Automatic transfers: Evolution of the service and impact on money

Randall C. Merris

Commercial banks began offering automatic transfers from consumer savings to checking accounts November 1. With transfers made automatically through prior arrangements with their banks, consumers can keep more of their bank balances in interest-bearing savings accounts. Automatic transfers also are intended to reduce the volume of checks returned for insufficient funds—a costly inconvenience for everybody concerned. They are also expected to make it easier for consumers to meet the minimum balance requirements of their checking agreements.

The authorization extends only to consumer accounts. Corporations, partnerships, and other organizations, including units of government, are excluded from use of the service under plans approved last May by the Federal Reserve and the Federal Deposit Insurance Corporation. A majority of mutual savings banks can also offer automatic transfers.

Voluntary for both banks and consumers, automatic transfers can be made only on written authorization of the customer. The authorization must be given when the customer signs up for the transfer program. Arrangements can be made for banks to transfer funds automatically from interest-bearing accounts at thrift institutions, such as savings and loan associations. In that case, all three parties, of course, have to agree to the transfers in advance.

Although ordinarily waived, banks have the right to require 30 days' notice for withdrawals from savings accounts. Regulations governing automatic transfers require that banks prominently disclose the information that they reserve this right for automatic transfer accounts, just like any other savings plans.

Banks must also keep monthly records on the dollar volumes of savings subject to automatic transfer, the number and volume of transfers, and any service charges or interest forfeitures that result from transfers.

As with other innovations in banking, the advent of automatic transfers has created uncertainties, for both banks and the monetary authorities, about the pricing and packaging patterns that will emerge. There are also uncertainties about the effects of this new service on the money supply and the conduct of monetary policy.

Impact on money

With consumers able to keep more of their bank balances in savings accounts, there will be a tendency for automatic transfers to reduce the money supply, as conventionally defined. The shift, therefore, has implications for monetary policy.

The money supply, defined most commonly as currency plus demand deposits held by the public, excludes savings deposits. This definition, called M1, is one of the measures of the money supply the Federal Reserve uses in conducting monetary policy. Money supply figures based on this definition will reflect any reductions in consumer checking balances resulting from the introduction of the automatic transfer service. And there will be no indication of the offsetting increase in savings deposits.

Although the Federal Reserve does not control M1 directly or completely, it sets target ranges for growth of M1. And efforts are made to meet the M1 targets through policy actions that directly affect the reserve holdings of member banks and indirectly influencing all financial markets. To gauge the effectiveness of monetary policy, the Federal Reserve monitors movements in M1 along with other changes in economic data.

As automatic transfers allow consumers to transact the same volume of business with smaller balances in their checking accounts, the income velocity of M1 can be expected to rise. This velocity, called V1, is GNP divided by M1. Because both GNP and M1 are expressed in dollars, V1 is a pure number rather than a dollar or percentage figure.

Although the income velocity of M1 tends to vary with economic conditions, rising with expansions and falling with contractions, the trend has been essentially upward since the Second World War. Calculated from seasonally adjusted data, V1 nearly tripled in just over three decades, rising from 2.0 in early 1947 to 5.9 in early 1978. Reflected in this trend is better economizing on M1 holdings as interest rates have risen and improvements in the techniques of money management that have opened up for both consumers and businesses.

Automatic transfers are just another in a series of innovations that, like bank credit cards, have allowed consumers to make more effective use of their money and, like savings certificates, have provided attractive alternatives to holding money.

Consumers held almost $93 billion in demand deposits last June.[1] That was over a third of the demand deposits counted in M1. It was over a fourth of the $352.8 billion seasonally adjusted M1 total.

Consumer demand deposits at weekly reporting banks—which include the large banks that are most likely to introduce automatic transfers—totaled almost $37 billion. These deposits accounted for close to 15 percent of the demand deposit component of M1 and about 10 percent of total M1.

If reductions in consumer demand deposits even approach the amounts that could eventually be shifted into savings accounts, the increase in the income velocity of M1 could be substantial. How much V1 increases, and how soon, depends on the number of banks that introduced automatic transfers and the success of the pricing and promotion schemes they employ.

[1]The consumer deposit figures are estimates of gross demand deposits. They are slightly larger than the adjusted demand deposits used in calculating M1.

Pricing and packaging

Some of the most important features of automatic transfer programs are still being determined—the types of savings plans being offered, transfer charges and account maintenance fees, minimum balance requirements, minimum transfer sizes, and the provisioning of complementary and competing bank services.

Savings plans. Most banks offering automatic transfer programs are marketing the new service through separate savings/checking plans set up as automatic transfer accounts. A few banks, however, have linked automatic transfers to regular checking and savings accounts, provided customers want the service and are willing to pay the fees and meet the minimum balance requirements. This second strategy possibly could lead to faster customer acceptance of automatic transfers. If it becomes a popular strategy, it could speed the shift in deposit balances, tending to reduce M1.

