RECORDS SECTION
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March 23, 1970.

TO: Board of Governors

FROM: Divisions of Federal Reserve Bank Operations and Research and Statistics (Messrs. Ring and Keir)

SUBJECT: Federal Reserve Emergency Credit Assistance to Nonmember Depositary-Type Financial Institutions.

PROPOSAL

The Conference of Presidents on March 9 suggested that the authority in the Board's letter of December 24, 1969, for making emergency loans to nonmember depositary institutions, be extended three or four months beyond the existing termination date of April 1, 1970.

RECOMMENDATION

Although it seems increasingly unlikely that Federal Reserve emergency credit assistance to nonmember institutions will be needed in the months ahead, the recommendation of the Conference of Presidents to continue authority for such assistance on a contingency basis appears to be a reasonable one. To achieve this end, the Divisions of Federal Reserve Bank Operations and Research and Statistics, therefore, recommend that the emergency authority granted in the Board's December 24 leter be extended beyond April 1 to August 1, 1970. By extending the authority for four months to August 1, both the April and July quarterly post-interest crediting periods would be covered. Thereafter, the authority could probably be allowed to expire. A proposed telegram granting extension of the authority to August 1 is attached.

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DISCUSSION

The Board's letter of December 24 (copy attached) describes procedures to be followed by the Reserve Banks, as lenders of last resort, in extending credit to nonmember depositary institutions that are caught in a liquidity squeeze during a period of monetary stringency. The procedures call for (1) direct credit to nonmember commercial banks and to savings and loan associations and mutual savings banks that are not members of the Federal Home Loan Bank system, after they have exhausted other sources of credit and (2) indirect credit through member banks in cases where the institutions do not have sufficient collateral to support a direct loan from the Reserve Bank.[1/]

To authorize extensions of such credit, the Board in its letter of December 24 granted permission until April 1, 1970, for (1) the Reserve Banks to discount for nonmember institutions paper that is eligible for discount for member banks and (2) member banks to act as the medium or agent of a nonmember bank in obtaining credit from a

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1/ Savings and loan associations and mutual savings banks that are members of the Federal Home Loan Bank System were to be covered by special emergency lending arrangements worked out between the Federal Home Loan Bank Board, the Treasury, and the Board of Governors. While the details of these arrangements were in place and ready to be activated during the January semi-annual post-interest crediting period, no occasion for their implementation actually arose. Staff of the FHLBB see even less likelihood that emergency assistance will be needed during the April and July post-interest crediting periods. But the arrangements previously worked out could be readily activated on the off-chance that a need should arise.

Reserve Bank. The provisions of the Federal Reserve Act under which the Board took the action are as follows:

> "In unusual and exigent circumstances, the Board of Governors of the Federal Reserve System, by the affirmative vote of not less than five members, may authorize any Federal reserve bank, during such periods as the said board may determine, ... to discount for any individual, partnership, or corporation, notes, drafts, and bills of exchange of the kinds and maturities made eligible for discount for member banks under other provisions of this Act..." [Paragraph 3, Section 13]

> "...No member bank shall act as the medium or agent of a nonmember bank in applying for or receiving discounts from a Federal reserve bank under the provisions of this Act, except by permission of the Board of Governors of the Federal Reserve System." [Section 19(e)]

No loans have been necessary under these emergency arrangements and the odds that any will be needed by August 1 are rather minimal. However, it would seem desirable that the Reserve Banks be able to respond quickly on the outside chance that an emergency situation should arise, particularly in the April and July periods following quarterly and semi-annual interest crediting.

The large decline of interest rates on short-term market securities since the turn of the year has greatly improved the savings prospects for depositary institutions of all types, and current savings flows have already begun to reflect this better outlook. While no recent data are available on deposit experience at nonmember commercial banks, member country banks have experienced increases recently in their consumer-type time and savings accounts as well as their other time accounts, with the overall expansion actually somewhat larger than in the comparable weeks of other recent years. It seems reasonable to assume that nonmember banks have probably experienced an improvement at least as good as that for country banks, although inflows attributable to large CD's at relatively large institutions account for some of the improvement at country banks and this pattern may not carry over to the nonmembers.

At mutual savings banks the improvement to date has been less pronounced than at commercial banks. In the first half of March, however, the largest savings banks in New York City--which bore the brunt of the earlier savings attrition--have gained funds on balance. Inflows for the period fell somewhat short of those for the comparable weeks in earlier years, but the improvement was, nevertheless, significant. Moreover, the volume of new passbook loans has receded to more nearly normal proportions, suggesting that pressure from withdrawals in the April quarterly reinvestment period will be substantially less than in January. Seasonally, savings banks typically come under the greatest pressure during April when depositors make withdrawals to pay income taxes.

Preliminary data for the whole country indicate that savings and loan associations experienced a small net expansion in their share capital during February. Although associations on the West Coast continued to experience some net attrition in February, preliminary evidence indicates that even they showed some net inflow during the first ten days of March. As net savings inflows have reappeared, associations have begun to pay down some of their advances with the Federal Home Loan Bank. This, together with further net market borrowing by the FHLBB, has swelled the liquidity of the Home Loan Bank System to about $2 billion. While renewed pressures are generally anticipated during the April quarterly reinvestment period, there are expected to be much less extreme than in January--in view of the higher rate ceilings now prevailing and the sharp continuing decline of short-term market rates. Thus, the liquidity available at the Home Loan Bank looks considerably more generous in relation to possible needs for S&L borrowing than was the case just prior to the January reinvestment period.

Attachments.