106TH CONGRESS
2d Session

HOUSE OF REPRESENTATIVES

REPORT
106–983

BANK RESERVES MODERNIZATION ACT OF 2000

OCTOBER 17, 2000.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. LEACH, from the Committee on Banking and Financial Services, submitted the following

R E P O R T

[To accompany H.R. 4209]

[Including cost estimate of the Congressional Budget Office]

The Committee on Banking and Financial Services, to whom was referred the bill (H.R. 4209) to amend the Federal Reserve Act to require the payment of interest on reserves maintained at Federal reserve banks by insured depository institutions, and for other purposes, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

The amendments are as follows:

Strike out all after the enacting clause and insert in lieu thereof the following:

SECTION 1. SHORT TITLE.

This Act may be cited as the "Bank Reserves Modernization Act of 2000".

SEC. 2. PAYMENT OF INTEREST ON RESERVES AT FEDERAL RESERVE BANKS.

(a) IN GENERAL.—Section 19(b) of the Federal Reserve Act (12 U.S.C. 461(b)) is amended by adding at the end the following new paragraph:

"(12) EARNINGS ON RESERVES.—

"(A) IN GENERAL.—Balances maintained at a Federal reserve bank by or on behalf of a depository institution may receive earnings to be paid by the Federal reserve bank at least once each calendar quarter at a rate or rates not to exceed the general level of short-term interest rates.

"(B) REGULATIONS RELATING TO PAYMENTS AND DISTRIBUTION.—The Board may prescribe regulations concerning—

"(i) the payment of earnings in accordance with this paragraph;

"(ii) the distribution of such earnings to the depository institutions which maintain balances at such banks or on whose behalf such balances are maintained; and

"(iii) the responsibilities of depository institutions, Federal home loan banks, and the National Credit Union Administration Central Liquidity Facility with respect to the crediting and distribution of earnings attributable to balances maintained, in accordance with subsection (c)(1)(B), in a Federal reserve bank by any such entity on behalf of depository institutions.".

89–006

(b) AUTHORIZATION FOR PASS THROUGH RESERVES FOR MEMBER BANKS.—Section 19(c)(1)(B) of the Federal Reserve Act (12 U.S.C. 461(c)(1)(B)) is amended by striking "which is not a member bank".

(c) TECHNICAL AND CONFORMING AMENDMENTS.—Section 19 of the Federal Reserve Act (12 U.S.C. 461) is amended—

(1) in subsection (b)(4) (12 U.S.C. 461(b)(4)), by striking subparagraph (C) and redesignating subparagraphs (D) and (E) as subparagraphs (C) and (D), respectively; and

(2) in subsection (c)(1)(A) (12 U.S.C. 461(c)(1)(A)), by striking "subsection (b)(4)(C)" and inserting "subsection (b)".

SEC. 3. TRANSFER OF FEDERAL RESERVE SURPLUSES.

(a) IN GENERAL.—Section 7(b) of the Federal Reserve Act (12 U.S.C. 290) is amended by adding at the end the following new paragraph:

"(4) ADDITIONAL TRANSFERS TO COVER INTEREST PAYMENTS FOR FISCAL YEARS 2001 THROUGH 2005.—

"(A) IN GENERAL.—In addition to the amounts required to be transferred from the surplus funds of the Federal reserve banks pursuant to paragraph (1), the Federal reserve banks shall transfer from such surplus funds to the Board of Governors of the Federal Reserve System for transfer to the Secretary of the Treasury for deposit in the general fund of the Treasury, such sums as are necessary to equal the net cost of section 19(b)(12), as estimated by the Office of Management and Budget, in each of the fiscal years 2001 through 2005.

"(B) ALLOCATION BY FEDERAL RESERVE BOARD.—Of the total amount required to be paid by the Federal reserve banks under subparagraph (A) for fiscal years 2001 through 2005, the Board of Governors of the Federal Reserve System shall determine the amount each such bank shall pay in such fiscal year.

"(C) REPLENISHMENT OF SURPLUS FUND PROHIBITED.—During fiscal years 2001 through 2005, no Federal reserve bank may replenish such bank's surplus fund by the amount of any transfer by such bank under subparagraph (A).".

