the flow of payments so that any potentially disruptive effects upon bank reserves can be avoided.

1974 TT&L Study and the Absence of a Short-Term Investment Authority

In June 1974, the Treasury completed a report on a study of the Treasury tax and loan account system. That report concluded that the implicit costs to the Treasury of tax and loan accounts had risen substantially beyond the value to the Treasury of the services associated with such accounts. The report recommended that for reasons of monetary management, the tax and loan account system be retained, but that means be developed for (1) employing a portion of the funds in ways that would provide adequate returns to the Treasury, and (2) compensating banks, for a limited number of services performed, from appropriated funds.

The Treasury has no present authority to invest temporarily surplus cash except in time deposits, and the 30-day minimum maturity for such deposits makes that course impracticable. It is essential that legislative authority be obtained to make possible the most efficient temporary employment of Treasury cash in interest-bearing assets.

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This authority, if enacted, would give the Treasury an option already generally available to, and widely used by, Treasurers of state and local governments, corporations and others, namely, the investment on a short-term basis of excess operating balances.

Present Administration of the Tax and Loan System

Since October 1974, pending enactment of proposed investment authority, the Treasury has developed a stop-gap procedure by calling tax and loan accounts at a rate which more nearly equalizes the aggregate earnings value of the average tax and loan balance, on the one hand, and the aggregate value of the compensable services rendered by the banks, on the other. During that time, the average daily callable tax and loan balance has been maintained at approximately \$1.5 billion and the average daily balance at the Federal Reserve Banks has been \$5 billion. This compares with approximately \$6 billion in tax and loan accounts and \$2 billion at Federal Reserve Banks at the time of Treasury's tax and loan study. In this way, the Treasury has captured more earnings on its operating balances because balances at the Federal Reserve Banks increase the profits of the Federal Reserve System and those profits are paid to the Treasury.

The use of this stop-gap procedure has, however, thwarted one of the basic purposes of the tax and loan system--to insulate the nation's monetary system from the impact of irregular cash flows. By quickly calling tax and loan deposits into the Treasury's accounts at the Federal Reserve Banks, the Federal Reserve System has been forced to compensate through open-market operations for the large swings in Treasury cash flows. This has caused confusion and uncertainty in the money market, put unnecessary pressures on the Government securities market, and made it more difficult for the Federal Reserve System to achieve its monetary objectives. There is no way to measure the toll that this has taken in the form of higher interest rates or the adverse impact it has had on the nation's economy. But it is a well-established phenomenon that uncertainty has a bearish influence on economic activity.

Furthermore, it is not feasible under the present stop-gap procedure to attain the full amount of potentially realizable earnings. First, it is impossible under some market conditions to maintain a tax and loan call schedule simply based upon Treasury's cash needs without being unduly disruptive of Federal Reserve monetary policy. In response to the needs of the Federal Reserve System, the Treasury may change its scheduled calls leaving more or less money in tax and loan accounts than otherwise would be the case. Second, it is impossible to reduce the level of tax and loan balances maintained by commercial banks to the break-even point (where the earnings value of the balances equals the value of services rendered) without creating substantial inequities among banks and jeopardizing the second purpose of the tax and loan system; that is, to provide a simple and efficient tax collection mechanism. This is because the volume of tax deposits handled by an individual bank bears no relationship to the volume of services rendered by that bank and also because banks vary significantly in the time it takes to transmit tax deposit information to the Federal Reserve Banks.

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In order to compensate banks equitably for services provided, each bank should be reimbursed in direct relation to the value of services provided by that bank. Currently, the Treasury has no feasible means available to selectively reimburse banks on an individual basis. Consequently, the current policy -- which treats banks on an aggregate basis -- could result in significant inequitable reimbursements of banks (overcompensation to banks providing a relatively small volume of services and undercompensation to banks providing a relatively high volume of services). If that were allowed to happen, many banks would be motivated to drop out of the tax collection system.

This result has been forestalled by leaving the total average tax and loan balance, including funds in transit between commercial banks and Federal Reserve Banks, above the point needed to adequately compensate banks in the aggregate. This assures that most banks are adequately compensated individually, but the Treasury loses potential earnings.

A condition that contributes to the inequity of the present procedure and also effectively limits the Treasury's ability to tap, even on an aggregate basis, the full earnings potential of the tax and loan accounts is the fact that tax deposits for which advices are in transit between commercial banks and Federal Reserve Banks cannot be called. The in-transit amount is estimated to be between one and two billion dollars on the average. There is no way, in the absence of investment authority, to effectively convert the in-transit balance to an earning asset. Furthermore, there are practical limitations on how low the callable tax and loan balance (the amount that has been reported to the Federal Reserve Banks) can be held on a continuing basis because of the time it takes to give notice of calls.

Although the present procedures do not yield precise measures of several key variables, the Treasury estimates that under current procedures, between \$50 million and \$100 million of earnings value is being lost per year at current interest rate levels in the absence of the investment authority.

Administration of the Tax and Loan System Under the Investment Authority

If the Congress enacts authority to invest Treasury cash as provided for in the draft bill, the Treasury would exercise the authority so as to achieve a balance between maximizing yield on investments and minimizing disruptions of the money markets. The system would be designed to provide an incentive for depositories to continue being a part of the collection system. It would not motivate them to decline to accept tax deposits from their customers on the grounds that their investable funds would be reduced simply by being part of the tax and loan system.

It is contemplated that the objectives of the tax and loan system would best be accomplished in most circumstances by lending to each depository maintaining a tax and loan account any balance in excess of our operating needs. These loans would be secured by a pledge of collateral. Our current thinking is that the loans would bear interest at rates reflective both of

the nature of the transaction, a collateralized loan of Federal funds, and of alternative sources of collateralized borrowing generally available to banks. In this respect, the rate could be related to the Federal funds rate or the rate on repurchase agreements in Government securities transacted by the Federal Reserve System. In this way, the Treasury would not actually be entering the market and the impact on money market rates would be virtually eliminated.

Alternative Investment Opportunity

Lending to depositaries might not at all times or for the full amount of investable funds be the best way of accomplishing the stated goals. It is desirable, therefore, to provide for the other investment authority, i.e., United States securities, as stipulated in the draft bill.

Depending upon the interest rate structure, the return on investments in obligations of the tax and loan depositaries could be lower than the market yield on Government securities. It would then be advantageous for the Treasury to buy its own securities. The availability of this authority would also add a dimension of flexibility to the Treasury's debt management, as well as to its cash management. However, the maximum short-run return on the investment of tax and loan deposits will not be our sole overriding objective. One of the basic purposes of the tax and loan account system, to help assure stable financial market conditions, will influence the form and timing of investments.

Reimbursement for Services

The investment of Treasury cash in earning assets will necessitate providing direct compensation to banks and other agents for certain services performed. These services are the handling of the tax and loan account, acceptance of Federal tax deposits for credit to such accounts, and the issuance and redemption of savings bonds. Banks and other agents will be compensated by the payment of fees from appropriated funds, and budget requests for the Treasury's Bureau of Government Financial Operations and the Bureau of the Public Debt will, therefore, include additional amounts to cover the payments.

Effect on Minority Banks

During hearings concerning H.R. 3035 of the 94th Congress, and related tax and loan account legislation before the House Subcommittee on Domestic Monetary Policy, the National Bankers Association provided persuasive testimony on the potentially adverse impact of the proposed legislation on minority-owned banks. The Government has actively encouraged the utilization of minority banks both by the public and private sectors. The Department is concerned that the immediate impact of the legislation would be detrimental to the objective assisting minority banks to achieve competitive equality and would be inconsistent with our ongoing activities in this area.

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Therefore, Treasury proposes to soften the impact of the legislation in this respect by placing with each minority bank participating in the minority bank deposit program a special Treasury demand deposit subject to call by the Treasury on seven days' notice. The average daily amount of deposit with each bank would be related to the bank's average daily tax and loan balance during the calendar year prior to enactment of the investment authority as reflected on the books of the Federal Reserve Bank of its district.

We would establish the initial balance at the time the investment authority is utilized and in an amount equal to the average tax and loan balance during that calendar year, less the imputed balance that would be required to provide income equivalent to the fees each minority bank would receive under the Treasury proposal to pay banks fees for the performance of certain services after enactment of the bill. The amount of such balance would be reduced each year in equal amounts so that at the end of five years, it will be entirely withdrawn. However, the Department does not feel that we could adopt such a procedure without a clear indication in the statute or the legislative history that such an arrangement reflects the intent of the Congress. Senate Report 94-1150 at page 9 and House Report 95-159 (Part 1) at page 3 provide such an indication with reference to H.R. 3035 and H.R. 5675, respectively.

Comments on Certain Technical Details of H.R. 5675

The wording of the first section of the bill preceding the first proviso is identical to the proposed legislation which the Treasury forwarded to the 95th Congress on January 17, 1977, and would authorize the temporary investment of any portion of the Treasury's operating cash in specific types of obligations. The Treasury continues to support the investment of its excess operating cash as provided in this section of the bill.

The two provisos to the first section of the bill were introduced during the 94th Congress by members of the Subcommittee on Domestic Monetary Policy of the House Committee on Banking, Currency and Housing. The first proviso would construe the section as not requiring the investment of the cash balance in any particular account. The Department does not see the need for including this proviso as the authority provided therein seems implicit in the basic authority of the bill. However, the Treasury has no objection to it.

The second proviso states that the section shall not be construed as permitting the Secretary of the Treasury to require the sale of obligations eligible for investment by any particular person, dealer or financial institution. We would construe this to mean that the Department would retain the ability to make the following options available to banks that wish to continue handling tax deposits for their customers.

1. Banks agreeing to sell their obligations to the Treasury would be permitted to continue to accept tax deposits as heretofore.

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2. Banks not willing to agree to sell obligations to the Treasury would be permitted to continue to accept tax deposits if (a) their annual volume of deposits is less than a specified amount, e.g., \$1.5 million, or (b) if the volume is in excess of such amount, the bank can arrange to deliver advices of credit to the Federal Reserve Bank of its district on the business day following the date it receives the tax deposits from its customers.

The reason for this limitation is that under the proposed investment of the Treasury's cash in obligations of depositaries, it is planned that the investment will be made as of the business day following the date the depositary accepts a tax payment from its customer. The mail time for many banks to the Federal Reserve Bank of their district is more than one business day. If Treasury permitted banks with a large volume of tax deposits to remit by mail without selling obligations to us, there would be a substantial loss of revenues to the Treasury and a windfall to the banks because of the deposits in transit to the Federal Reserve Banks. We assume that what we are proposing is not in conflict with the second proviso.

Section 2(c) of H.R. 5675 permits the Secretary of the Treasury to designate banks and savings and loan associations which are insured by a state or agency thereof, or corporation chartered pursuant to the laws of any State to act as depositaries of public money and as fiscal agents of the United States. The Treasury has not had an opportunity to adequately research the significance of the expansion of eligibility to these institutions. In addition to the insurance coverage, the Federal insurance program provides for loss recoupment through large premium reserves and standby borrowing authority, and for loss prevention through Federal regulations and examinations. We are not aware of the details of the several non-Federal insurance funds so that we are dealing at this time with an unknown area. The Congress should be aware that the Treasury would not expect to automatically exercise the authority embodied in Section 2(c) of H.R. 5675 without imposing regulatory safeguards to satisfy ourselves that the risks were within reasonable bounds.

The CHAIRMAN. Thank you very much, Mr. Mosso.
Governor Partee.

STATEMENT OF J. CHARLES PARTEE, MEMBER, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM

Mr. PARTEE. Thank you, Mr. Chairman.

I appreciate the opportunity to appear before this distinguished committee to present the views of the Federal Reserve Board on H.R. 5675. The Board strongly recommends the enactment of this bill, because by providing a means for earning a direct return on the Treasury's liquid balances it will materially reduce certain operational difficulties encountered by the Federal Reserve in its day-to-day management of monetary policy.

Until recent years, Treasury cash management practices were conducted with a view to keeping fluctuations in Treasury balances from influencing the supply of bank reserves and short-term interest rates. This policy, in effect, recognized that the level of the Treasury balance is quite volatile because cash flows to the Treasury—from taxes and Federal borrowing—tend to be bunched at particular times of the month and year, whereas cash outlays are more evenly distributed. It makes a difference whether the Treasury maintains its cash with private depositories or with the Federal Reserve. By holding most of the balance in tax and loan accounts at commercial banks and potential reserve effects of fluctuations in the Treasury's cash position are minimized. When funds moved to or from the Treasury, they simply shifted between private and public demand deposits at banks and exerted little net impact on the total supply of reserves available to the banking system. The need for Federal Reserve open market operations to offset the reserve effects of variation in the Treasury's balance was reduced correspondingly.

The Treasury did maintain an operating balance at Federal Reserve banks as well, on which the bulk of its checks were drawn. But as checks for outlays were cashed, the operating balance was quickly replenished by "calls" on the Treasury's tax and loan accounts at private banks. In this way the Treasury held a roughly constant balance with the Federal Reserve System.

Of course, some deviation in the level of the operating balance was inevitable. An accurate current measure of the volume of Treasury checks written was difficult to obtain, and it was hard to forecast exactly when outstanding checks would clear through the Federal Reserve. Nevertheless, the procedure was highly effective in reducing the degree of fluctuation in the Treasury's account at the Federal Reserve banks. Thus, from the standpoint of minimizing the impact of swings in the Treasury's cash position on the supply of bank reserves, the former Treasury tax and loan account system worked well, and the implementation of monetary policy was insulated quite successfully.

In 1974, however, the Treasury reexamined the tax and loan account system, especially with regard to the foregone potential interest earnings on its cash balance. An earlier study had concluded that the Treasury was adequately compensated for this revenue loss by services provided by the banks. But with the general rise in market interest rates

that had occurred during the late 1960's and early 1970's, and the need to maintain larger balances consistent with growing Federal outlays, it appeared that the foregone interest income on the Treasury's balance had come to exceed substantially the value of services rendered to the Treasury by the depository institutions maintaining tax and loan accounts.

The Treasury did not have the authority to invest directly in short-term earning assets, and thus to earn some income with its idle cash. But it was assured of an indirect return when it reduced its noninterest bearing deposits at commercial banks and transferred the bulk of its cash balance to the Federal Reserve System. When the Treasury's account with the Federal Reserve is increased, the System makes corresponding additions to its holdings of Government securities. And since virtually all of the earnings on Federal Reserve assets are turned over to the Treasury, this transfer of deposits provides a return to the Treasury that would not be available if the balances remained with depository institutions.

Unfortunately, this change in procedure has complicated the task of managing monetary policy. This is so because virtually all of the short-run volatility in Treasury deposits now occurs in the accounts held with Federal Reserve banks. Since variation in the level of such deposits has a dollar-for-dollar impact on the supply of reserves available to the banking system, the current concentration of the Treasury's cash position in these accounts greatly increases the need for offsetting Federal Reserve open market operations.

When most of the Treasury's cash balance is held at Federal Reserve banks—as has been the case since 1974—increases in the Treasury's account reduce the overall reserve position of the banking system, and decrease ease that position. Erratic swings in the Treasury balance are often large and concentrated, so that the Federal Reserve must take action through open market operations to offset the unwanted influence on bank reserves. The need for intervention in the Government securities market on this scale has sometimes made the conduct of monetary policy in the short run more difficult.

A few comparisons will help to illustrate the significance for open market operations of this shift in Treasury policy. In 1970—before the Treasury began to alter its cash management techniques—the average weekly change in Treasury deposits at the Federal Reserve was only \$124 million. In 1976—after the new policy had been fully implemented—the average weekly change jumped to \$2 billion. Principally due to this enormous increase in volatility, the average weekly change in reserves provided or absorbed by Federal Reserve open market operations rose to nearly \$2.5 billion in 1976 from less than \$400 million in 1970.

The shift is even more striking when one focuses on the weeks of peak need to offset technical factors affecting bank reserves. In 1970, the maximum week-to-week change in reserves resulting from open market operations amounted to just under \$1.2 billion, and the movement in the Treasury balance necessitated only \$130 million of this change. By 1976, however, open market operations added or absorbed more than \$4 billion of reserves in 12 different statement weeks, and in each case fluctuation in the Treasury balance was the dominant

factor requiring action. The largest of these week-to-week changes required intervention totaling \$6 billion.

To date the Federal Reserve has generally been able to execute the requisite volume of open market operations needed to offset the unwanted reserve effect of these enlarged swings in the Treasury balance. However, there have been significant difficulties. The Treasury balance has become harder to estimate, large day-to-day variations in the balance make it more difficult to develop a consistent short-term operating strategy, and the sheer size of the operations required has at times constrained the Systems flexibility in pursuing the more general objectives of monetary policy.

The Federal Reserve's success in offsetting the reserve impact of sharp fluctuations in the Treasury balance has been aided by the availability of a relatively large market supply of Government securities, as is typical of periods with relatively low interest rates and low inventory financing costs. As the economy continues to expand, however, the picture could change. If pressures on financial markets intensify, Government securities are likely to be less readily available in the market and a large volume of open market operations may become more difficult to accomplish.

Thus, from a monetary policy standpoint, the Board urges prompt action on the proposed legislation. Passage of H.R. 5675 would permit the Treasury to receive at least the amount of earnings it is obtaining now without the present complications and operational costs to Federal Reserve open market policy. Moreover, there should be distributional advantages if the Treasury maintains its balance with depository institutions. Then, when balances shift between the private sector and the Treasury, the supply of funds in regional and local credit markets can remain unaffected. If these funds are moved instead to and from the Federal Reserve, there can be unsettling transitory effects on individual credit markets, since the impact of offsetting open market operations tends to focus initially on major money market center institutions.

