Operations of the Federal Reserve Bank of St. Louis – 1972

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FUNCTIONS performed by the Federal Reserve System can be divided into three broad categories: economic stabilization, bank supervision, and the performance of numerous services for commercial banks, the U.S. Government, and the public. The economic stabilization role is primarily conducted on a Systemwide basis through the Board of Governors and the Federal Open Market Committee (FOMC), while the service and supervisory roles are largely responsibilities of the twelve Federal Reserve Banks. Since this Bank annually reviews economic stabilization policy decisions elsewhere,[1] this article will review only the supervisory and service operations.

The Federal Reserve Bank of St. Louis and its branches at Little Rock, Louisville, and Memphis serve the Eighth Federal Reserve District, which includes all of the state of Arkansas and parts of Illinois, Indiana, Kentucky, Mississippi, Missouri, and Tennessee. A change in the geographical makeup of the Eighth District occurred in 1972; 24 counties in western Missouri containing 26 member and 92 nonmember banks were transferred to the Tenth Federal Reserve District to be served by the Federal Reserve Bank of Kansas City. The transfer of these counties, which are economically more aligned with Kansas City than with St. Louis, resulted in shorter distances for check and cash delivery routes and thus in improved service for the banks in the area. This was the first change in district boundaries since 1926, when two New Mexico counties were transferred from the Dallas to the Kansas City District. At the end of 1972 there were 430 member and 976 nonmember banks in the Eighth District. Although fewer in number than nonmember banks, member banks held nearly 60 percent of total deposits in the District.

SUPERVISION

One of the major functions of the Federal Reserve Banks is supervision of state member banks and bank holding companies to insure a safe, efficient banking system.

A major supervisory function is the annual examination of state banks which are members of the Federal Reserve System to evaluate their assets, liabilities, capital adequacy, liquidity, operations, and management while assuring compliance with applicable laws and regulations. The information obtained from these examinations is used by banking authorities to correct unsatisfactory conditions and to assist banks in improving their operations. Examiners from the Federal Reserve Bank of St. Louis examine the 95 state member banks in the Eighth District, usually in conjunction with examiners from the state supervisory authority. All national banks are required by law to be members of the Federal Reserve System, but they are examined by representatives of the Comptroller of the Currency. Other insured banks are examined by the Federal Deposit Insurance Corporation (FDIC) and state supervisors, while the few noninsured banks are examined by state examiners only.

Federal Reserve Banks also supervise bank holding companies. At the end of 1972, the St. Louis Reserve Bank had jurisdiction over 14 multiple bank holding companies headquartered in the Eighth District[2] and 72 one-bank holding companies registered in the District. Applications to form bank holding companies and for bank holding companies to acquire bank or bank-related subsidiaries are processed by the Federal Reserve Banks. The Reserve Banks have been delegated authority by the Board of Governors to approve certain types of bank holding company applications; the remaining applications are processed and forwarded to the Board of Governors for final disposition.

Bank holding companies are required to file annual reports which are reviewed by the Examination Department of this Bank for completeness and accuracy. These reports are analyzed to determine the financial condition of the holding company and its subsidiaries and to assure compliance with applicable laws

[1] Annual reviews of FOMC monetary actions for the years 1964 through 1971 are contained in Reprints 13, 17, 22, 28, 39, 57, 68, and 76, available on request from this Bank.

[2] These 14 multi-bank holding companies had 56 bank subsidiaries in the Eighth District and 12 in other districts.

and regulations. Inspections of bank holding companies are also conducted to evaluate the management of the holding company and its nonbanking subsidiaries. Examination reports of subsidiary banks are analyzed to determine the soundness of the banks and to appraise their management.

Other supervisory functions include the admission of state banks to membership in the System and the approval of bank mergers and new branches of state member banks.

SERVICES

In addition to its supervisory role, the Federal Reserve Bank of St. Louis and its branches perform numerous services for banks, the Government, and the public; these services include collecting and transferring funds, distributing coin and currency, maintaining the reserve accounts of member banks, serving as fiscal agent for the Government, conducting economic research, and performing educational functions concerning the banking system, Federal Reserve operations, and stabilization policy.