(b) TECHNICAL AND CONFORMING AMENDMENT.—Section 7(a) of the Federal Reserve Act (12 U.S.C. 289(a)) is amended by adding at the end the following new paragraph:

"(3) PAYMENT TO TREASURY.—During fiscal years 2001 through 2005, any amount in the surplus fund of any Federal reserve bank in excess of the amount equal to 3 percent of the paid-in capital and surplus of the member banks of such bank shall be transferred to the Secretary of the Treasury for deposit in the general fund of the Treasury.".

Amend the title so as to read:

A bill to amend the Federal Reserve Act to authorize the payment of interest on reserves maintained at Federal reserve banks by insured depository institutions, and for other purposes.

BACKGROUND AND NEED FOR LEGISLATION

During the past ten years, there has been a significant decline in the amount of required reserves held by depository institutions at the Federal Reserve Banks. In late 1993, reserve balances were approximately $28 billion whereas, today, they are about $6 billion. While the Federal Reserve Act requires depository institutions, including all banks, thrifts, and credit unions, to maintain reserves against their transactions accounts, many institutions have been able to reduce the amount of funds they must hold in their reserve accounts through the use of "sweep" programs that permit funds to be transferred out of reservable transaction accounts (e.g. checking accounts) into nonreservable instruments (e.g. money market deposit accounts) at the end of each day. A strong incentive for the development and use of these sweep programs has been and continues to be the fact that depository institutions do not receive interest on the reserves they are required to hold at the Federal Reserve Banks.

For most depository institutions, required reserves are calculated based on an average of the applicable deposits held by a depository institution over a two-week computation period. The first $5 million in applicable deposits is not included in the calculation. Smaller financial institutions in particular benefit from this exemption. The Federal Reserve assesses a ratio of 3% to applicable deposits held by an institution between $5 million and $44 million. The current ratio for applicable deposits over $44 million is 10%. The Federal Reserve has discretion to change the first tier between 3% and 9%, and the second tier within the range of 8% and 14%. The Federal Reserve currently does not require any reserves for nonpersonal time and savings accounts, although the percentage required to be held as reserves could range from 0% to 3%. Similarly, the Federal Reserve requires no reserves to be held for Eurocurrency liabilities although it has the discretion to do so.

The decline in the amount of reserves potentially presents an important policy question because the sole purpose for requiring reserves, as reflected in the Federal Reserve Act, is to provide a tool for the implementation of monetary policy. While the Federal Reserve Board has stated that the decline in reserves held by Federal Reserve banks during the past decade has not yet affected its ability to effectively conduct monetary policy, it believes volatility could mount in the future and cause potentially disruptive fluctuations in the money market. The Federal Reserve has stated that reserve requirements continue to play an important role in the conduct of open market operations, which are aimed at influencing general monetary and credit conditions by varying the cost and availability of reserves to the banking system. Reserve requirements help to ensure a stable, predictable demand for reserves, and therefore the Federal Reserve is better able to achieve stable short-term interest rates by controlling the supply of reserves through transactions with financial institutions.

PURPOSE AND SUMMARY

The purpose of H.R. 4209 is to authorize the Federal Reserve Board to pay interest on the reserves that depository institutions maintain at Federal Reserve Banks. Currently, depository institutions that maintain deposits on reserve at Federal Reserve Banks do not receive any interest on their deposits. Due to the constraint imposed on depository institutions in their ability to earn a return on assets, depository institutions have undertaken considerable effort in recent years to find methods to reduce their reserve requirements and have thus undercut this key monetary policy tool. Payment of interest on reserves provides a way of removing an incentive for depository institutions to avoid the reserve requirements and eliminating an inefficiency in the regulatory system that could have a negative effect on smaller institutions who are unable to take advantage of mechanisms to avoid reserve requirements.

