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REPORT
105–346

THE FINANCIAL REGULATORY RELIEF AND ECONOMIC EFFICIENCY ACT OF 1998

REPORT

OF THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

TO ACCOMPANY

S. 1405

SEPTEMBER 24, 1998.—Ordered to be printed

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SEPTEMBER 24, 1998.—Ordered to be printed

Mr. D'AMATO, from the Committee on Banking, Housing, and Urban Affairs, submitted the following

REPORT

[To accompany S. 1405]

The Committee on Banking, Housing, and Urban Affairs, to which was referred the bill (S. 1405), having considered the same, reports favorably thereon with an amendment and recommends that the bill as amended do pass.

INTRODUCTION

On July 30, 1998, the Senate Committee on Banking, Housing, and Urban Affairs (the "Committee") ordered to be reported S. 1405, the "Financial Regulatory Relief and Economic Efficiency Act of 1998," a bill to provide for improved monetary policy and regulatory reform in financial institution management and activities, to streamline financial regulatory agency actions, to provide for improved consumer credit disclosure, and for other purposes. The Committee reports the bill favorably with an amendment in the nature of a substitute, and recommends that the bill as amended do pass.

PURPOSE AND SUMMARY OF NEED FOR LEGISLATION

The purpose of this legislation is to strengthen our nation's financial institutions, to increase their ability to compete and to lower the costs of credit to consumers. The Committee recognizes the trend of increased dependency on credit among consumers, as well as a marked increase in consumer debt burden. Thus, the Committee believes it is necessary to do everything possible to lower the regulatory costs that increase the price of credit. As such, this legislation is intended to allow financial institutions to devote more resources to the business of lending and less to the bureaucratic maze of compliance with unnecessary regulations. This, in

turn, should permit institutions to provide financial services at the best possible price to consumers.

Senators Shelby and Mack have worked to reduce the regulatory burden on financial institutions in an effort to reduce the costs of credit to consumers since the 102nd Congress, when they introduced S. 1129, the Regulatory Efficiency for Depository Institutions Act. In the 103rd Congress, Senators Shelby and Mack introduced S. 265, the Economic Growth and Regulatory Paperwork Reduction Act of 1993. Portions of S. 265 were included in Title III of the Riegle Community Development and Regulatory Improvement Act of 1994. Congress passed into law S. 650, the Economic Growth and Regulatory Paperwork Reduction Act of 1995, which continued Senators Shelby and Mack's efforts to streamline an over regulated financial industry. S. 1405 is simply the latest bill to ensure the regulatory framework that governs the financial industry is as unambiguous and efficient as possible. A key difference of this legislation from years past, is that S. 1405 provides the Federal Reserve with an additional tool in which to conduct monetary policy. The Committee believes this additional authority will, in the long run, benefit consumers in the form of price stability, or low inflation.

HISTORY OF THE LEGISLATION

On November 7, 1997, S. 1405, the "Financial Regulatory Relief and Economic Efficiency Act" was introduced by Senators Shelby and Mack and referred to the Committee. The bill was cosponsored by Senator D'Amato, the Chairman of the Committee on Banking, Housing, and Urban Affairs, Senators Faircloth, Bryan, Grams, Kerry, Bennett, Gramm, Hagel, Allard, Enzi and Moseley-Braun.

The Committee held two hearings on this legislation. At the first hearing, on March 3, 1998, the Committee received testimony from Hon. Laurence Meyer, Governor of the Federal Reserve Board; Mr. Rex Hammock, Chairman of Hammock Publishing, on behalf of the National Federation of Independent Business; Mr. Neil Mahoney, President and Chief Executive Officer of Woronoco Savings Bank; and Mr. Edward Furash, Chairman of Furash and Company.

At the second hearing, on March 10, 1998, the Committee received testimony from Hon. Laurence Meyer, Governor of the Federal Reserve Board; Hon. John D. Hawke, Under Secretary for Domestic Finance of the Department of the Treasury; Hon. Andrew Hove, Acting Chairman of the Federal Deposit Insurance Corporation; Hon. Ellen Seidman, Director of the Office of Thrift Supervision; Mr. Edward Leary, Commissioner of Financial Institutions of Utah, on behalf of the Conference of State Bank Supervisors; Mr. Steven A. Yoder, Executive Vice President and General Counsel of AmSouth Bank of Alabama, on behalf of the American Bankers Association; Ms. E. Lee Beard, President and Chief Executive Officer of First Federal Savings & Loan of Hazleton, PA, on behalf of America's Community Bankers; Mr. Joseph S. Bracewell, Chairman and Chief Executive Officer of Century National Bank, on behalf of the Independent Bankers Association of America; Ms. Margot Saunders, Managing Attorney for the National Consumer Law Center; and Mr. Frank Torres, Legislative Counsel for the Consumers Union.

On July 30, 1998, the Committee met in Executive Session to consider S. 1405. The Committee considered and adopted, without objection, an amendment in the nature of a substitute that was offered by Senator Shelby. This amendment incorporated amendments that other Committee Members offered and that were agreed to on a bipartisan basis. Senator Shelby's amendment made changes to S. 1405 regarding: customer affinity groups; non-controlling investments to Savings and Loan holding companies; "haircuts" for net capital regulations on mortgage servicing rights; the Savings Association Insurance Fund (SAIF) special reserves; and struck language affecting the Federal Home Loan Bank System, anti-tying provisions, brokered deposits, and the Truth in Lending Act. The Committee rejected an amendment offered by Chairman D'Amato prohibiting banks from double charging for automatic teller machine withdrawals by a vote of 7-11. Senators D'Amato, Sarbanes, Dodd, Kerry, Bryan, Boxer and Moseley-Braun voted in favor of the amendment. Senators Gramm, Shelby, Mack, Faircloth, Bennett, Grams, Allard, Enzi, Hagel, Johnson and Reed voted against the amendment. Senator Hagel withdrew his amendment to modernize the Federal Home Loan Bank System.

The Committee ordered S. 1405 reported to the Senate by a voice vote.

PURPOSE AND SCOPE OF LEGISLATION

The bill, as ordered reported by the Committee, contains five Titles that substantially amend a number of banking laws. The provisions in these Titles remove unnecessary and burdensome regulations that provide no supervisory benefit to the regulators, but serve only to increase the operational cost of financial institutions. Each provision has been analyzed and reviewed to ensure no negative impact on the safety and soundness of the financial system.

Title I: Improving Monetary Policy and Financial Institution Management Practices

Title I is designed to assist the Federal Reserve Board (the Board) in conducting monetary policy and financial institutions in managing their business activities. Two provisions, interest on reserves and interest on business checking accounts, specifically address recent technological developments that have negatively impacted the Federal Reserve's ability to maintain a stable federal funds market. Additional provisions repeal outdated laws, cut bureaucratic red tape and allow institutions to commit more resources to the business of lending and less to the regulatory maze of compliance.

Banks are required to maintain a reserve balance of ten percent of all transaction deposits above a certain threshold. The reserve requirement can be satisfied with vault cash or with balances held at Federal Reserve Banks. However, the balances maintained at Federal Reserve Banks do not receive any payment of interest from the Federal Reserve. Banks have long complained about the reserve requirement and contend that the requirement is nothing more than a tax. As a result, a key strategy for banks is to minimize the balance at Federal Reserve Banks and reduce the amount of deposits that require reserves.

While the Board has used the reserve requirement to control the growth of M1 in the past, the Board now focuses on the price of reserves (the federal funds rate) to implement monetary policy. In testimony before the Senate Banking Committee, Federal Reserve Board Governor Laurence Meyer testified that reserve requirements continue to play a critical role in the implementation of monetary policy. Mr. Meyer said:

> First, [reserve requirements] provide a predictable demand for the total reserves that the Federal Reserve needs to supply through open market operations in order to achieve a given federal funds rate target. Second, because required reserve balances must be maintained only on an average basis over a two-week period, depositories have some scope to adjust the daily balances they hold in a manner that helps stabilize the federal funds rate.[1]

Banks also hold balances as a precautionary measure to protect themselves from potential overdrafts with the Federal Reserve System. An overdraft is essentially a loan or an extension of credit—a practice discouraged by the Federal Reserve. Such precautionary demands distort the pricing function of the federal funds rate and therefore make it difficult for the Federal Reserve to determine the quantity of reserves to supply. According to Governor Meyer:

> In the absence of reserve requirements, or if reserve requirements were very low, the daily demand for balances at Reserve Banks would be dominated by these precautionary demands, and as a result, the federal funds rate could often diverge markedly from its intended level.[2]

Recent financial market innovations have reduced required reserve balances from $28 billion in 1993 to approximately $9 billion in 1997. The most recent innovation used to avoid the reserve requirement is the computerized retail sweep account. It avoids the reserve requirement by sweeping consumer transaction deposits into personal savings accounts—accounts that are not subject to reserve requirements.