Table I

VOLUME OF OPERATIONS[1]

	Dollar Amount (millions) 1972	1971	Percent Change
Checks collected[2]	$171,092.6	$155,803.1	9.8%
Noncash collection items	455.7	268.9	69.5
Coin counted	77.2	86.0	−10.2
Currency counted	1,968.9	1,866.8	5.5
Transfers of funds	397,204.6	349,249.4	13.7
U.S. Savings Bonds[3]	605.6	585.0	3.5
Other Government securities[3]	20,710.9	23,629.2	−12.4
U.S. Government coupons paid	219.4	229.4	− 4.4
Food Coupons received and counted	273.8	249.2	9.9

	Number (thousands) 1972	1971	Percent Change
Checks collected[2]	512,966	480,946	6.7%
Noncash collection items	751	804	− 6.6
Coin counted	652,056	725,885	−10.2
Currency counted	266,323	248,806	7.0
Transfers of funds	410	356	15.2
U.S. Savings Bonds[3]	10,311	10,724	− 3.9
Other Government securities[3]	415	581	−28.6
U.S. Government coupons paid	706	804	−12.2
Food Coupons received and counted	129,610	89,873	44.2

[1]Total for the St. Louis, Little Rock, Louisville, and Memphis offices.
[2]Excludes Government checks and money orders.
[3]Issued, exchanged, and redeemed.

Collection and Transfer of Funds

The Federal Reserve System plays a central role in the payments mechanism and is presently embarked on a program designed to accelerate the transfer-of-funds process. Checks drawn on commercial banks are at present the means of settling most nonbank financial transactions. Payment by check offers many advantages over payment by cash, including less risk from theft or loss, greater convenience in making many types of transactions, and provision of a record of disbursements. The use of checks is facilitated by the collection and clearing operations of the Federal Reserve Banks, which provide a mechanism for settlement of checks collected by commercial banks. Settlement is accomplished by entries to the reserve accounts of member banks.

With a growing economy, the number of checks written per year has risen at a rapid rate. The St. Louis Federal Reserve Bank and its branches cleared 513 million checks with a dollar value of $171 billion in 1972. This represented a 6.7 percent increase in number and a 9.8 percent increase in dollar value over the 1971 levels (see Table I).

Automation has been increased in an effort to improve the efficiency of check clearing operations; virtually all of the checks cleared by the St. Louis Bank in 1972 were processed by computer. With the anticipation of a continued increase in check volume, still more rapid means of transferring funds have been investigated and are being developed. The goal of such efforts is an Electronic Funds Transfer System (EFTS) in which electronic signals replace paper checks as the means of transfer.

Although such a system will evolve over a number of years, a substantial amount of funds are already transferred by electronic means, through the Federal Reserve Communications Network. These wire transfers are used for large transactions such as those resulting from interbank loans, check collection, and U.S. Treasury obligations where immediate payment is desirable. In 1972, 410,000 wire transfers totalling $397 billion were made by the four offices of the St. Louis Bank, an increase of 15.2 percent in number

Table II

PERCENT RESERVE REQUIREMENTS

	Net Demand Deposits up to $5 Million		Net Demand Deposits in Excess of $5 Million		Time Deposits up to $5 Million and Savings Deposits	Time Deposits in Excess of $5 Million
	Reserve City Banks	Other Member Banks	Reserve City Banks	Other Member Banks		
Prior to November 9, 1972 . . .	17	12½	17½	13	3	5

	Net Demand Deposits (Millions of Dollars)					Time Deposits up to $5 Million and Savings Deposits	Time Deposits in Excess of $5 Million
	2 or Less	Over 2 to 10	Over 10 to 100	Over 100 to 400	Over 400		
November 9, 1972	8	10	12	16½* 13**	17½	3	5
November 16, 1972	8	10	12	13	17½	3	5
In effect February 1, 1973 . . .	8	10	12	13	17½	3	5

*Reserve City Banks
**Other Member Banks

and 13.7 percent in value over the 1971 levels. The number of transactions was small compared to the number of checks processed, but the value of funds transferred by wire in 1972 exceeded the value of checks processed by $226 billion.

Following the Board of Governors' "Statement of Policy on the Payments Mechanism" in June 1971, Regional Check Processing Centers (RCPCs) were established at strategic locations around the country to give overnight clearing service to participating banks. The Federal Reserve Bank of St. Louis and its branches at Little Rock, Louisville, and Memphis began RCPC operations in 1972. By the end of 1972, the St. Louis RCPC was able to offer overnight clearing services to banks in the City of St. Louis and eight surrounding counties in Missouri and Illinois. At the same time the Little Rock RCPC zone had expanded to include 42 Arkansas counties, while the Louisville zone included 41 Kentucky and Indiana counties and the Memphis zone contained 35 counties in Tennessee, Arkansas, and Mississippi.

