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CONFIDENTIAL (FR) January 7, 1970.

To: Board of Governors

From: Divisions of Research and Statistics and Supervision and Regulation

Subject: Possible reduction in burden on banks of reporting detail on loans to purchase and carry securities.

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As instructed by the Board, the staff has reviewed possible alternative means for reducing the burden on banks of proposed expanded reporting requirements under Regulation U.[1/] The proposals were that all banks governed by Regulation U be required to report more detailed data annually on loans to purchase or carry securities, (other than to brokers and dealers) and that the 100 banks with the greatest amount of such lending be required to report monthly.

This memorandum discusses (1) a minimum cutoff by amount of purpose loans to reduce the number of banks reporting detailed breakdowns annually, (2) a reduction in the number of banks reporting monthly, and (3) quarterly rather than monthly reporting for the panel group.

(1) Reduction in the number of banks reporting annually.

The initial staff proposal to the Board recommended that all commercial banks, all savings banks, and all branches and agencies

1/ Meeting of January 5, 1970; see memorandum "Proposed Bank Reporting of More Detail on Loans to Purchase and Carry Securities," dated December 17, 1969.

of foreign banks classified as "banks" by State law be required to report detail on their security loans annually, as of each June 30. Only 4,017 of the 13,467 insured commercial banks had security loans outstanding as of June 30, 1969, and would have had to file the report. In addition, 29 FDIC-insured and non-insured mutual savings banks, and an unknown number of branches and agencies of foreign banks and non-insured commercial banks would have had to file the report.

The staff proposal was based on the assumption that a regulatory report such as that under consideration should be required of all banks covered by Regulation U. In addition, it seemed equitable that banks should have a reporting obligation similar to that already applicable to broker/dealers covered by Regulation T.[2/]

To reduce the burden of expanded reporting requirements, the annual reporting of detailed breakdowns of security loans might be required only of banks whose aggregate security loans exceeded an established cutoff level on the reporting date. Table 1 below presents the number of insured commercial banks and the percentage of total security loans reported by all such banks as of June 1969 for

2/ Because the registration requirement under Regulation G is based on amount of "purpose" lending, smaller lenders are not subject to that regulation and do not have to report. Larger lenders must file reports at least as detailed as that proposed for banks.

various alternative cutoff levels. Individual bank data for other lenders covered by Regulation U are unavailable.

Table 1

Insured Commercial Banks Required to Report Detail -- Various Cutoffs 3/

Security Loan Cutoff	Number of Banks Reporting Detail	Per cent of Total Security Loans
$0	4,017	100.0
$50,000	2,472	99.6
$100,000	1,844	98.5
$250,000	1,161	95.9

The adoption of a $100,000 cutoff for item 3b, Schedule A of the Call Report, beneath which banks annually would report only total security loans and not detail, would have released 2,173 insured commercial banks from loan classification and reporting requirements. Nevertheless, with 1,844 banks reporting, 98.5 per cent of the universe of insured commercial bank security loans would be reported in the desired detail. The marginal loss in universe coverage with higher cutoff levels than $100,000 is fairly substantial and would release from reporting only a relatively small number of banks.

3/ Data as of June 30, 1969.

Three problems would result from the application of a size cutoff in releasing banks with small security loans balances from detailed reporting requirements. First, some of the increased accuracy in loan classification by banks expected to result from use of the new reporting requirement and instruction manual would not be achieved. Second, an incentive would be created for banks to understate security loans at the cutoff margin, through various kinds of "window dressing," so that such understatement would release them from recordkeeping and reporting requirements. A downward bias in the data would result.

Third, and perhaps more important, parallel relief would not be afforded branches and agencies of foreign banks, since these institutions do not now report, hence need not calculate, any statistic comparable to the total of loans to others than brokers or dealers for the purpose of purchasing or carrying securities (item 3b of Schedule A of the Call Report). Any size cutoff would unavoidably be based on this total, since it is reported to some authority by all <u>other</u> banks covered by the regulation. Hence, even with such a cutoff, these branches and agencies would still be obliged to create such a loan classification, whether or not they were ultimately obliged to file the detail report.[4/]

Neither the distortion in statistics nor the lack of uniform treatment of security lenders which would result from the adoption of a size cutoff is desirable. On the other hand, the very high

4/ Alternatively, branches and agencies of foreign banks might be inclined to ignore the obligation to make this calculation, and simply to report totals less than the cutoff, at least in marginal cases.

coverage of the universe of debt which would be achieved with a $100,000 total security loan cutoff, and the large number of banks which would be released from the burden of classifying loans for detailed reporting purposes, substantially offset these problems. Accordingly, the staff recommends that only those banks covered by Regulation U whose loans to others than brokers and dealers to purchase or carry securities equal or exceed $100,000 on June 30 of any year be required to report according to the format already proposed.

(2) Reduction in the number of banks reporting monthly.

The intial staff proposal to the Board recommended that the 100 banks with the largest total of security loans on June 30, 1969 be required to report security credit detail monthly. This group includes all banks which had outstanding $7 million or more in such loans on that date, and it represented approximately two-thirds of the total of security loans at all commercial banks on that date. The staff tested this group of banks for representativeness and found that their geographic distribution was wide, with more than one reporting bank in all Federal Reserve Districts with the exception of Boston. In addition, these banks consistently maintained their dominant position in security lending over time.

Similar tests have now been applied to the group of banks extending more than $10 million in security loans as of the June 1969

Call date. Numbering seventy, these banks have a geographic distribution comparable with the 100 bank panel in Table 2 below. While three districts would be represented by only one bank in the reduced monthly reporting group, the broad geographic distribution shown at the bottom of the table suggests that representation in the smaller group is substantially the same as with the larger group. Although the 70 bank group represented only 60 per cent of total commercial bank security lending in June 1969 (versus 67 per cent by the 100 bank group), this smaller group is equally as stable over time as the larger group in ranking by outstanding security loans.