HEARINGS

The full Committee heard testimony on H.R. 4209 on May 3, 2000. Witnesses at the hearing were: Gary Gentler, Under Secretary for Domestic Finance, the Department of the Treasury; Laurence H. Meyer, Member, Board of Governors of the Federal Reserve System; Thomas P. Jennings, Senior Vice President and General Counsel, First Virginia Banks, Inc. on behalf of Financial Services Roundtable; Carl R. Tannenbaum, Senior Vice President and Chief Economist for Treasury Research, LaSalle Banks, Chicago, IL, on behalf of American Bankers Association; Manuel Mehos, Chairman, President and CEO, Coastal Banc, Houston TX, on behalf of America's Community Bankers; and A. Pierce Stone, President and CEO, Virginia Community Bank, Louisa, VA on behalf of Independent Community Bankers of America.

The Subcommittee on Financial Institutions and Consumer Credit also had hearings on this issue as part of regulatory relief issues. On May 12, 1999, the Subcommittee heard testimony on H.R. 1585, Depository Institution Regulatory Streamlining Act of 1999, which included a provision regarding payment of interest on reserves. Witnesses at the hearing included: Laurence H. Meyer, Member, Board of Governors of the Federal Reserve System; John D. Hawke, Jr., Comptroller of the Currency, Office of the Comptroller of the Currency; Andrew Hove, Vice Chairman, Federal Deposit Insurance Corporation; Carolyn Buck, Chief Counsel, Office of Thrift Supervision; Robert Fenner, General Counsel, National Credit Union Administration; John P. Burke, Chairman, Conference of State Bank Supervisors, and Banking Commissioner, State of Connecticut; Edward L. Yingling, Executive Director of Government Relations, American Bankers Association; Robert N. Barsness, Chairman and President, Prior Lake State Bank, Prior Lake, Minnesota, and President, Independent Community Bankers of America; David R. Taylor, President and CEO, Rahway Savings Institution, Rahway, New Jersey, and on behalf of America's Community Bankers; Frank Torres, Legislative Counsel, Consumers Union; Margot Saunders, Managing Attorney, National Consumer Law Center, Inc.; and Jean N. Fox, Director of Consumer Protection, Consumer Federation of America Foundation.

In the 105th Congress, the Subcommittee on Financial Institutions and Consumer Credit reviewed payment of interest on reserves as part of a regulatory burden relief hearing on July 16, 1998. Testifying at the hearing were: The Honorable Sue Kelly; the Honorable Bill McCollum; The Honorable Jack Metcalf; Richard S. Carnell, Assistant Secretary for Financial Institutions, Department of the Treasury; Laurence H. Meyor, Member, Board of Governors of the Federal Reserve System; Donna Tanoue, Chairman, Federal Deposit Insurance Corporation; Julie Williams, Acting Comptroller, Office of the Comptroller of the Currency; Carolyn Buck, Chief Counsel, Office of Thrift Supervision; Timothy R. McTaggart, Bank Commissioner, State of Delaware, on behalf of the Conference of State Bank Supervisors; James E. Smith, President and CEO, Union State Bank and Trust, Clinton, MO, on behalf of the American Bankers Association; Anthony S. Abbate, President and CEO, Interchange Bank, Saddle Brook, NJ, on behalf of the Independent Bankers Association of America; Lee E. Beard, President and CEO, First Federal Bank, Hazelton, PA, on behalf of America's Community Bankers; Arthur R. Cunningham, CCM, CPA, Senior Assistant Treasurer, Pioneer Hi-Bred International, Inc., Johnston, IA, on behalf of the Treasury Management Association; Rex Hammock, Chairman, Hammock Publishing, Inc., Nashville, TN, on behalf of the National Federation of Independent Business; and Margot

Saunders, Managing Attorney, National Consumer Law Center, also on behalf of the U.S. Public Interest Research Group.

Committee Consideration and Votes

On May 17, 2000, the Committee met in open session to mark up H.R. 4209, the "Bank Reserves Modernization Act." During the markup, the Committee approved, by voice vote, an amendment to H.R. 4209. With a quorum being present, a motion to adopt and favorably report H.R. 4209, as amended, to the House was approved by voice vote.

Committee Oversight Findings

In compliance with clause 3(c)(1) of rule XIII of the Rules of the House of Representatives, the Committee reports that the findings and recommendations of the Committee, based on oversight activities under clause 2(b)(1) of rule X of the Rules of the House of Representatives, are incorporated in the descriptive portions of this report.

