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Betty R. Turner

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I. Introduction

Since 1980 the financial marketplace has experienced a period of rapid evolution during which financial institutions[1] have abandoned their differentiated product and service lines, within government regulatory limits, to compete with each other in obtaining funds from depositors and investors. For example, only commercial banks historically provided checking account services; now, many depository and nondepository institutions offer transaction services similar to checking accounts.[2] The thrift institutions — savings and loan associations, mutual savings banks, and credit unions — provide their customers with "checking" account services through negotiable order of withdrawal (NOW) accounts and share draft accounts.[3] Investment banking houses, nondepository institutions, introduced the money market mutual fund,[4] which provides inves-

1. The term "financial institutions" includes both depository and nondepository financial intermediaries that collect funds from suppliers of funds and channel them to borrowers. Depository institutions are commercial banks and thrift institutions — savings and loan associations, credit unions, and mutual savings banks. Nondepository financial institutions include, for example, finance companies, insurance companies, and investment banking firms.

2. Checking accounts are demand deposits that the depositor may withdraw upon demand by writing a check. Time deposits pay interest to the depositor and theoretically are not redeemable upon demand. Time deposits include passbook savings accounts as well as certificates of deposit and savings certificates. *See generally* G. Smith, Money and Banking 107-09 (1982). The Federal Reserve Board of Governors has defined transaction accounts as "time deposits issued in connection with an agreement that permits the depositor to obtain credit by check or similar devices for the purpose of making payments or transfers to third persons or others." 47 Fed. Reg. 58,218 (1982).

3. New England thrift institutions first offered negotiable order of withdrawal (NOW) accounts in the early 1970's. These accounts, available to individuals, sole proprietorships, and not-for-profit corporations, paid 5¼% interest and permitted checking transactions. Credit unions soon followed with share draft accounts (so named because credit union members' accounts are called shares, which also paid interest and permitted the drawing of drafts similar to checks. In late 1978 commercial banks introduced the automatic transfer from savings (ATS) account, which permitted transfers from savings accounts earning interest at 5¼% into checking accounts. The Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA), 12 U.S.C. § 3503(a) (Supp. V 1982), expressly authorized interest-bearing NOW accounts for all depository institutions on a nationwide basis.

4. An investment banking firm is a specialized financial intermediary that primarily

tors a market rate of return while also allowing them some transactions privileges.[5] Money market mutual funds are the most threatening competitors to depository institutions because the different regulatory systems for depository institutions and investment banking firms have created an "unlevel playing field"[6] for these businesses in their battle for funds.[7]

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purchases securities from a seller at an agreed price and then sells the securities to investors at a profit. Investment banking firms have developed open-end investment companies, known as mutual funds, that continually sell or redeem their own shares to or from investors. These mutual funds invest the proceeds from share purchases in short-term securities, such as bank certificates of deposit, Treasury bills, and commercial paper; the funds then pass the returns, less administrative costs, to the investors. Closed-end investment companies, in contrast, have only a fixed number of shares outstanding not subject to continuous redemption. Of the 1600 investment companies registered with the Securities and Exchange Commission (SEC), 160 money market mutual funds hold $180 billion of the $250 billion total assets. The remainder are mutual funds that invest in common stock or longer-term debt obligations. Golembe Associates, Inc., Commercial Banking and the Glass-Steagall Act 11 (Feb. 18, 1982).

5. The Merrill Lynch Ready Assets Trust (Ready Assets) account is an example of a money market mutual fund. The Ready Assets prospectus states that the trust

> is not a bank nor does it offer fiduciary or trust services. Shares of the Trust are not equivalent to a bank account. As with any investment in securities, the value of a shareholder's investment in the Trust will fluctuate. The shares of the Trust are not subject to the protection of the Securities Investor Protection Corporation.

Merrill Lynch Ready Assets Trust 48 (Apr. 29, 1982) (prospectus). The fund is organized as a Massachusetts business trust and invests in short-term money market securities including "short-term United States Government securities, Government agency securities, bank money instruments [certificates of deposit and bankers' acceptances], corporate debt instruments including commercial paper and variable amount master demand notes, and repurchase and reverse repurchase agreements." *Id.* at 1. The minimum initial investment is $5000, and subsequent purchases must be in denominations of $1000 or more. The fund declares and reinvests dividends daily. Shareholders may redeem shares by checks in amounts of $500 or more. *Id.* at 16. The shareholder's yield on the fund is his share of the daily interest or discount earned on the instruments, adjusted for gains and losses, less administrative costs. *Id.* at 23. Thus, the investor enjoys the liquidity advantages of the transactions features along with the market returns associated with the fund's portfolio securities. The Ready Assets account is only one feature of Merrill Lynch's Cash Management Account Program, which also includes a margin account for the purchase of securities and a Visa credit card account. *See generally* Adams, *Money Market Mutual Funds: Has Glass-Steagall Been Cracked?*, 99 BANKING L.J. 4, 12-16 (1982). Other money market mutual funds may differ from the Ready Assets account in the required initial or subsequent investment amounts or the required redemption denomination. *See infra* part III.B.

6. The Investment Company Institute (ICI), a nonprofit trade organization of approximately 800 mutual funds, their investment advisors, and their principal underwriters, suggested this metaphor. Memorandum from Investment Company Institute to Depository Institutions Deregulation Committee at 8 (November 3, 1982) [hereinafter cited as ICI Memorandum].