The Federal Reserve Board fears that the proliferation of retail sweep accounts will jeopardize their ability to control the federal funds rate and therefore lead to substantial rate volatility. If this were to occur, all money market participants (bankers, securities dealers, mutual funds, etc.) would suffer an increase in the cost of doing business due to the unnecessary and significant increase in risk.

Governor Meyer testified that the Federal Reserve Board needs the authority to compete directly with the retail sweep accounts by offering interest on reserves. This additional monetary tool would provide incentives for market participants to unwind many of the sweeps and significantly increase the level of transaction deposits.

Another provision, intended to relieve the consumer demand for sweep accounts, removes the current prohibition on banks, thrifts, and nonmember banks from paying interest on demand deposits.

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[1] Testimony of Laurence H. Meyer, Governor, Federal Reserve Board, S. 1405 Hearings, March 3, 1998. (Hereinafter "Meyer Testimony'.)

[2] Meyer Testimony, supra, note 1.

The current prohibition on interest on demand deposits dates back to 1933, when it was believed that country banks would deposit their excess funds into money center banks in order to fund speculation in the stock market. Thus, monies needed to be loaned to farmers would be diverted to Wall Street for speculation instead of "productive" uses in rural areas. Governor Meyer questioned whether such rationale was ever valid, and assured the Committee that rationale was absolutely not valid today.

Banks, especially small banks, are actually at a competitive disadvantage due to the 65 year old price control. One witness, Edward Furash, an established management and strategic consultant in the financial services industry testified:

> [the payment of interest on business checking accounts] will significantly improve the ability of the banking system to restore its competitiveness with the capital markets through pricing clarity and product simplification, while at the same time reduce bank risk by reducing the need to engage in sweep accounts and complex balance sheet manipulations to match capital markets interest rates.[3]

Removing the prohibition of the payment of interest on business checking accounts would also give small, community banks a better chance to compete. According to Cornelius Mahoney, Chairman of America's Community Bankers:

> Restrictions on [business checking accounts] make community banks less competitive in their ability to serve the financial services of many business customers. * * * [T]he quandary is that if community banks don't offer sweep accounts * * * their business customers are likely to leave. The problem is that sweep accounts are expensive and can be very labor intensive, especially for smaller institutions.[4]

Sweep accounts are not only labor intensive and expensive for banks. According to the National Federation of Independent Business (NFIB)—an association representing over 600,000 small business owners—sweep accounts impose costs on small business as well: [5]

> We soon found that the sweep account resulted in a flood of paper from the bank: each day a reconciliation statement letting us know how the money had been shifted around. And, because this is done via the mail, there is always a two-to-three day delay in information flow so we never have an accurate, up-to-the-minute view of the flow of funds among our banking accounts. * * * [sweep ac-

[3] Testimony of Edward Furash, Chairman, Furash & Company, S. 1405 Hearings, March 3, 1998.

[4] Testimony of Cornelius Mahoney, Chairman, America's Community Bankers, S. 1405 Hearings, March 3, 1998.

[5] Senator Shelby also submitted a letter dated March 2, 1998 into the record from the U.S. Chamber of Commerce in favor of removing the prohibition of interest on business checking accounts. "* * * the U.S. Chamber supports your legislation to remove restrictive regulations on the ability of financial institutions to offer interest bearing checking accounts. By allowing for more open competition, your legislation offers an important opportunity to small business owners to establish a more complete relationship with their financial service providers."

counts] are a bookkeeping nightmare for a small business * * *[6]

While the benefits of removing the price control seem evident, not all witnesses agreed. The most widely known opponent of the removal of the prohibition, First Union Corporation,[7] was invited to testify on the matter, but chose not to appear in person. In written testimony, First Union Corporation, testified:

> Small banks could become less profitable, less competitive, more susceptible to takeover and more sensitive to interest rate changes and economic cycles, possibly adversely impacting the safety and soundness of the banking industry when the next recession occurs.[8]

The Committee was not convinced by this argument. In fact, the Independent Bankers Association of America ("IBAA") surveyed its members in 1997 and found that 71 percent of its members favored the payment of interest on reserves and the interest on business checking.[9] In addition, the Committee received letters from the Comptroller of the Currency, the Chairman of the Federal Deposit Insurance Corporation, and the Director of Office of Thrift Supervision all stating that permitting the payment of interest on business checking accounts would not threaten the stability of the banking system or cause supervisory concerns, but instead, would improve overall institution efficiency.

First Union continued:

> The competitive need for an interest bearing corporate product is diminishing rapidly since already over 300 banks have corporate sweep account capabilities and the number is rising rapidly.[10]

The Committee also dismissed this argument since 300 banks represent less than three percent of all banks and thrifts nationwide (300/10,783=2.8%).

Responding to concerns identified by the American Bankers Association and the Independent Bankers Association of America, such as the Year 2000 problem and repricing of services, the Committee did include a transition period with regard to the removal of the prohibition on interest on corporate demand deposits. Upon enactment of S. 1405, banks would be allowed to offer a 24-transaction reservable money market account until January 1, 2001 at which time the 1933 interest prohibition would be repealed in its entirety. Thus, starting January 1, 2001, banks would be permitted—not mandated—to offer interest on business checking accounts.

Governor Meyer of the Federal Reserve Board echoed the Committee's perspective on both interest on reserves and business checking accounts:

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[6] Testimony of Rex Hammock, Member, National Federation of Independent Business, S. 1405 Hearings, March 3, 1998.

[7] See "First Bigfoot Bank," Forbes, March 23, 1998, pp. 44–45. This article documents First Union's interest in maintaining the prohibition against the payment of interest on business checking accounts.

[8] Testimony of First Union Corporation, S. 1405 Hearings, March 3, 1998. (Hereinafter "First Union Testimony".)

[9] "IBAA Survey on Interest-Bearing Commercial Transaction Accounts," 1997.

[10] First Union Testimony, supra, note 8.

> These legislative proposals are important for economic efficiency: Unnecessary restrictions on the payment of interest on demand deposits and reserve balances distort market prices and lead to economically wasteful efforts to circumvent them.[11]

In addition to allowing banks to offer interest on business checking, the Act repeals a number of outdated statutory mandates that do little to ensure safety and soundness or any other public policy goal. Specifically, Title I removes a number of regulatory restrictions on thrifts and their holding companies that will allow thrifts to compete with other financial service providers in a safe and sound manner. The bill would repeal the dated statutory mandate for liquid assets and give the regulator greater flexibility in establishing the proper liquidity requirements; this would give thrifts equitable treatment with banks, that do not have statutory liquidity requirements. Section 105 of the bill would repeal the current geographic restriction on thrift investments in service corporations. As one witness testified:

> section 105(a) would permit savings associations to engage in a wide range of joint venture opportunities * * * including community development projects. For many savings associations, this would be a more efficient way of engaging in such activities and would provide a benefit to communities and consumers * * *.[12]

This Title also makes a number of changes that will give financial institution management greater flexibility in the day-to-day management of corporate activities. For instance, Section 111 of S. 1405 will give national banks greater discretion in establishing the size of, and the procedures for electing, Boards of Directors. Section 113 will allow banks to purchase and hold their own stock (a basic power under corporate law). Section 113 will also allow banks to take their own stock as additional collateral in "work-out" situations; this will provide lenders with greater security against default and can only enhance the safe and sound operations of a lender. The Committee believes that these existing regulatory limitations on such basic corporate decisions hinders managerial flexibility, and promotes cumbersome business operations. By doing this, such regulations deny shareholders of earnings and increase the price of financial services for consumers, without any countervailing public policy benefit.