I have left all comments on the technical implementation of H.R. 5675 to Mr. Mosso, since he has direct responsibility for administration of Treasury balances. However, I would like briefly to comment on one provision of the bill. Under present law, commercial banks, mutual savings banks, and federally chartered credit unions may all hold Treasury deposits. Savings and loan associations are the only type of depository institution not authorized to participate in the tax and loan account system, and this bill would add them to the list. In this connection, I would like to point out that savings and loans typically hold a very large share of their earning assets in long-term mortgage loans. Since Treasury operating balances are by their very nature volatile, it seems particularly important that the regulatory authorities insist that these institutions add to their short-term assets in amounts commensurate with any such balances obtained.

The CHAIRMAN. Thank you, Governor Partee.

Secretary Mosso, let me ask you why this legislation is needed. On the first page of your statement you say that H.R. 5675 would give the Treasury an option—I'm quoting—"already generally available to the State and local governments to corporations and other institutions, the option to invest temporarily excess operating cash."

Now if State and local governments and others can already do this through telephonic transfer of funds from time deposit accounts to demand accounts, then why does the Treasury need special legislation in order to manage its funds more efficiently? Why can't you do this just by being on top of this and making sure that your money works as hard as possible?

Mr. Mosso. Well, we don't have the authority to use some of the investment outlets that others can use. For example, the only significant investment outlet that we are authorized to use is time deposits and that, because of the 30-day nature of the time deposit, doesn't help us. Our balances are too volatile for that. We can't use regular savings accounts. We can't buy securities in the market. We lack the necessary authority.

The CHAIRMAN. If H.R. 5675 is enacted, then the Treasury will be authorized to convert interest-free demand deposits held in tax and loan accounts to interest-bearing loans to the depository institutions. Demand deposits held by member banks are subject to reserve requirements whereas loans are not. Would this legislation have any impact on the level of bank reserves on the availability of loanable funds and/or on the Federal funds market?

Mr. PARTEE. The way I would put it is that this bill would permit the Treasury to convert cash balances at the Federal Reserve to cash balances at private institutions. Today, the vast majority of Treasury balances are held with us. And, as I said in my statement, all of the volatility that occurs from day to day in those balances has to be offset fully by open market operations.

If the nature of the instrument that the Treasury has with the private banks is a loan—and this hasn't all been determined as yet—it might be something equivalent to a Federal funds transaction. It is true that there will not be required reserves on that transaction, whereas if it is a Treasury balance with the bank in deposit form there will be required reserves. So as I see it, there would be some reduction in net required reserves of the banking system that would occur as a result of this, and there will be some need for offsetting open market operations. That is, when funds are transferred as a result of a tax payment from the private sector to the Treasury, and if the Treasury on the next day invests these balances in loans to the institutions rather than deposits, there would be a reduction of required reserves amounting probably to about 10 or 12 percent of the balances transferred and open market operations will have to take action by selling securities equal to about 10 percent or 12 percent of that amount.

The CHAIRMAN. That action would be necessary to avoid a monetary effect?

Mr. PARTEE. That's right.

The CHAIRMAN. Where you neutralize as far as monetary policy is concerned is by that kind of action?

Mr. PARTEE. Yes. But today, as things work out in practicality, securities sales equivalent to 100 percent of the deposit transfer are necessitated because the next day, rather than shifting to a loan, the Treasury brings the whole balance into the Federal Reserve and dollar-for-dollar we have to take the offsetting action. So that, as I see it, passage of the bill would reduce our market activities on account of

variations in Treasury balances by probably close to 90 percent—perhaps 85 percent.

The CHAIRMAN. You're thinking of this offsetting action strictly as a matter of neutralizing the procedure for monetary policy. How about the effect on bank earnings?

Mr. PARTEE. The effect of a further shift out of demand deposits by the Treasury would reduce—

The CHAIRMAN. It would mean you would diminish the bank earnings?

Mr. PARTEE. Yes, but most of the Treasury's balance has already been transferred to the Federal Reserve. This bill would permit a little more efficiency, I believe. Mr. Mosso can address that feature, but it would be possible, I think, to utilize funds in transit in a way that now can't be done.

The CHAIRMAN. Would the decrease in the required reserves offset as far as bank earnings are concerned?

Mr. PARTEE. No.

The CHAIRMAN. That wouldn't offset the loss of interest on demand deposits?

Mr. PARTEE. No, because banks can reduce required reserves by only a fraction of the amount of the deposit reduction.

The CHAIRMAN. In fact, they are paying it.

Mr. PARTEE. Yes.

The CHAIRMAN. Well, then, the effect on bank earnings would be negative?

Mr. PARTEE. It would be negative, but I don't think it's quantitatively a very large figure.

The CHAIRMAN. Can you figure out what that is?

Mr. PARTEE. The estimate that was made by the Congressman was \$75 million. That seemed to me quite large.

The CHAIRMAN. You don't think that would be offset by the effect on reserves?

Mr. PARTEE. No.

Mr. MOSO. If I might add to that, Mr. Chairman, the estimate of \$50 to \$100 is essentially the impact that it would have on the private sector. Now that would not all come out of bank earnings, however, because part of that has already been given away through analysis credits to corporate customers so that some of this would be a reduction in the earnings value to corporate treasurers.

The CHAIRMAN. Mr. Mosso, do you have any idea what the proportion would be, any estimate?

Mr. MOSO. I have no idea.

The CHAIRMAN. Is it likely that the banks would suffer about half this loss?

Mr. MOSO. I really have no idea.

The CHAIRMAN. Governor Partee, do you think that enactment of H.R. 5675 would result in any need for the Federal Reserve to create a short-term, say a 1-day time deposit category for use by the Treasury?

Mr. PARTEE. I don't see that there would be any necessity for that. As I said, the particular form that the Treasury arrangement with the banks and others would take has not been determined. I would

expect it to be something that would qualify as a loan and therefore not be subject to reserves. If we were to create a 1- 2- or 3-day time deposit—which the Federal Reserve would have the authority to do by redefining time deposit—then the arrangement could take a deposit form. There would be a 6 percent reserve on it in the case of a bank, but the question would arise as to why such time deposits were not available for the remainder of the public and private sectors.

One-day deposits would have substantial market implications for competitors of commercial banks, such as sales finance companies and consumer finance companies which raise funds in that area of the market, and we would want to think long and hard about the merits of such a deposit category. In the case of State and local governments, Mr. Chairman, we do permit these units to have savings accounts with commercial banks in unlimited amount. That means that the State and local governments can presently earn up to the 5-percent ceiling rate of interest from day of deposit to day of withdrawal and, as you mentioned before, they can arrange for telephonic transfers. We considered that arrangement in the case of the Treasury a few years ago when the concern about foregone earnings arose. It was decided that the Treasury's account is so very active that the conversion of tax and loan accounts to savings accounts would be a gross misuse of the latter term, and so it wasn't done.

The CHAIRMAN. Secretary Mosso, you say on page 9 that H.R. 5675, the bill before us, gives the Treasury the ability to set rates in relation to prevailing market conditions. In your appendix, you say that the rate could be related to the Federal funds rate or the rate on repurchase agreements in Government securities.

You heard my questioning of Congressman Mottl on whether or not we ought to have some statutory language that would require you in the execution of this law to get market rates of interest. There's nothing in the language of the bill to indicate what interest rates should be charged.

Should there be language indicating at least a minimum interest rate tied to market rates?

Mr. Mosso. Well, I think if it were phrased to give us some maneuvering room, it would be all right, if it were phrased as an objective. But I might point out that in the process of the study in arriving at where we are today, we have seriously considered three different market rates as being most applicable. At one point we thought the Treasury bill rate would be most applicable and we used that in our tax and loan study. Subsequently, we thought the Federal funds rate might be more applicable and at the present time we think that the repurchase agreement rate is probably the best rate.

That illustrates that we need some flexibility to move as the money market develops and to select that rate which is most appropriate at a particular time.

Also, there are other variables besides rate. There's the balance that you apply it to in the whole formula. We have to factor in the fee that we are paying. So I think there's a mix of considerations here that you ought not to tie us down too tightly, but certainly to state an objective would be acceptable.

The CHAIRMAN. What's to prevent this administration or a future administration from charging concessionary rates and permitting loss

of earnings similar to what we face today and the great benefit of their friends in the banking industry and the loss to the taxpayer?

Mr. Mosso. Well, I do think then it's basically a matter of public disclosure. We have laid all of the facets of the things bare in our tax and loan study and have analyzed them to the point now where there's no mystery in it to anybody. So I don't think anybody in the future would be able to make concessions without it being rather obvious.

The CHAIRMAN. Governor Partee, would you have any objection in principle to public unit NOW accounts specifically for the benefit of State and local governments?

Mr. PARTEE. No, I wouldn't have an objection in principle. But I think they can enjoy the same arrangement in effect by having savings accounts with telephonic transfers to a small demand balance.

The only objection I would have is as following: As you know, Mr. Chairman, as a result of the bill you preferred to a year ago, you asked that we do a study of effects of payment of interest on demand deposits. We have done so. The tack that has been taken as a result of that study is development of the NOW account concept partly as a way to hold down—at least in the transition—the unknown impact of transfer funds and the impact on bank income and bank positions.

Since that concept hasn't generally contemplated NOW accounts for other than the household sector of the economy, it seems to me that the change you suggested might be somewhat disruptive. That is to say, businessmen might ask, if you're going to have NOW accounts for State and local governments, why not NOW accounts for businesses? And if you have NOW accounts for State and local governments, businesses, private individuals, and nonprofit institutions, that's essentially payment of interest on demand deposits so there would be no transitional period under which we could monitor the results of the change.

Let me just say that it's somewhat difficult in terms of the strategy on ongoing legislative proposals to include NOW accounts for State and local governments at the present time.

The CHAIRMAN. Governor Partee, you voice some concerns about the provisions of H.R. 5675 which authorize S. & L.'s to take part in the tax and loan account system in view of the fact that they typically hold a large share of their earnings assets in long-term mortgage loans while tax deposits are inherently volatile. However, Treasury regulations already require that tax and loan account deposits be fully collateralized by Treasury securities or similar liquid assets.

Do you think any additional requirements would need to be imposed in S. & L. before they were allowed to take part; and if so, why?

Mr. PARTEE. I really put that in, Mr. Chairman, as a comment to the Home Loan Bank Board rather than to the Congress. The member savings and loans have a minimum liquidity requirement—it's presently 7 percent—and that in practice does mean they have Government securities in their portfolio. They will use those Government securities, I'm sure, as collateral for the Treasury balances that they obtain. But one needs to recognize that those Treasury balances are going to be much more volatile than the average account that the savings and loans have, and if the liquidity reserve requirement of the Home Loan Bank Board is left unchanged the practical effect will be that the

actual liquidity of savings and loans will drop—perhaps to too low a level. So it seems to me there needs to be recognition that these funds are going to be in and out within 30 days, and they can't be invested in any substantial measure in long-term home mortgages.

The CHAIRMAN. You have confidence that the Home Loan Bank Board will be able to handle that?

Mr. PARTEE. Yes, I just thought that I would use this occasion to point it out to you.

[It was requested that the following letter appear in the record at this point:]

FEDERAL HOME LOAN BANK BOARD,
Washington, D.C., June 30, 1977.

HON. WILLIAM PROXMIRE,
Chairman, Committee on Banking, Housing and Urban Affairs, U.S. Senate,
Washington, D.C.

DEAR MR. CHAIRMAN: In your letter of June 22, you note the concern voiced by Mr. Partee of the Federal Reserve Board regarding the need for savings and loan associations, if they are given the authority to participate in the Treasury tax and loan account system, to hold short-term liquid assets in amounts commensurate with such accounts. You indicate that your Committee would like to have our views regarding this concern, and an opinion as to whether or not additional regulatory requirements would need to be instituted if savings and loans are permitted to participate in the Treasury tax and loan account system.

It is true, as Mr. Partee states, that the typical savings and loan holds a large share of its earnings assets in long-term mortgage loans. Yet this does not necessarily have a bearing with respect to the degree of liquidity of savings and loans and their ability to meet a Treasury call on tax and loan accounts. The reason for this is that there is a continuing and substantial volume of loan payments coming into savings and loans, as well as other significant cash flows, such as new savings, repayment of the unpaid amount of mortgages, and the sale of loans or loan participations. In addition, savings and loans generally hold liquidity in excess of regulatory requirements, primarily in the form of short-term U.S. Treasury securities, in order to meet unexpected cash needs and future loan commitments. A savings and loan which took on a tax and loan account would not necessarily have a more difficult cash flow management problem. Any necessary cash flow management expertise as an incident to participating in the Treasury tax and loan account system would be merely an extension of the type of expertise that savings and loans already require because of existing uncertainties about future cash flows and needs.

As a result, it does not appear necessary for the Board to adopt additional measures to govern savings and loans' management of their liquidity position in order to be able to meet their responsibilities as tax and loan repositories. Nonetheless, the Board realizes the need for careful consideration of the implications of savings and loan participation in the tax and loan account system.

The Board believes that the best way to deal with this is for the Board to carefully monitor insured savings and loan participation in the tax and loan account system after they obtain this authority. If it should turn out that such institutions do have problems with cash flow management incident to participation in the tax and loan account system—and we strongly doubt that they would—the Board could then consider using its present liquidity requirement authority so as to require savings and loans with tax and loan accounts to hold an appropriately higher level of required liquidity. Since the Board already has adequate authority under its existing regulatory control of liquidity requirements to do so, we do not envision that an additional regulatory scheme would need to be instituted as a result of savings and loan participation in tax and loan accounts.

Respectfully,

DANIEL J. GOLDBERG,
Acting General Counsel.

Mr. Mosso. If I might add a point to that, Mr. Chairman, the Treasury accepts a rather wide range of collateral for tax and loan accounts and much of it is not particularly liquid. Treasury securities

are a major factor, but we accept almost anything with a governmental stamp on it.

Mr. PARTEE. FHA loans?

Mr. MOSO. Yes.

The CHAIRMAN. We discussed the effect this legislation might have on bank earnings and we took the figure of \$50 to \$100 million as a possible adverse effect it would have on banks and corporations and so forth, but I understand if this legislation is enacted the Treasury intends to compensate financial institutions directly for services rendered. But I understand you intend to base the rate of compensation on data obtained in your 1974 study, even though that study had a number of shortcomings.

Mr. Mosso. That's true initially, yes, sir.

The CHAIRMAN. You rely on the banks' own report on what the services cost them and there was an extreme variation in unit costs among reporting banks. In the case of handling Federal tax deposits, the costs reported ranged from a low of 1½ cents to a high of \$3.10. That's about as wide a range as I can imagine per transaction. Are you still planning to base compensation rates on this study?

Mr. Mosso. Well, we are planning to use those as the base for our initial charges, but we will, as soon as the authority is enacted, then try to independently arrive at an estimate of what would be fair in each case.

The CHAIRMAN. How do you know you're going to save anything on this legislation if you compensate them for their services? Do you know that this compensation is likely to be relatively modest, limited, compared to the \$50 to \$100 million that you get in interest that you're not getting now?

Mr. Mosso. In calculating that \$50 to \$100 million, that was after allowing for the payment of fees at the rates in the tax and loan study. So that I think we have provided amply for the payment of fees and still came up with the net gain of \$50 to \$100 million. As times goes on, those fees will firm up as we examine them in actual working situations.

The CHAIRMAN. And how soon and how often do you intend to review those rates to determine if they are adequate?

Mr. Mosso. Well, I have no set timetable at this point, but it will be a continuous type of review and I would anticipate probably making some kind of review at least annually.

The CHAIRMAN. Presumably the larger banks receive some economies of scale. Do you intend to establish different rates of compensation for different sizes of banks?

Mr. Mosso. No, sir. I think we will have to set a uniform rate for each service that's being performed. I don't think that our study bears out the statement you just made, at least in terms of the reports we got from the tax and loan study. It's not necessarily the size of bank that determines the cost.

The CHAIRMAN. Well, the size of the bank might relate also to the size of deposit because in a particular city you're operating probably with big banks and therefore large deposits. The larger the deposit, the lower the cost to the bank per dollar, I would think.

Mr. Mosso. That is true to some extent. Well, it's true as far as size of deposit, and that does vary by size of bank. We are proposing at

the outset to make some allowance for the smaller banks in terms of a minimum balance that would not be invested. In other words, they would have a small amount that we would not invest. Therefore, they would have a nominal amount of earnings and that would help to offset the size difference.

The CHAIRMAN. One final question, Secretary Mosso. The statement submitted by the American Bankers Association asserts Treasury should compensate banks for services rendered other than those connected with tax and loan accounts or savings bonds. It mentions specifically handling IRS tax loans and levies, reporting various currency and foreign transactions, microfilming checks under the Bank Secrecy Act, and maintaining lists of designated nationals.

Do you believe that the legislation should provide for compensation for that kind of service as the ABA proposes?

Mr. Mosso. I think those should be taken up on their own merits. Most of those services are mandated by law and there was no provision made for compensation to banks.