Committee on Government Reform and Oversight Findings

As provided for in clause 3(c)(4) of rule XIII of the Rules of the House of Representatives, no oversight findings have been submitted to the Committee by the Committee on Government Reform.

Constitutional Authority

In compliance with clause 3(d)(1) of rule XIII of the Rules of the House of Representatives, the Constitutional Authority of Congress to enact this legislation derived from Article I, section 8, clause 1 (relating to the general welfare of the United States): Article I, section 8, clause 3 (relating to Congressional power to regulate commerce); Article 1, section 8, clause 5 (relating to the power "to coin money" and "regulate the value thereof"); and Article I, section 8, clause 18 (relating to making all laws necessary and proper for carrying into execution powers vested by the Constitution in the government of the United States).

New Budget Authority and Tax Expenditures

In compliance with clause 3(c)(2) of rule XIII of the Rules of the House of Representatives, and as noted in the enclosed CBO estimate, H.R. 4209 would not have any net effect on annual revenues over the 2001–2005 period.

Advisory Committee Statement

No advisory committees within the meaning of section 5(b) of the Federal Advisory Committee Act were created by this legislation.

Congressional Accountability Act

The reporting requirement under section 102(b)(3) of the Congressional Accountability Act (P.L. 104–1) is inapplicable because this legislation does not relate to terms and conditions of employment or access to public services or accommodations.

Congressional Budget Office Cost Estimate and Unfunded Mandates Analysis

U.S. Congress,
Congressional Budget Office,
Washington, DC, October 6, 2000.

Hon. James A. Leach,
Chairman, Committee on Banking and Financial Services, House of Representatives, Washington, DC.

Dear Mr. Chairman: The Congressional Budget Office has prepared the enclosed cost estimate for the Bank Reserves Modernization Act of 2000.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contacts are Carolyn Lynch (for revenues), and Patrice Gordon (for the private-sector impact).

Sincerely,

Dan L. Crippen, *Director.*

Enclosure.

H.R. 4209—Bank Reserves Modernization Act of 2000

Summary: H.R. 4209, the Bank Reserves Modernization Act of 2000 (BRMA), would permit the Federal Reserve System to pay interest on reserves held on deposit at the Federal Reserve by insured depository institutions. The reduction in revenues as a result of the interest payments would be offset by transfers from surplus funds of Federal Reserve Banks to the U.S. Treasury over the next five years. Pay-as-you-go procedures would apply because the bill would affect receipts. CBO estimates that the bill would not have any net effect on annual revenues over the 2001–2005 period because the estimated loss in revenues would be offset by transfers from Federal Reserve surplus funds. Enacting H.R. 4209 would decrease revenues after 2005. CBO estimates that the loss in revenues would total approximately $1.1 billion over the 2006–2010 period.

H.R. 4209 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act (UMRA) and would not affect the budgets of state, local, or tribal governments.

Estimated cost to the Federal Government: The estimated budgetary impact of H.R. 4209 is shown in the following table.

	By fiscal year, in millions of dollars—						
	2001	2002	2003	2004	2005	2001–05	2006–10
CHANGES IN REVENUES							
Allowing Interest on Reserves	−189	−136	−88	−91	−96	−600	−548
Surplus Transfer to the Treasury	189	136	88	91	96	600	−600
Net Budgetary Effect	0	0	0	0	0	0	−1,148

The initial budgetary effect of BRMA would be a decrease in the payment of profits from the Federal Reserve System to the U.S. Treasury. The Federal Reserve remits its profits to the Treasury, and those payments are classified as governmental receipts, or revenues, 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 the reserve balances and issues of currency that comprise the bulk of its liabilities. Since the Federal Reserve pays no interest on reserves or currency, and the Treasury 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 decrease the Federal Reserve's profits and thereby reduce federal revenues by $600 million over the period from 2001 to 2005. This budgetary response has several components. First, the Federal Reserve's payment of interest on required reserves balances held at Federal Reserve banks would reduce governmental receipts. It is anticipated that some depository institutions and depositors would respond to the interest payments on reserves by shifting funds out of retail sweep accounts and into demand deposit accounts. This secondary response would increase required reserve balances and partially offset the loss in federal revenues from the payment of interest on reserves. Finally, the profits of depository institutions or their customers would increase with a consequent increase in tax revenues. That result would also have the effect of partially offsetting the decline in federal receipts. The legislation stipulates that this overall revenue loss would be offset by a transfer from surplus funds of Federal Reserve banks to the U.S. Treasury for each of the fiscal years 2001 through 2005.

