Banking insights

Banks now offer savings deposit service to businesses

Effective November 10, 1975, amendments to Federal Reserve System and Federal Deposit Insurance Corporation regulations allowed all insured commercial banks to accept savings deposits from businesses for the first time since 1933. The limit placed on the amount of these deposits is $150,000 per depositor per bank. Currently, banks can pay up to 5 percent on business savings accounts—the maximum rate permitted on any commercial bank savings accounts. Thus authorized, commercial banks can now compete on more equal grounds for business funds with savings and loan associations (S&Ls), which have not been prohibited from accepting commercial savings deposits.

An investment alternative for businesses

Bank savings accounts provide an alternative investment outlet for businesses with temporarily idle funds, especially small businesses. Before the reintroduction of commercial savings accounts at banks, the business with cash in excess of current needs could (1) hold the funds in currency and/or demand deposits, (2) deposit the funds in savings accounts at S&Ls, (3) purchase shares in money market mutual funds, or (4) make direct investments in money market instruments such as Treasury bills and negotiable certificates of deposit (CDs). A bank savings deposit possesses certain attributes that in some instances offer advantages either as a substitute for or a supplement to these other investment alternatives.

Currency and demand deposits. These rank lowest among the choices in terms of nominal return on investment. But while they bear no explicit rate of interest, they are the most liquid of the investment alternatives—that is, they can be mobilized for transactions purposes in the shortest period of time (immediately) with the least risk of capital loss (none, abstracting from bank failures or depreciation due to inflation). Moreover, they yield implicit returns in the form of services a bank provides to its depositors. Many banks today, however, are willing to transfer funds from a savings account to a checking account upon telephone notification by the depositor. A business whose bank offers this telephone transfer service may now find bank savings deposits preferable to demand deposits as a temporary repository for idle funds because their higher explicit nominal rate of return is available with little or no loss of liquidity.

Savings deposits at S&Ls. This second alternative may afford businesses higher earnings than comparable deposits at commercial banks to the extent that the S&Ls in the relevant market actually offer the maximum legal rate, which is ¼ percent higher than what commercial banks may pay. However, the S&L deposits are not as readily convertible into transactions balances as are bank savings deposits unless the S&L has an agreement with a commercial bank whereby a depositor's funds can be transferred from his S&L account to his bank checking account immediately upon notification by the depositor. This service is offered by some S&Ls, primarily in the larger metropolitan areas. Where it is not offered, the higher liquidity of savings deposits at banks may more than compensate for their lower interest return vis-à-vis their counterparts at S&Ls.

Money market mutual funds. When interest rates on short-term market instruments are above the offering rate on savings deposits, money market mutual funds may be

an attractive investment alternative for businesses. Shares in many of these mutual funds can be purchased in units as low as $1,000, and some funds permit investors to write checks on their shares. The main drawback of a money market mutual fund is uncertainty of return due to daily fluctuations in short-term interest rates. Certainty of return is much greater in the case of savings deposits since offering rates are changed infrequently, if at all, and then usually with advance notification only at the start of a calendar quarter.

Money market instruments. Businesses can buy and sell money market instruments, but such operations are feasible on an economical basis only to larger businesses and corporations due to the relatively large minimum denominations in which these instruments are issued and the large units in which they are traded in the secondary market. For example, Treasury bills and CDs are issued in minimum denominations of $10,000 and $100,000, respectively, and are normally traded in units of $1 million. Some small businesses would be precluded from purchasing these obligations due to their high minimum denominations. Other small businesses, though not deterred by minimum denominations, find the effective return reduced by transactions costs of purchases and sales in the secondary market. Like money market mutual funds, daily fluctuations in short-term interest rates make the return on direct investments in money market instruments uncertain unless held to maturity.

