



BANK OF AMERICA

A.W. CLAUSEN

President

May 18, 1977

The Honorable Paul W. Tsongas
U. S. House of Representatives
419 Cannon House Office Building
Washington, D. C. 20515

Dear Congressman Tsongas:

We are pleased to enclose for your review Bank of America's policy statement advocating payment of interest on consumer checking accounts.

Bank of America favors the nationwide introduction of NOW accounts by all depository institutions. Enabling legislation, however, must provide that all institutions be subject to the same NOW account regulations, such as interest rate ceilings, reserve requirements, and timing of introduction.

We are also advocating that the required reserves on NOW accounts be held in the form of specially issued U.S. government securities -- as a means of partially offsetting the additional costs of NOW account implementation.

In forwarding this statement to you, we invite your comments both on this issue and the broader issue of comprehensive financial reform. We continue to believe that Congress must undertake broad scale reform to correct the inequalities and inefficiencies created in our country's financial system by piecemeal legislation over the years.

Sincerely,

BANK OF AMERICA STATEMENT ON NOW ACCOUNTS

Legislation to introduce consumer NOW (Negotiable Order of Withdrawal) accounts nationwide is desirable, provided that all eligible financial institutions are treated equally.

Over the years, imbalances and distortions have developed in our financial system as a result of piecemeal legislation. Comprehensive financial reform, long past due, does not appear to be imminent. As a result, Bank of America endorses the following NOW account proposal because some positive reform is better than none.

The NOW account is, in effect, an interest-bearing consumer demand deposit account, which permits consumers to write checks drawn against their savings account balances and payable to third parties. NOW accounts are currently offered only in New England by commercial banks, mutual savings banks and other thrift institutions. Many consumers have found these accounts to be beneficial.

Available only to individuals and nonprofit organizations, NOW accounts have been prohibited to businesses. When the program is extended nationwide, the extension should apply initially only to categories of customers already eligible. This limitation will provide the time financial institutions and the public need to adjust to the new transaction account. Congress can decide later whether to permit payment of interest on all demand deposits, a broadening that should be permitted ultimately. But an evolutionary process, similar to the one that eventually authorized business savings deposits last year, would be both responsible and appropriate.

It is essential that all depository institutions operate under the same rules and regulations, especially with regard to NOW accounts. Legislated inequities would limit consumer options and reduce the ability of depository institutions to compete for these accounts, thereby affecting the institutions' capacity to offer savings, consumer-lending and other services. Congress should include equal treatment provisions in NOW legislation, specifically on these points:

- 1.) Timing of introduction
- 2.) Interest rate ceiling
- 3.) Reserve requirement.

Timing of Introduction

An equitably competitive environment requires simultaneous introduction of the NOW account by all commercial banks, mutual savings banks, savings and loan associations, and credit unions. Presently, credit unions in many states offer customers share draft accounts (similar to NOW accounts), but should not be permitted to do so. Instead, in the interest of overall competitive equity, credit unions should be authorized to offer NOW accounts on the same basis as other depository institutions.

There should be a period of preparation between the time legislation is enacted and the time depository institutions introduce the new service. This period should be one year, so that new reporting systems may be developed, new pricing methods researched and new procedures established.

Commercial banks will not all be affected to the same extent by the introduction of NOW accounts. The impact on earnings from the payment of interest on these accounts will depend on the size and composition of a bank's deposits. At one extreme, a bank that currently does not handle consumer checking accounts will be unaffected, but a bank with significant retail business can expect to incur somewhat higher costs as consumers switch from noninterest-earning demand accounts to NOW accounts. The waiting period will enable all banks to develop the most appropriate strategy for managing the impact of these increased expenses.

This period also should be used to educate the consumer about the advantages of a NOW account, and the disadvantages, as well, since not all depositors will benefit from this type of account. The New England experiment has demonstrated that the consumer who benefits the most is one who maintains an account with a relatively large average balance and low volume of activity. Conversely, the consumer who has relatively low balances and high levels of activity may incur higher transaction charges and, thus, may not benefit from a NOW account.

Interest Rate Ceiling

A transition period should follow the waiting period. It would enable adjustments in the financial system to proceed on an orderly basis. A gradually increasing interest rate ceiling should be imposed uniformly on NOW accounts during the transition period -- which should last approximately two years. At the end of that time, the ceiling should be eliminated completely and institutions permitted to pay rates competitive with the market. The length of the transition should be specified in enabling legislation so depository institutions

can prepare adequately to take part in a competitive market. A required legislative review of events when the ceiling is due to be lifted is neither necessary nor desirable. Mandatory reviews tend to perpetuate the status quo and delay adjustments that make a free market rate available to the consumer.

Reserve Requirement

The reserve requirement for NOW accounts should be equal among all depository institutions. Currently, savings and loan associations, credit unions and commercial banks (Federal Reserve member and nonmember banks), offer similar financial services. But they are subject to widely different reserve requirements -- which directly affect the profitability of deposits and, therefore, the service charges they impose. The requirements also influence the institutions' ultimate willingness to offer a particular service. Therefore, all depository institutions offering NOW accounts should be required to maintain the same level of reserves on these accounts. Any other course would mandate a competitive inequality among depository institutions by making NOW accounts more profitable for some institutions than others, regardless of quality of service.

It would be appropriate for the central bank (the Federal Reserve) to hold these reserves. However, it is more important that reserves be equal than that they all be deposited in one system. Therefore, the Federal Home Loan Bank might hold NOW account reserves for savings and loan associations, and the National Credit Union Administration might hold reserves for credit unions. Nonmember commercial banks that wish to remain outside the Federal Reserve System could be permitted to deposit their NOW account reserves with a member bank. That bank, in turn, would pass the reserve deposits through to a Federal Reserve Bank.

The current reserve requirement for NOW accounts in New England is 3 percent (the same level the Federal Reserve imposes for regular savings deposits) and should be applied to NOW accounts, at all institutions, nationwide. This rate -- lower than that for demand accounts -- would reduce costs to institutions and, thus, ultimately benefit the consumer.

Earnings on Reserves

The Federal Reserve staff study ("The Impact of the Payment of Interest on Demand Deposits," January 31, 1977) and Chairman Arthur F. Burns have specifically linked the payment of interest on reserves to NOW accounts. Yet, payment of interest on reserves ideally should be considered in a package with the closely related matter of the Federal Reserve charging for its services. Joint consideration would strengthen analysis of the impact such a widely implemented program would have on Federal Reserve membership and on conduct of monetary policy in general. The Federal Reserve staff study suggested that the cost of introducing nationwide interest on demand accounts could be burdensome to depository institutions, and that permitting reserves to earn a return would ease the burden. Because the proposal concerns payment of interest on NOW accounts, payment should be restricted to NOW account reserves.

Payment of interest on NOW account reserves could be accommodated by requiring that such reserves of all institutions be held in the form of U.S. Government securities. The Treasury could issue a special security to be used solely for NOW account reserve requirements. During the recommended two-year transition period, the return on the reserves provided by U.S. Government securities could temporarily be set at a rate proportionate to the interest rate earned by NOW account

depositors. At the end of the period, the securities would be permitted to pay interest at a market rate.

The payment of interest on reserves will not complicate federal financial management or enlarge the federal deficit. The reason is that individuals, as well as all types of depository institutions (except credit unions), pay taxes on their interest income. Thus, additional revenues for the Treasury would be generated by taxes on interest income from reserves and on interest income of NOW account depositors.

In summary, NOW accounts should be offered nationwide to consumers and nonprofit organizations by all depository institutions competing under the same set of rules and requirements.