Other provisions in this Title are intended to provide greater discretion in corporate governance, particularly corporate structure reorganization such as the adoption of a holding company format, or the merger of affiliated institutions within a holding company format. The Committee realizes that there are legitimate public policy goals that require continued regulatory involvement. Accordingly, the provisions such as Section 110 and 112 of this bill will facilitate expeditious restructuring while retaining a role for legitimate regulatory oversight. The Committee believes that management is best-

[11] Meyer Testimony, supra, note 1.

[12] Testimony of E. Lee Beard, President and CEO, First Federal Savings & Loan Association of Hazleton, testifying on behalf of America's Community Bankers, March 10, 1998, pp 3–4 (Hereinafter "ACB Testimony").

positioned to make informed decisions regarding corporate restructuring. Clearly, management should be permitted to implement these decisions as cheaply and efficiently as possible—in such a way that both shareholders and customers can enjoy the full benefit of the efficiencies that can be achieved through restructuring.

Finally, Title I repeals several restrictions that the Competitive Equality Banking Act of 1987 (CEBA) imposed on so-called "limited purpose" financial institutions. When these restrictions were imposed, they were intended to be temporary; CEBA was intended as a stop-gap measure, to ensure "competitive equality" until comprehensive financial modernization legislation could be enacted. Eleven years later, as Congress continues to wrestle with a myriad issues relating to financial modernization, the "temporary" restrictions continue to apply.[13]

CEBA institutions have been frozen in place, operating under restrictive limitations on their activities. Further, any unintended breach of any of these restrictions triggers the divestiture requirements under current law. In recognition of the burden imposed on these institutions, Title I includes a number of provisions that relax the restrictions and draconian penalties of CEBA. The Committee believes that these provisions will permit the CEBA institutions to compete fairly with traditional financial institutions, and provide consumers with greater choices, and ultimately, lower prices.

Title II: Streamlining Activities of Institutions

Title II of the bill makes a number of changes in the federal banking laws that are necessary to allow financial institutions to pursue new business strategies. This Title amends provisions that do not have significant safety-and-soundness or consumer-protection implications, but have inhibited the development of new business lines or new means of delivering financial products. The Committee's intent in permitting these incremental changes in the business authority of various financial institutions is to enhance consumer choice and create greater opportunities for competition among market participants. The Committee believes that expanding choices and creating greater competition within the industry will ultimately benefit consumers of financial services through lower prices and development of products that best respond to the needs of consumers.

For instance, Section 201 of the bill, which was prepared with the cooperation of the Office of Thrift Supervision (OTS) staff, will update the community development investment authority of thrifts to parallel the authority of national banks. The current provisions are outdated and inflexible, and minimize the opportunity for thrifts to make important investments in the community. Currently, Federal savings associations "are limited in their ability to fully serve their low- and moderate-income communities."[14] Director Seidman of the OTS testified that this Section would, "replace obsolete statutory cross-references with the same statutory lan-

[13] See, Sen. Rep. No.19, 100th Cong., 1st Sess. (1987) pp. 492–494; cf., P.L. 100–86, Sec. 203.

[14] Ms. E. Lee Beard, President & CEO, First Federal Bank, on behalf of America's Community Bankers, prepared testimony before the House Banking Committee, July 16, 1998.

guage that currently defines the types of community development investments that can be made by national banks." [15]

Section 203 will allow so-called "credit card banks" to offer credit cards for business-purposes. Clearly, these institutions have the capacity to compete in the credit card market, and thereby help to lower the cost of these products to the public. Nevertheless, these institutions have been unable to offer such credit cards because of the technical confines of the Truth In Lending Act ("TILA"), under which such cards qualify as "commercial credit."

In connection with various types of retail loan and deposit programs, financial institutions have traditionally established relationships with what are known as "affinity groups," for the purpose of offering the members of such groups various financial products and services. The affinity group's endorsement serves to increase the members" awareness of the financial institution. The exemption provided by Section 204 will facilitate payments by lenders to affinity groups for a narrow range of real estate lending transactions. Only those "federally related mortgage loans" (as defined in the Real Estate Settlement Procedures Act ("RESPA")), for which the loan proceeds are not used to acquire the real property securing the loan, are exempt from the restrictions of Section 8 of RESPA.

In order to qualify for this exemption, a lender must also provide a direct benefit to the borrower from the endorsement. To be consistent with the intent of this provision, such benefit must be tangible, substantive and provided as part of the consummation of the loan agreement, either as a discount or reduction of settlement costs or fees or as a binding promise to provide some other benefit during the term of the loan. Other benefits that would be appropriate under this provision would include rate or fee reductions on other financial services or merchandise. All such benefits would necessarily be negotiated with, and approved by, the endorsing affinity group on behalf of its members. In general, the value of the "direct financial benefit" under this section will be dictated by competition in the marketplace for the endorsements from affinity groups.

Section 205 clarifies the law with regard to unfair practices and the verification period of the Fair Debt Collection Practices Act ("FDCPA"), without jeopardizing any of the consumer protections of that Act. In addition, this section addresses the current conflict in law between the Higher Education Act and the FDCPA.

Title III: Streamlining Agency Actions

The third Title of this bill is intended to streamline operations of various Federal financial regulators. The provisions in this Title will allow regulators to focus their energies on their primary responsibilities: that is, to ensure safety-and-soundness of the nation's banking system by identifying, monitoring and addressing risks to the financial industry. This Title will eliminate redundant regulatory reports regarding topics such as regulatory accounting standards and the antitrust implications of mergers. In both these instances the law is not being altered to eliminate reporting re-

[15] Testimony of Ellen Seidman, Director, Office of Thrift Supervision, S. 1405 Hearings, March 10, 1998.

quirements, but rather to do away with redundant reporting requirements. Changes like these will not impact meaningful public policy goals that these reports were intended to further. But they will allow regulators to focus on the achievement of these and other important goals and minimize wasted man hours on the preparation, review and approval of redundant reports.

Other provisions of this Title are intended to allow regulators to cut extraneous costs.[16] For instance Section 301 will limit the number of occasions that the Affordable Housing Advisory Board must meet, and eliminate attendant costs of these meetings by eliminating the requirement that these meetings be held at different locations through out the country.

Section 307 eliminates the SAIF (Savings Association Insurance Fund) Special Reserve Fund (the Fund) that was established in 1996 primarily for budget-scoring purposes. This change is supported by the Federal Deposit Insurance Corporation and the Office of Thrift Supervision. Current law would require Congress to take the $800 million of excess reserves (above the statutory 1.25 percent reserve ratio) to fund the Special Reserve Fund. This, however, would subject insured institutions to the risk of significant insurance premium increases since the $800 million in excess funds serves as a buffer or cushion, should the Fund ever be drawn upon for failing institutions. Such a situation could, once again, lead to a disparity in the BIF (Bank Insurance Fund)-SAIF insurance premium. Congress spent a great deal of time and effort in 1996 to address this disparity, and the Committee believes that situation should be avoided if at all possible.

Title IV: Miscellaneous

Title IV's provision address Truth In Lending Act ("TILA") disclosures and a number of governance issues relating to Federal agencies under the Committee's jurisdiction. Section 401 simplifies the advertisement requirements under truth-in-lending. The Committee recognizes that TILA provides important consumer protections, but also contains a number of onerous disclosure requirements of marginal use to consumers. The Committee is also cognizant of ongoing efforts between various stakeholders to produce a TILA/RESPA reform package. This attempt to create a comprehensive harmonization of TILA and RESPA has been ongoing for several years with no tangible results. Nevertheless, the Committee does not want to disturb this process; accordingly, the Committee has refrained from far-reaching TILA disclosure modifications in this bill.