The plans banks have announced show they favor service charges and balance requirements for pricing automatic transfers, rather than interest forfeitures and reductions in the interest rates paid on savings deposits subject to automatic transfer.

Most banks offering automatic transfers have announced they will pay the highest interest rate legally allowed on bank savings—currently 5 percent a year. As with other savings accounts, however, banks have picked various means of compounding interest (continuous compounding, daily interest, and less frequent compounding) and various rules for when deposited funds begin to earn interest.

Minimum balance requirements. Banks have announced various minimum balance requirements, stating the requirements in terms of checking balances and savings balances, separate minimums for both types of balances and minimums for the combined totals of both. Banks that previously used minimum checking balances as an implicit charge for handling checks seem in some cases to still be using this device, but combined now with a minimum savings balance that implicitly prices transfers.

Many banks are promoting zero-balance checking, while relying on explicit transfer charges, monthly maintenance fees, and minimum savings balances for reimbursement of their check-clearing and transfer costs. Some banks, especially the large ones, waive transfer fees and monthly charges when the savings balances are large enough. Where the exact amounts for cleared checks are transferred—rather than minimum dollar amounts—the zero-balance checking plans are practically the same as the NOW accounts available in New England (see box).

To the extent that minimum balances on checking accounts are used to cover the costs of automatic transfers, shifts from checking to savings balances are apt to be mitigated and the tendency to reduce M1 eased. Larger minimum balance requirements for savings accounts subject to automatic transfers, on the other hand, will tend to increase the shift from demand deposits to savings balances, reducing M1.

Minimum transfer amounts. Several banks have set minimums for the amounts that can be transferred. Most of these minimums are in the $25 to $100 range. For banks that want to develop broad markets for their automatic transfer programs, minimum amounts that can be transferred have to be low enough for a moderate-wage earner to deposit a weekly paycheck and make at least one transfer before the next payday and still not significantly lower the original savings balance. The range of minimums from $25 to $100 seems to suit this marketing purpose.

Because the minimum amount that can be transferred determines the amount that is apt to be put in a checking account at any one time, balances in consumer demand accounts can be expected to vary directly with minimum transfer amounts. For that reason, the prevalence of large-amount minimum transfers would reduce the downward effect of automatic transfers on M1.

Transfer fees and monthly charges. Some banks are charging a fee for every automatic transfer of funds. Others are charging for every transfer over a certain number allowed free every month. Most of the charges that have been announced are from 10 to 50 cents per transfer. In a few cases, transfers are priced at a dollar or more. A few banks charge by the check, rather than the transfer.

Many banks levy monthly charges for maintaining accounts, either instead of per-transfer charges or in combination with them. In some cases, both the monthly charge and the transfer charge are waived if the savings balance is high enough—usually $1000 to $5000. Waiver of charges and the large minimum balance requirements indicate the banks are target marketing their transfer plans to savers with big balances and low activity in their accounts.

In terms of the price mechanism, monthly charges tend to reduce the number of consumers enrolling in automatic transfer plans. Per-transfer charges tend to reduce both the number of enrollees in the plans and the activity in their accounts. Either way, the higher the charge, the less the downward influence on demand deposits and, therefore, M1.

The per-transfer charges in many plans are probably high enough to bring a significant reduction in the activity in consumer checking accounts. Checking accounts free of service charges have led many consumers away from economizing on their check writing in the past decade. Transfer fees could bring a slight reversal in this trend.

Other bank services. Automatic transfers do not provide one service already offered under overdraft protection plans—the provision of automatic loans. Because of the credit these plans provide, some customers will still want overdraft protection. But, because of the comparatively high interest charges for overdraft loans (18 percent a year for credit card plans and often 15 to 18 percent for other plans) this service will provide only limited competition with automatic transfers. Because of the convenience, bank customers will also still want preauthorized payment of their bills. This service, however, can be tied to automatic transfer plans.

The only banking service that will probably be replaced at most banks offering automatic transfers is telephone transfers from savings to checking accounts.

Many banks are evidently using the introduction of automatic transfers as a catalyst to the revision of their schedules for the pricing of other retail banking services. Several banks have taken the occasion to announce changes in their charges for regular checking accounts and requirements for minimum balances, as well as increases in charges for checks returned due to insufficent funds. Some banks are also taking a look at preauthorized bill payment and telephone transfer services for the first time, to be used either in conjunction with automatic transfers or as a substitute for them.

Impact on monetary policy

Considerations of pricing and packaging create uncertainties about the extent of shifts that can be expected from checking to savings deposits. But while these uncertainties complicate the use of M1 targets in the conduct of monetary policy, two factors are working in favor of the monetary authorities.

One is that the shift will not come all at once. Automatic transfers are expected to bring only a gradual downward shift in the demand for M1 and, therefore, a fairly slow increase in the income velocity of M1. Many banks indicate they have no immediate plans for introducing automatic transfers. Many customers will not sign up at first. For many, automatic transfers are simply priced out of their reach for now. Also, some of the plans that have been announced require that customers still maintain some checking balances.