In summary, savings deposits at commercial banks should prove to be an attractive short-term investment alternative to businesses because these balances are potentially very liquid, have a certain return, and deposits can be made in any amount up to a $150,000 maximum balance. This last attribute should make savings deposits especially appealing to small businesses. In addition to these features, in periods when short-term market interest rates fall below the rates paid on savings deposits, as has been the case in recent months, such deposits may be preferred over other temporary investment vehicles even by larger businesses. By opening accounts in more than one bank, a business can invest more than $150,000. However, few banks offer such an opportunity to a noncustomer, especially when the funds appear highly interest-sensitive.

Growth in the Seventh District

Latest data available for all U.S. commercial banks show business savings slightly over $6 billion in mid-1976. Half of this was accounted for by the large banks in major U.S. cities (weekly reporting banks), which hold 55 percent of all commercial banking assets. In February 1977 business savings deposits at the 55 Seventh District weekly reporting banks averaged $625 million and accounted for slightly more than 13 percent of the total at weekly reporting banks nationwide.

Except for the large banks, data on business savings are available only from quarterly condition reports. Latest available readings (September 30, 1976) show significant differences in the importance of these deposits among member banks in various size classes in the five district states. (See table.)

These data indicate that, within this district, business savings deposits are most prevalent at banks in Iowa, Michigan, and Wisconsin. In these three states business savings deposits are higher as a percent of total savings deposits in almost every bank size group than in Illinois and Indiana. Moreover, the average amount of business savings deposits per bank is higher in Iowa, Michigan, and Wisconsin in most deposit-size classes. Notable exceptions to this pattern are the smallest banks in Iowa, where business savings deposits are relatively unimportant and the largest banks in Illinois, where the significance of these deposits is much greater than at smaller banks in the state.

Although business savings deposits are not yet as important at Illinois and Indiana banks, their more rapid growth rates in these states over the March-September period indicate that they may be catching up. One reason for the lagging importance of these deposits at Indiana banks is that state banking

laws prohibited business savings accounts at commercial banks until January 14, 1976, two months after the Federal Reserve Board lifted its prohibition.

The greater popularity of business savings deposits at Iowa, Michigan, and Wisconsin banks may be related to the fact that prior to the change in bank regulations permitting these deposits, S&Ls in some areas of these states had been actively soliciting commercial savings accounts. This had two effects—first, to familiarize businesses with this kind of account and second, to attract deposits away from commercial banks. Thus, when banks were authorized to accept business savings deposits, those that had lost deposits to S&L savings accounts may have been more aggressive in promoting their own

Business savings deposits at Seventh District member banks, September 30, 1976

	Deposit size (million dollars)					
	Less than 10	10-50	50-100	100-500	Over 500	All banks
Illinois						
Amount outstanding ($000s)	1,629	29,862	40,338	88,722	98,105	258,656
Percent of total savings	1.7	2.0	2.5	3.1	3.8	3.0
Average amount per bank ($000s)	27	169	611	1,888	16,351	727
Percent increase*	227.8	9.3	12.8	55.9	60.4	42.4
Number of banks	60	177	66	47	6	356
Indiana						
Amount outstanding ($000s)	110	5,995	9,378	22,052	7,826	45,361
Percent of total savings	0.5	1.4	2.8	2.4	1.4	2.0
Average amount per bank ($000s)	8	84	469	1,225	2,609	363
Percent increase*	**	38.9	57.4	63.6	146.0	68.4
Number of banks	13	71	20	18	3	125
Iowa						
Amount outstanding ($000s)	489	18,473	14,814	42,745	—	76,521
Percent of total savings	1.2	3.5	4.1	8.0	—	5.2
Average amount per bank ($000s)	17	212	823	3,288	—	524
Percent increase*	42.3	8.0	38.6	57.7	—	38.5
Number of banks	28	87	18	13	—	146
Michigan						
Amount outstanding ($000s)	2,512	25,983	18,742	82,494	199,055	328,786
Percent of total savings	6.2	2.8	3.5	3.6	4.3	3.7
Average amount per bank ($000s)	140	274	892	3,173	19,906	1,934
Percent increase*	40.4	59.6	55.4	36.0	35.8	38.5
Number of banks	18	95	21	26	10	170
Wisconsin						
Amount outstanding ($000s)	2,289	20,711	14,842	32,712	23,496	94,050
Percent of total savings	5.4	3.6	3.5	6.2	5.4	4.7
Average amount per bank ($000s)	120	280	873	2,974	11,748	764
Percent increase*	60.6	43.3	55.4	25.0	38.0	37.0
Number of banks	19	74	17	11	2	123
Seventh District						
Amount outstanding ($000s)	7,029	101,024	98,114	268,725	328,482	803,374
Percent of total savings	2.9	2.5	3.0	3.8	3.6	3.4
Average amount per bank ($000s)	51	200	691	2,337	15,642	873
Percent increase*	73.4	27.1	32.6	45.8	44.1	41.0
Number of banks	138	504	142	115	21	920