Significant changes in check collection procedures and reserve requirements were also implemented during 1972. Before these changes took place, banks outside overnight check clearing zones were allowed to delay payment to the Reserve Bank for one or more days after being presented a check drawn against them. This practice resulted in a form of Federal Reserve credit known as "float."[3] Under a change in the Federal Reserve System's Regulation J ("Collection of Checks and Other Items by Federal Reserve Banks") implemented on November 9, 1972[4], all banks using the Federal Reserve check collection system must remit for checks drawn against them in immediately available funds the same day the checks are presented for payment. This accelerated collection and transfer of funds was designed to reduce float.

The change in check collection procedures was purely technical, and the loss of reserves resulting from reduction in float was not intended to result in any change in the stance of monetary policy. The reduction in reserves was more than offset by a release of reserves caused by a simultaneous change in the System's Regulation D ("Reserves of Member Banks"), which reduced certain required reserve ratios. The purpose of the Regulation D change was to restructure reserve requirements on net demand deposits by eliminating the distinction between banks based on their location. Before the change, deposits at "Reserve City Banks" were subject to higher required reserve ratios than those at "Country Banks" of the same size. Now, reserve requirements are determined solely by the amount of deposits of the bank. All member banks of equal deposit size are required to meet the same required reserves[5] (see Table II).

Distributing Currency

Although checks are the major means of payment in this country, coin and paper currency still play an important role. Currency is more universally accept-

[3]Float results when a bank presenting a check to the Reserve Bank is given credit for the check before the bank against which the check is drawn pays the Reserve Bank. The longer the time period between crediting the bank presenting the check and collecting the funds from the bank against which the check is drawn, the greater the amount of float. On the Federal Reserve balance sheet, float is the difference between the value of cash items in process of collection on the asset side and deferred availability cash items on the liability side.

[4]The change was originally scheduled for implementation on September 21 but was delayed until November 9 by court action.

[5]Changes to Regulations D and J are discussed in greater detail in the Federal Reserve *Bulletin* (July 1972), pp. 626-630.

able than checks and is a more convenient, less time consuming, and cheaper method of settling relatively small transactions. The demand for coins has increased with the increased use of vending machines.

The public adjusts its money holdings between demand deposits and currency according to its preferences for holding each. The demand for currency, for example, usually rises sharply before Christmas. To meet the public's demand for currency, member banks order funds from their Reserve Bank, which charges the order to the banks' reserve accounts; member banks with excess currency deposit it in their reserve accounts. Nonmember banks generally receive currency from and transfer excess currency to member banks. At the Reserve Bank, the usable currency is then redistributed, and the unfit is removed from circulation to be destroyed.

Coin and paper currency handled at the four offices of the St. Louis Bank increased in 1972 as the demand for a hand-to-hand medium of exchange rose with increased economic activity. More than 266 million pieces of paper currency valued at nearly $2 billion were counted by the St. Louis Bank in 1972. This represented a 7 percent increase in number and a 5.5 percent increase in value over 1971 figures. Pieces of coin counted in 1972 declined as a result of new counting procedures implemented during the year. Under the new procedures, coins are counted and wrapped in one operation rather than two.

Lending Activity

Federal Reserve member banks may borrow from their Reserve Bank over short-term periods to meet reserve deficiencies under certain conditions. The volume of these borrowings is influenced by the discount rate (the rate charged on borrowings from Reserve Banks) and market interest rates.[6] Use of the borrowing privilege, called the "discount window," normally increases when the discount rate is low relative to the Federal funds rate (the rate at which one commercial bank lends funds to another, usually for one business day) or to rates of other short-term instruments such as Treasury bills and prime commercial paper. Conversely, loans to member banks usually decline when the discount rate rises relative to these other rates.

During the entire year of 1972, the discount rate remained at 4.5 percent, having been reduced from 4.75 percent on December 13, 1971.[7] Short-term market interest rates rose during 1972. Member bank borrowings from the St. Louis Bank was, accordingly, higher in 1972 than in 1971, especially in the second half of the year as the differential between money market rates and the discount rate increased (see Table III). Daily average member bank borrowings increased from $2.6 million in September to $41.1 million in December. In 1972, 198 advances totalling $1.35 billion were made to 25 banks. This represents a four-fold increase over 1971 when advances totalled $337.1 million. Daily average outstandings in 1972 were $6.6 million, compared to $1.5 million in 1971.