Basis of estimate: The estimates assume that the provisions would become effective early in fiscal year 2001, unless otherwise specified.

The allowance of interest on reserve balances

Allowing the payment of interest on the reserves that depository institutions hold on deposit at the Federal Reserve ("required and excess reserve balances") would shift profits from the Federal Reserve to depository institutions and reduce governmental receipts. This budgetary effect is divided into three components. First, the bill would result in the Federal Reserve paying interest on the level of its required reserve balances expected under current law, reducing its net income and, therefore, governmental receipts. Second, the payment of interest on reserves is expected to cause demand balances at depository institutions to increase. That increase would raise the level of reserve balances held at the Federal Reserve, which would invest them at a higher rate than it would pay on them. This change in projected reserves would increase governmental receipts, but only partially offset the loss caused by the payment of interest on reserves projected under current law. Third, the reduction in governmental receipts would be partially offset by increased income tax receipts. The net effect of interest payments on reserves and the anticipated shift to more demand deposit accounts would result in higher profits for depository institutions or their customers.

	Allowing interest on reserve balances (by fiscal year, in millions of dollars)—						
	2001	2002	2003	2004	2005	2001–05	2006–10
	CHANGES IN REVENUES						
Revenue from Federal Reserve:							
Interest on Required Reserves	−291	−234	−209	−219	−229	−1,182	−1,311
Profits from Increased Reserves	39	53	92	97	101	382	580
Net Revenue Effect	−252	−181	−117	−122	−128	−800	−731
Income Tax Revenue	63	45	29	31	32	200	183
Allowing Interest on Reserves	−189	−136	−88	−91	−96	−600	−548

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 just under $7 billion today. The widely reported expansion of consumer and business sweep accounts have caused this decline. In typical sweep accounts, banks shift their depositor's 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. 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 required reserve balances to decline further to about $4 billion by 2002. Thereafter, CBO projects them to rise gradually with growth in the economy.

H.R. 4209 would permit the Federal Reserve to pay interest on required and excess 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. Staff at the Federal Reserve, however, have indicated that, given the authority, the Federal Reserve would only pay interest on required reserve balances and it would choose an interest rate near the key short-term rate, the federal funds rate. The likely rate would be roughly 15 basis points lower than the federal funds rate to account for the lack of risk. Federal Reserve staff have indicated that the Federal Reserve 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 to build reserves. That is considered to be an unlikely scenario. Accordingly, CBO assumes that the Federal Reserve would pay interest only on required reserves, at a rate 15 basis points below the federal funds rate.

CBO projects that the federal funds rate will average about 5.5 percent over the 10-year period from 2001 through 2010. The payment of interest on reserves is assumed to start early in fiscal year 2001. CBO projects that BRMA would cause the Federal Reserve to pay interest to depository institutions of about $291 million in 2001 on the $4.25 billion of required reserve balances expected under current law. Such interest payments would decline to about $234 million in 2002 and $209 million in 2003 because of lower reserve balances. Over the 2001–2005 period, such interest payments would total approximately $1.2 billion. Those payments would reduce the profits of the Federal Reserve—and thus its payment to the Treasury—by the same amount.

Projected Impact of the Bill on the Volume of Reserves. If the Federal Reserve pays interest on required reserve balances, there would be a second budgetary effect on the Federal Reserve 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 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, although presumably at a lower rate than what they could receive with alternative use of the funds. The closing of business sweep accounts, in general, is not expected because depository institutions are not allowed to offer interest-bearing demand deposits to businesses. As a result, businesses would have little incentive to relinquish their interest-bearing sweep accounts.

