**TESTIMONY OF**
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**BEFORE THE**
**FINANCIAL INSTITUTIONS AND CONSUMER CREDIT SUBCOMMITTEE**
**HOUSE FINANCIAL SERVICES COMMITTEE**
**U.S. HOUSE OF REPRESENTATIVES**

**HEARING ON H.R. 758 AND H.R. 859**

**MARCH 5, 2003**

Thank you, Mr. Chairman, for the privilege of appearing before you and the distinguished members of your Subcommittee on this legislation. I am Bruce Bent CEO of The Reserve Funds. It is an honor to be on a panel with such outstanding financial leaders and I agree that business checking accounts should be able to earn interest.

I agree with and commend Representatives Toomey and Kelly and the co-sponsors for their leadership in trying to level the playing field between small and large banks.

Big banks and brokerage houses have used conventional sweep accounts as a way of paying interest on business checking accounts but only large banks and businesses were able to benefit. Small businesses were not able to take advantage of them due to the minimum balance requirement. Smaller banks also lacked the resources necessary to install such a system, with the net result being that big banks paid interest on checking accounts, small banks did not. This inequity cried out for correction, consumers were placed at a disadvantage.

When this legislation was first proposed in 1996, it was the only solution to this inequity and, therefore, it garnered widespread support. Between then and now, however, there has been a technological revolution that solves the problem and makes this legislation unnecessary. Technological breakthroughs have transformed our capabilities everywhere but nowhere faster than in financial services as this committee knows so well.

I, therefore, commend you, Mr. Chairman, for holding this hearing in light of the totally changed capabilities of financial institutions since the Congress last considered this subject.

This legislation has been made obsolete by innovation in the private market and the use of computer technology to create the "Reserve Return Sweep" accounts. But before I go into detail I would like to provide you with some background on The Reserve Funds and our role in the banking industry. The Reserve Fund, the worlds' first money market mutual fund, was founded in 1970 when we filed with the Securities and

Exchange Commission and opened to investors in the fall of 1971. The money market fund was created to fill a void in the marketplace. There needed to be a safe, liquid place to put cash that would provide a rate of return that reflected actual money market interest rates not the administered rate dictated by Regulation Q. I wanted a product that would be safe and convenient for consumers including businesses as well as being a smart investment. As we all now know, the money market fund filled that void and has been extremely successful with over $2 trillion now invested.

The same void that existed in the 1970s for individual bank accounts existed for business checking accounts. We wanted to find the same type of solution for businesses that we provided for individuals, an account that would provide a market rate of return, safety and liquidity. We created a bank "Sweep Account" that moved balances from business checking accounts at banks and into the Reserve money fund. Cash was swept back to the banks as checks cleared. Since the minimum account was $1,000 both the local gas station and General Motors could receive effective cash management with interest on what had been fallow deposits.

The sweep account was successful, but we thought there was room for improvement. Unfortunately, there is one drawback to this type of account and it is a major one, banks are not able to maintain the deposits on their balance sheet. This was particularly troubling for community and regional banks.

To address this issue, we launched the "Reserve Return Sweep" account in the year 2000. This product is an FDIC insured sweep account designed to help banks retain customer deposits while affording competitive interest rates for commercial accounts and, as an added advantage, no reserves are required on the balances. It is a viable alternative to third party money funds and in-house repurchase agreement programs which had hung the banker between providing premier services to customers and losing access to deposits. We have eliminated this dilemma, now both the bank and the depositor are well served at a very low cost to banks that is more than offset by the lending spread of 300 to 350 basis points they now can earn on the recaptured balances. Maintaining deposits on the banks balance sheet is crucial to loan funding and growth, potentially lowers the cost of funds, and reduces reliance on outside funding which usually means brokered deposits and often "hot" money. Prior to the creation of the Reserve Return Sweep account, non-bank competitors (brokers) jumped into the race to aggregate assets through money market mutual funds and while the depositors were well served most areas of the country and the banks therein were not. Because of the size criteria at money funds, arguably more money invested in the money funds wound up in London, Hong Kong and Tokyo than in any city in the U.S. other than New York. No more.

One of the purposes of the Gramm-Leach-Bliley Act was to level the playing field between large and small competitors and the "Reserve Return Sweep" account does just that. Allowing interest to be paid on business checking accounts in the manner proposed would disrupt the balance created by the Gramm-Leach Bliley Act. This delicate balance would be disturbed since the proposal grants the same powers to all banks large and small. The super giant banks would still have the advantage and the capital and are therefore better suited to win a rate war that would result with the passage of this legislation.

When Regulation Q was summarily repealed in 1982 the rate war it precipitated was a direct result and it cost the taxpayer $200 billion when the S & L's collapsed. We do not need another rate war particularly at this point in our financial markets. Multi-bank holding companies have the obvious advantage of a national presence and the ability to multiply their FDIC coverage by the number of banks in their group. The other 8,000 banks are set at $100,000 but with "Reserve Return Sweep" this is multiplied by the reciprocal linking of participating banks so that they too can compete.

I seriously doubt that in the last two hundred years anyone has ever appeared before Congress that did not have an ax to grind and I am no different, this legislation is potentially harmful to our product, but I am also concerned about the impact this well intentioned legislation will have on the banking industry and therefore, the entire economy.

Paying interest on business checking sounds fair but in reality when balances are excessive businesses already receive free checking, reduced rates on loans and, in general, the usual reciprocity that one would logically expect. Even larger balances are already swept to bank money market accounts and when coupled with "Reserve Return Sweep" nothing is overlooked. The broad based "interest on checking" proposed here would simply result in banks charging for the service they currently provide "free" and net little if anything for businesses and a potential rate war for an economy that would be better served with hugs and kisses. The banks will also incur the costs, risks and time in restructuring their portfolios to accommodate this new demand level.

I started my career as a clerk in a 2,000 square foot dry-goods store. I started my company with a $4,000 loan from my father, a U.S. postal clerk. I still think of myself as a little guy and I am very proud of the fact that my invention of the money market fund has enabled tens of millions of people to get a fair deal on their savings. One thing I have trouble with is that the money fund may have facilitated the concentration of banking in the U.S. and the lessening of competition and service to the customer. Fortunately, America still being a capitalistic society, over 900 community banks have been formed over the last four years alone to fill the void created by the unwillingness or inability of the mega banks to serve small business in particular.

Allowing (which is effectively forcing) banks to offer interest on checking balances puts these community banks at a competitive disadvantage.

I think that we can all agree that small businesses would benefit from earning interest on their balances. But this goal can be accomplished without passing legislation which has unintended consequences. The marketplace now has the appropriate solution which is cost effective and simple. Small banks will not have to deal with the cost or complexities of traditional sweep accounts and they will be able to keep their deposits on their books and profitably provide interest on business checking accounts. It is a win-win solution for small businesses which also includes the 8,000 small banks in America. We should allow the creativity and innovation of the marketplace to continue to provide the right solutions. As I have learned from my numerous years in the financial services industry, products will be developed that meet the demands of consumers. The Reserve Return Sweep account is an example of this.

Thank you and I would be happy to answer any questions at the appropriate time.