One change that the Committee did believe deserved immediate attention was retained. Section 401 will simplify the disclosures that are required at the end of radio and television advertisements for consumer credit. Currently, advertisers are required to provide so much detailed information at the end of an advertisement that the disclosure is little more than a garbled exercise in speed-reading. Section 401 would allow credit advertisers, at their option, to

[16] Section 306 of the bill as introduced has been eliminated. This provision eliminated the Thrift Depositor Protection Oversight Board. This provision was eliminated from this bill because it was contained in S.318, the Home Owners Protection Act of 1998, which was enacted into law on July 29, 1998 (P.L. 105–216).

provide an abbreviated disclosure of essential terms of the credit agreement, along with an "1–800" number that the consumer may call for more detailed information. This provision also establishes requirements for the 1–800 service that will make sure that consumers who use it will obtain complete TILA disclosures at no long-distance charge. The Committee believes that by simplifying the on-air disclosure to those basic terms that allow comparison shopping, and by providing the consumer with the opportunity to obtain further disclosure free-of-charge and in a more deliberate manner, the consumer will benefit from more meaningful information. America's Community Bankers supports this Section testifying they "[believe] that the simplicity of providing basic rate information, giving a toll free number, and making further information available upon request will significantly reduce regulatory burden of creditors while enhancing the consumer's ability to comprehend the credit product being advertised."[17]

Another important provision in this Title is Section 402, which will raise the salaries of the entire Board of Governors of the Federal Reserve Board. Currently the Chairman of the Federal Reserve is paid less than a Presidential Cabinet Member and less than some of the staff at the Federal Reserve Board. The Committee realizes that individuals are not drawn to service on the Federal Reserve Board by the salary. Nevertheless, the Committee believes that this gesture is an appropriate means of acknowledging a Chairman's tremendous responsibility and service in what has been described as "one of the world's toughest jobs."[18] During his tenure at the Federal Reserve, Chairman Greenspan has provided cool and deliberate guidance for our nation's economy. Realizing that inflation represents the single greatest threat to our country's long-term economic viability, Chairman Greenspan has dedicated a tremendous amount of time and effort to controlling inflation. He has provided the stability and leadership that is responsible for the unprecedented economic growth that the U.S. economy has enjoyed since the last recession ended in 1991.[19]

The bill would also transfer the health insurance coverage of retirees and certain employees of the Federal Reserve System and the Federal Deposit Insurance Corporation to the Federal Employees Health Benefits program. This provision is supported by both the Federal Reserve and the FDIC. Consolidating these two insurance programs should reduce costs to the Federal government by increasing the pool of covered individuals (thereby reducing risk).

Section 404 of this bill will remove the condition that at least one member of the Federal Housing Finance Board be a "Community Representative." This condition has existed since the Board was created in 1989, and the Committee believes that it is responsible for the fifth seat on the Board going unfilled.

Title V: Technical Corrections

This Title is comprised of technical corrections to the Deposit Insurance Funds Act, Federal Deposit Insurance Act, Economic

[17] ACB Testimony, supra, note 11.
[18] The Economist, May 9, 1998.
[19] See, e.g., Congressional Research Services, Current Economic Conditions and Selected Forecasts, CRS Report to Congress, Rep. No. 96–963E (Gail Makinen, August 4, 1998).

Growth and Regulatory Paperwork Reduction Act and the International Bank Act.

SECTION-BY-SECTION ANALYSIS

Section 101. Interest on reserves

This provision would allow the Federal Reserve to pay interest on reserve balances maintained at a Federal Reserve bank at a rate no greater than the federal funds rate. Recent developments in technology (sweep accounts) have allowed banks to decrease their reserve deposits, which could cause an increase in interest rate volatility. Interest on reserves would decrease this potential volatility and assist the central bank in conducting monetary policy.

Section 102. Interest on business checking accounts

This provision allows depository institutions to offer negotiable order of withdrawal accounts to all businesses.

Section 103. Repeal of savings association liquidity provision

This section repeals the 1950 statute requiring savings associations to hold liquid assets in an amount no less than four percent to ten percent of their total demand deposits and borrowing payable within one year. Commercial banks and state savings banks are not subject to a similar requirement. The liquidity of these institutions is monitored through the examination process pursuant to flexible safety and soundness guidelines.

Section 104. Repeal of thrift dividend notice requirement

This provision would repeal the statutory requirement imposed on savings association subsidiaries of SLHCs to provide the OTS with 30-days notice of the payment of any dividend. The current provision applies only to savings associations owned by SLHCs. No similar provision applies to savings associations controlled by individuals, bank holding companies or even national banks owned by holding companies.

Section 105. Reduction of regulatory requirements for thrift investments in service companies

This amendment removes the geographic and ownership limitations on investments in first-tier service companies and imposes, instead, the activity-based limitations found in OTS regulations. In addition, it changes the term "service corporation" to "service company" to make consistent with the change made last year in Public Law 104–208 with regard to banks.

Section 106. Elimination of thrift multi-state multiple holding company restriction imposed on SLHCs

Currently, a bank holding company may own thrift subsidiaries in separate states, but a savings and loan holding company may not, unless one of three exemptions is applicable. An SLHC can own a subsidiary out of state if it buys the thrift in a neighboring state and then merges it with an in-state subsidiary. The provision would eliminate the existing multi-state multiple restriction im-

posed on thrift holding companies allowing them the choice of whether to merge or not to merge.

Section 107. Removal of prohibition on SLHC acquiring a non-controlling interest in another SLHC or thrift

This provision would allow a savings and loan holding company to acquire a five to twenty-five percent non-controlling interest of another SLHC or savings association, subject to the approval of the Director of OTS.

Section 108. Repeal of deposit broker notification to FDIC

The section simply repeals the requirement of brokers to file a written notice (not a filing) with the FDIC before the deposit broker solicits or places any deposit with an insured depository institution so brokers cannot mislead consumers.

Section 109. Uniform regulations governing extensions of credit to executive officers

This provision would adopt a single common regulation—Regulation O, 12 C.F.R. Part 215—to apply to loans for executive officers of all insured institutions.

Section 110. Expedited procedures for certain reorganizations

This section would expedite the reorganization of a national bank into a bank holding company by permitting national banks, with two-thirds approval of its shareholders of the bank and the Comptroller, to reorganize into a subsidiary of a bank holding company without first forming the phantom bank.

Section 111 (a). Increase the one year term for national bank directors and allow banks to have staggered board of directors

This provision would permit national banks to elect their directors for terms of up to three years in length, and would permit these directors to be elected on a staggered basis in accordance with regulations issued by the OCC, so that only one-third of the board of directors is elected each year.

Section 111 (b). Removal of upper limitation on number of board of directors

This provision would permit the Comptroller to remove the limitation on the number of board members, currently 25, in order to allow a bank more flexibility in determining the composition of its board. The lower limit of five would remain.

Section 112. Permit national banks to merge or consolidate with subsidiaries or other nonbank affiliates

This section would permit a national bank, upon approval of the Comptroller and pursuant to regulations, to merge or consolidate with its subsidiaries or nonbank affiliates without providing for an increase in powers for the national bank.

Section 113 (a) & (b). Repeal prohibition on a national bank's purchasing or holding its own shares

This provision would repeal the prohibition on a bank owning or holding its stock but retain the prohibition on making loans or discounts on the security of the banks own shares. This amendment would codify an OCC interpretation and eliminate any confusion about the authority of national banks to take legitimate corporate actions to reduce capital or otherwise acquire their own shares.

Section 113 (c). Clarification of the Bank Holding Company Act

This provision amends an unintended consequence of section 2615 of the Omnibus Consolidated Appropriations Act for FY 1997 (P.L. 104–208), which inadvertently conflicts with another provision of federal law (12 U.S.C. Sec. 2279aa–4).

Section 114. Depository institution management interlocks

Section 205(8)(A) of the Depository Management Interlocks Act of 1978 (DIMIA) permits a diversified savings & loan holding company to request the Office of Thrift Supervision to permit it to have on its Board an outside director of a non-affiliated institution. This provision expands the authority of the OTS, so that it may approve "dual service" for not only outside directors, but also management officials, so long as it does not result in "a monopoly or substantial lessening of competition in financial services in any part of the United States.'

Section 115. Modify treatment of purchased mortgage servicing rights in tier 1 capital

The provision authorizes the appropriate Federal banking agencies to jointly simplify capital calculations by not requiring banks or thrifts to distinguish between types of mortgage servicing rights. This would allow regulators to value marketable mortgage servicing assets in capital determinations up to 100% of their fair market value rather than the current level which is limited to 90% of fair market value.

Section 116 (a). Crossmarketing restriction on limited-purpose banks

This provision would repeal the current crossmarketing restriction, allowing CEBA banks to crossmarket their products and services with the products and services of affiliates.

Section 116 (b). Restriction on daylight overdrafts

This provision would expand "permissible overdrafts" to include overdrafts incurred by affiliates that incidentally engage in financial services activities, if the overdraft is within the restrictions imposed by Section 23A and 23B of the Federal Reserve Act.