CBO assumes that depository institutions would eliminate approximately 30 percent of retail sweep accounts currently in existence by 2002, and half of those that otherwise would be established. As a result of the closings of retail sweep accounts, demand deposits on which required reserves are calculated would increase at depository institutions. CBO projects that required reserve balances would increase above the level expected under current law by about $10 billion in 2002 and $15 billion by 2005. 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 0.55 and 0.65 of a percentage point. As a result of the rate differential, the Federal Reserve would generate additional profits of about $382 million through 2005 and remit them to the Treasury as governmental receipts.

Projected Impact on Income Tax Revenues. Allowing interest on reserve balances held at the Federal Reserve would have a third budgetary effect that would also reduce—but not eliminate—the decline in revenue from the payment of interest on current balances. The net effect of interest payments on reserves and the anticipated shift to more demand deposit accounts is expected to be a reduction in the profits of the Federal Reserve and an increase in the profits of depository institutions or their customers, with a consequent increase in income tax revenues. CBO assumes that the profits of depository institutions or their customers would increase by roughly the same amount that the profits of the Federal Reserve decline. It is likely that, instead of retaining the additional interest income from the Federal Reserve, depository institutions would pass through some of the increased profits to their consumer and business customers by, for example, 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 additional taxes. Although some of the additional interest income of depository institutions may be passed through in nontaxable form either to their customers or to nontaxable entities, this amount is expected to be negligible. CBO assumes that depository institutions and their customers face an average marginal tax rate on income of 25 percent and estimate that income tax receipts would increase by about $63 million in 2001 and approximately $200 million through 2005. That increase in receipts would offset one-quarter of the reduction in governmental receipts from reduced Federal Reserve profits.

Transfer from surplus funds of the Federal Reserve

During the first five years BRMA would be effective (fiscal years 2001 through 2005), the legislation provides that the revenue loss associated with allowing interest payments on reserve balances would be offset by requiring the Federal Reserve to remit from its surplus fund to the Treasury an amount equal to the estimated annual net revenue loss. In addition, during this same five-year period, the bill would make the Federal Reserve payment of net earnings to the Treasury mandatory and the Federal Reserve would not be allowed to replenish its surplus fund. Those provisions would have the effect of reducing the cost of the legislation to zero for the first five years the bill is in effect and postpone the accumulated net revenue loss to the federal government to the sixth year, 2006.

Out of its annual earnings, the Federal Reserve covers its operating costs, pays a small dividend to its member banks, retains monies for its surplus fund, and voluntarily remits the remaining profits to the U.S. Treasury. The Federal Reserve's surplus fund is a stock of retained earnings accumulated over time and is set by the Federal Reserve banks each year at a level equal to the paid-in capital of its member banks. The fund can be used as collateral for issuance of Federal Reserve notes and may be viewed as a fiscal cushion. The surplus funds are invested in Treasury securities and the interest generated is remitted to the Treasury along with other profits of the Federal Reserve. During the first five years BRMA is in effect, the Federal Reserve would remit to the Treasury all of its earnings above its operating costs and member bank dividend payments because the Federal Reserve would be prevented from replenishing its surplus fund and its payment of net earnings to the Treasury would be mandatory. In fiscal year 2006, however, the Federal Reserve would be expected to replenish its surplus fund by the entire amount that was transferred from the fund to the Treasury during the 2001–2005 period, an estimated $600 million. This response is anticipated because the Federal Reserve has replenished its surplus account at its first available opportunity with past legislated surplus fund transfer payments. The legislated surplus fund transfer under BRMA, therefore, has the effect of postponing the accumulated net revenue loss to the Treasury during the first five years the legislation is in effect until the sixth fiscal year, 2006. CBO estimates that the revenue loss in fiscal year 2006 would be about $700 million. The Federal Reserve would be expected to retain $600 million out of its earnings to replenish its surplus fund instead of remitting these profits to the Treasury. The remaining $100 million is the estimated net revenue loss of allowing interest payments on reserve balances for that year. CBO estimates that the resulting revenue loss for the 2006–2010 period would be approximately $1.1 billion.

