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Statement of the Shadow Financial Regulatory Committee

On

Removal of Archaic Bank Regulatory Restrictions

May 5, 2003

Interest on Business Checking Accounts and on Banks' Balances at the Federal Reserve

"The Business Checking Freedom Act of 2003," H.R. 758, passed by the House, would repeal the prohibition of bank payment of interest on business checking accounts, effective after two years. In the interim, banks would be permitted to sweep balances into and out of interest bearing money market deposit accounts (MMDAs) 24 times a month (each business day). At present, banks are using more complex methods of sweeping large business deposits into interest-bearing obligations, thereby avoiding the existing restrictions as well as removing deposits from their books at day end to avoid the Federal Reserve's Regulation D reserve requirement.

The Committee supports this change. It would repeal an unwarranted restriction initially enacted in the Banking Act of 1933 that gave banks a government-enforced cartel that reduced competition for business deposits. Over time, competition among banks effectively removed the prohibition on deposit interest payments, at least for larger business depositors. It is time to allow market forces to operate freely for small businesses as well.

H.R. 758 also would allow the Federal Reserve to pay interest on balances banks maintain at Federal Reserve banks at rates not to exceed the level of short-term interest rates. At present, these reserve balances do not bear interest. This has been a tax on checking accounts in the form of foregone interest banks otherwise could earn on balances.

Recently, banks generally have minimized required reserves by sweeping checking account balances into accounts not subject to reserves. This Bill, if enacted by the Senate, would reduce the necessity for these sweeps.

Commercial Companies' Use of Industrial Loan Companies

The "Financial Services Relief Act of 2003," H.R. 1375, approved by a subcommittee of the House Financial Services Committee in April, would preempt the right of states to block approval by the Comptroller of the Currency for national banks to establish interstate de novo branches. State-chartered banks could also open branches in those states, subject to approval by their regulators, but not subject to approval by the host-state bank regulator. Thus, host states could no longer require banks to open branches only by purchasing existing banks. This desirable change would further reduce barriers to entry that limit the number and variety of banking offices available to consumers.

This legislation, if enacted, also would allow commercial companies, such as retailers, to compete with established banks. They could do this by buying industrial loan companies (ILCs), which now exist in only a few states. The legislation would allow ILCs (which offer FDIC-insured deposits and are examined by the FDIC) to branch nationwide. ILCs may be owned by commercial firms without the parent becoming a bank holding company subject to regulation by the Federal Reserve. Thus, retail and other companies could offer depository and other banking services in their stores or in other locations. Consumers might find these facilities more convenient, less costly, or otherwise preferable to their present banking arrangements.

The Committee endorses this legislation, because it would benefit consumers by increasing the competitiveness of the banking system. It also would reduce the scope of the Bank Holding Company Act. The Committee has previously urged the Act's repeal.