Section 116 (c). Activities limitations

This provision repeals the restriction which prohibited limited-purpose banks from engaging in activities they were not engaged in prior to March 5, 1987. Limited-purpose banks would still be prohibited from both accepting demand deposits and engaging in

the business of commercial lending (i.e. a limited-purpose bank can do one or the other, but not both).

Section 117. Divestiture requirement

This section would modify the provision of CEBA which requires divestiture of a limited-purpose bank in the event the bank or its owner fails to remain qualified for the CEBA exception. The amendment allows limited-purpose bank owners to avoid divestiture by promptly correcting the violation (within 180 days of receipt of notice from the FRB) that would otherwise lead to divestiture and implementing procedures to prevent similar violations in the future.

Section 201. Updating the authority for thrift community development investments

This provision would replace obsolete language with regard to the investment of a savings association in real estate or loans secured by real estate in concordance with title I (Community Development Block Grant program—CDBG) of the Housing and Community Development Act of 1974, with the same statutory language that currently defines the types of community development investments that can be made by national banks and state member banks.

Section 202. Repeal section 11(m) of the Federal Reserve Act

Repeals the limitation on the amount of stocks and bonds member banks may hold as collateral for a loan. Also eliminates arbitrary 15 percent capital limit under current law.

Section 203. Business purpose credit extensions

This provision would make clear that the prohibition on commercial lending by credit card banks does not include the use of credit card accounts for business purposes.

Section 204. Affinity groups

This provision clarifies that affinity arrangements and co-branding arrangements with regard to non-purchase money transactions are legal if the consumer receives a direct financial benefit from the endorsement.

Section 205 (a). Unfair practices

Provides for collection on bad checks, if it is "reasonable, does not exceed $25, results from the collection of a check returned for insufficient funds, and notice of the charge was conspicuously posted * * *"

Section 205 (b). Clarification of allowable collection activities during the verification period

This provision codifies aspects of an FTC interpretation and analyses rendered by Federal Courts that if a debtor has not requested verification of the debt or notified the collector of a dispute, the collector may attempt to collect a debt during that 30-day period, as long as the activities and communications do not overshadow or contradict the consumer information provided in law.

Section 205 (c). Amendment to Fair Debt Collections Practices Act (FDCPA) to address conflicts with the Higher Education Act (HEA)

Exempts a "prejudgment administrative wage garnishment permitted under section 488A of the Higher Education Act" from the definition of communication with regard to the collection of any debt.

Section 206. Restriction on acquisitions of other insured institutions

This provision would allow limited-purpose banks to acquire insured institutions which have Prompt Corrective Action capital categories of "undercapitalized" or lower.

Section 207. Mutual holding companies

This section includes numerous technical changes to the mutual holding company provisions of the Home Owners" Loan Act, as well as some clarifying language. It specifically authorizes a mid-tier stock holding company as currently permitted by several states. It would facilitate capital raising by permitting the subsidiary stock holding company or the subsidiary association to issue one or more classes of voting stock, and build in more flexibility by allowing shares authorized at the time of the initial mutual holding company formation to be subsequently issued.

Section 208. Call report simplification

This provision calls for: the modernization of the call report filing and disclosure system; the uniformity of reports and simplification of instructions; and the review of the call report schedule. The exact same provision was included in Section 307 of the Riegle Community Development and Regulatory Improvement Act of 1994.

Section 301. Elimination of further development of the supplemental disclosure of fair market value of assets and liabilities as duplicative

This section would clarify that banking agencies need no longer pursue further development of the supplemental disclosure method. Even so, Section 36 of FDIA and its supporting regulations provide agencies with discretion to seek additional information in regulatory reports and annual reports regarding fair market value.

Section 302. Creditor fairness/payment of interest in receiverships with surplus funds

This provision gives the FDIC the authority to establish a uniform interest rate with regard to receiverships.

Section 303. Amends the reporting requirement of differences in accounting standards

Amends the requirement for each agency to produce an Annual Report on "Agency Differences in Reporting Capital Ratios and Related Accounting Standards." Instead, this provision directs the Federal banking agencies to jointly produce one report.

Section 304. Streamlining of Bank Merger Act application filing requirements

This provision eliminates the requirement that each federal banking agency request a competitive factors report from the other three federal banking agencies as well as the Attorney General. The proposed provision would decrease that number to two, with the AG continuing to be required to consider the competitive factors of each merger transaction. The provision also requires the responsible banking agency to take into account appropriate competitive measures when considering the competitive effect of mergers.

Section 305. Elimination of SAIF and DIF special reserves

This provision would eliminate the need for the establishment of a SAIF "special reserve." Beginning in 1999, the FDIC will be required to establish a SAIF special reserve equal to that amount of SAIF funds that is above 1.25% on January 1, 1999. The FDIC has suggested that this could mean an amount of nearly $800 million set aside for a special reserve, yet, none of these funds could be used in calculating the reserve to deposit ratio of the SAIF.

Section 401. Amend TILA requirements for credit advertising

Provide a uniform rule for all credit products advertised on either radio or TV. As an optional alternative to current disclosure requirements, credit advertisements in those media would state basic rate information, give a toll free number, and make further information available upon request.

Section 402. Positions of Board of Governors of Federal Reserve System on the Executive Schedule

This provision simply raises the pay of the Chairman of the Federal Reserve Board from Level II of the Executive Schedule to Level I (approx. $14,800) and the Board Members from Level III to Level II (approx. $10,500).

Section 403. Coverage of employee health plans at Federal banking agencies

The FDIC will eliminate its alternative health insurance plan at the end of the 1997 health benefits year, due to a recently ratified agreement with the National Treasury Employees Union. Most of the employees will be able to enroll in the Federal Employees Health Benefits Program (FEHBP) during the open season this fall. However, employees are required to be enrolled in FEHBP for at least five years immediately prior to retirement in order to carry FEHBP coverage in retirement. Thus, without a legislative change, the FDIC will have to maintain a non-FEHBP plan for the approximately 2,000 retired employees and those within five years of retirement around the country. This provision allows employees within five years of retirement to carry FEHBP coverage in retirement and is consistent with legislation that Congress passed on behalf of the OCC and OTS in 1994. This provision also applies to the Federal Reserve System.

Section 404. Federal Housing Finance Board position

This section eliminates the Consumer Representative requirement for a member of the Board of Directors, since no such position has ever been filled. In doing so, this provision does not reduce the required number of Directors, merely this specific requirement.

Section 405. Reports by indenture trustee

This provision amends the Trust Indenture Act of 1939 to require an indenture trustee to annually forward each indenture security holder a form requesting change of address information.

Section 501. Technical error in DIFA amendment

Section 2707 amends section 7(b)(2) of the FDIA to provide that assessment rates for SAIF members may not be less than assessment rates for BIF members. It currently begins as follows: "Section 7(b)(2)(C) of the Federal Deposit Insurance Act (12 U.S.C. 1817 (b)(2)(E), as redesignated by section 2704(d)(6) of this subtitle) is amended—". The proper reference is to section 7(b)(2)(E) of the FDIA.

Section 502. Conform rules for continuation of deposit insurance for member banks converting charters

Section 8(o) of the Federal Deposit Insurance Act (FDIA) provides for termination of deposit insurance when a member bank ceases to be a member of the Federal Reserve System, subject to an exception for certain mergers or consolidations. Prior to FIRREA, section 4(c) and (d) were referenced in a single subsection: subsection (b). In FIRREA, Congress divided former section 4(b) into two separate sections, 4(c) and 4(d), but neglected to change the reference in section 8(o). Later, in a technical amendment designed to correct the error, Congress amended section 8(o) to include an exception for section 4(d). This incomplete amendment was insufficient to encompass the original intent of section 8(o) because no exception was included for section 4(c), which provides for state-to-federal and federal-to-state conversions. Providing a technical amendment to section 8(o) to include a cross reference to section 4(c) would remedy this omission and restore the original intent.

Section 503 (a). Waiver of the citizenship requirement for national bank directors

This provision provides that the Comptroller may waive the U.S. citizenship requirement for up to a minority of a national bank's directors. The Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA) inadvertently deleted the long-standing authority of the Comptroller to waive the citizenship requirement for up to a minority of directors of national banks that are subsidiaries or affiliates of foreign banks.