Second, they frequently are imposed upon institutions other than banks and if there's to be compensation to one it should be to all. So that that involves a whole range of subjects that I don't believe should be brought into this legislation. The fees that we are talking about, the services that we are talking about, are those that are either directly related to the tax and loan accounts or are handled specifically by my part of the Treasury where we know what the story is and we are presently allowing credit for it in the tax loan system whereas we are not in any of these other cases.

The CHAIRMAN. Senator Lugar, do you have any questions?

Senator LUGAR. Mr. Chairman, following up your earlier question in which (I suspect), you were trying to determine the rate of interest that would be paid, if I remember your answer to the question, you felt that publicity was the major factor in determining what was fair and reasonable at that point. Do you suspect that that is more likely to be the case with regard to Federal transactions than has been the case, at least as I have observed frequently, at the State and local level where clearly one of the great problems is that many county treasurers, for example, are simply insufficiently sophisticated to make the sort of transactions they ought to or, worse still, on occasion are involved in some degree of political chicanery and are not doing so? Are you drawing a distinction at the Federal level that the searchlight of truth here is more likely to function and make certain that Federal taxpayers receive a better arrangement than would local taxpayers in some other problems and that sort of thing?

Mr. Mosso. Well, I wasn't drawing that distinction, but I think that's probably true since we are dealing here with a single highly centralized system with huge amounts of money involved and it's impossible for us to operate in that kind of environment without having the General Accounting Office and others observing what we're doing. I think when you get into the State and local area there are smaller amounts involved. There probably are services that are not as readily determinable as the factors that will be involved here at the Federal arena.

Senator LUGAR. So you were pleading still for discretion, for guidelines or objectives as opposed to some statutory language that zeros this in?

Mr. Mosso. Yes, sir. I would have no objection at all to objectives, but I think you must bear in mind that the rate of return is only—it's measurable, but it's only one factor in the total formula. We still will and do have monetary policy considerations. We have debt management considerations and we have the fact that we are dealing with soon to be almost 20,000 institutions and they vary greatly in size and location and distance from the Federal Reserve Bank. So all of those things are going to take some delicate balancing and we do need some freedom to do that and we are perfectly willing to expose what we have done and our reasons for it to the Congress.

Senator LUGAR. Would you wish to speculate—I don't want to be too general—as to why this type of legislation has not passed in recent years, why we're still at this particular point. It appears that many sectors of the public as represented in these hearings find it highly favorable. The House of Representatives passed it without the Senate voting. Why is it an idea whose time has come now as opposed to several years ago?

The CHAIRMAN. If I might intervene at this point, what happened last year is this passed the House overwhelmingly. This year it passed 384 to 0. It's a very good question why it didn't become law. I suppose it was our fault here because what we did was to add to the interest on Treasury deposits the State and local governments and that is much more comprehensive and there was quite a bit of resistance to that and we just weren't able to get it through the Senate with that language. So this year we're going to put it through without putting State and local abroad and try to get State and local through separately.

Senator LUGAR. I see.

The CHAIRMAN. Did you want to go ahead?

Senator LUGAR. I suppose I was just curious, even besides this technical problem, why, even 5 years ago—

Mr. Mosso. It wasn't until 1974 that the Treasury changed its position. It was thought within the Treasury that the earning value of the balances was offset by the services that were being rendered by banks. The last previous study was made in 1964 and again had reached that conclusion that the Federal Government was getting a fair shake. But from 1964 interest rates began to rise and when we reexamined the question we decided that some of the services that had been allowed before as compensable service probably should not be. Some of the services that the chairman was mentioning before—banks do render a number of services for the Treasury that are not compensated which we are now saying should not be compensated through the tax and loan system. It should be taken up as a separate issue.

Senator LUGAR. Is it fair to say just as a layman looks at this question that this is another step in the direction of trying to separate compensation and services? For example, this is a rough analogy, but in the NOW account situation that we are looking at in which individual investors are claiming that they ought to be compensated through interest on their accounts, some banks—not all—are saying that this

will mean that they will have to bill a number of services that have been taken for granted by the ordinary depositor, that in the past as the *quid pro quo* for not obtaining interest they offered some services. Essentially, are you saying in this much larger realm of Federal deposits that what was taken for granted in the 1964 study as some reasonable offset, by the time the 1974 study or whatever basis we now have, that's no longer so; the value of this money is substantially greater than what you believe will be a fair compensation for services to banks and, therefore, that has really changed the picture materially and that's why we are proceeding rationally into this type of legislation?

Mr. Mosso. Yes, I think that's a fair way of putting it. We have in this, as in a number of other areas, we are simply saying let's price each service on its own and we are not bundling things up and making rough judgments about what this bundle is worth versus what that bundle is worth. We are going to take them one at a time and we will pay the banks for the services that they render and we will expect them to pay us for the money that we invest with them.

Senator LUGAR. Now this leads to the question the chairman was talking about a moment ago, and that is that obviously the value of money—that is, the rate of interest to be paid—may be something due to this searchlight and the scrutiny and the overall picture that we can see better. But on the other side, the services rendered by the various financial institutions do appear to have a very wide range for transaction and for other cost bases and it just seems to me the heart of the matter then, if the taxpayer is going to receive dividends we think will come from this, is in trying to find some fair amount of determining what these charges ought to be.

Now you're suggesting the 1974 survey offers a basis to start out with, even given the enormous ranges, but how is the press taking a look at these sorts of transactions and the same way the press would take a look at the interest charges or this committee would or whoever is to have oversight going to make heads or tails out of this gamut of charges. You are suggesting that larger banks would not be given a different view than smaller banks which seems fair, but still there are going to be some banks that are a great deal more efficient than others. Some may be doing a great job of administration. How do we rationalize all of that and isn't there need for updating pretty quickly?

Mr. Mosso. Well, it isn't going to be easy. I don't want to mislead anybody that it will be easy to arrive at a rate that is fair and one that does provide reasonable compensation to the majority of banks. We think that it is essential, though, just to minimize the judgments that have to be made—we think it's essential to have a uniform rate and that means then that the rate itself would be an incentive for a bank, if it is not efficient and does not think it's getting a fair return, its one recourse will be to improve its own efficiency. Then presumably there will be banks that are highly efficient in a given type of operation and they will make some money, but I think that's inevitably a part of the system and it's a good part of the system. There will be an incentive in the fee structure for everybody to do a better job.

Senator LUGAR. And this will all be publicly disclosed. In other words, the public now will know what financial institutions are charging for specific services.

Mr. Mosso. Well, that's right. Our fees will be publicly known, yes.

The CHAIRMAN. Thank you very, very much, gentlemen. We have some questions we'd like to ask you for the record. We hope when you correct your remarks you will reply in writing on those.

[The following was received for the record:]

Written Response to Additional Questions
Addressed to Mr. Mosso

In response to your request for draft language which would indicate Congressional intent that investments be made at prevailing market interest rates while giving the Treasury sufficient flexibility to cope with a wide range of conditions, we propose the following sentence. It would be inserted at line 7 of page 2.

Investment in obligations of depositaries maintaining Treasury tax and loan accounts shall be made at rates of interest prescribed by the Secretary of the Treasury after taking into consideration prevailing market rates of interest.

Effective Date

QUESTION: The investment authority provided by H.R. 5675 is effective upon the date of enactment, according to the language of the House-passed bill.

Do you anticipate that Treasury will be in a position to use this authority immediately following the date of enactment?

If not, should the legislation provide a reasonable period of time, say 90 days, before the authority becomes effective?

ANSWER: We will need 3 or 4 months to get the investment program underway. However, there is no reason to defer the effective date. We will implement the authority as soon as possible after enactment, and all of our efforts will be directed at that objective. Nothing can be lost by having an effective date sooner than we can take advantage of it; but much can be lost by setting an effective date that might itself delay the start of the investment program.

QUESTION: Similarly, it appears to me that there should be some period of time designated, perhaps 180 days, within which the Treasury would have to develop and put into effect the regulations necessary to carry out the provisions of section 2, permitting savings and loans to participate in the tax and loan account system.

What would be a reasonable time frame for this?

ANSWER: As far as the Treasury is concerned, we expect that, with one exception, regulations to carry out the provisions of section 2 could be developed and put into effect at the same time the investment authority is extended to the commercial banks. This is because the extension to S & L's requires no significant change in Treasury regulations. That one exception is concerned with the extension of the investment authority to the institutions that are not Federally insured as provided in section 2(c). With respect to non-Federally-insured savings and loan associations, an additional short period of time will be needed -- probably not more than 4 months. Given the Treasury's willingness to extend the tax and loan system to S & L's without delay, there would seem to be no necessity for a statutory deadline.

Interest on Reserves

QUESTION: At the present time, member banks do not earn interest on reserves, but the Federal Reserve does earn interest on them. Most of those earnings are remitted to the Treasury.

Did you allow for this loss of earnings in calculating the gains to the Federal Treasury from passage of this legislation, which you estimate to be between \$50 and 100 million?

ANSWER: Yes. The reduced Federal Reserve System revenue flowing to the Treasury because of the lower reserve balances is implicit in the \$50 - 100 million estimate.

Provisos

QUESTION: The first section of H.R. 5675, as passed by the House, giving the Treasury short-term investment authority, contains two provisos. Please tell the Committee in each case whether the Treasury considers these provisos to be useful and necessary in achieving the purposes of the Act, that is, to gain the optimum return on excess cash balances, or whether you would recommend any changes. These are the provisos:

1. "That the authority granted under this section shall not be construed as requiring the Secretary of the Treasury to invest any or all of the cash balance held in any particular account;"

2. "...shall not be construed as permitting the Secretary to require the sale of such obligations by any particular person, dealer, or financial institution."

ANSWER: The Treasury does not consider these provisos to be necessary in achieving the purposes of the Act. However, the apparent intent of these provisos is consistent with our view of the tax and loan investment program, and we have no objection to them.

In-Transit Balances

QUESTION: You say that at the present time, Treasury loses earnings due to the time it takes for banks to inform the Federal Reserve of the balances they hold, because of delays in the mail, etc.

How do you intend to overcome this problem under the new legislation?

ANSWER: The in-transit balances represent tax deposits for which advices of credit are in transit between the commercial banks and the Federal Reserve Banks. The in-transit time extends from the time the tax deposit is made at the commercial bank until the advice of that deposit is received by the Federal Reserve Bank. This time is normally from one to three days, but may extend to four and five days.

Under current procedures, the Treasury cannot call the in-transit balance because it doesn't have knowledge of the amounts deposited until receipt of the appropriate advices.

Under the proposed investment authority, it is planned that the in-transit balance in excess of one day will be converted to an earning asset. To accomplish this, it is planned that the investment will be made as of the business day following the date the commercial bank accepts a tax payment from its customer, regardless of when that tax deposit is actually received by the Federal Reserve Bank. In this way, while the Treasury will not have the ability to call the funds until the advice of credit is received and processed, it will receive value for the funds as of the first day after deposit.

Costs of Present System

QUESTION: You say that the present system of drawing tax and loan account balances down quickly, in the absence of any investment authority, has exacted a toll "in the form of higher interest rates, higher transaction costs, and a generally adverse impact on the nation's economy." That's a strong statement-- especially when you say in the same sentence that "there is no way to measure the impact."

What efforts have you made to calculate the costs, and what leads you to believe that the costs are so high, in the absence of any systematic study?

ANSWER: This is a very complex area, and it is doubtful that such costs are quantifiable. It is a well-established phenomenon, however, that uncertainty in markets has a bearish influence on security prices, thereby pushing interest rates upward, and it is very evident that the current accelerated tax and loan call procedures have generated uncertainty. This has been documented in the financial press and in the day-to-day observations of the market by Treasury and Federal Reserve officials.

With the current procedures, virtually all of the volatility of Treasury deposit flows are directly transferred to the monetary system, necessitating large, frequent, offsetting Federal Reserve open market operations. The transaction cost derives from the dealer profit margins that attach to this large volume of buying and selling by the Federal Reserve. The effect on rates, and on economic activity, derives from the caution that attaches to the difficulty that the market has in ascertaining whether the Federal Reserve System is just compensating for Treasury activity or is trying to execute some basic policy objective.

Inclusion of S & L's

QUESTION: Do you believe that S & L's should be subjected to any additional collateral or related requirements?

ANSWER: With one exception, we do not believe that S & L's should be subjected to any additional collateral or related requirements. The one exception is the savings and loan associations which are insured by a state or agency thereof, or by a corporation chartered pursuant to the laws of any state. Federal insurance provides for loss recoupment through large premium reserves and stand-by borrowing authority, and for loss prevention through regulations and periodic examination. We are not aware of the details of the several non-Federal insurance arrangements and do not know if they provide comparable protection. We would use institutions covered by a particular insurance plan only after satisfying ourselves that the risks were within reasonable bounds, and this might entail additional regulatory requirements.

DEPARTMENT OF THE TREASURY,
Washington, D.C., June 24, 1977.

HON. WILLIAM PROXMIRE,
Chairman, Committee on Banking, Housing and Urban Affairs, U.S. Senate,
Washington, D.C.

DEAR MR. CHAIRMAN: At the time of the hearings on H.R. 5675, you also requested my views on certain amendments proposed by the Credit Union National Association. The amendments are intended to give credit unions parity with other financial institutions participating in the tax and loan account system.

We have reviewed the proposed amendments and the Credit Union National Association correspondence which you furnished, and I have the following comments:

1. Heretofore, credit unions have not been arbitrarily barred from participating in the tax and loan account system. Credit unions, by their nature, are consumer-oriented in that one of their stated purposes is to "... make more available to people of small means credit for provident purposes through a national system of cooperative credit." On the other hand, tax and loan deposits are made by business firms. The tax and loan system is designed to allow a business concern to make tax payments through the institution maintaining its transactional account and, currently, transactional accounts are primarily the purview of the commercial banks. The company's check does not have to flow beyond that bank since the bank charges its customer's account and simultaneously credits the Treasury tax and loan account. This arrangement avoids delays due to check clearings and makes the full amount of the deposit available to the Treasury in the fastest possible way with the least operating expense. Since credit unions have not maintained the transactional accounts of business firms to any significant extent, from the Treasury's viewpoint they have not been in a position to further the objectives of the Treasury's tax collection mechanism.

2. As of the end of 1975, there were approximately 23,000 credit unions throughout the country having an average size of \$1.7 million. Should H.R. 5675 be enacted so as to embody savings and loan associations and credit unions in the tax and loan system, over 20,000 additional institutions could be eligible to participate (bringing the system potentially to over 34,000 institutions). An increase of that size would undoubtedly increase substantially the operational costs of the present system, while the volume of the deposits collected through the system would generally remain unchanged. We would have to carefully weigh the impact of such a potentially massive increase on both the operating efficiency and the administration of the system by Treasury and in the Federal Reserve Banks.

3. On the second page of its letter, the Credit Union National Association paraphrases a statement by Chairman Parren J. Mitchell of the House Subcommittee on Domestic Monetary Policy, to support its position that the tax and loan system should be expanded to include State-chartered, insured credit unions. Specifically, the Credit Union National Association statement is as follows:

"Including insured (credit unions) in the tax and loan account system will not pose a problem on the assurance of financial condition because all depository institutions under the proposed investment authority must pledge collateral in order to receive TT&L deposits. If individual (credit unions) cannot pledge collateral, they cannot receive TT&L deposits."

It is important to note that while the Treasury takes collateral security for the amount of known deposits with a bank, the flow of funds through accounts is such that the Treasury cannot be currently aware of the deposits received by banks for which information is in transit and not yet recorded in the system. Hence, the Treasury is vulnerable to careless or fraudulent acts on the part of institutions handling Government accounts, and the mere satisfaction of collateral pledging requirements does not provide absolute protection against losses resulting from such acts.

I appreciate the opportunity to comment on these amendments before their formal consideration.

Sincerely yours,

DAVID MOSSO,
Fiscal Assistant Secretary.

The CHAIRMAN. We are now going to have a distinguished panel: Rex Morthland, representing the American Bankers Association; Orlanda Darden, representing American Savings & Loan League; David Harper, accompanied by Samuel Foggie, representing the National Bankers Association; Richard S. Lawton, representing the National Savings & Loan League; and Edwin B. Brooks, Jr., representing the U.S. League of Savings Associations.

Gentlemen, we have a substantial panel here. It's past 11 o'clock, so we hope you can confine your oral remarks if possible to 5 minutes or so and we will be glad to print the entire statement in full in the record.

Mr. Morthland, go right ahead, sir.

**STATEMENT OF REX J. MORTHLAND, REPRESENTING THE
AMERICAN BANKERS ASSOCIATION**

Mr. MORTHLAND. Thank you, Mr. Chairman.

I will submit my written statement and make a brief summary.

The American Bankers Association favors the enactment of section 1 of H.R. 5675, but as a matter of equity and fairness within the financial system it opposes the enactment of sections 2 and 3 of the bill.

These sections 2 and 3 represent a significant expansion of the power of savings and loan associations. It is an additional movement by these associations into the area of demand deposit services and, more significantly, it relates directly to business accounts rather than to the accounts of individuals and families which has been the area that the savings and loan associations have claimed as their major interest.

We understand that Congress soon will consider legislation which would redefine the powers and responsibilities of financial institutions. We believe that would be the proper time to consider extending the power of maintaining Treasury tax and loan accounts to savings and loan associations.

Thank you.

The CHAIRMAN. Thank you very much.