Fiscal Agency

Federal Reserve Banks also serve as bankers to the Federal Government. The functions they perform as fiscal agent include the handling and transfer of Government funds and assistance in the management of the public debt.

The principal Government checking accounts from which the Treasury makes its disbursements are maintained at the Federal Reserve Banks. When the Government collects taxes or sells securities to the public, the payments received are normally deposited initially in Treasury tax and loan accounts at those commercial banks which have been designated special depositories. The Treasury periodically calls in funds from these accounts and uses them to replenish its working balances at the Reserve Banks.

Reserve Banks also play a significant role in the management of the public debt. They assist in marketing new Government securities by (1) circulating subscription forms and receiving applications for the purchase of the securities, (2) allotting the securities according to the Treasury's directions, and (3) delivering them to the purchaser. In addition, the Reserve Banks redeem securities at maturity, make security exchanges, and pay interest by redeeming coupons.

In 1972 more than 10 million savings bonds and 400,000 other Government securities with a total value of more than $21 billion were issued, exchanged, or redeemed by the Federal Reserve Bank of St. Louis. In addition, 706,000 Government coupons with a value of more than $200 million were paid by this Bank.

[6]The interest rate charged on borrowings from Reserve Banks is still referred to as the discount rate, although most lending is now in the form of advances. The Board of Directors of each Reserve Bank sets the discount rate for the Bank subject to review and determination by the Board of Governors.

[7]The discount rate at all twelve Federal Reserve Banks was raised to 5 percent effective January 15, 1973.

Table III

LOANS TO MEMBER BANKS

(Dollar Amounts in Thousands)

	Average Amount Outstanding*	Federal Funds Rate*	Discount Rate	Federal Funds Rate Minus Discount Rate
January	$ 552	3.50%	4.50%	−1.00%
February	17	3.29	4.50	−1.21
March	1,371	3.83	4.50	− .67
April	1,519	4.17	4.50	− .33
May	39	4.27	4.50	− .23
June	3,220	4.46	4.50	− .04
July	5,085	4.55	4.50	.05
August	3,334	4.80	4.50	.30
September	2,630	4.87	4.50	.37
October	7,448	5.04	4.50	.54
November	11,647	5.06	4.50	.56
December	41,093	5.33	4.50	.83

	Number of Banks	Number of Advances	Aggregate Amount of Advances (including renewals)
Total advances, 1972	25	198	$1,349,145
Total advances, 1971	31	185	337,126
Daily average outstandings			
1972			6,551
1971			1,513

*Monthly average of daily figures

An additional fiscal agency activity is the redemption of Government food coupons. These redemptions showed a substantial increase in 1972, when 130 million coupons with a total value of $274 million were received and counted by this Bank. This represented a 44.2 percent increase in number and a 9.9 percent increase in value over 1971 redemptions.

Research

The Research Department of the St. Louis Reserve Bank collects and analyzes a broad range of regional, national, and international economic data. These analyses are used by the President of this Bank in the formulation of monetary policy recommendations at the meetings of the Federal Open Market Committee. Additionally, information and data related to economic developments are made available to the public through this *Review* and other publications.[8]

An increasing amount of Research Department activity is devoted to the study of bank market structure. Included in this activity is the Research Department's analysis of competitive and service factors involved in bank holding company and merger applications.

Bank Relations and Public Information

The four offices of the St. Louis Bank endeavor to maintain personal contact with all banks in the Eighth District, to assist member banks with their operations related to the Federal Reserve, and to provide educational programs on economic and banking topics to the public.

One of the services available to member banks is the Federal Reserve "Functional Cost Accounting Program," which provides a cost-income profile of each participating bank's major functions. These data enable an individual bank to compare current operating data with its previous operating statistics as well as with a group of banks of similar size.

During 1972, officers and staff members of the Federal Reserve Bank of St. Louis and its branches delivered 304 addresses before groups of bankers, businessmen, and educators. This Bank was represented at 284 banker, 51 professional, and 244 miscellaneous meetings. Under the bank visitation program, 1,308 banks were visited. During 1972, 249 groups requested films, and 5,257 visitors toured the four offices.

FINANCIAL STATEMENTS

Total assets of the Federal Reserve Bank of St. Louis and its branches at the end of 1972 were $3.71 billion, a decline of 6.9 percent from 1971 (see Table IV). The decline resulted primarily from a $400 million decrease in cash items in process of collection caused by the new check collection procedures described above. This decrease was partially offset by a $188 million increase in the Gold Certificate account to $534 million.[9] Two-thirds of the Bank's assets were held in U.S. Government securities, primarily short-term bills and notes. Remaining assets, including the Special Drawing Rights account, notes of other Federal Reserve Banks, Federal agency obligations, and bank premises, totalled $219 million.