Section 503 (b). Technical Amendment to Section 11 which currently prohibits the Comptroller from having an interest in any national bank "issuing national currency."

This provision simply updates section 11 to reflect that national banks no longer issue national currency, while maintaining the

provision that prohibits the Comptroller from owning interest in the national banks they regulate.

Section 503 (c). Technical Amendment to repeal Section 51 (obsolete minimum level of capital)

This provision repeals Section 5138 of the Revised Statutes (first enacted in 1864), which imposes minimum capital requirements for national banks. This minimum capital requirement (ranging from $50,000 to $200,000) is obsolete, since Congress granted the Federal banking agencies the regulatory authority to establish minimum capital requirements in 1983.

Section 504. Conforming change to the International Bank Act

Allows branches and agencies of foreign banks that satisfy the asset test imposed on domestic banks to be examined on an 18-month cycle instead of the 12-month cycle.

REGULATORY IMPACT STATEMENT

In compliance with paragraph 11(b) of the rule XXVI of the Standing Rules of the Senate, the Committee makes the following statement regarding the regulatory impact of the bill.

S. 1405 reduces the regulatory burdens on financial institutions by eliminating and streamlining various regulatory and statutory requirements and prohibitions. In addition, many provisions of the bill would lower the cost of regulation by reducing the regulatory hurdles that hinder efficient corporate governance.

CHANGES IN EXISTING LAWS

In the opinion of the Committee, it is necessary to dispense with the requirements of paragraph 12 of the rule XXVI of the Standing Rules of the Senate in order to expedite the business of the Senate.

COST OF THE LEGISLATION

Senate Rule XXVI, section 11(b) of the Standing Rules of the Senate, and section 403 of the Congressional Budget Impoundment and Control Act, require that each committee report on a bill containing a statement estimating the cost of the proposed legislation, which has been prepared by the Congressional Budget Office. The estimate is as follows:

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, September 2, 1998.

Hon. ALFONSE M. D'AMATO,
Chairman, Committee on Banking, Housing, and Urban Affairs,
U.S. Senate, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for S. 1405, the "Financial Regulatory Relief and Economic Efficiency Act of 1998."

If you wish further details on this estimate, we will be pleased to provide them. The principal CBO staff contacts are Carolyn Lynch and Mark Booth.

Sincerely,

JUNE E. O'NEILL, *Director.*

Enclosure.

CONGRESSIONAL BUDGET OFFICE COST ESTIMATE

S. 1405—The Financial Regulatory Relief and Economic Efficiency Act of 1998

Summary: S. 1405 would make numerous changes to the relationship between financial institutions and the federal agencies that are responsible for regulatory and monetary policy. Most significantly, the bill would permit the Federal Reserve System to pay interest on reserves held on deposit at the Federal Reserve, and it would repeal the provision of law that prohibits depository institutions from paying interest on commercial demand deposits. The bill also would transfer the health coverage of retirees and certain active employees of the Federal Deposit Insurance Corporation (FDIC) and the Federal Reserve System to the Federal Employees Health Benefits (FEHB) program. In addition, the bill would eliminate the requirement for the FDIC to establish a "special reserve" for the Savings Association Insurance Fund (SAIF) and it would raise the pay of the Chairman and six other members of the Board of Governors of the Federal Reserve System.

CBO estimates that the bill would reduce federal revenues by $575 million and direct spending by $54 million over the period from 1999 through 2003. Consequently, pay-as-you-go procedures would apply to the legislation. The provisions regarding interest on reserves account for most of the budgetary effect, with the rest coming from the provisions that would transfer the health insurance coverage of certain employees. The provisions to remove the requirement that the FDIC establish the SAIF reserve and to raise the pay for the Board of Governors of the Federal Reserve System are estimated to have an insignificant budgetary effect. CBO estimates that no significant budgetary effects would result from the remaining provisions, which largely clarify or streamline certain rules and procedures.

S. 1405 contains no intergovernmental mandates as defined in the Unfunded Mandates Reform Act (UMRA) and would have no significant effects on the budgets of state, local, or tribal governments. S. 1405 would, however, impose a private-sector mandate as defined by UMRA by requiring indenture trustees to mail forms once a year to holders of indenture securities requesting change of address information. For reasons described below it is unlikely that the direct costs of this mandate would exceed the statutory threshold established in UMRA ($100 million in 1996, adjusted annually for inflation), although CBO cannot make that determination with confidence. The bill would also change existing laws in ways that could lower the costs to depository institutions of complying with existing federal requirements.

Estimated cost to the Federal Government: The estimated budgetary impact of S. 1405 is shown in the following table.

[By fiscal year, in millions of dollars]

	1999	2000	2001	2002	2003	2004–08
CHANGES IN DIRECT SPENDING						
FDIC:						
Estimated budget authority	0	0	0	0	0	0
Estimated outlays	160	−14	−15	−18	−20	−144
FEHB Program:						
Estimated budget authority	−178	6	7	8	10	58
Estimated outlays	−178	6	7	8	10	58
Total, direct spending:						
Estimated budget authority	−178	6	7	8	10	58
Estimated outlays	−18	−8	−8	−10	−10	−86
CHANGES IN REVENUES						
Interest on required reserves and business demand deposits	−145	−116	−98	−102	−107	−609
Shift of Federal Reserve employees and retirees to FEHB Program	−11	1	1	1	1	5
Total, Revenues	−156	−115	−97	−101	−106	−604

Note.—FDIC=Federal Deposit Insurance Corporation; FEHB program=Federal Employees Health Benefits program.

The source of the largest budgetary effect of S. 1405 is the federal payment based on the profits of the Federal Reserve System. The Federal Reserve remits its profits to the Treasury, and those payments are classified as governmental receipts, or revenue, in the federal budget. Any additional income or costs to the Federal Reserve, therefore, can affect the federal budget. The Federal Reserve's largest source of income is interest from its holdings of Treasury securities. In effect, the Federal Reserve invests in Treasury securities in reserve balances and issues of currency that comprise the bulk of its liabilities. Since the Federal Reserve pays no interest on reserve or currency, and the Treasury Department pays the Federal Reserve interest on its security holdings, the Federal Reserve earns profits.

By allowing the Federal Reserve to pay interest on reserves, the bill, according to CBO's analysis, would reduce the Federal Reserve's profits and thereby reduce federal revenues by $568 million over the period from 1999 to 2003. The estimate includes an anticipated response by depository institutions and depositors that would increase the amount of demand deposits and, therefore, required reserves. CBO estimates that this response would reduce, but not eliminate, the expected loss in federal revenues.

In addition, direct spending would decrease by an estimated $18 million in 1999, $8 million in both 2000 and 2001, and $10 million in both 2002 and 2003. The savings would result from the transfer of health coverage of retirees and certain active employees of the FDIC and the Federal Reserve System to the Federal Employees Health Benefits (FEHB) program. The shift would reduce costs because the health insurance the agencies currently provide these employees is more costly than health insurance under the FEHB program. Because the transfer would include the retirees and certain active employees of the Federal Reserve System, revenues would also be affected. The transfer would cause revenues to increase by $1 million per year from 2000 through 2003, but to decrease by $11 million in 1999.

Basis of estimate: The estimates assume that the provisions become effective at the beginning of fiscal year 1999, unless otherwise specified.

Paying Interest on Reserve Balances.—S. 1405 would allow the Federal Reserve to pay interest on the reserves that depository institutions hold on deposit at the Federal Reserve ("required and excess reserve balances"). That payment would cause a shift in profits from the Federal Reserve to depository institutions that, on net, would reduce governmental receipts. The budgetary effect can be divided into two components. First, the bill would cause the Federal Reserve to pay interest on the level of its required reserve balances expected under current law, reducing its net income and, therefore, governmental receipts. The reduced receipts would be offset only partially by increased corporate income tax receipts from the higher profits of depository institution. Second, the payment of interest on reserves held at the Federal Reserve and on commercial demand deposits held at depository institutions would cause demand balances at depository institutions to increase. That increase would raise the level of reserve balances at the Federal Reserve, which would invest them at a rate higher than it would pay on them. This change in projected reserves would increase governmental receipts on net, but would only partially offset the loss caused by the payment of interest on reserves projected under current law.