[Complete statement follows:]

STATEMENT OF REX J. MORTHLAND
ON BEHALF OF THE
AMERICAN BANKERS ASSOCIATION
BEFORE THE
SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
ON H.R. 5675, TREASURY INVESTMENT OF OPERATING CASH BALANCES

June 6, 1977

Mr. Chairman, my name is Rex J. Morthland, Chairman of the Board, Peoples Bank and Trust Company of Selma, Alabama. I am a past president of the American Bankers Association and presently am a member of its Board of Directors. We appreciate this opportunity to present the views of our Association on H.R. 5675.

The American Bankers Association is in complete agreement with the U. S. Treasury's cash management objective of obtaining an appropriate return on its idle liquid funds. In furtherance of that objective we support Section 1 of H.R. 5675 which would permit the Treasury to invest its tax and loan funds in interest bearing obligations. However, we are firmly opposed to those portions of Sections 2 and 3 which would permit savings and loan associations to become Treasury tax and loan account depositories ^{without} providing conditions of competitive equity which are fundamental to changes in powers.

Investment of Treasury Operating Balances

Section 1 would permit the Secretary of the Treasury to invest any portion of the Treasury's operating cash for periods up to 90 days in (1) open-end obligations of depositories maintaining Treasury tax and loan accounts secured by a pledge of acceptable collateral and in (2) obligations of the United States and its agencies.

We approve any fair and reasonable method of calculating the earning rate on invested Treasury balances. Previous testimony of Treasury witnesses indicates this rate would be related to (but not in excess of) the Federal funds

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rate on interbank lending or the rate applying to repurchase agreements on Government securities arranged by the Federal Reserve System.

Any depository would have the option of transferring tax and loan balances immediately to the Federal Reserve rather than paying interest on the funds invested for the Treasury in their own obligations.

Treasury Cash Management and Monetary Policy

Nearly all of the more than 14,000 banks in the country maintain Treasury tax and loan accounts. Tax and loan funds are created by the transfer of internal revenue taxes paid by business firms from the taxpayer's account in the taxpayer's bank to the Treasury's tax and loan account in the same bank in most cases. This is a simple collection system which minimizes time needed to collect Treasury funds.

Before October 1974, these tax payments remained temporarily in the banks where the funds originated. When needed to meet Treasury disbursements, the funds were transferred to the Treasury's account with the Federal Reserve Banks. Any transfer of tax and loan funds from the banks to the Federal Reserve causes a substantially equal reduction of bank reserves. Then, when funds are disbursed from the Treasury's account in the Federal Reserve Banks the reduced reserves are restored. These tax and loan fund transfers from the banks to Federal Reserve Banks and the subsequent reflows through Treasury disbursements can have severe destabilizing effects on the money market unless they occur almost simultaneously.

Until October 1974, the monetary impact of such transfers was minimized because tax and loan funds were transferred from the banks to the Federal Reserve Banks approximately as needed for disbursement by the Treasury. This procedure did produce a large volume of idle Treasury balances in the banks at times, but until 1974, it was generally thought that the earning value of the tax and loan funds to banks was largely offset by the cost of bank services to Federal agencies.

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The report on a Treasury study in 1974 concluded that the earnings value of tax and loan funds at the then currently high interest rates was significantly greater than the costs of services to the Treasury. Since the Treasury was not legally permitted to earn a return on its idle funds, the present tax and loan account procedure was instituted in October 1974. It involves rapid withdrawal of the major part of tax and loan funds from the banking system and a buildup in the Treasury's account at the Federal Reserve Banks. In consequence, the Treasury's tax and loan account balances in the banking system declined sharply: from an average of about \$5 billion before the fall of 1974, to about \$1-1/2 billion (See Table 1 attached).

The Treasury indirectly derives increased income from its larger balances in the Federal Reserve. The Federal Reserve invests these increased balances in Treasury and agency securities. This increases earnings of the Federal Reserve System which flow through to the Treasury since nearly all of the System's net income after dividends is paid to the Treasury.

The present tax and loan procedure, however, creates serious problems in controlling the money supply. When tax and loan funds are withdrawn from the banking system and Treasury balances in the Federal Reserve Banks build up, the Federal Reserve purchases securities to prevent a decrease in the money supply. Later as the funds are disbursed out of the Treasury's account at the Reserve Banks, offsetting open market sales by the Federal Reserve are made to prevent an increase in money supply. These large scale compensatory open market operations are unsettling and add an element of uncertainty to monetary management because the effects of open market operations in a given market are not exactly predictable. The Federal Reserve has expressed considerable concern about the monetary effects of this present tax and loan process, and the Treasury and the banking system share that concern. Section 1 of H. R. 5675 would largely

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eliminate this element of potential money market instability created by the Treasury's present cash management procedure.

Treasury Tax and Loan Accounts in Nonbank Institutions

Sections 2 and 3 of H.R. 5675 would permit qualifying savings and loan associations to act as Treasury depositories, to receive Federal taxes by opening Treasury tax and loan accounts, and to issue interest bearing obligations to the Treasury. The American Bankers Association opposes this expansion of powers of savings and loan associations until conditions of competitive equality between types of regulated financial institutions are established.

The Treasury's tax and loan account procedure is essentially a tax collection system based on demand deposits. Tax and loan accounts are demand deposits. Currently savings and loan associations are not authorized to maintain demand deposits. Permitting them to maintain Treasury tax and loan accounts then is a significant broadening of powers. Accordingly, the powers described in H.R. 5675 could be granted only if savings and loan associations are subject to the same reserve requirements and the same interest rate ceilings.

In banks, the Treasury's tax and loan account system is a very efficient method for speeding up the collection of taxes since the funds are transferred from the demand accounts of business firms to the Treasury's account generally in the same bank on the same day. No similar system exists for savings and loan associations. The deposit and withdrawal of Treasury funds into and from savings and loan associations would be made through the banking system. This would introduce unnecessary transactional activity with little perceivable benefits to savings and loan associations.

The offsetting benefits of tax and loan accounts to savings and loan associations are likely to be very small because these funds are clearly not suitable for home mortgages. Use of T&L funds for that purpose would be an

extreme case of borrowing short-term and lending long-term. The fact is that tax and loan accounts are highly volatile as evidenced by data in the attached tables. For example, as shown on Table 1, in 1973, the last full year before the Treasury began to transfer the major portion of tax and loan funds from banks to its accounts at the Federal Reserve, the daily tax and loan balances at banks ranged from a high of \$10.9 billion to a low of \$0.5 billion, a 20-time difference between low and high. The swings within each month are also very erratic. In September of the same year (1973), daily tax and loan balances ranged from \$0.5 billion to \$6.6 billion, a 12-time difference (See Table 2 for the monthly ratios of highs to lows).

This circumstance brings into serious question whether any significant amount of these funds could be used even for qualifying consumer loans that have much shorter maturities than home mortgages. The degree of tax and loan account volatility also raises questions of savings and loan vulnerability to liquidity problems due to the Treasury's collateral requirements. These institutions hold only small amounts of Treasury or Federal agency securities. They are held mainly as liquidity reserves and thus would not be available to collateralize obligations issued to the Treasury. Consequently, savings and loan associations would be required to invest most of the funds derived through their tax and loan accounts in short-term government securities suitable for pledging purposes. Only the small amount of tax and loan funds remaining would be available for other uses.

Cost of Bank Services to Treasury Agencies

Banks perform a number of mandatory services for the Treasury in addition to those related to tax and loan accounts. Although the Treasury has agreed that banks should be compensated for such services, it is intended in connection with H.R. 5675 to cover only the maintenance of tax and loan accounts and

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related activities and the handling of savings bonds. No provision, however, has been made for offsetting the costs of certain other services that banks are required to perform for Treasury agencies. These include: handling IRS tax liens and levies, maintaining records and reporting various currency and foreign transactions, keeping records and providing reports on the volume of the Treasury's foreign assets control operation, microfilming checks under the Bank Secrecy Act, and maintaining lists of "Designated Nationals."

The unit costs and the overall workloads involved in all of the services banks perform for Treasury agencies have increased greatly since the Treasury's 1974 study. Our Association firmly believes that a provision of adequate compensation for all such services be made a part of this legislation. Otherwise, there is little likelihood that the costs of servicing the Treasury, except in the narrowly defined area related to tax and loan accounts and savings bonds, will ever be addressed. Moreover, if reimbursement for services is made a budgetary requirement, requests for information are more likely to be minimized and limited to material truly needed.

Conclusion

The American Bankers Association is fully in accord with the objective of Section 1 in H.R. 5675 which would permit the Treasury to earn interest on its idle cash balances, given a reasonable rate of interest to be paid by depositories on the funds involved. Our Association agrees with the Treasury and the Federal Reserve desires to eliminate the current cash management procedure which severely interferes with the smooth functioning of the money market and complicates the task of reaching monetary policy objectives.

The Association opposes the provisions of Sections 2 and 3 which would permit savings and loan associations to act as Treasury depositories and to hold tax and loan accounts. The Treasury is on record as saying that all depository institutions would be treated alike. However, the granting of tax

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and loan depository powers -- tantamount to conferring demand deposit powers on savings and loan associations -- without requiring the same competitive ground rules as for banks would be inequitable and should be considered in the broader context of overall financial institutions reform. In addition, the obvious volatility of these balances and mandatory pledging requirements would clearly preclude using such funds in any significant amount for housing finance and probably even for consumer loans.

Finally, the American Bankers Association believes it appropriate and equitable to request a provision in H.R. 5675 that would require the reimbursement of commercial banks for certain rapidly growing services they provide to Treasury agencies.

We appreciate this opportunity to present our views on H.R. 5675.

Table 1

U. S. Treasury Tax and Loan Accounts							
Monthly High, Low and Daily Average Balances							
(in billions of dollars)							
Under Procedure Before October 1974				Under Procedure Beginning October 1974			
	High	Low	Daily Average		High	Low	Daily Average
1972-Jan.	8.2	4.5	6.1	1974-Oct.	4.8	0.2	1.5
Feb.	7.6	3.0	5.7	Nov.	2.4	*	0.9
Mar.	8.3	4.1	6.3	Dec.	3.9	0.4	2.1
Apr.	9.7	3.6	5.9				
May	10.3	7.4	9.2	1975-Jan.	3.1	0.4	1.7
June	7.6	2.3	4.9	Feb.	2.1	0.3	0.8
July	7.3	3.2	5.7	Mar.	3.7	0.1	1.4
Aug.	5.9	2.3	3.8	Apr.	5.4	0.1	1.5
Sept.	8.1	0.8	3.8	May	6.3	0.8	2.2
Oct.	8.0	3.0	5.3	June	3.6	0.1	1.5
Nov.	6.8	2.8	4.7	July	2.5	0.7	1.2
Dec.	8.9	1.5	5.2	Aug.	1.6	0.1	0.6
				Sept.	3.0	0.1	1.5
1973-Jan.	8.8	3.2	6.2	Oct.	3.0	0.7	1.4
Feb.	10.9	5.4	7.8	Nov.	2.2	0.9	1.4
Mar.	10.3	5.8	8.2	Dec.	4.1	0.4	1.6
Apr.	9.7	1.9	5.9				
May	9.5	3.9	6.7	1976-Jan.	2.2	0.2	1.3
June	8.7	1.4	4.4	Feb.	3.0	1.1	2.0
July	8.3	2.6	4.6	Mar.	3.2	0.5	1.4
Aug.	4.2	1.6	2.3	Apr.	2.7	0.2	1.1
Sept.	6.6	0.5	2.9	May	2.8	0.7	1.5
Oct.	6.0	2.6	4.1	June	4.3	0.4	1.8
Nov.	4.8	0.9	2.5	July	2.5	0.3	1.2
Dec.	7.8	1.0	3.7	Aug.	2.9	0.3	1.5
				Sept.	4.5	0.3	2.1
1974-Jan.	8.3	3.4	5.8	Oct.	2.3	0.6	1.5
Feb.	6.9	2.7	4.4	Nov.	2.6	0.3	1.5
Mar.	6.9	1.6	4.2	Dec.	4.2	0.3	1.5
Apr.	8.6	0.5	3.6				
May	9.3	3.2	5.5	1977-Jan.	2.9	0.3	1.4
June	6.8	0.8	3.4	Feb.	3.0	0.4	1.4
July	7.2	1.7	3.4	Mar.	5.9	0.3	1.5
Aug.	3.1	0.6	2.2	Apr.	6.3	0.2	1.9
Sept.	5.5	0.7	3.1				

* Less than \$0.05 billion

Source: Monthly Treasury Bulletin

Table 2

Ratios of Treasury Tax and Loan Account Daily High Balances
Within Each Month to Daily Low Balances

Under Procedure Before October 1974		Under Procedure Beginning October 1974	
	Ratio <u>1/</u>		Ratio <u>1/</u>
1972-January	1.8	1974-October	28.8
February	2.5	November	344.0
March	2.0	December	10.4
April	2.7		
May	1.4	1975-January	8.1
June	3.4	February	8.0
July	2.3	March	58.4
August	2.5	April	66.8
September	10.2	May	8.3
October	2.7	June	57.7
November	2.5	July	3.9
December	6.1	August	23.9
		September	44.5
1973-January	2.7	October	4.2
February	2.0	November	2.5
March	1.8	December	11.5
April	5.2		
May	2.4	1976-January	8.8
June	6.4	February	2.6
July	3.2	March	7.1
August	2.6	April	11.6
September	12.1	May	4.0
October	2.3	June	12.0
November	5.4	July	8.7
December	8.1	August	10.1
		September	13.1
1974-January	2.4	October	3.8
February	2.5	November	8.8
March	4.4	December	12.6
April	16.5		
May	2.9	1977-January	9.5
June	8.1	February	8.1
July	4.2	March	19.5
August	4.9	April	31.7
September	8.0		

1/ High daily balance divided by the low daily balance within the month.

Note: Ratios are based on high and low balances rounded to nearest million dollars.

The CHAIRMAN. Mr. Darden.

**STATEMENT OF ORLANDO W. DARDEN, REPRESENTING AMERICAN
SAVINGS & LOAN LEAGUE**

Mr. DARDEN. Thank you, Mr. Chairman.
[Complete statement follows:]

AMERICAN SAVINGS AND LOAN LEAGUE, INC.

SUITE 224 • WOODWARD BUILDING
733 FIFTEENTH STREET, N.W. • WASHINGTON, D.C. 20005
(202) 628-5624

June 3, 1977

Honorable William Proxmire, Chairman
Committee on Banking, Housing and
Urban Affairs
Room 5300
Dirksen Building
Washington, D.C. 20510

Dear Chairman Proxmire and Members of the Committee:

As a member of the Legislative Committee of the American Savings and Loan League and its seventy-seven member minority owned and operated savings and loan associations in twenty-four states and the District of Columbia, I am pleased to have this opportunity to present our views in support of H.R. 5675.

The American Savings and Loan League strongly supports H.R. 5675 as introduced by Chairman Parren Mitchell of the House Domestic Monetary Policy Sub-committee and passed by the House of Representatives. We believe that the legislation, as proposed would create several advantages for savings and loan associations. It would:

1. balance the inequities of the current tax and loan collection system in its exclusion of savings and loan associations as depository institutions,
2. permit equitable compensation to savings and loan institutions for services they render to the Treasury Department,
3. help moderate the economic swings which affect deposit flows to savings associations, and
4. promote the success of minority owned and operated savings and loan associations, as has been the current policy with regard to minority banks.

First, let me briefly discuss the inequities that currently exist among financial institutions as they relate to their inclusion in the tax and loan account system. The Treasury Department has confirmed that in past years close to two-hundred and sixty million dollars in net revenues have been foregone annually by the Department's not having investment authority and thereby earning little or no interest on tax and loan accounts. Due to this loss, taxpayers have suffered.

A FORCE WITHIN A MOVING ECONOMY

Honorable William Proxmire
June 3, 1977
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General consensus among supporters of this legislation is that the Treasury Department has a duty to maximize the utilization of public revenue and thereby promote sound fiscal management. The Federal Home Loan Bank Board, in its presentation to the House Sub-committee on Monetary Policy stated, "...in light of the apparent present interest in revising the management of public funds authority, it is the Board's view that it is an opportune time to make provision for thrift association participation in the program." The Banking Committee's report affirmed the fact that mutual savings banks are already in the system and Federally chartered credit unions were made eligible to act as depositories by statute. We believe that by placing a portion of tax and loan accounts in the savings and loan industry, the list of eligible tax and loan depositories would be broadened. Consequently, Congress would provide a benefit for taxpayers--a greater public convenience--and would obtain optimum use of Treasury funds.

Passage of H.R. 5675 would permit equitable compensation to savings and loan associations for services they render to the Treasury Department. The commercial banking business has long justified its absolute monopoly and the interest free use of tax and loan account funds by stating that it performs other services for the Government for which it is not adequately compensated. We might point out that savings and loan associations also perform many of these same services--such as sale and redemption of U.S. Savings Bonds. However, unlike banks, they are not paid a fee by the Treasury for processing such transactions. Savings associations also provide a significant service to the Treasury and its customers by annually reporting interest earned on deposits through the 1099 Tax Forms. In recent years, savings and loans have joined in offering direct deposit services to Social Security and Railroad Retirement recipients. Many associations also cash Treasury checks, sell food stamps, distribute tax forms, and sell commemorative coins such as the Bicentennial quarters and half dollars. Such services to the public do not justify the interest free use of these public monies.