As a means of reducing the burden of frequent reporting on the banking community, the staff recommends that the Board require monthly reporting by this smaller 70 bank panel.

(3) Quarterly versus monthly reporting by a panel of banks.

The staff continues to believe that monthly reporting of bank security lending is highly important to support timely consideration of changes in margin requirements, and for analytical purposes. Such consideration is very likely to be intitiated by assessment of the sensitivity of stock market credit to speculative advances and declines in stock prices, which may be short-term in nature. A series which was available only quarterly would not adequately serve this purpose.

DISTRICT AND BROAD GEOGRAPHIC DISTRIBUTION OF THE COMMERCIAL BANKS WITH THE LARGEST VOLUME OF SECURITY LOANS

June 30, 1969

DISTRICT	100 Largest	70 Largest
Boston	1	1
New York	14	12
Philadelphia	5	5
Cleveland	8	5
Richmond	5	1
Atlanta	6	3
Chicago	16	13
St. Louis	3	1
Minneapolis	3	3
Kansas City	4	3
Dallas	20	14
San Francisco	15	9
	100	70

BROAD GEOGRAPHIC REGION	---per cent--- 100 Largest	70 Largest
East	25	27
Central	40	40
West	35	33
	100	100

For analysis, it is highly desirable that the bank series be available for use in conjunction with the already developed monthly series on margin account lending by brokers. Bank lending accounts for approximately one-third of total stock market credit collateralized by non-exempt securities, and differences between brokerage and bank operations, in terms of borrowing flexibility, suggest differences in customer behavior. Accordingly, the bank security lending component is important in developing meaningful estimates of total stock market credit.

It does not seem likely that shifting from monthly to quarterly reporting would reduce the burden on the reporting banks sufficiently to justify the sacrifice in timeliness of data. The major burden of the proposed report is not the direct cost of reporting, but rather the fixed cost of classification of loans which underlies this reporting. Banks with a small volume of loans to purchase or carry securities, which would report only annually, may find it less costly to classify all of their security loan accounts once each year, for purposes of the report. By contrast, however, those banks which would be required to file more frequent reports, under the proposals, have large security loan balances. Such banks, whether reporting monthly or quarterly, would almost certainly find it more efficient and less costly to adjust their accounting procedures to allow for <u>regular</u> maintenance of loan classifications as an adjunct to loan negotiation and review procedures. Once the initial classification of loans has been made by these banks, actual reporting would involve no more than the generating of sub-totals from existing classifications.

Since the marginal cost of obtaining these sub-totals would be small relative to the fixed costs of the reporting requirement, and negligible for those large banks which would automate the process, a reduction in the frequency of reporting by active security lenders from monthly to quarterly would be unlikely to reduce significantly the reporting burdens. This conclusion is supported by responses of some banks to earlier field testing, in which bank estimates indicated that quarterly rather than monthly reporting would not reduce costs by two-thirds.

In addition, processing costs for the data, whether at the Board or the Federal Reserve Banks, would be insignificant under either monthly or quarterly reporting; a total of only 70 punched cards would be produced by the district Banks for each reporting, and no district would be responsible for more than 14 reports.

On balance, the staff believes that requiring quarterly, rather than monthly, reporting by a **panel** of banks would not sufficiently reduce the burden on reporting banks to overcome the greater difficulty of analysis of stock market credit trends. While stock market credit is not significant enough to warrant commitment of Board resources to continuous analysis, there is an important need for timely data which reflect the sensitivity of stock market credit to short-term movements in stock market activity, both for policy decisions when the need arises, and for research directed at the effect on credit of margin requirements. Accordingly, the staff recommends that the reduced panel of 70 banks be required to report monthly, as originally proposed, rather than quarterly.

Revised Recommendations.

In summary, the staff continues to feel strongly that monthly reports of detail on security lending should be obtained from a panel of larger banks and that annual reports should be obtained from all banks that are significantly engaged in security lending. However, as a means of reducing the burden on the banking community, the staff proposes that the number of monthly reporting banks be reduced, and that only banks with security loans in excess of $100,000 on the reporting date be required to file detail on the annual report. Such reductions can be made without substantial distortion in estimates of stock market credit extended by banks. As revised, the staff recommendations are:

1. That the proposed reports be required, and that in order to provide as much lead time as possible, the Reserve Banks immediately notify respondents as follows:

a. All commercial banks, all savings banks, and all branches and agencies of foreign banks in the U.S. classified as "banks" by State law will be required to report detail on security loans on June 30, 1970 if their aggregate security loans are $100,000 or more on that date, and similarly for each June 30 thereafter. Banks below the cutoff would report only the total of such loans.

b. Effective January 31, 1971, and the last day of every month thereafter, those 70 commercial banks reporting the largest volume of security loans on the June 1969 Call Report will be required to complete a similar regulatory report.

2. That the Board delegate authority to the Chief of the Capital Markets Section to effect any small shifts in the composition of the 70 bank monthly panel that are dictated by the results of the June 1970 reporting.

3. That the Chief of the Capital Markets Section have authority to effect minor changes in the 70 bank panel from time to time, if and as needed.

4. That the Board authorize the printing of 35,000 copies of an approximately 16 page manual to be mailed to the Reserve Banks. These will be printed outside the Board at a cost of from $2,600 to $3,500.

(b) (5)

[redacted]

If these revised recommendations are approved by the Board, appropriate changes will be made in the forms, instruction manual, and letters attached to the previous memorandum.