REVENUE EFFECT OF ALLOWING INTEREST ON RESERVE BALANCES

[By fiscal year, in millions of dollars]

	1999	2000	2001	2002	2003	2004–08
CHANGES IN REVENUES						
Federal Reserve revenue	−193	−155	−131	−136	−143	−812
Income tax revenue	48	39	33	34	36	203
Total, revenue effect	−145	−116	−98	−102	−107	−609

Interest Payments on Reserves Projected Under Current Law. Because depository institutions currently do not earn a return on reserve balances, they have an incentive to minimize such balances. Required reserve balances measured almost $30 billion at the end of 1993, but have since fallen sharply to about $10 billion today. The widely-reported expansion of consumer sweep accounts has caused this recent decline. In typical sweep accounts, banks shift their depositors' funds from demand deposits, against which reserves are required, into other depository accounts, against which no reserves are required. The banks shift the funds back to the demand deposit accounts the next business day, or when needed by the depositor. Sweep accounts for business demand deposits have existed in various forms since the early 1970s and have had the same effect of reducing required reserves. Recent advances in computer technology have now made the shifting of funds feasible for many consumer ("retail") accounts as well. Under current law, CBO expects the expansion of retail sweep accounts to continue and, based on its March 1998 baseline, required reserve balances to decline further to about $4.4 billion by 1999. Thereafter, CBO projects them to rise gradually with growth in the economy.

S. 1405 would permit the Federal Reserve to pay interest on reserve balances. The Federal Reserve would be allowed to choose the interest rate, although the rate chosen could not exceed the general level of short-term interest rates. The Federal Reserve has indicated that, given the authority, it would pay interest on required reserve balances and it would choose an interest rate near the key short-term rate, the federal funds rate. The rate likely would be roughly 10 basis points lower than the federal funds rate to account for the lack of risk. The Federal Reserve has indicated, however, that it would choose not to pay interest on excess reserves unless required reserve balances fell to such a low level that interest on excess reserves was needed in order to build reserves. CBO assumes, therefore, that the Federal Reserve would pay interest only on required reserves, at a rate near the federal funds rate. Based on its March 1998 baseline assumptions, CBO projects the federal funds rate to average about 5.7 percent in 1999 and decline to about 5.2 percent by 2001 and thereafter. CBO assumes that the payment of interest on reserves would start early in fiscal year 1999. CBO projects that the bill would cause the Federal Reserve to pay interest to depository institutions of about $250 million in 1999 on the $4.4 billion of required reserve balances expected under current law. Interest payments would decline to about $235 million in each of the following two years because of lower interest rates. Over the period from 1999 through 2003, interest payments would total about $1.2 billion. Those payments would reduce the profits of the Federal Reserve—and thus its payment to the Treasury—by the same amount.

Because receipts of interest by depository institutions presumably would increase their profits by the same amount that the Federal Reserve's profits declined, overall profits in the economy would remain unchanged. Assuming that depository institutions face a marginal tax rate on corporate income of 25 percent, we estimate that corporate income tax receipts would increase by about $60 million in 1999 and $300 million through 2003 as a result of the additional interest income. That increase in receipts would offset one-quarter of the reduction in governmental receipts from reduced Federal Reserve profits. Thus, the net revenue loss to the federal government from the interest payments with no change in projected reserves would be about $190 million in fiscal year 1999 and approximately $900 million over the period from 1999 through 2003.

It is possible that, instead of retaining the additional interest income, depository institutions would pass some of the increased profits through to their business and consumer customers by raising interest rates on deposits or lowering rates on loans. If a complete passthrough did occur, then the customers—not the depository institutions—would accrue the income and pay the additional taxes. The increase in income tax revenues would be roughly similar to that estimated without such a passthrough assumption.

Projected Impact of the Bill on the Volume of Reserves. If the Federal Reserve paid interest on required reserve balances and depository institutions were allowed to pay interest on business demand deposits, there would be a second budgetary effect that would reduce—but not eliminate—the net revenue loss from the payment of

interest. In particular, based on a survey by the Board of Governors of the Federal Reserve System, we would expect reserve balances to increase because depository institutions would close a significant share of their retail and business sweep accounts and, as a result, maintain a higher level of required reserves. By doing so, the institutions could eliminate the costs of maintaining the sweep accounts and receive a return on their required reserves. However, closing the sweep accounts could reduce the earnings of banks because the return on required reserves—approximately the federal funds rate—likely would be lower than what they could receive with free use of the funds from the sweep accounts.

CBO assumes that by 2001, depository institutions would eliminate 30 percent of both retail and business sweep accounts currently in existence, and half of those that otherwise would be undertaken. Although S. 1405 would not permit the payment of interest on business demand deposits until after January 1, 2001, the bill would allow businesses to deposit funds in a new money market account (MMDA) upon enactment of the bill through July 1, 2001. Depositors in those accounts would receive interest and be permitted up to 24 transactions in any month. Because reserve requirements would also apply to those accounts, they would be similar in many ways to interest-bearing demand deposits. Despite the similarities, during this transition period CBO assumes a slower rate of closings of business sweep accounts than if interest were immediately allowed on business demand deposits. As a result of the closings of retail and business sweep account, demand deposits on which required reserves are calculated would increase at depository institutions. CBO therefore projects that required reserve balances would increase above the level expected under current law, by about $17 billion in 2001 and $19 billion by 2003.

Although the Federal Reserve would pay interest on the added reserves at approximately the federal funds rate, it would invest the reserves in Treasury securities, earning a rate of return in excess of the federal funds rate by an amount estimated at between 0.6 and 0.7 of a percentage point. As a result of the rate differential, the Federal Reserve would generate additional profits of $465 million through 2003 and return them to the Treasury as governmental receipts. Other corporate profits, including those of the firms that generate the computerized sweep account software and the depository institutions, would decline on net, however, by the same amount as the increase in the Federal Reserve's profits. (Again, overall profits in the economy would be unchanged.) The reduced profits of corporations would cause corporate income tax receipts to fall, assuming the same marginal tax rate as before of 25 percent, by about $115 million through 2003. The overall net effect of the added reserves would be to increase governmental receipts by about $45 million in 1999 and $350 million over the 1999–2003 period. This effect, therefore, offsets about 40 percent of the five-year revenue loss estimated for the payment of interest assuming no change in projected reserves. The overall estimated budgetary effect of the provisions allowing interest on reserve balances and interest on commercial demand deposit accounts is a reduction in revenue of $145 million in 1999 and $568 million over the 1999–2003 period. Over the period from 2004 through 2008, the overall

revenue loss would total $609 million, making the 10-year revenue loss total slightly less than $1.2 billion.

Health Insurance Transfer for Certain Employees.—The bill would transfer the health insurance coverage of retirees and certain active employees of the FDIC and the Federal Reserve System to the Federal Employees Health Benefits programs. These employees are currently covered by in-house health insurance plans. The legislation would also require the two agencies to make a one-time payment to the Office of Personnel Management (OPM), which administers the FEHB program in order to cover the long-term cost of the government's contribution toward the insurance premiums of the newly covered individuals. CBO estimates that over the 1999–2000 period, overall direct spending would decline by $54 million and revenues would decline by $7 million as a result of the bill.

The shifting of the FDIC employees and retirees to the FEHB program would reduce direct spending in each year because the FDIC pays more for health insurance than the FEHB program would pay. The current FDIC plan is more expensive then the typical FEHB plan because the insured employees are older and fewer in number, and it provides more general coverage. Ongoing savings would grow from an estimated $7 million in fiscal year 1999 to $11 million in 2003. CBO assumes that the FDIC would make the required one-time payment to OPM in January 1999. We estimate that the one-time payment would be $170 million; but we also estimate that the FDIC would save $10 million in the same year from lower health insurance costs. The net cost to the FDIC in 1999, therefore, would be $160 million. Reflecting the transfer from the FDIC, the FEHB program would receive the payment of $170 million in that year but would incur additional costs of about $3 million to insure those employees and retirees, for net savings of $167 million to the FEHB program.