As you know, the savings and loan industry has long advocated that tax and loan account deposits be permitted at insured savings associations and housing-oriented lending institutions. Tax and loan accounts are expected to help moderate the economic swings which affect deposit flows to savings and loan associations, and consequently the funds available for mortgage lending. Opponents to the inclusion of savings and loans within the bill have argued that Treasury balances--either in deposit form or in short term obligations--are extremely volatile. As such, the question is whether any significant portion of these funds could be used for home mortgages or other normal S&L loans.

Honorable William Proxmire
June 3, 1977
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In answer to that question, the liquidity problem is not new to savings and loans. We recognize that these accounts remain in a depository institution for a very short time, but, as with commercial banks, authority has been given to savings and loans to make short term investments, which we do regularly. Minority S&Ls particularly are very familiar with volatile accounts, for they have experienced some of the widest and most erratic swings in volumes of deposits. The entire savings and loan industry is fully equipped to handle tax and loan accounts and we feel that the passage of this legislation will help moderate the economic swings which affect deposit flows by providing more money to be used.

Favorable treatment of this bill would also indirectly promote the success and development of minority owned and operated S&Ls. It is our understanding that the tax and loan account system has provided a Government sponsored means of encouraging the growth of minority owned and operated commercial bank institutions for the past seven years. Similarly, the minority owned and operated savings and loan associations which form the American League are providing important thrift and home-ownership services in our communities. On April 8, President Carter gave his support to the minority bank deposit program and called for renewed emphasis with a goal of one-hundred million dollars for deposits by the end of 1977. We do not challenge the administration's recognition of the worth of the minority bank program, but, we strongly believe that our minority owned and operated savings and loan associations deserve an opportunity to participate in the Federal Government's program designed to encourage minority financial institutions. Broadening the eligibility for tax and loan accounts as contained in H.R. 5675 is an important step toward achieving that goal.

No one can challenge the competency of the S&L industry to handle tax and loan accounts. In the estimation of many observers, S&Ls have successfully adopted on-line and other modern computer technologies. In order to receive tax and loan deposits, eligible S&Ls would have to pledge collateral. If individual S&Ls cannot pledge collateral, no funds can be received. This covers the issue of assurances on the financial condition of eligible savings and loan associations.

In conclusion, we repeat our support for H.R. 5675 as has the Treasury Department, the House Monetary Sub-committee, and others here before this honorable committee. We therefore urge the Senate Banking, Housing and Urban Affairs Committee to speedily process this legislation so that it might be favorably considered by the entire Senate.

Thank you.

Orlando W. Darden
Member
ASLL Legislative Committee

The CHAIRMAN. Thank you, Mr. Darden.
Mr. Harper.

STATEMENT OF DAVID B. HARPER, ACCOMPANIED BY SAMUEL L. FOGGIE, REPRESENTING THE NATIONAL BANKERS ASSOCIATION

Mr. HARPER. Mr. Chairman and members of the committee, my name is David Harper, and I am president of the Gateway National Bank in St. Louis, Mo. Appearing with me is Samuel L. Foggie, president of the United National Bank of Washington, D.C. I am currently serving as chairman of the Government Relations Committee of the National Bankers Association—the trade association for the Nation's minority-owned banks.

We welcome this opportunity to appear today in support of H.R. 5675, a bill to authorize the Secretary of the Treasury to invest public moneys and for other purposes.

Mr. Chairman, in lieu of reading the statement, we have presented this a couple of times in the testimony to the House for the S. & L.'s and other banks involved. Our case has been made very clearly I think. It was adopted by the Government Relations Committee prior to this and set out both times in front of the House, and it's supported by the Treasury. We are open for questions.

The impact on minority banks would be severe. The various administrations, executive administrations and legislative and Treasury administrations have supported this method to support minority banks over the years and the banks have grown from 27 to 85 banks specifically as a result of this support. At this time if this is kind of yanked out from under us, the business in effect, we are looking for a 5-year phaseout to allow us to reorganize and regain or restructure the support we have been receiving from these corporations.

The other point we want to make is this program has been the least expensive program of the Federal Government with major corporations to support minority communities. We see great support in our communities as a result of this and we would like to have some method to phase it out.

The CHAIRMAN. Thank you very much, Mr. Harper.

Mr. FOGGIE. I don't have anything particular to add to this, just to emphasize the point that a 5-year phaseout of the method that's used now would give the minority banks the benefit to regroup and, of course, we are naturally concerned about earnings and of course a lot of the banks are having a difficult time now in earning a profit and this would completely cause serious problems with these banks as to their very existence.

I'd be glad to answer any questions.

The CHAIRMAN. I understand that a 5-year phaseout as you say is supported by the Treasury and they would accomplish that through report language.

Mr. HARPER. Yes.

The CHAIRMAN. All right. We'll be back with questions.

[Complete statement follows:]

STATEMENT OF
DAVID B. HARPER AND SAMUEL L. FOGGIE
FOR THE NATIONAL BANKERS ASSOCIATION
BEFORE THE SENATE COMMITTEE ON BANKING, HOUSING
AND URBAN AFFAIRS
June 6, 1977

Mr. Chairman and members of the Committee, my name is David Harper, and I am President of the Gateway National Bank in St. Louis, Missouri. Appearing with me is Samuel L. Foggie, President of the United National Bank of Washington, D.C. I am currently serving as Chairman of the Government Relations Committee of the National Bankers Association -- the trade association for the nation's minority owned banks.

We welcome this opportunity to appear today in support of H.R. 5675, a bill to authorize the Secretary of the Treasury to invest public moneys and for other purposes.

Since this bill has been passed twice by the House of Representatives and was approved last year by your Committee, we do not believe it is necessary for us to go into the complete background of the legislation. However, I do want to make a brief statement to point out how two separate developments converged which have adversely affected minority banks.

As you know, Members of Congress have questioned the Treasury Tax and Loan Account system for years. They have long felt that the Treasury should be earning some return on idle funds in banks. In 1974 a bill with 122 sponsors was introduced in the House which would have achieved that result. The Treasury, aware of the Congressional interest, was in an awkward situation. With interest rates at a high level Treasury officials realized that they could not earn any return on these funds without enabling legislation. So instead, they stepped up the rate of withdrawals to squeeze the balances down to a bare minimum.

The second development started in 1970 when the Government launched the minority bank deposit program. Part of that program was directed at Government

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agencies and departments that utilize banks to carry out their basic functions. This program has continued to grow and on Thursday, April 28, while meeting with the board of directors of the National Bankers' Association, President Carter pledged his full support to continuing and expanding this program.

The other aspect of the deposit program was a drive by government and business to get corporations in the private sector to use minority banks wherever possible. Many corporations responded by paying part of their taxes through minority banks. In 1970 when the program was started the minority banks had the use of these funds for approximately 20 days before they were called in by the Treasury Department. As the volume increased, the minority banks, for the most part, were reclassified and the balances were held on average for only nine days. In 1974, when the Treasury put the squeeze on all Tax and Loan Account balances, we found we had the use of the funds for only three days. In fact, in many cases we have use of the funds for less than three days because our posted balances include uncollected funds.

This speed-up in Tax and Loan withdrawals has already had a dramatic impact on minority banks. Between 1974 and the end of 1976, total deposits in the nation's 85 minority owned banks dropped by approximately \$200 million. The Treasury Tax and Loan Account system has been in existence since 1917, and it has served its function well. Minority banks did not invent it. Nor did we seek a special classification or status under the system. It was there and minority banks, with the help of government and business, used it to attract funds into minority communities for a brief period before the money went to the Treasury.

The Tax and Loan Account was a very convenient way for major corporations to put funds to work to help develop minority business and minority communities. Our organization -- the National Bankers Association working primarily with the Department of Commerce and the Treasury Department -- has for six years been conducting a broad-based campaign to encourage corporations to use our banks.

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We believe in the objectives of H.R. 5675. We think the Treasury should have the flexibility to manage its funds as other financial managers do. However, in implementing this new Tax and Loan Account system we are asking that the Treasury Department be allowed to work out a five-year phase-in system for minority banks. This would give our banks the needed time to devise new relationships with the many corporations that have been paying part of their taxes through minority banks.

The Treasury Department is aware of and sympathetic to our problem and has so testified before the Committee on Banking, Finance and Urban Affairs of the House and before this Committee last year. Treasury officials have stated that if it is the intent of Congress they will devise a phase-in program. H.R. 5675 gives the Treasury the needed authority. If the Senate concurs with the House on this legislation, we can work out the program directly with Treasury.

In closing, Mr. Chairman, we respectfully request that this legislation be moved as expeditiously as possible. It is non-controversial, in fact, it has passed the House twice by unanimous votes. Minority banks are a very small fraction of the 14,000 banks participating in the Tax and Loan Account System. Yet, delay in passing this legislation is having the greatest impact on our banks.

We thank you for this opportunity to present our views and we will attempt to answer any questions the Committee might have.

The CHAIRMAN. Mr. Lawton.

**STATEMENT OF RICHARD S. LAWTON, REPRESENTING THE
NATIONAL SAVINGS & LOAN LEAGUE**

[Complete statement follows:]

STATEMENT OF RICHARD S. LAWTON

on behalf of

The National Savings and Loan League

before the

Senate Committee on Banking, Housing and Urban Affairs

on

Tax and Loan Accounts

June 6, 1977

Mr. Chairman and members of the Committee, my name is Richard S. Lawton. I am President and Chairman of the Board of Washington-Lee Savings and Loan Association of McLean, Virginia. I appear here today on behalf of the National Savings and Loan League and its member associations located throughout the United States.

The National League appreciates this opportunity to present its views on H.R. 5675 which passed the House of Representatives unanimously on April 25, 1977. As you know, the bill would enable the United States Treasury to obtain an investment return on funds maintained in tax and loan accounts which now produce no income to the Treasury, and would authorize savings and loan associations to be depositories of public monies and perform the collection and remittance functions associated with such accounts.

The National League has urged for many years that savings and loan associations be eligible depositories for tax and loan

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funds and that the Treasury be paid an adequate return on the balance maintained in these accounts.

In all candor, Mr. Chairman, the day has long passed when financial institutions, such as savings and loan associations which manage over \$400 billion in assets, are members of Federal agencies created by the Congress, and thousands of which are chartered directly by the Federal government, can justifiably be excluded from rendering tax and loan account services to the Federal Treasury and the tax paying public.

The empty cliches advanced over the years to preserve this inequitable treatment of savings and loan associations are now recognized for what they are -- without substance, an unjustifiable cost to the United States Government, a needless inconvenience to taxpayers, and totally without legislative merit.

One of the perennial arguments advanced in support of the maintenance of commercial bank monopoly of tax and loan account privileges was that the volume and volatility of tax and loan balances was incompatible with savings and loan association operations since we are basically long-term residential lenders. This was nothing more than a complete distortion of the financial facts of life.

In the calendar year just ended (1976) the flow of funds in and out of the nation's savings and loan associations amounted to more than \$437 billion. Savings receipts, savings withdrawals, and mortgage payments received amounted to \$358 billion, while funds involved in the closing of new mortgage loans accounted for the balance.

As a matter of fact, fund flows were even greater than those just enumerated when the daily management of the almost \$40 billion in cash and government securities owned by associations are included, a substantial portion of which is composed of day to day money-market investments of the kind desired for tax and loan fund collateralization.

Transactions associated with tax and loan accounts obviously would impose no managerial or market problems for our associations which already are accustomed to handle close to \$2 billion in financial transactions during the normal business day. The inclusion of tax and loan account balances on association books could only have the desirable effect of increasing funds available to the home buying public, particularly during periods of monetary restraint.

Tax and loan accounts, as this Committee well knows, are composed primarily of tax payments by businesses which the latter make through their local banks. The company's check does not have to flow beyond its local bank since the bank merely debits its business customers account and simultaneously credits the Treasury tax and loan account.

The Treasury then calls on these balances as it requires for transfer to its federal reserve account in order to meet its payments. While the balances remain in the depository bank they yield no income to the Treasury. The investment income from these balances is retained by the bank in their entirety.

My own association's tax payments are made in this manner. I can see no reason why these payments generated by my association's

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activities are needlessly required to pass interest free through another financial intermediary on their way to the Treasury.

As a matter of fact my association has many business-employer savings account investors who are primarily engaged in residential construction, sales, and development that could be serviced in the same manner without the burden and cost of additional financial transactions which the present prohibitions imposes.

I can assure you that my association and thousands of others would like very much to have the opportunity to render this service to our corporate account holders and thus increase the funds available to those seeking housing accommodations, as well as augmenting Treasury revenues.

Opponents of this legislation have, obviously with tongue in cheek, maintained that savings and loan associations would not have sufficient securities to adequately collateralize tax and loan deposits. This is another statement without substance. As a matter of record, savings and loan associations currently have liquidity investments amounting to about \$40 billion, most of which are invested in Treasury securities. In fact, savings and loan association liquidity investments are almost four times greater than those of mutual savings banks, yet the latter are eligible tax and loan account depositories.

We have always advocated, and still do, that tax and loan deposits be adequately collateralized and that the Treasury be reimbursed -- interest wise -- for the funds it maintains in these accounts.

In these days of searching public, congressional, and executive department concerns about inflation and federal budget deficits, and the need for balancing expenditures with revenues, it is difficult to understand why the Congress should countenance, contrary to researched Treasury studies and testimony on this very legislation, an unnecessary and indefensible federal income shortfall of from \$50 million to \$100 million which the present treatment of tax and loan accounts entails.

The income shortfall to the Treasury may even be greater than the \$100 million the Treasury estimates it lost last year. During 1976 the Treasury estimates its operating cash balances averaged \$8.8 billion, consisting of \$7.3 billion at the twelve Federal Reserve Banks and \$1.5 billion at commercial banks in tax and loan accounts. Treasury balances have been running considerably higher than normal this year as a result of abandonment by the Administration of the tax rebate and grant portion of its fiscal stimulus program.

The interest free treatment of tax and loan accounts was often justified as a quid pro quo for the services which tax and loan depositories rendered for the Treasury. In fact, savings and loan associations provide most of these same services and without any direct or indirect compensation. Here I have reference to the cashing of Treasury checks, the issuance and redemption of savings bonds, issuance of food stamps, handling of U. S. commemorative coins, and the reporting of interest payments to Internal Revenue on Form 1099 and the stocking and making available of Internal Revenue tax forms to the general public.

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Mr. Chairman, the objectives of this legislation are clear and uncomplicated. The bill would increase Treasury revenues and remedy an inequity between depository financial institutions that has been permitted to exist for far too many years. This Committee and the Congress can render a real service to the tax paying public and the American home saver by the enactment of H.R. 5675. We appreciate your interest in this measure and urge its early adoption.

The CHAIRMAN. Thank you, Mr. Lawton.
Our final witness is Mr. Brooks.

**STATEMENT OF EDWIN B. BROOKS, JR., REPRESENTING THE U.S.
LEAGUE OF SAVINGS ASSOCIATIONS**

[Complete statement follows:]

STATEMENT OF ED BROOKS, JR.
TO THE
SENATE BANKING, HOUSING AND URBAN AFFAIRS COMMITTEE

June 6, 1977

MR. CHAIRMAN:

My name is Ed Brooks, Jr. I am President of Security Federal Savings and Loan Association of Richmond, Virginia. I appear today in my capacity as Legislative Policy Committee Vice Chairman of the United States League of Savings Associations.*

The U. S. League appreciates this opportunity to appear before your Committee and express its wholehearted support for H.R. 5675 as passed by the House of Representatives April 25. This legislation provides a long overdue reform for the Government's tax and loan account system, and, for the first time, broadens eligibility to include savings and loan associations.

Heretofore, tax and loan accounts -- which typically represent deposits by corporate treasurers of Federal tax withholdings from employee paychecks -- have been limited to "incorporated bank and trust companies." This phrase includes mutual savings banks; according to Treasury testimony credit unions are empowered to receive "T&L" deposits

*The United States League of Savings Associations (formerly the United States Savings and Loan League) has a membership of 4,400 savings and loan associations, representing over 98% of the \$400 billion in assets savings and loan business. League membership includes all types of associations -- Federal and state-chartered, insured and uninsured, stock and mutual. The principal officers are: John Hardin, President, Rock Hill, S.C.; Stuart Davis, Vice President, Beverly Hills, Ca.; Lloyd Bowles, Legislative Chairman, Dallas, Tex.; Norman Strunk, Executive Vice President, Chicago, Ill.; Arthur Edgeworth, Director-Washington Operations; and Glen Troop, Legislative Director. League headquarters are at 111 E. Wacker Drive, Chicago, Ill. 60601; and the Washington Office is located at 1709 New York Ave., N.W., Washington, D. C. 20006; Telephone: (202) 785-9150.

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Under the established system, such institutions enjoy interest-free use of the funds until called by the Treasury and forwarded to the District Federal Reserve Banks.

Stated simply, Section 1 of H. R. 5675 guarantees that the Government will receive an interest return on these tax collection deposits. The Congressional Budget Office has estimated that this reform will save the Treasury at least \$89 million next year and \$139 million by 1982, and we warmly applaud this long overdue change in the T&L system.

Sections 2 and 3 of the bill make the necessary banking and tax law changes to permit Federally-chartered and insured savings and loan associations, and those insured by a State or agency thereof or corporation chartered pursuant to State law, to become eligible depositories -- under Treasury rules. If the T&L system is to be modified to encourage use of interest-bearing accounts, it seems obvious to us that the institutions which specialize in thrift accounts -- the roughly 5,000 savings and loan associations of our nation -- should be allowed to receive these deposits. We believe that savings association participation would be beneficial to the public and equitable to our institutions.

