Observations on Regulation D and the Use of Reserve Requirements

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.