The transfer between the Federal Reserve and FEHB would have a similar effect, but significantly fewer employees would be affect at the Federal Reserve. We estimate that the Federal Reserve would make a one-time payment of $12 million to OPM in 1999, with associated savings of $1 million, for a net reduction in revenues of $11 million. The associated savings to the Federal Reserve and costs to the FEHB program beyond 1999 would both approximate $1 million per year, although the FEHB costs may be slightly less and the Federal Reserve's savings slightly more. Also the budgetary effects on the Federal Reserve are recorded on the revenue side of the budget. Thus, the resulting increases in federal revenues beyond 1999 would approximate the increases in FEHB costs for coverage of the Federal Reserve personnel, and the net budgetary impact each year would be negligible.

Special Reserve for SAIF.—The bill would repeal the requirement for the Savings Association Insurance Fund (SAIF) to establish a special reserve fund. CBO expects that the cost of that repeal would total less than $500,000 in any year.

Under current law, on January 1, 1999, the Federal Deposit Insurance Corporation (FDIC) must set aside all balances in the SAIF that exceed the required reserve level of $1.25 per $100 of insured deposits. The reserve funds become available to pay for losses in failed institutions only if the SAIF reserve balance subse-

quently falls below 50 percent of the required reserve level, and the FDIC determines that it is expected to remain at hat level for a year.

Currently, the SAIF reserve is about 1.36 percent of insured deposits, and CBO expects that by January 1999, about $1.1 billion would be available for transfer to the special reserve. At that point, the SAIF fund balance would drop of $1.25 per $100 of insured deposits. CBO's baseline assumes administrative costs and thrift failures would remain sufficiently low to avod raising assessment rates on SAIF-insured institutions through 2003. We expect that SAIF would continue to earn interest on its remaining fund balances of over $9 billion in 1999, and that the fund ratio would slowly climb each year, reaching about 1.4 percent by 2003.

Although CBO baseline estimates do not assume that the cost of thrift failures in any year would exceed the net interest earned by the SAIF, unanticipated thrift failures could result in a drop in the SAIF fund reserve ratio below 1.25 percent. The baselne reflects CBO's best judgment as to the expected value of possible losses during a given year, but annual losses would likely vary from the levels assumed in the CBO baseline. Thus, some small probability exists that thrift failures could increase sufficiently to drive the reserve ratio below the required level of 1.25 percent, but not so low as to trigger use of the special reserve.

When the balance of an insurance fund balance dips below the required ratio, the FDIC is forced to increase assessments for deposit insurance to restore the fund balance to the required level. Thus, if thrift losses were to exceed baseline estimates by a significant amount, we would expect the FDIC to increase insurance rates in order to maintain the SAIF's fund balance. Eliminating the special reserve would add to the fund balances and would make it less likely that the FDIC would have to raise insurance premiums. The probability that this change would affect premium rates in quite small, however, and therefore CBO expects that the cost of eliminating the special reserve would total less than $500,000 in any year.

Pay-as-you-go considerations: The Balanced Budget and Emergency Deficit Control Act sets up pay-as-you-go procedures for legislation affecting direct spending or receipts. CBO estimates that S. 1405 would reduce receipts by $1.179 billion and outlays by $2 million over the period from 1999 through 2008. The project changes in receipts and outlays are shown in the following table for fiscal years 1999 through 2008. For the purposes of enforcing pay-as-you-go procedures, only the effects in the current year, the budget year, and the succeeding four years are counted.

The budget excludes from pay-as-you-ago calculations expenses associated with maintaining the deposit insurance commitment. CBO assumes that the budgetary effects of shifting the health insurance coverage of FDIC employees would be excluded from the pay-as-you-go calculation because they would be associated with maintaining the deposit insurance commitment. The budgetary effects on the Federal Reserve, and the corresponding effect on outlays of the FEHB, would not be excluded. Most of the effect on receipts is caused by the provision authorizing the Federal Reserve to pay interest on required reserves.

[By fiscal year, in millions of dollars]

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Changes in outlays	−11	1	1	1	1	1	1	1	1	1
Changes in receipts	−156	−115	−97	−101	−106	−110	−115	−121	−126	−132

Estimated impact on State, local, and tribal governments: S. 1405 contains no intergovernmental mandates as defined in UMRA and would have no significant effects on the budgets of state, local, or tribal governments.

Estimated impact on the private sector: Corporate debt securities are often issued under, and controlled by, a trust indenture. An indenture is a contract that outlines the maturity date, interest rate, redemption rights, and other terms under which debt securities (in the form of bonds and debentures) are issued. The Trust Indenture Act of 1939 (TIA) requires that an indenture be executed by both the corporate issuer and a trustee who acts on behalf of bondholders. S. 1405 would impose a private-sector mandate by amending TIA so that once a year indenture trustees would have to mail each holder of an indenture security a form requesting change of address information. The bill would allow trustees to include the request form in other customary mailings under the Trust Indenture Act when possible.

Although it is unlikely that the direct costs of this private-sector mandate (net of savings) would exceed the statutory threshold for private-sector mandates ($100 million in 1996 dollars, adjusted annually for inflation), CBO cannot make that determination with confidence because of the uncertainties involved in identifying the number of beneficiaries who would have to notified and the extent of the offsetting savings that would accrue to depository institutions from other provisions in the bill.

One of the difficulties that arise in estimating the number of beneficiaries occurs because the bill does not clearly define the term "indenture security holder." Based on discussions with congressional staff, industry experts, and the Securities and Exchange Commission, CBO concludes that the term may apply either to a relatively small group of registered security holders or to a significantly larger group of beneficial (individual) security holders. Most securities are not registered in the name of beneficial holders but are held in securities depositories for banks and brokerage firms that hold securities for their customers. Although it is clear that the first group is smaller and easier to contact than the other, CBO was unable to obtain adequate information on the number of security holders in either category. Since some experts estimate the average cost of a mailing and other administrative actions associated with obtaining change of address information to be about $5 per person, if the bill were to affect over 20 million beneficial security holders, it would exceed the cost threshold for private-sector mandates. However, if the indenture trustees only need to mail to registered security holders, it is most likely that the direct costs of the mandate would not exceed the threshold.

Many provisions in the bill would change existing laws in ways that could lower the costs to depository institutions of complying with existing federal requirements. The majority of trust indentures are handled by about 340 banks and thrifts. Those institu-

tions could benefit from the changes the bill would make to reduce the burden of some existing regulations. Thus, the net direct cost of private-sector mandates imposed by the bill could easily fall below the threshold. However, CBO does not have enough information about how the benefits of cost-reduction provisions would be distributed to banks and thrifts to eliminate the potential savings to institutions affected by the mandate.

S. 1405 would also authorize the Federal Reserve to pay interest on reserve balances held on deposit at the Federal Reserve. Along with the authority to pay interest on reserves, the bill would authorize the Board of Governors of the Federal Reserve System to prescribe regulations concerning the responsibilities of correspondent banks that maintain balances at the Federal Reserve on behalf of other institutions. Commercial banks, Federal Home Loan Banks and corporate credit unions serve as correspondent banks for many depository institutions that are not members of the Federal Reserve. Based on information provided by the Board of Governors of the Federal Reserve System, CBO expects the Federal Reserve would not use its authority to issue regulations unless problems arose in the crediting and distribution of interest earnings. Thus, this provision would not impose a private-sector mandate as defined by UMRA. If, after a period of time, the Federal Reserve determined a rule was necessary, the rule would most likely require that correspondent banks pass the interest earnings back to the institutions for which they maintain required balances at the Federal Reserve. The cost to the correspondent banks of complying with such a rule would be negligible.

Previous CBO estimates: On June 1, 1998, CBO prepared a cost estimate for H.R. 1836, the Federal Employees Health Care Protection Act of 1998, as ordered reported by the Senate Committee on Governmental Affairs on April 1, 1998. It contained, among other provisions, the same transfer of health insurance as in S. 1405. The budgetary effects of those provisions cited in that estimate are identical to those included in this estimate of S. 1405.

On Sept. 5, 1997, CBO prepared a cost estimate for H.R. 2323, the Small Business Banking Act of 1997, as introduced on July 31, 1997. The bill would also authorize the Federal Reserve to pay interest on required reserves and depository institutions to pay interest on business demand deposits. The budgetary effect of those provisions cited in the cost estimate for H.R. 2323 differs from that cited in this estimate of S. 1405, which incorporated more recent economic data and forecasts, additional research into the anticipated response of depositors and depository institutions, and a different effective date.

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