Some have questioned whether T&L accounts are appropriate deposits for institutions, such as ours, which specialize in long-term mortgage lending. These funds are no more "volatile" than the ordinary day-in, day-out

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passbook accounts which provide the foundation of our thrift and mortgage lending business. We are specialists in making long-term commitments to provide mortgage financing to homebuyers based on projections of available funds months into the future. We envision that tax and loan accounts will prove predictable sources of funds for home finance. The opportunity for savings and loan associations to compete for these deposits could provide an added measure of stability to housing finance, particularly in periods of economic stress. As mentioned above, mutual savings banks, whose specialized investments resemble ours, presently receive T&L deposits since they are considered "banks".

In 1977 no one should seriously question our ability to handle these accounts. The 5,000 savings and loan associations of this country now exceed \$400 billion in assets; we are the second largest class of financial institutions, and our members include the largest institution operating in a number of major metropolitan areas. (Indeed, the "average" S&L was larger than the "average" commercial bank -- \$80.7 million versus \$68.9 million -- at year end 1976.) We utilize such tools as the overnight "Federal funds" market in our daily cash management. Our associations possess highly sophisticated money management systems -- both internally, and with our Federal Home Loan Banks -- including on-line data processing.

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Our ability to process T&L accounts has also been questioned since we generally are not authorized checking accounts and are not members of the Federal Reserve System. There is nothing in H.R. 5675 which commands the use of checking accounts. Employee tax withholdings could be deposited by corporate treasurers in a savings account and transfers could be arranged between that account and the Treasury's interest-bearing account contemplated by Section 1 of this legislation. Treasury Assistant Secretary David Mosso testified to a House Subcommittee that subsequent collection from savings and loan associations would be no different than that already used for commercial banks which are not members of the Federal Reserve System. T&L accounts in savings associations could be processed through the 12 Federal Home Loan Banks or, alternatively, through correspondent commercial banks.

Another question has been raised whether we possess sufficient holdings of Government securities to "collateralize" T&L deposits as required in Section 1 of H.R. 5675. As of December 31, 1976, savings associations held \$30 billion in U. S. Government securities in their liquidity accounts -- a figure three times as large as the daily average Treasury operating cash balance, and hundreds of times in excess of that needed to collateralize the tax and loan deposits we might expect to attract in competition with 14,500 commercial and mutual savings banks.

The interest-free use of tax and loan account funds has traditionally been justified by the services performed for the Government by commercial

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banks. We might point out that savings and loan associations perform many of these same services: reporting of interest on 1099 Forms; direct deposit of Social Security and Railroad Retirement benefits; cashing Treasury checks; selling food stamps; offering commemorative coins such as the Bicentennial quarters and half dollars. In our view, such services to the public do not justify the interest-free use of tax-and-loan monies.

We would note, in particular, the discrepancy in treatment where U. S. Savings Bonds are concerned. At present, commercial banks are reimbursed for issuing and redeeming Savings Bonds, though our institutions are not. The Treasury has proposed a reimbursement system for this service, which we support as a business-like approach to the conduct of Treasury operations.

Finally, we can assure the Committee that savings and loan associations taking advantage of any new authority would fully expect to do so under rules comparable to those applied to commercial banks.

Before closing, I would like to mention one additional facet of this legislation. Implementation of the H.R. 5675 authority may adversely affect a special program involving minority-owned and operated commercial banks. The Treasury, we understand, has developed a "phase-in" plan to soften the loss of interest-free deposits for these institutions. We have no objection to this special exception to encourage the growth of minority banks; indeed, we applaud President Carter's April 8th directive to Department and Agency heads to encourage Federal deposits in minority banks. Similarly, minority-owned and operated savings and loan associations are providing important thrift and

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home ownership services for their communities. They, too, deserve an opportunity to participate in any national program of tax and loan and other Federal deposits, and HR. 5675 is a useful step in that direction.

In summary, Mr. Chairman, I would again point out that extending T&L opportunities to our nation's second largest class of supervised financial institutions -- savings and loan associations -- is simply a matter of service to the public and fairness. It could add stability to funds available for housing. It neither affects the "competitive balance" of the financial system nor raises profound issues of deposit powers. In our view the amendments contained in Sections 2 and 3 of H.R. 5675 -- which authorize domestic building and loan associations to become eligible tax and loan depositories -- deserve your support and belong in any meaningful reform of the tax and loan account system.

The U. S. League of Savings Associations asks your prompt approval of H.R. 5675.

Thank you for this opportunity to present our views. I invite your further questions.

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The CHAIRMAN. Thank you, Mr. Brooks. Thank all of you gentlemen for an excellent job. You have certainly done a fine job of concisely summarizing your statements and accommodating the committee by compressing your opening statements very well.

Mr. Morthland, you say that the American Bankers Association believes that there should be Treasury compensation for a number of other services performed by banks in addition to those connected with tax and loan accounts or savings bonds which Treasury intends to provide compensation for if this bill is enacted.

In your prepared statement you listed IRS tax liens and levies, handling those levies and tax liens, reporting various currency and foreign transactions, microfilming checks under the Bank Secrecy Act, and maintaining lists of designated nationals.

In response to that, Secretary Mosso who preceded you as you heard him say, said the Treasury is opposed to providing such compensation because the services that you mentioned are similar to those provided by many other private businesses which also don't receive any compensation from the Treasury and he said this should be handled in separate legislation and shouldn't be made part of this.

What's your response to that?

Mr. MORTHLAND. My response for the association, sir, is that the Treasury does need authorization before it can provide such compensation and this should be one of the points on which we raise this issue.

The CHAIRMAN. Well, do you feel strongly, if the Secretary of the Treasury says that a particular kind of service, like you specifically mentioned that I just enumerated would be handled separately—do you thing that that would be an unjust way of handling this situation?

Mr. MORTHLAND. No, sir; not if it is handled separately.

The CHAIRMAN. OK. Now you say further, Mr. Morthland, that ABA opposes those sections of H.R. 5675 which would permit savings and loan associations to take part in the tax and loan account system. You mentioned the fact that tax and loan accounts are legally demand deposits and that banks are required to hold reserves against them while savings and loans are not. But this legislation would in effect convert those demand deposits into loans against which there are no reserve requirements. So it seems to me that the banks and the S. & L's would be on an equal footing in that regard.

In view of that, would you still say it's inequitable to include the S. & L's in the tax and loan account system along with the banks, the mutual savings banks, and the credit unions?

Mr. MORTHLAND. Yes, Mr. Chairman. This proposal is but one of a series of proposals expanding the powers of the savings and loan associations without any balancing of the inequalities in reserve requirements in general.

The CHAIRMAN. In this particular case—and maybe I misunderstand it—in this particular case, the point is that it would convert the deposits into loans gains which no reserve requirements are required and so it would seem in this respect the S. & L's and the banks would be on an equal footing.

Mr. MORTHLAND. Mr. Chairman, I'm not trying to quibble over the fact that they really go through what is a demand deposit because the initial deposit is in a demand deposit. Then, as I understand the

Treasury's proposal, it would then move into some form of a loan or an obligation against which savings reserves would not be required.

The objection of the association is based on two points. One, that it did move through a demand deposit and, secondly, that it was related essentially to business types of activities. This is an expansion of powers of the savings and loan associations into areas in which they normally have not been participating and at the same time they are preserving and maintaining the differential in interest rates that can be paid on time or savings accounts and also have lower reserve requirements. Our association simply believes that this ballgame is getting to be very, very large and that the playing rules should be the same for all participants. If savings and loan associations keep moving in as they would be here, into areas that are closely akin to, if not demand deposits, they should come under the same limitations and the same responsibilities that commercial banks do.

My other point was that I believe that Congress is on the verge of considering again a restructuring of the powers and responsibilities of all types of financial institutions and that that would be a more appropriate place to consider the expansion of powers of the savings and loan association into the tax loan account business.

The CHAIRMAN. Now you may recall we had a discussion with Mr. Mosso on the effect this legislation might have on bank earnings and I think that's a proper area of concern. I pursued that with him and there was at one point an estimate that it would be the full \$50 to \$75 million and then he said that he thought part of that might be shared by corporations.

Now just looking at it from the standpoint of the commercial banks, inasmuch as this legislation would also result in your losing some of these deposits to S. & L.'s perhaps that might be an even greater source of loss of earnings, at least it could be a source of loss of earnings.

Mr. MORTHLAND. It would be a source. I can't put a quantitative figure to it.

The CHAIRMAN. Conceivably, it might be as big as \$50 to \$100 million or bigger.

Mr. MORTHLAND. Are you referring now to the loss to the savings and loan associations?

The CHAIRMAN. No, the gain to the savings and loan associations and the loss to the banks, because as I understand it this would enable the S. & L.'s to do something that the bank can do now and the S. & L.'s cannot. Most of the tax and loan accounts are deposited as I understand it in commercial banks.

Mr. MORTHLAND. Yes; I don't think the loss to commercial banks would be the entire amount that the Treasury estimated it was not recovering right now.

The CHAIRMAN. Yes, but then, in addition to that, there's the fact that you would lose part of these deposits that you now have to be transferred to the S. & L.'s in some cases. Whether that's 10 percent or 50 percent or what, we don't know. Whatever it would be it would represent to some extent a loss of earnings.

Mr. MORTHLAND. There would be some loss, but obviously the banks would not lose the entire amount that the Treasury was referring to.

The CHAIRMAN. Now, Mr. Brooks and Mr. Lawton, you both state that despite the extremely short-term nature of the tax and loan account deposits, the sections of H.R. 5675 allowing you to hold these deposits will increase the availability of funds for home mortgages despite the fact that these are very long-term obligations. Governor Partee of the Federal Reserve Board who testified just before you claimed that you will not be able to put those funds into housing in any way because they are so short term and of course your housing commitments are very long term.

How will you be able to use these deposits to increase mortgage lending?

Mr. BROOKS. Mr. Chairman, right now, with the passbook savings account which is payable from the date of deposit to date of withdrawal, it's quite volatile. We are familiar with that and we have this in and out money. We have business firms putting money in and taking it out. To the extent that this increases our overall liquidity base some of this liquidity might take place at some of the other liquidity bases and we could use it for housing. We have already operated ever since I have been in business really with a substantial amount of liquidity and this would be adding to it and giving us a base so that against that we could leverage our funds and put more into housing.

The CHAIRMAN. So you argue, although this is volatile money, that it would be part of your liquidity base and it would put you into a position where you would be able to put at least some additional amount into housing?

Mr. BROOKS. I believe we could. You know, Mr. Chairman, it's interesting to note that down in Richmond, Va., where I'm located—

The CHAIRMAN. Let me see if I can get some kind of quantitative estimate. For each \$1 million average daily balances in these accounts, how much would be generated in mortgage loans? Any idea? Would it be 50 percent, 25 percent, 10 percent?

Mr. BROOKS. I really don't have any figure right now. I'd be glad to supply something later, an estimate, if we can come up with something.

The CHAIRMAN. Mr. Lawton.

Mr. LAWTON. Well, I agree wholeheartedly with what Mr. Brooks has said. We are in a volatile business now, Mr. Chairman. We have 40 to 50 percent of our deposits in passbook savings and they are subject to call on any business day that we open our doors and so those funds could be just as easily withdrawn as the funds that we would get on tax and loan accounts.

In my testimony I said that I thought we were equipped to handle these funds efficiently and, as Mr. Brooks has said, it would increase our cash flow, and part of that would fall off into mortgage lending. I could not state with certainty what this volume would be, but it certainly would be something worth study.

The CHAIRMAN. I'm going to yield in just a minute but let me just say that I want to pursue this issue when I come back. My time has elapsed.

Senator SCHMITT. I was not reminding you of that. I just wanted to ask a question relative to this, but I will wait.

The CHAIRMAN. Why don't you ask Senator Lugar to yield and then he can resume.

Senator SCHMITT. Is there any estimate now of the amount of these demand deposits, tax and loan deposits, that is required to cover what the Federal Government asks for on one business day?

The CHAIRMAN. You're directing this to Mr. Lawton?

Senator SCHMITT. The panel in general, but particularly I guess really the commercial banks. What percentage of your tax and loan deposits, the volatile money, do you have to keep because the Government may demand it on a given business day?

Mr. MORTHLAND. I can speak from my own banks experience. The Treasury tax and loan account goes down to zero, two or three times a month, which means that aside from a possibility of offsetting against other flows, we cannot commit these funds to anything other than the most liquid type of money market instruments.

Senator SCHMITT. Do you have any estimate of what this might be, what percent of other types of funds might be freed up by savings and loan associations if this act became law or this bill?

Mr. MORTHLAND. Senator, I wouldn't presume to make an estimate for the savings and loan associations.

Senator SCHMITT. Well, but your own experience should give you some indication, or the committee some indication of what that amount would be very small so that you have to be very careful. Is that correct?

Mr. MORTHLAND. That is correct. However, the particular bill that you have in mind is one which would change the Treasury's money management—I'm trying to be responsive in an unbiased way. At the present time, however, the Treasury's money management takes almost all of the funds out of the commercial bank system on a regular basis.

Senator SCHMITT. Do you have figures of what the average amount is in the entire system?

Mr. MORTHLAND. No, but I can state that Treasury draws most of those funds out and transfers it to the Federal Reserve System where the Federal Reserve System lumps these funds together with other activities of its own. I would assume that if this bill were passed the Treasury tax and loan system would go back to the system that existed—as far as balances—that existed before 1974. We would have a larger average amount left in the Treasury tax and loan accounts, but with wider swings even yet.

Senator SCHMITT. Of course, I am new to the committee and these particular kinds of questions I ask generally for the education. I would remind you that any time you come before this committee after having been here last session, you may find some new people that still need some education. So don't abbreviate your statements thinking everybody has already heard it. But I also concur that abbreviated statements are usually very useful.

I would like to ask any of the panel to comment on what seems to be the major question here and in many other types of legislation that we are considering or going to consider, and that is, are we in fact—the banks and financial community going to move away from the traditional boundaries that have separated various types of institutions, credit unions, savings and loan institutions and banks and others that

came into existence to fill certain specific needs at certain specific times and legislation—and I'm not expressing a preference one way or the other, but legislation has clearly started to obscure the traditional boundaries. Would any of you like to comment on the necessity of doing this and are we really leading toward just one type of financial institution in this country?

Mr. LAWTON. Senator, I would like to respond to your question. I don't believe this particular piece of legislation in any way, shape or form is expanding the boundaries or changing the basic complex of our business. What we are asking for here is that we be treated the same as all of the other financial institutions that handle these tax and loan accounts. Savings banks are a perfect example. They are able to handle these accounts. Credit unions are. Savings banks make mortgage loans. We make mortgage loans. We are just asking to be included as a type of institution that can handle these accounts. We have no intention of abandoning our basic concept of doing business.

Mr. BROOKS. Senator Schmitt, I would endorse that concept but in addition I think we shouldn't lose sight of the fact that if the savings and loan associations are granted this power, which would better serve the taxpayers of this country, there will be better than 15,000 more outlets of depositories that the people of this country could go to to make these deposits—that is, primarily the business firms can go to to make these deposits. I don't think we should lose sight of that fact either.

Mr. DARDEN. Senator, also, I think each of the other two gentlemen from the S. & L. industry have indicated that there's no question that there is a strong desire to keep the S. & L. industry as it is now known. However, in view of one of the commitments that this committee as I understand it is to further the opportunities for housing in these United States, and if as a result of the legislation such as the legislation that is now before this committee is passed as we are suggesting, it would surely undoubtedly further that opportunity by allowing some of these funds, even though they are volatile, to still be used in the use of mortgage money.

For example, it is not uncommon for some members of this industry to use the secondary market which each of you is familiar with and many times in the course of 1, 2 or 3 weeks that same money, depending on how it can be timed—this is a matter of money management—can in fact be used for purposes of making loans which ultimately are sold to the mortgage corporations or to other secondary markets.

So in the course of a 2 or 3 week cycle these same funds which normally may not be available to allow for that many more persons to have advantage of homes and housing—and that of course if one of the principal purposes of this industry—this being done in no way whatsoever endangering the necessary requirements of a 7 or 3 percent short term or long term liquidity based on the bank board's requirement at a given time.

Mr. MORTHLAND. Senator, in the opinion of the American Bankers Association, this is a further smoothing out of distinctions between types of institutions. I think a review such as was given by Chairman Burns in February, in the Federal Reserve in which he outlined the successive steps of smoothing over distinctions between types of in-

stitutions and the expansion of powers of the savings and loan associations, would indicate that, although not there yet, we are moving toward a more common type of financial institution. This does not mean there would not be specialization, but it would be specialization on a voluntary basis, even as there is specialization within the banking community now between wholesale and retail banks. The emphasis of the ABA here is that as these powers are broadened; we should be competing on equal terms. The major inequalities now are the differential in interest rate ceilings and the differential in reserve requirements between banks and savings and loan associations. Mutual savings banks are not here today, but they also come into the same category.

MR. HARPER. We think this legislation is important and we have seen it sidetracker with additional issues. In other words, primarily, the legislation is to allow the Treasury to invest its funds. Other things get tacked on and we have something tacked on here now that becomes an issue and we'd hate to see that issue become more important than the main issue, and I would think that in keeping with other thoughts that this could very well be dealt with separately in terms of expanding the legislation or expanding authorities tacked onto this legislation. We would like to see it go through fairly cleanly if at all possible, at least not see it bogged down and lost because of an issue.