[8]A list of the recurring publications of the Research Department is contained in the January 1973 issue of this *Review*.

[9]This change in the Gold Certificate account was caused in part by revaluation of gold in 1972.

Table IV

COMPARATIVE STATEMENT OF CONDITION

(Dollar Amounts in Thousands)

ASSETS

	December 31, 1972	December 31, 1971
U.S. Government Securities:		
Bills	$1,065,852	$1,157,788
Certificates	—	—
Notes	1,317,964	1,365,056
Bonds	124,403	126,175
TOTAL U.S. GOVERNMENT SECURITIES	$2,508,219	$2,649,019
Discounts and Advances	51,800	—
Acceptances	—	—
Federal Agency Obligations	47,117	18,621
TOTAL LOANS AND SECURITIES	$2,607,136	$2,667,640
Gold Certificate Account	534,206	346,208
Special Drawing Rights Certificate Account	15,000	15,000
Federal Reserve Notes of Other Banks	35,124	40,140
Other Cash	21,120	17,475
Cash Items in Process of Collection	444,584	854,530
Bank Premises (Net)	14,609	14,682
Other Assets	34,143	26,644
TOTAL ASSETS	$3,705,922	$3,982,319

LIABILITIES AND CAPITAL ACCOUNTS

LIABILITIES

	December 31, 1972	December 31, 1971
Deposits:		
Member Bank — Reserve Accounts	$ 814,166	$1,015,178
U.S. Treasurer — General Account	142,418	153,419
Foreign	9,860	9,520
Other Deposits	11,178	27,851
TOTAL DEPOSITS	$ 977,622	$1,205,968
Federal Reserve Notes (Net)	2,319,569	2,118,926
Deferred Availablity Cash Items	335,415	584,961
Other Liabilities and Accrued Dividends	19,406	22,112
TOTAL LIABILITIES	$3,652,012	$3,931,967
CAPITAL ACCOUNTS		
Capital Paid In	26,955	25,176
Surplus	26,955	25,176
Other Capital Accounts	—	—
TOTAL CAPITAL ACCOUNTS	$ 53,910	$ 50,352
TOTAL LIABILITIES AND CAPITAL ACCOUNTS	$3,705,922	$3,982,319

MEMORANDA: Contingent liabilities on acceptances purchased for foreign correspondents decreased from $8,667,000 on December 31, 1971 to $6,086,000 on December 31, 1972.

Table V

COMPARATIVE PROFIT AND LOSS STATEMENT

(Dollar Amounts in Thousands)

	1972	1971	Percent Change
Total Earnings	$141,543	$136,856	3.4%
Net Expenses	23,757	21,912	8.4
Current Net Earnings	117,786	114,944	2.5
Net Additions (+) or Deductions (−)	−1,590	+3,551	—
Net Earnings Before Payments to U.S. Treasury	$116,196	$118,495	− 1.9%
Distribution of Net Earnings:			
Dividends	$ 1,544	$ 1,474	4.7
Interest on Federal Reserve Notes	112,873	115,887	− 2.6
Transferred to Surplus	1,779	1,134	56.9
TOTAL	$116,196	$118,495	− 1.9%

Liabilities of the St. Louis Bank and its branches declined to $3.65 billion, 7.1 percent lower than the year-earlier figure. The reduction in deferred availability cash items, also resulting from the check collection procedure changes, was largely responsible for the decline. Federal Reserve Notes, the principal type of currency in circulation, amounted to $2.3 billion, more than 60 percent of the Bank's liabilities. This amount represents a 9.5 percent increase over the amount outstanding at the end of 1971. Deposits, consisting mainly of member bank reserve accounts, amounted to $978 million.

Federal Reserve Banks' earnings arise from interest on Government securities, interest on loans to member banks, and reimbursements for certain fiscal agency functions. In 1972, the portion of the System's earnings allocated to the St. Louis Bank and its branches totalled $141.5 million, an increase of 3.4 percent from a year earlier (see Table V). After statutory dividends of $1.5 million were paid to member banks and operating expenses of $23.8 million were met, $1.8 million was transferred to surplus and $113 million, or 79.8 percent of total earnings, was paid to the Treasury as interest on Federal Reserve Notes.