The analysis shows that the transfer of the surplus funds does not reduce the cost of the bill to the federal government over the long term, it just postpones it. It also is important to note that the transfer of surplus funds from the Federal Reserve to the Treasury has no import for the fiscal status of the Federal government either. If the surplus funds are held at the Federal Reserve, they are invested in government securities and the interest generated is remitted to the Treasury. If the surplus funds and transferred to the Treasury instead, they reduce the public debt and in turn the interest payments owed by the Treasury. Since the interest payments would be identical in either case, where the funds reside has no *economic* significance. Hence, any transfer of the Federal Reserve surplus fund to the Treasury would have no effect on national savings, economic growth, or income.

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 H.R. 4209 would not affect receipts over the 2001–2005 period, but would reduce receipts by $1,148 million over the 2006–2010 period, as shown in the following table. For the purposes of enforcing pay-as-you-go procedures, only the effects in the budget year and the succeeding four years are counted.

	By fiscal year, in millions of dollars—									
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Changes in receipts	0	0	0	0	0	−700	−105	−109	−114	−120
Changes in outlays	Not applicable									

Estimated impact on state, local, and tribal governments: H.R. 4209 contains no intergovernmental mandates as defined in UMRA and would not affect the budgets of state, local, or tribal governments.

Estimated impact on the private sector: H.R. 4209 would require the Federal Reserve to pay interest on required reserve balances held on deposit at the Federal Reserve. The bill would also authorize the Board of Governors of the Federal Reserve System (FRB) to prescribe regulations concerning the responsibilities of correspondent banks that maintain balances at the Federal Reserve on behalf of other institutions. Such private institutions as 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 FRB, CBO expects the FRB would not use its authority to issue regulations unless problems arose in the crediting and distribution of interest earnings. Thus, this bill would impose no new private-sector mandates as defined by UMRA. If after a period of time the FRB determined a rule was necessary, the FRB indicates that the form a rule would mostly likely take is to 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.

Estimate prepared by: Federal Revenues: Carolyn Lynch. Impact on the Government Sector: Susan Sieg Tompkins. Impact on the Private Sector: Patrice Gordon.

Estimate approved by: G. Thomas Woodward, Assistant Director for Tax Analysis.

SECTION-BY-SECTION ANALYSIS

Section 1. Short title

This Act may be cited as the "Bank Reserves Modernization Act of 2000."

Section 2. Payment of interest on reserves at Federal Reserve Banks

This section permits the Federal Reserve to pay interest on the reserves that depository institutions maintain at Federal Reserve Banks at a rate not to exceed the general level of short-term interest rates. The Federal Reserve may prescribe regulations relating to payments and distributions. This section also permits funds to be transferred from the surplus funds of Federal Reserve Banks as a means to pay for the costs that are implicit to the bill.

CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3(e) of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman):

FEDERAL RESERVE ACT

* * * * * * *

SEC. 7. (a) DIVIDENDS AND SURPLUS FUNDS OF RESERVE BANKS.—
(1) * * *

* * * * * * *

(3) PAYMENT TO TREASURY.—During fiscal years 2001 through 2005, any amount in the surplus fund of any Federal reserve bank in excess of the amount equal to 3 percent of the paid-in capital and surplus of the member banks of such bank shall be transferred to the Secretary of the Treasury for deposit in the general fund of the Treasury.

(b) TRANSFER FOR FISCAL YEAR 2000.—
(1) * * *

* * * * * * *

(4) ADDITIONAL TRANSFERS TO COVER INTEREST PAYMENTS FOR FISCAL YEARS 2001 THROUGH 2005.—

(A) IN GENERAL.—In addition to the amounts required to be transferred from the surplus funds of the Federal reserve banks pursuant to paragraph (1), the Federal reserve banks shall transfer from such surplus funds to the Board of Governors of the Federal Reserve System for transfer to the Secretary of the Treasury for deposit in the general fund of the Treasury, such sums as are necessary to equal the net cost of section 19(b)(12), as estimated by the Office of Management and Budget, in each of the fiscal years 2001 through 2005.

(B) ALLOCATION BY FEDERAL RESERVE BOARD.—Of the total amount required to be paid by the Federal reserve

banks under subparagraph (A) for fiscal years 2001 through 2005, the Board of Governors of the Federal Reserve System shall determine the amount each such bank shall pay in such fiscal year.