Senator SCHMITT. I get the impression that all of you might agree on one thing, and that is that if we in fact are going to move towards greater commonality of functions between the various financial institutions, that equity has to be a primary consideration. I also get the impression that all of you are not sure we ought to move all the way to a single type of financial institution, that you feel each of you is offering a unique service that can best be done by a more or less specialized industry. Is that correct?

MR. HARPER. I personally don't think this legislation should address itself to equity. I think that's a separate issue. I think that the equalization of powers or whether you're pulling together or separating or just what is not the point of this legislation.

Senator SCHMITT. I would just submit that we have to deal with pieces of the total problem and very often we tend to focus on the pieces and forget its context in the total problem, and being a new member of this committee, the reason I ask questions is I want to make sure I understand the total problem of which this is potentially a piece. And you may argue that it's not.

MR. HARPER. I'm saying it's not unless you include a change in the practice today. If you keep the practice the same and allow the credit unions to invest its funds, then this doesn't become an issue. If, in fact, you make changes, then it opens the whole issue up and you should consider the whole issue and not just a part of it and the thing begins to change and shift and I would think you could get bogged down considerably by just a minor issue of this sort.

Senator SCHMITT. Thank you. My time is up.

The CHAIRMAN. Senator Lugar's time is up. He yielded his time to you, but we will go back to him.

Senator SCHMITT. I think he just shook his head up and down.

The CHAIRMAN. Senator Lugar.

Senator LUGAR. Thank you, Mr. Chairman.

I have just two questions. First of all, Mr. Darden, in your testimony you mention the possible benefits of this legislation to minority savings and loans. What is the benefit? In other words, I'm not certain that I have discovered this.

Mr. DARDEN. Well, let me attempt to respond and see if I can't satisfy your query on that, Senator.

For example, Community Federal, which is based here in Washington, D.C.—and I'm the president of Community Federal—we are the newest S. & L. in town. In 36 months we are at \$13 million. Even though we are at \$13 million, we have developed a portfolio of about \$16 million in multiples. This is because we have been able to take advantage of the secondary market to which I alluded to a little earlier.

Having the additional funds which do not affect our liquidity but just the use of those funds for a limited period of time allows for us to fund mortgages and thereby still have the funds available within a given specified period of time, depending on the funding by the secondary market which allows us to—in answer to the specific question the chairman asked—may allow for a million dollars, maybe as much as 25 percent of that million dollars actually being used for additional loans. If we as an industry can have that kind of an advantage and particularly for those of us as minority S. & L.'s who are primarily located in the urban areas of this Nation and who are serving the communities in a fashion that may be reasonably unique to the industry as such, we are in fact having the advantage of this new legislation which would afford us a greater flexibility, a greater ability to penetrate, and a greater ability to serve and to carry out the mandate of the two basic purposes of the S. & L.'s—namely, to develop thrift and to make home loan mortgages available for indigenous people of the community.

Senator LUGAR. Mr. Harper, do you agree with that situation? I'm not simply asking with respect to S. & L.s, but there was at least an inference in your testimony that minority bankers likewise might be assisted by it.

Mr. HARPER. I think any money that minority financial institutions can get from any source is going to be helpful. We don't think this legislation, however, or a change in the banking system in effect, would necessarily in the long term—or in the short term—benefit us.

Senator LUGAR. How would you anticipate getting more money from this legislation as a banker? Why do you think more money would come to your bank?

Mr. HARPER. To an S. & L. you're speaking of?

Senator LUGAR. No. To either a bank or an S. & L.

Mr. HARPER. Well, the amount of Government deposits would be expanded in financial institutions as much as right now the Government can manage its funds in keeping with public interest—current public interest is to draw those funds down and if there's a heavy money market operation the funds are in the reserve banks and there are minimum balances. Now they charge for it. They keep more money in the banks, therefore the more stable economy, the more funds. There's going to be a negative impact, however, on minorities and I should say upon individuals who are borrowing funds. In the past, minorities and net savers are lending their funds to communities. As

these communities, as a direct result of minority institutions and other support, have been bringing these communities economically up they have become net borrowers of funds at a time when the shift of funds, the cost of funds being shifted—the burden is being shifted from the borrower to the saver. So, in effect, much of the burden of the increased cost of funds will be shifting from the general public tax base to individuals who are now net borrowers. So there's going to be many different shifts take place and we can see the impact on minority communities in terms of additional cost of funds. I could go quite a ways into this.

Senator LUGAR. How do you think you would finally come out?

Mr. HARPER. We'd have more funds to lend.

Senator LUGAR. How about expenses?

Mr. HARPER. At any cost, more funds to lend in our communities will have an expansive impact in our community and our institutions themselves will grow and our people will be better off.

Senator LUGAR. So on a net basis, this law would benefit minority institutions?

Mr. HARPER. It's not going to be a disadvantage to anybody. It's going to be a plus for everybody and it's a question right now I think, while we're all at the table, to decide right now at the beginning how this thing is divided up. We don't think that this particular time however is the time to address itself to a change in the system. We think that that should be in other legislation, but it's important that this legislation be passed. The economic expansion will impact everybody indirectly anyway.

Mr. MORTHLAND. Senator, there's another part of that legislation which really affects the minority institutions and that is the proposal that funds not be drawn out of the minority institutions on exactly the same basis that they are on the other institutions and the reference was to a five-year phaseout. The American Bankers Association is in favor of this particular provision. And again, I hesitate to interpret somebody else's business for him, but I would think the thing of greatest help to the minority institutions would be the fact that the Treasury would allow balances to build up in the Treasury tax and loan account, a noninterest bearing account, as contrasted to the type of investment account as authorized in H.R. 5675. Treasury would allow these balances to build up in the tax and loan accounts and would not draw them down as rapidly as they do from all other financial institutions and that this balance would be reduced basically 20 percent a year so that there would be additional funds available to a minority institution as contrasted with other financial institutions.

Senator LUGAR. Mr. Morthland, while you have the microphone, would you comment on the Secretary's earlier comments regarding the charges that banks would be allowed to make, compensatory charges? Obviously, in your testimony the Chairman has pointed out other services for which you believe banks ought to be compensated, but are you in general agreement with the ideas of how you would be able to charge the Treasury for services that are going to be offered? Does this come into some degree of equity as you see it?

Mr. MORTHLAND. Yes, sir. My testimony was that the American Bankers Association favored section 1 of the bill. Perhaps I should

have expanded on that if we measure importance of testimony by length of time taken, but I thought that the simple statement was sufficient. We think that the Treasury wants to be equitable on this issue. It is to the advantage of the Treasury to see that funds are kept in the banking institutions. They have testified that they have problems in money management under the present system. The bill does not require any institution to keep funds and put it into an interest paying form. If the Treasury's interest charges are too high they simply would let it flow through. They still would handle the Treasury tax and loan deposits, no doubt, but rather than keep it they would allow it to flow on through to the Federal Reserve System.

Senator LUGAR. So this option of being a part of it or not and your leverage as banker in dealing with the Treasury, your negotiation—

Mr. MORTHLAND. Yes, Senator, that part of it, and the other part of it is that we really believe that Treasury officials in government are trying to do a good job. I don't think there's any skullduggery or attempts to do anybody else in. People in the Treasury are conscientious people.

Senator LUGAR. Thank you.

The CHAIRMAN. Mr. Darden, I was very impressed by your response on the volatility issue and how in your experience you say S. & L.'s are less versatile because of their access to secondary markets. You raise a point that had completely escaped me in the secondary market. I think it's an excellent point.

At the same time, I'm just wondering about a minority S. & L. in the District of Columbia which I think is certainly desperately needed—I'm very concerned about the redlining we have suffered from some of the other institutions and we have established that pattern, there's no question about it, and some of the minority institutions have done a fine job in overcoming that, I wonder when you go into the secondary market if you aren't per force taking funds that we might expect and would hope would go into the community and are probably not going to the community at all. If you go into the secondary market, you're buying national, aren't you?

Mr. DARDEN. No. I'm sorry. I had reference, Senator Proxmire, to the sale. What we're doing, for example, as you know, in this community—for example, the Fort Lincoln project which we are the principal lenders on, we committed to that developer.

The CHAIRMAN. You take the first mortgage and—you take the mortgage, I should say, and then you sell that in the secondary market?

Mr. DARDEN. We sell it to the secondary market and then we're having the money recycled and then we're putting it out again which gives us a—

The CHAIRMAN. An opportunity to do more in the community?

Mr. DARDEN. Yes, than we're able to do on a normal basis. So with the added money that would be deposited through the proposed legislation we would have that much more flexibility and that much more of an ability to be effective in this community as lenders.

The CHAIRMAN. I don't want to misunderstand what you're saying. Did you say that you feel that the industry itself is pretty sophisticated in handling volatile money or are you saying that you're able to do this, you and a few others, and that therefore perhaps you could

share with us and share with the S. & L.'s generally how to handle volatile money such as tax and loan accounts so they could be used in housing more widely? Is this pretty well known, I'm asking?

Mr. DARDEN. I think it's generally well known. I speak with a limited amount of background, Senator, since I have been only in the industry for 3 years, but I have been in the lending business for 8 years because I established a mortgage banking company in 1968, but I have had the opportunity to observe in going into various parts of the country to see that other S. & L.'s are in fact in the metropolitan areas in other parts of the country are able to use funds that are volatile. It has already been established that probably 60 percent of our money is passbook money which is actually demand money at any time, but we still have been able to maintain the liquidity requirements even though we are dealing in a very volatile situation and not have any problems as far as the regulatory authorities are concerned. So as we would expand the base of deposits coming from the proposed legislation, we know as a matter of record, based on the mortgage demands that we see in this particular area here, that we would be that much more effective. We have already established that very clearly and very proudly so in the last 36 months.

The CHAIRMAN. Mr. Harper, I was also impressed by the point you made that hadn't occurred to me at all. It hadn't seemed to occur to the Government witnesses either who appeared—the Federal Reserve Board and the Treasury and others—that this might result—I'm not sure you're right—maybe you are—this might result in the Treasury being able to leave its money for a longer period in the banking system since it wouldn't be sterile—it would be earning a return. If that's correct, then it would seem to me that not only the points that you made are valid—that is greater stability in the economy and funds available perhaps on a little longer basis for housing and so forth—but also that this might benefit the earnings of all the institutions. In other words, if they could leave that money there longer, the return for the S. & L.'s and the banks might be better. Is that correct?

Mr. HARPER. Well, I wouldn't say that would be true.

The CHAIRMAN. Well, at least it would modify the loss of earnings to the banking system.

Mr. HARPER. It would—for minority banks, it would be true. For the industry in general, probably not.

The CHAIRMAN. Why not?

Mr. HARPER. The reason I say that is because the amount of bank reserves are controlled by the open market operations of the Federal Reserve. So the amount of balance we have are already controlled. So we are not necessarily expanding balances and if we did it would be pulled back down anyway.

The CHAIRMAN. But bank deposits aren't the only place this money goes. It can go into Treasury securities and securities of various kinds and so forth. If they're getting a return in the banking system they would have less concern to shifting it out instead of Treasury bills.

Mr. HARPER. Let me answer the question in terms of minority banks and maybe even more specifically in terms of the bank that I work for, and I know the impact on that and maybe a more qualified person can talk about the general industry.

It would have the effect of increasing our deposits and therefore our profitability. I think I should leave it with that because I suspect that those balances will remain longer and it would be almost pointless in having legislation if they pulled it out as quickly as they are pulling it out now.

The CHAIRMAN. And I would think—and I would like Mr. Morthland or Mr. Brooks or Mr. Darden or anybody else who would like to comment—correct me on this—there would be at least some tendency for the Treasury to be able to justify keeping that money on deposit longer rather than moving it into other securities. Am I wrong or right on that?

Mr. BROOKS. I think you would be right on that as long as they are earning a good return on it. There would be less likelihood it would be shifted out of the system.

The CHAIRMAN. After all, there would be many times when the return on Treasury bills over our history has been far below the return on any kind of a deposit that was earning interest. I can recall very well when Treasury bill return was almost negative. At least it was down to half a percent. And under those circumstances, I can understand why it might be wise money management for the Secretary of the Treasury to keep money in deposit longer.

Mr. BROOKS. Under those circumstances, it would be a substantial motivation to leave it in the system.

Mr. MORTHLAND. Mr. Chairman, I think the net effect of the passage of section 1, would almost result in no net earnings to participants in the system. There would be almost a tradeoff because the funds—

The CHAIRMAN. That's very good to hear. That would be of benefit over what I had understood because I understood there would be a substantial loss. Now you're saying there would be a washout.

Mr. MORTHLAND. There would be a tradeoff on the earnings side. The funds that would have been left with the financial institutions would bear a rate very similar to the rate on open money market instruments. Whether we're talking about 90-day Treasury bills, whether we're talking about REPO's or whether we're talking about Federal funds, the rate paid to the Treasury would approximate the rate we might be able to earn on those funds. Our Treasury tax and loan account balances are very volatile. They would not go down to zero under the proposed legislation, but we would not be able to put those into loans or anything else. We would put the funds into money market instruments and the Treasury would be obtaining from us approximately the same rate of return. Whatever advantage might accrue to an institution, at least in my opinion, would be those in efficiency of management where we were compensated by the Treasury for services rendered and those institutions that were most efficient might get some additional benefit from being able to perform the services more quickly than institutions in general.

The CHAIRMAN. All right, sir.

Mr. Harper or Mr. Foggie, the committee is aware of the problems this legislation would cause for minority banks and we continue of course to be sympathetic with them, as we were when we reported the legislation out last year. I wonder if at this point you will still need the full 5-year phase-in period 20 percent per year or whether it would

be more appropriate to give the Treasury more flexibility in handling the phasein since as you point out the speed up in tax and loan withdrawals has already had a dramatic impact on minority banks. I assume you have already adjusted to lower earnings on those accounts. Can you tell the committee whether you still feel need the full 5 years? Can you justify that full 5-year period?

Mr. HARPER. There was nothing scientific about arrival at the 5-year period to start with. The 5-year period was negotiated in the light of the change and in the light of the anticipated time of the legislation. So in light of that discussion I would say we would certainly appreciate the 5-year phasein period. We substantially are looking to major corporations to recommit in some other form their support to our communities. Presently we have made no progress at all in that direction because there's been a wait and see attitude.

Mr. FOGGIE. I just wanted to add, since the President's endorsement of the minority bank depository program, there is evidence that Treasury tax and loan deposits are increasing again in minority banks and, of course, I suspect that this will continue because this is the only vehicle now that's being used by major corporations through the Treasury tax and loan account route, and the 5 years certainly will give us time to work out other methods of directing our funds from these corporations into minority communities.

The CHAIRMAN. What effect would it have, though, if the Congress cut that down to 3 or 4 years?

Mr. FOGGIE. We'd have to work faster. This is the only thing that I can say now. I certainly hope that Congress would not. Five years will certainly give us working room.

Mr. HARPER. We'd have to work faster is one thing. The other part is we would have to cut operations. Right now we supply a disproportionate amount of services to our customers. I point out in our testimony the amount of, for instance, Treasury checks that we cash are much higher than industry in general. In our commercial loans in St. Louis, 85 percent are Government guaranteed, SBA guaranteed loans. A normal commercial bank couldn't operate that way, but with the support of our corporate communities we find we can.

Now these loans are out for 10 years and I don't know how we can compensate for that in a very short period of time. We think 5 years is fairly short in terms of coming out of this thing. As I mentioned before, we were 27 banks when the Treasury tax and loan legislation began—I'm sorry—when the program began. We are 85 banks now and many of these banks built up expenses and made loans and provided services based on perceived income. The President of the United States just a month ago reaffirmed this program and it's kind of difficult for us to go to corporations at this point and say, "Look, even though there is reaffirmation of a valuable program, as it has been over the years, we've got to find another way to work it out or the work that you have put into this and the support you have given us is all going to go to nought," and the economies that are beginning to develop will then begin to collapse because we'll have to contract our operations. Those loans we have made to individuals with SBA guarantee term loan are all determined by short-term credit and we have to support our short-term credit. That is going to be negative.

The CHAIRMAN. You argue that your operation is typical?

Mr. HARPER. It is typical.

The CHAIRMAN. It's not an atypical situation? It seems to be a very, very heavy proportion, 85 percent, SBA guaranteed.

Mr. HARPER. You will find that generally to be the the case in the larger cities of the country. You won't find it to be the case in some of the more rural areas. But in the new banks that have expanded, there's been heavy emphasis on SBA guaranteed loans in the commercial area.

The CHAIRMAN. That's the commercial banks, of course.

Mr. HARPER. Yes.

The CHAIRMAN. Mr. Darden, you mentioned President Carter's recent actions in support of minority bank deposit program. Have you approached the administration about getting some support for minority S. & L.'s both with respect to Government time deposits which you could already receive and also tax deposits which you could receive in the future under this legislation?

Mr. DARDEN. I have approached them but I have not been successful, Mr. Chairman. As a matter of fact, when I found out about that legislation and had one of my committee meetings it was requested that I make some immediate communication with the White House on this. I made calls then but my calls were not returned so I would be able to follow through. As a matter of fact, as a result of that matter which was brought to the public's attention on April 8, 1977, I then began subscribing to the President's summary so I would be able to have a better feel for what's going on in the administration. But we have not been successful in doing anything about that at all because at that point it became rather obvious to us as an individual S. & L. and surely as a member of the legislative committee of the Savings & Loan League that something needs to be done in order to put the minority S. & L.'s on parity with the minority commercial banks as relates to the attitude on the part of the administration, and any assistance we can have from your committee would be most helpful, sir.

