GAO Highlights

Highlights of GAO-17-117, a report to congressional requesters

October 2016

FEDERAL RESERVE

Observations on Regulation D and the Use of Reserve Requirements

Why GAO Did This Study

Section 19 of the Federal Reserve Act requires depository institutions to maintain reserves against a portion of their transaction accounts solely for the implementation of monetary policy. Regulation D implements section 19, and it also requires institutions to limit certain kinds of transfers and withdrawals from savings deposits to not more than six per month or statement cycle if they wish to avoid having to maintain reserves against these accounts. The transaction limit allows the Federal Reserve to distinguish between transaction accounts and savings deposits for reserves purposes.

GAO was asked to review certain effects of Regulation D. This report's objectives include examining depository institutions' implementation of Regulation D's requirements, the effect of the transaction limit on their customers, and central banks' varying dependence on reserve requirements and the monetary policy implications.

To examine these issues, GAO conducted a generalizable survey of 892 depository institutions (with a response rate of 71 percent); analyzed consumer complaint data from federal financial regulators; reviewed federal statutes and regulations, Federal Reserve System publications, and academic literature; and interviewed regulatory agency officials, representatives from banking and credit union associations, and depository institutions selected based on institution type and size.

The Federal Reserve and other federal banking regulators provided technical comments on a draft of this report, which we incorporated as appropriate.

View GAO-17-117. For more information, contact Lawrance L. Evans, Jr. at (202) 512-8678 or evansl@gao.gov.

What GAO Found

The methods by which depository institutions can implement Regulation D (Reserve Requirements of Depository Institutions) include maintaining reserves against transaction accounts and enforcing a numeric transfer and withdrawal (transaction) limit for savings deposits if they wish to avoid classifying those accounts as reservable transaction accounts. GAO estimates that 70–78 percent of depository institutions limit savings deposit transactions. Other methods include automatically transferring balances from transaction (e.g., checking) accounts to savings deposits in order to reduce reserve requirements. Institutions may choose to maintain transaction account reserves against savings deposits to eliminate the need to enforce the transaction limit. But some institutions GAO surveyed indicated that they had operational burdens associated with monitoring and enforcing the transaction limit (for example, 63–73 percent cited challenges, such as creating forms and converting and closing accounts). Available data indicate that few customers exceeded or expressed concerns about the limit.

Monetary policy—actions taken to influence the availability and cost of money and credit (i.e., interest rates)—can be conducted with varying dependence on reserve requirements. While many central banks around the world use reserve requirements, some have reduced their reliance on them due, in part, to the associated cost and administrative burdens. GAO reviewed how different central banks rely on reserve requirements and found a wide range of frameworks, including those with: (1) different mandatory reserve requirements (as compared to the United States), (2) voluntary reserve requirements, and (3) no reserve requirements at all. For example, countries with different mandatory reserves frameworks require maintaining reserves against all deposits, which eliminate the need to impose limits on transfers and withdrawals from specific accounts. While the Board of Governors of the Federal Reserve System (Federal Reserve) has used reserve requirements to help achieve the interest rate targets it sets in the market for reserves (federal funds market), central banks of other developed countries such as Canada, Australia, Sweden, and Denmark, among others, do not rely on reserve requirements. Instead, they use interest rates under their direct control to restrict interest rates from moving outside of a targeted range (corridor operating approach).

The authority for the Federal Reserve to pay interest on reserves has reduced some of the costs associated with reserve requirements in the United States. One of the alternatives to the current reserve requirement framework that GAO examined would require legislative change to further reduce some of these costs and burdens. Other approaches, while proven feasible for some foreign central banks, have implications for the conduct of monetary policy (e.g., require the pursuit of a corridor operating approach). Given the differences in financial systems across the globe, it is unclear whether the practices used by other nations would translate to the United States. Moreover, lowering or eliminating reserve requirements would raise a number of operational and technical issues for monetary policy implementation. For example, lowering or eliminating reserve requirements could introduce the need to manage potential volatility in short-term interest rates. Therefore, minimizing the burdens associated with reserve requirements would have to be weighed against the costs and monetary policy implications of any alternative framework when considering changes.