*From six months earlier.
**None outstanding as of March 31, 1976.

savings accounts in order to regain these deposits. Furthermore, some businesses, familiar with this type of deposit as a result of prior "education" by the S&Ls, may have chosen to open a savings account with a commercial bank because of the typically greater liquidity of bank savings deposits and other bank-customer relationships.

Implications for monetary policy

The emergence of business savings deposits at commercial banks may complicate monetary policy decisions depending on the quantities involved and the type of monetary policy pursued. Since the early 1970s the Federal Reserve System has moved toward a monetary aggregates approach to policy; that is, it has attempted to use its policy instruments to maintain growth rates of *M*-1 and *M*-2 within specified ranges over a reasonable time period.[1] The rationale for this approach is that the monetary authorities are seeking to provide money and credit to the economy in volumes consistent with the achievement of the optimum possible combination of the nation's economic goals. The relationship between the monetary aggregates and income, employment, and price stability goals is learned through observation of the economy's behavior in the past. However,the introduction of business savings deposits at commercial banks can be expected to alter some of these past relationships, and uncertainty about these changes could cause errors in the choice of the appropriate target growth rates for the monetary aggregates.

Suppose that corporations convert what would have otherwise been idle demand deposits into savings deposits at commercial banks. This conversion implies a reduction in the amount of demand deposits and hence *M*-1 (assuming no change in the demand for currency) the public wants to hold at any given level of interest rates. The same level of economic activity can now be supported with a smaller quantity of *M*-1. The substitution of savings deposits at commercial banks for demand deposits, in and of itself, will reduce the quantity of demand deposits.[2] If the Federal Reserve were following an *M*-1 target and attempted to restore *M*-1 to its original level, some unintended stimulus to the economy might result.

However, if an *M*-2 target were being pursued under these same circumstances, this problem would not be encountered. No shift in the demand for *M*-2 would occur since the fall in the demand for demand deposits is offset by an equal and opposite change in the demand for savings deposits, also a component of *M*-2. While the demand for the elements comprising *M*-2 has changed, there is nothing inherent in this assumed substitution of savings deposits for demand deposits that requires the Federal Reserve to adjust its *M*-2 target to achieve desired economic effects. Although the savings-demand deposit substitution will not alter the *M*-2 target, it will create excess reserves, which, unless absorbed by the central bank, can lead to an expansion in *M*-2 above its targeted level (see footnote 2).

Of course, there are myriad assets other than demand deposits which bank savings deposits can be substituted for. Depending on what assets are involved in these substitutions, the relationship between growth in the monetary aggregates as now defined and economic performance is likely to change. The dilemma for policy makers is that different kinds of shifts in the composition of asset preferences are taking place simultaneously, and accurate information as to kinds of shifts taking place and quantities involved is not always ascertainable.

Paul L. Kasriel

[1] *M*-1 is defined as currency and demand deposits held by the public. *M*-2 equals *M*-1 plus commercial bank time and savings deposits other than large negotiable certificates of deposit.

[2] The reduction in demand deposits is likely to be less than the increase in savings deposits since this substitution will create excess reserves, assuming a lower required reserve ratio for savings deposits than for demand deposits. Unless absorbed by the central bank, these excess reserves will provide a base for the expansion of total bank deposits, part of which will probably include demand deposits.