Mr. MORTHLAND. Mr. Chairman, may I ask the permission of the committee to submit the excerpt to which I referred from the Federal Reserve Board's staff study?

The CHAIRMAN. Yes. I think that would be very helpful. I'm glad you bring that up. We should have done that at the time you brought it up. We will be happy to have that printed in the record.

[The information is reprinted as follows:]

INSERT "A" -- Extracted from Federal Reserve Board Staff Study, "The Impact of the Payment of Interest on Demand Deposits," Jan. 31, 1977

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Explicit Interest Payments on Transactions-Type Balances

Over the past decade there has been an increasing number of innovations and regulatory changes which have resulted in the explicit payment of interest on balances used directly or indirectly to transfer funds to third parties. Both banks and thrift institutions are currently authorized to offer NOW accounts in the six New England states. On a nationwide basis, banks have been permitted to transfer funds from a savings to a demand account on the telephone order of a customer, making it more convenient for the customers to hold a portion of transactions balances in savings accounts. And, businesses and State and local governments have been permitted to hold savings accounts at commercial banks, which have enabled them to transfer precautionary and to some degree transactions balances out of demand deposits.

Most of these developments benefited households and small businesses, and many were associated with efforts of thrift institutions to enter third-party payment deposit markets that have been dominated by commercial banks. The following list provides a chronology of the innovations, and regulatory and legislative changes that have produced--directly or indirectly--transactions accounts bearing explicit interest.

1. September 1970 Savings and loan associations were permitted to make preauthorized nonnegotiable transfers from savings accounts for household-related expenditures. ^{1/}
2. June 1972 State-chartered mutual savings banks in Massachusetts began offering NOW accounts.
3. September 1972 State-chartered mutual savings banks in New Hampshire began offering NOW accounts.

^{1/} Authority contained in the Housing Act of 1970.

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4. January 1, 1974 All depository institutions in Massachusetts and New Hampshire (except credit unions) were authorized by Congress to offer NOW accounts. ^{1/} Accounts similar to NOWs, but noninterest-bearing, began to be offered by state-chartered thrifts in other states in the course of the year.
5. January 1974 First Federal Savings and Loan, Lincoln, Nebraska installed customer bank communication terminals (CBCTs) in two supermarkets, allowing its customers to make deposits to or withdrawals from savings accounts. Such withdrawals can be used to pay for merchandise purchased from the stores. The First Federal system, known as Transmatic Money System, is now being franchised to other S&Ls.
6. Early 1974 onward Money Market Mutual Funds came into existence on a large scale basis. These funds which invest in money market instruments, allow their shareholders to redeem shares either by checks drawn on accounts established at designated banks, by wire transfer, by telephone or by mail.
7. August 1974 Federal credit unions were permitted to issue credit union share drafts which are check-like instruments payable through a commercial bank. ^{2/}
8. November 1974 Commercial banks were authorized to accept savings deposits from state and local governments.
9. April 7, 1975 Member banks were authorized by the Federal Reserve to make transfers from a customer's savings account to his checking account upon telephone order from the customer. This authority permitted banks to match the competition of thrift institutions offering the service of immediate transfer of funds from savings accounts to a commercial bank demand account on telephone order of the customer. Such plans permit the payment of interest on an account that can be converted quickly to a transaction balance.

^{1/} Public Law 93-100 signed August 16, 1973.

^{2/} Section 721.3, Rules and Regulations of the National Credit Union Administration (NCUA), established rules for experimental pilot EFT programs which include share draft plans.

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10. April 16, 1975 The Federal Home Loan Bank Board broadened its 1970 action to allow S&Ls to make pre-authorized third party nonnegotiable transfers for any purpose.
11. September 2, 1975 Commercial banks were authorized by Federal regulatory authorities to make preauthorized third party nonnegotiable transfers from a customer's savings account for any purpose.
12. November 10, 1975 Commercial banks were authorized by Federal regulatory authorities to offer savings accounts to partnerships and corporations operated for profit, limited to \$150,000 per customer per bank. In conjunction with telephone transfers, this authority permitted the payment of interest on funds that can be readily used for transactions.
13. February 27, 1976 Federal legislation authorizing NOW accounts in the States of Connecticut, Maine, Rhode Island, and Vermont became effective.

The CHAIRMAN. I want to thank all of you gentlemen very much for your excellent testimony. It's been most responsive and helpful and we've got a fine record. Thank you.

[Whereupon, at 12:25 p.m., the hearing was adjourned.]

[Additional material received for the record follows:]

STATEMENT OF THE HONORABLE MARK W. HANNAFORD ON H.R. 5675,
TAX AND LOAN ACCOUNT LEGISLATION
Prepared for Hearings Before the Senate Banking, Housing &
Urban Affairs Committee
June 6, 1977

Mr. Chairman, I strongly support H.R. 5675 as it was passed by the House of Representatives and urge this Committee to act favorably on this measure. The merits of this legislation ranging from the investment authority granted to Treasury, the inclusion of savings and loan associations into our tax and loan system, and special consideration for softening the impact of the investment authority on minority-owned banks will, I hope, impress upon your members the need for swift passage of this bill by your Committee.

It can certainly be said that this legislation is long overdue and that among its most impressive features is the advocacy of efficient cash management by the Federal Government, reducing potential revenue losses to taxpayers. In addition, H.R. 5675 would permit reimbursement to depository institutions for certain services rendered in connection with maintaining TT&L accounts on a more equitable basis than is currently the case. At hearings held by the House Banking Committee's Domestic Monetary Policy Subcommittee, it was revealed that savings and loan associations provide most of the reimbursable services that commercial banks render to the Federal Government. However, because they are not currently eligible members of the TT&L system, savings and loans are not compensated for some of these services while the banks are. As a Treasury Department study on the tax and loan account system revealed, during 1972 commercial banks were able to utilize federal TT&L funds to generate earnings which exceeded the expenses of handling these accounts by \$170 million.

Operating under the current system, Treasury has recently taken the initiative to limit its losses on tax and loan account funds. In 1976, for instance, average TT&L balances in commercial banks declined to 21 percent of Treasury's operating cash as opposed to 65 percent during 1974. The average TT&L balance in fiscal year 1974 was \$3.9 billion compared to \$1.4 billion in fiscal year 1976. Yet, as Fiscal Assistant Secretary David Mosso stated before the Domestic Monetary Policy Subcommittee, a substantial loss occurs through the inability to turn tax and loan funds in-transit between commercial banks and Federal Reserve banks into an earning asset. While no firm estimates of this loss are available, the amount of in-transit funds may be as high as \$1 billion.

TT&L Investment Authority and Monetary Policy

An occurrence in late April involving Treasury's tax and loan account funds and the Fed's conduct of monetary policy illustrates why the proposed new tax and loan system is far superior than that which exists. As a New York Times article on April 29 discloses, 3 days earlier, on April 26:

The Fed could not complete its reserve adding operations... because of 'an acute shortage of collateral,' or Treasury securities which the Fed purchases from dealers, frequently for short periods of time.

A few days earlier, Treasury had withdrawn almost \$3 billion of noninterest bearing TT&L funds from commercial banks. With the shortage of Treasury securities on the market, however, Treasury was forced to redeposit the amount withdrawn. This cumbersome action resulted in Treasury's losing interest for that full day on about \$3 billion. The full sum of that loss, moreover, will probably never be recouped even though some adjustments for that loss will be attempted. In addition, this redeposit represented a temporary but destabilizing influence on the money market with potential adverse effects on short-term interest rates. Under the new system granting Treasury an income-earning capability for TT&L funds, "massive swings" of Treasury funds could be eliminated. Thus, with the avoidance of redeposits, the smooth conduct of monetary policy by the Federal Reserve can be enhanced.

CUNA



Credit Union National Association, Inc.

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JONATHAN LINDLEY
Executive Assistant
Managing Director

June 3, 1977

The Honorable William Proxmire
Chairman, Banking, Housing and
Urban Affairs Committee
United States Senate
Washington, DC 20510

RE: H.R. 5675 - Investment of Public Funds

Dear Chairman Proxmire:

The Credit Union National Association, Inc. (CUNA) submits this letter with regard to H.R. 5675, the House-passed bill reforming Treasury's Tax and Loan system and extending eligibility to insured savings and loan associations. CUNA asks your help in clearing up a legal problem which for 43 years has precluded credit unions from participating in the system.

Federal credit unions have had the authority to accept TT&L deposits since passage of the original Federal Credit Union Act in 1934 (12 U.S.C. 1767). This is recognized in the House Banking Committee's report on H.R. 5675. However, Treasury has never promulgated regulations to implement this authority. Consequently, credit unions have been effectively barred from handling public funds.

CUNA is concerned that H.R. 5675, as passed by the House, still neglects credit unions in two respects.

SATISFACTION OF TAXPAYER LIABILITY

The Treasury Tax and Loan account system depends for its workability on two types of statutory authority. First is the authorization for a depository institution to receive the payments and act as fiscal agent of the United States. As noted, federal credit unions were given this authority in 1934 with passage of the Federal Credit Union Act.

The second aspect of this system is the authority given to Treasury in the tax code to prescribe the circumstances under which payment of tax funds to a depository institution satisfy the tax liability of the

taxpayer. Under present law, Treasury's authority extends only to banks and trust companies. H.R. 5675 extends that authority to savings and loan associations.

Under the bill, however, Treasury still lacks authority to extinguish taxpayer liability at the time funds are deposited in a credit union. Taxpayers will not utilize credit unions as depositories if the tax liability of the taxpayer is not extinguished at the time of payment to the credit union. Credit unions will therefore continue to be precluded from handling public funds by practical considerations.

For these reasons CUNA asks that H.R. 5675 be amended to include credit unions as authorized recipients of Treasury tax loan account funds under the same circumstances as banks, trust companies and savings and loan associations where payment to the institution will satisfy taxpayer liability to the United States Government. We have enclosed as Exhibit A an amendment to H.R. 5675 to accomplish this.

STATE-CHARTERED CREDIT UNIONS

H.R. 5675 expands the Treasury Tax and Loan system to include state-chartered savings and loan associations as well as federal S&Ls. The expansion to include state-chartered S&Ls is limited to those institutions which are 1) insured and 2) pledge collateral against the deposits. CUNA urges your Committee to grant parity to state-chartered, insured credit unions. Otherwise, state-chartered credit unions will be the only depository financial institution not authorized to receive public funds.

The justification for including state-chartered, insured savings and loan associations in the system is equally applicable to state-chartered credit unions. To paraphrase from the "Fact Sheet" by Chairman Parren J. Mitchell of the House Subcommittee on Domestic Monetary Policy discussing the new authority for savings and loan associations:

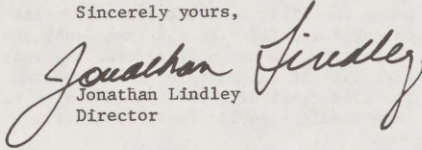
"Including insured (credit unions) in the tax and loan account system will not pose a problem on the assurance of financial condition because all depository institutions under the proposed investment authority must pledge collateral in order to receive TT&L deposits. If individual (credit unions) cannot pledge collateral, they cannot receive TT&L deposits."

We have enclosed in this letter as Exhibit B an amendment to H.R. 5675 which will expand the Tax and Loan account system to cover state-chartered, insured credit unions.

- 3 -

We appreciate the opportunity to comment on this important legislation. We will be happy to supply any additional information that your Committee may desire.

Sincerely yours,


Jonathan Lindley
Director

Enclosures

cc: To all members of the
Senate Banking Committee

JL:jb

EXHIBIT A

Section 3 of H.R. 5675 is amended to read as follows:

(a) Subsection (c) of section 6302 of the Internal Revenue Code of 1954 (relating to use of Government depositaries) is amended--

(1) by striking out "or trust companies" and inserting in lieu thereof ", trust companies, domestic building and loan associations or credit unions"; and

(2) by striking out "and trust companies" and inserting in lieu thereof ", trust companies, domestic building and loan associations, and credit unions".

(b) Subsection (e) of section 7502 of the Internal Revenue Code of 1954 (relating to mailing of deposits) is amended by striking out "or trust company" each time it appears and inserting in lieu thereof ", trust company, domestic building and loan association, or credit union".

(c) The amendments made by this section shall apply to amounts deposited after the date of the enactment of this Act.

EXHIBIT B

Section 2(c) of H.R. 5675 is amended by striking "and", the fourth time it appears, and by adding ", and credit unions" after "(including cooperative banks)".

Section 2 is further amended by adding at the end thereof the following new subsection:

(d) The Federal Credit Union Act (12 U.S.C. 1751-1790) is amended--

(1) by adding the following new section:

(210) Any credit union the accounts of which are insured under this subchapter shall be depositaries of public money and may be employed as fiscal agent of the United States. The Secretary of the Treasury is authorized to deposit public money in each insured credit union, and shall prescribe such regulations as may be necessary to enable such credit unions to become depositaries of public money and fiscal agent of the United States. Each credit union shall perform all such reasonable duties as depositaries of public money and fiscal agent of the United States as may be required of it including services in connection with the collection of taxes and other obligations owed the United States."; and

(2) by redesignating Section 210 of the Federal Credit Union Act (12 U.S.C. 1790) as Section 211.



NATIONAL CREDIT UNION ADMINISTRATION

Washington, D. C. 20456

28 JUN 1977

Office of the Administrator

Honorable William Proxmire
Chairman
Committee on Banking, Housing
and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

This is in response to your letter of June 21, 1977, requesting comments on the inclusion of credit unions in the Treasury tax and loan system.

The letter from Credit Union National Association (CUNA) is correct in referencing the fact that Federal credit unions have always had the authority to accept Treasury tax and loan deposits (12 U.S.C. § 1767). It is also correct that Treasury must promulgate regulations to implement this authority and that Treasury is restrained from such promulgation until such time as the Internal Revenue Code is amended to extinguish taxpayer liability for funds placed in a credit union.

The National Credit Union Administration supports the CUNA proposal. We have examined the Treasury regulations pertaining to depositories and would anticipate that upon passage of H.R. 5675, Treasury would include credit unions in these regulations. We do not anticipate at this time that the National Credit Union Administration would need to institute any additional regulatory requirements other than those necessary to conform to the Treasury regulations.

I hope these comments are of assistance.

Sincerely yours,

C. AUSTIN MONTGOMERY

Administrator (acting)



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June 8, 1977

The Honorable William Proxmire
Chairman
Committee on Banking, Housing and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

The National Association of Mutual Savings Banks, on behalf of its member institutions, would like to take this opportunity to comment on H. R. 5675 and urge the members of the Committee on Banking, Housing and Urban Affairs to favorably report this legislation. This bill would accomplish two important public policy objectives. First, it would modernize the Treasury's tax and loan account system by permitting such funds to become interest-bearing. Second, it would increase the number of financial institutions eligible to participate in the tax and loan system.

If H. R. 5675 is passed, the federal government will be permitted for the first time, to earn interest on its tax and loan accounts, and the estimates are that this change could net \$50 to \$100 million per year in increased revenues to the Treasury. Thus, there can be little debate as to the merits of Section 1 of H. R. 5675.

We note, however, that some questions have been raised during the hearings regarding Section 2 of the bill, which would authorize savings and loan associations to act as depositories for tax and loan accounts. In our view, the public benefits to be derived from this feature of the bill are likewise compelling. Opening up the tax and loan system to a broader number of participants will encourage wider competition among financial institutions for these types of public funds. Greater competition can be expected, in the first instance, to result in increased returns in the form of interest and/or services to the federal government, and eventually to add to the deposit base of mortgage-oriented thrift institutions.

JUN 14 1977

The Honorable William Proxmire - 2 -

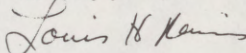
June 8, 1977

In its testimony before the Committee, the American Bankers Association has once again raised the all too familiar argument that public funds are too volatile for savings and loan associations to handle. Leaving aside the self-serving arrogance of this assertion, the fact is that thrift institutions are equally competent to moderate fluctuations in individual accounts by balancing them with other accounts and making appropriate liquidity adjustments. This money management technique is by no means limited to the commercial banking industry, and the ABA argument conveniently overlooks the fact that mutual savings banks, which are similar in asset and liability structure to savings and loan associations, are eligible and currently do participate in the tax and loan system.

We would, therefore, urge that the Committee report the entire bill as passed by the House of Representatives and resist any efforts to strike that section of the bill which would further increase competition by thrift institutions for the deposit of public funds. In authorizing thrift institutions to participate in the tax and loan account system, we would suggest that the Committee favorably view Section 2(c) of H.R. 5675 which would extend similar authority to institutions whose deposits are insured by entities other than the FDIC or FSLIC. Section 2(c) of the bill would be of major importance in such states as Massachusetts, for example, where most mutual savings bank deposits are insured by Mutual Savings Central Fund, Inc.

We trust that the foregoing will be of use to the Committee in its subsequent deliberations on H. R. 5675, and we respectfully request that you place this letter in the official transcript of the hearings so that we may be on record as supporting this important legislation.

Sincerely yours,



Louis H. Nevins
Director-Counsel

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