Automatic transfers and NOW accounts compared

Automatic transfers from savings have been compared—too closely in some cases—with NOW accounts. NOW is an acronym for a check-type draft called a *negotiable order of withdrawal.* NOW accounts pay explicit interest and offer their owners the privilege of writing orders of withdrawal that, like checks, can be made payable to third parties.

Savings banks in Massachusetts and New Hampshire began offering NOW accounts in 1972. Under special authorization by Congress, these accounts are available today at savings banks, savings and loan associations, and commercial banks throughout New England. And despite approval of automatic transfers by the Federal Reserve and the FDIC, congressional authorization of NOW accounts has recently been extended to federally chartered banks and thrift institutions in New York State.

Although acceptance of NOW accounts was slow at first, even by some banks and thrift institutions, they have become widely used as a form of savings and payments in all six New England states. Over 70 percent of the commercial banks in New England were offering NOW accounts at the beginning of 1978. Altogether, that was 682,855 accounts worth $1.8 billion. They earned over $7.3 million in interest in December 1977. An average of 13 NOW drafts were written that month on each account.

Automatic transfers from savings can be viewed to some extent as a substitute for authorization of NOW accounts nationwide—an idea that was considered in 1976 and 1977. The two, however, are very different, and comparisons between NOW accounts in New England and automatic transfers should be drawn with caution.

The experiment in New England, where banks and thrift institutions offer NOW accounts on the same terms, differs sharply from the automatic transfer services that are becoming available at many of the nation's largest and most innovative banks, without the direct participation of savings and loan associations.

The experience in New England has been of some help to banks in providing an initial guide to pricing transfers and tailoring them to customer needs. But NOW accounts are imperfect as a guide to longer-range planning for automatic transfers, which will surely show their own patterns of consumer demand, account activity, and bank operating costs.

Experience with NOW accounts is apt to be of little use either in predicting how long it will take automatic transfers to become widely accepted as a banking service or in estimating initial and long-run deposit shifts from checking to savings balances.

As automatic transfer services become more widely available, the Federal Reserve will have already been monitoring its use, studying the effects on M1, and adjusting its M1 targets as needed.

The other is that M1 is not the only definition the Federal Reserve uses in making monetary policy. A more broadly defined monetary aggregate is M2, which includes the currency and demand deposits in M1 plus time and savings deposits at commercial banks, excluding large negotiable CDs (those of $100,000 or more). This measure is not affected directly by shifts from consumer checking accounts to savings accounts. It includes both.

Although dollar-for-dollar shifts from checking to savings balances do not affect M2 directly, this measure is influenced indirectly by the declines in the average reserves member banks are required to hold against their deposits. Reserve requirements for banks belonging to the Federal Reserve System are stated in terms of non-interest-bearing reserves as a proportion of deposits of a particular type.

Requirements for demand deposits vary from 7 percent to 16.25 percent, graduated by the deposit holdings of the banks. Requirements for savings deposits are 3 percent, regardless of the dollar holdings of a particular bank.

Shifts into savings deposits reduce the average reserve requirement as a proportion of total deposits. Without offsetting action by the Federal Reserve, lowering the ratio of required reserves to deposits can lead to expansion of bank credit, and consequently, M2.

The introduction of automatic transfers is expected to take long enough that the Federal Reserve will not need to engage in sudden large-scale moves to absorb member bank reserves. Reserves released through growing acceptance of automatic transfers can be neutralized by the Federal Reserve through its day-to-day dealings in government securities.

Through open-market operations, the Fed can sell government securities, reducing total reserves in the banking system. The volume of sales arising from the introduction of automatic transfers will probably be small, comparable certainly to the operations used in connection with earlier revisions in average reserve requirements and occasionally to offset Treasury financing activities.

A fall in average reserve requirements resulting from automatic transfers will be consistent with the secular decline in member bank reserve requirements since the Second World War. Having to hold reserves in the form of non-interest-earning assets is a burden on member banks that is not shared by the many state-chartered banks that have elected not to become members of the Federal Reserve System.

With no change in the current structure of reserve requirements, automatic transfers will reduce the implied costs of membership in the Federal Reserve through the reduction in average reserve requirements.

By making bank savings accounts more attractive, automatic transfers could bring savings flows that amount to more than mere shifts from checking balances. Not only will bank savings accounts be made more attractive compared with other interest-earning assets consumers may hold, but depositors may in some instances need to switch funds from other sources to meet the minimum balance requirements of automatic transfer plans. Unexpected changes in M2 arising from these shifts are not apt to be large.

Introduction of automatic transfers may also increase the general acceptance of M2 as a definition of money. By making bank savings deposits more readily available for consumer purchases and payments, automatic transfers can enhance inclusion of these deposits in the money supply. From the standpoint of policy, M2 will certainly be easier to follow during the transition than M1.

Crucial to policy makers, of course, are linkages between the money supply and economic activity. As always, the Federal Reserve will be watching both M1 and M2 and their relationships to movements in the real economy.