(C) REPLENISHMENT OF SURPLUS FUND PROHIBITED.—During fiscal years 2001 through 2005, no Federal reserve bank may replenish such bank's surplus fund by the amount of any transfer by such bank under subparagraph (A).

* * * * * * *

DIVISION OF EARNINGS.

SEC. 19. (a) * * *

(b) RESERVE REQUIREMENTS.—

(1) * * *

* * * * * * *

(4) SUPPLEMENTAL RESERVES.—(A) * * *

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⟦(C) The supplemental reserve authorized under subparagraph (A) shall be maintained by the Federal Reserve banks in an Earnings Participation Account. Except as provided in subsection (c)(1)(A)(ii), such Earnings Participation Account shall receive earnings to be paid by the Federal Reserve banks during each calendar quarter at a rate not more than the rate earned on the securities portfolio of the Federal Reserve System during the previous calendar quarter. The Board may prescribe rules and regulations concerning the payment of earnings on Earnings Participation Accounts by Federal Reserve banks under this paragraph.⟧

⟦(D)⟧ *(C)* If a supplemental reserve under subparagraph (A) has been required of depository institutions for a period of one year or more, the Board shall review and determine the need for continued maintenance of supplemental reserves and shall transmit annual reports to the Congress regarding the need, if any, for continuing the supplemental reserve.

⟦(E)⟧ *(D)* Any supplemental reserve imposed under subparagraph (A) shall terminate at the close of the first 90-day period after such requirement is imposed during which the average amount of reserves required under paragraph (2) are less than the amount of reserves which would be required during such period if the initial ratios specified in paragraph (2) were in effect.

(12) EARNINGS ON RESERVES.—

(A) IN GENERAL.—Balances maintained at a Federal reserve bank by or on behalf of a depository institution may receive earnings to be paid by the Federal reserve bank at least once each calendar quarter at a rate or rates not to exceed the general level of short-term interest rates.

(B) REGULATIONS RELATING TO PAYMENTS AND DISTRIBUTION.—The Board may prescribe regulations concerning—

(i) the payment of earnings in accordance with this paragraph;

(ii) the distribution of such earnings to the depository institutions which maintain balances at such banks or on whose behalf such balances are maintained; and

(iii) the responsibilities of depository institutions, Federal home loan banks, and the National Credit Union Administration Central Liquidity Facility with respect to the crediting and distribution of earnings attributable to balances maintained, in accordance with subsection (c)(1)(B), in a Federal reserve bank by any such entity on behalf of depository institutions.

(c)(1) Reserves held by a depository institution to meet the requirements imposed pursuant to subsection (b) shall, subject to such rules and regulations as the Board shall prescribe, be in the form of—

(A) balances maintained for such purposes by such depository institution in the Federal Reserve bank of which it is a member or at which it maintains an account, except that (i) the Board may, by regulation or order, permit depository institutions to maintain all or a portion of their required reserves in the form of vault cash, except that any portion so permitted shall be identical for all depository institutions, and (ii) vault cash may be used to satisfy any supplemental reserve requirement imposed pursuant to subsection (b)(4), except that all such vault cash shall be excluded from any computation of earnings pursuant to [subsection (b)(4)(C)] *subsection (b)*; and

(B) balances maintained by a depository institution [which is not a member bank] in a depository institution which maintains required reserve balances at a Federal Reserve bank, in a Federal Home Loan Bank, or in the National Credit Union Administration Central Liquidity Facility, if such depository institution, Federal Home Loan Bank, or National Credit Union Administration Central Liquidity Facility maintains such funds in the form of balances in a Federal Reserve bank of which it is a member or at which it maintains an account. Balances received by a depository institution from a second depository institution and used to satisfy the reserve requirement imposed on such second depository institution by this section shall not be subject to the reserve requirements of this section imposed on such first depository institution, and shall not be subject to assessments or reserves imposed on such first depository institution pursuant to section 7 of the Federal Deposit Insurance Act (12 U.S.C. 1817), section 404 of the National Housing Act (12 U.S.C. 1727), or section 202 of the Federal Credit Union Act (12 U.S.C. 1782).

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