7. In addition to competing with one another, the commercial banks, thrifts, and mutual funds are testing the regulators as they attempt to offer services historically within the domain of the investment banking business. For example, bank holding companies have been attempting to acquire discount brokerage houses, which execute purchase and sale or-

The Banking Act of 1933,[8] including the Glass-Steagall Act,[9] separated commercial banking activities from investment banking activities, set maximum interest rates that banks could pay on deposits,[10] and provided insurance for deposits at commercial banks.[11] Throughout the 1970's high interest rates in the financial marketplace spurred competition among the financial institutions to attract funds by offering consumers a market rate on their savings. Regulation Q prohibited commercial banks and other depository institutions from offering a market rate of return on deposit accounts,[12] and the Glass-Steagall Act prohibited them from offering an instrument competitively equivalent to the money market mutual funds.[13] The drain of funds from depository institutions to

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ders of customers in the securities markets. In September 1982 the Federal Deposit Insurance Corporation (FDIC) issued a statement indicating that a nonmember bank, a bank not a member of the Federal Reserve System but under the authority of the FDIC, would not violate the Glass-Steagall Act, *see infra* part II.A., by conducting securities activities through a subsidiary. FDIC Statement of Policy on the Applicability of the Glass-Steagall Act to Securities Activities of Subsidiaries of Insured Nonmember Banks, FDIC News Release PR-72-82 (Sept. 1, 1982). In January 1983 the Comptroller of the Currency allowed Security Pacific National Bank to acquire Kahn & Co. Also in January the Federal Reserve Board approved BankAmerica Corporation's application to acquire Schwab & Co., Inc. *See* American Banker, Jan. 10, 1983, at 1, col. 1. The Federal Reserve Board ruled that discount brokerage activities were "so closely related to banking as to be a proper incident thereto." 12 U.S.C. § 1983 (c) (8) (1976). The Justice Department and the SEC did not object to the acquisition. *See* American Banker, Jan. 10, 1983, at 1, col. 1.

Mutual funds, on the other band, recently have sought bank charters to avail themselves of FDIC insurance and other perceived advantages. In February 1983 the Comptroller of the Currency approved the applications of The Dreyfus Corporation and J. & W. Seligman and Company, Inc., two mutual funds, to acquire or establish "nonbank banks" (banks that accept deposits but do not make commercial loans). The institutions would not be "banks" as defined under the Bank Holding Company Act of 1956, but would be banks for other purposes. The Federal Reserve Board took the position that the acquisitions would violate the Glass-Steagall Act and in March 1983 threatened to take action against J. & W. Seligman and Company under the Federal Reserve Act. The Federal Reserve argued that the transaction involved affiliation between a member bank and an organization "engaged principally" in the issue and sale or distribution of securities. In April 1983 the Comptroller of the Currency announced a moratorium on the issuance of "nonbank bank" charters, and the Federal Reserve has introduced legislation to restrict the formation of these institutions. Banking Expansion Reporter, Vol. 2, No. 8, at 2-3 (Apr. 18, 1983).

8. 148 Stat. 162 (1933).

9. 12 U.S.C. §§ 24, 78, 377, 378 (1976); *see infra* note 24.

10. Pursuant to this congressional directive, the Federal Reserve Board of Governors promulgated Regulation Q. *See* 12 C.F.R. pt. 217 (1982).

11. The Federal Deposit Insurance Corporation (FDIC) provides deposit insurance for banks, and the Federal Savings and Loan Insurance Corporation (FSLIC) provides insurance for savings and loan associations.

12. *See* 12 C.F.R. pt. 217 (1982).

13. Investment Company Institute v. Camp, 401 U.S. 617 (1971); *see infra* notes 29-34 and accompanying text.

the money market mutual funds, resulting from depositors' desires to earn a market rate of interest not permitted under Regulation Q,[14] prompted Congress to enact the Depository Institution Deregulation Act of 1980[15] (DIDA), which phases out Regulation Q's interest rate ceilings on deposits by 1986. Although the DIDA was an appropriate measure, it did not eliminate the ceilings and thus did not permit depository institutions to offer market rates on deposit accounts. Consequently, billions of dollars continued to flow from savings accounts at depository institutions to the higher yielding mutual funds.[16] In 1982 Congress considered amending the Glass-Steagall Act,[17] but finally decided to amend it indirectly through a section of the Garn-St. Germain Depository Institutions Act. The provision now expressly authorizes a new money market deposit account "directly equivalent to and competitive with money market mutual funds."[18] The Depository Institutions Deregulation Committee (DIDC)[19] promulgated the rules[20] for the new money market deposit account, which commercial banks and thrift institutions began offering on December 14, 1982. The account has limited transactions features, federal insurance, and can earn interest "at any rate."[21]

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14. 12 U.S.C. §§ 371(a), (b) (1976).

15. 12 U.S.C. §§ 3501-09.

16. *See infra* part II.B.

17. *See infra* part II.D.

18. Garn-St. Germain Depository Institutions Amendments of 1982, § 327, 12 U.S.C.A. § 3503(c)(1) (West Supp. 1982).

19. The Depository Institutions Deregulation Committee (DIDC), established under the Depository Institutions Deregulation Act of 1980 (DIDA), comprises the following voting members: Secretary of the Treasury (currently Donald Regan), Chairman; Chairman of the Board of Governors of the Federal Reserve System (currently Paul Volcker), Vice Chairman; Chairman of the FDIC (currently William Isaac); Chairman of the Federal Home Loan Bank Board (currently Richard Pratt); and Chairman of the National Credit Union Association (currently Edgar Callihan). The Comptroller of the Currency (currently Todd Conover) is a nonvoting member of the DIDC. The DIDC's function is to monitor the phase-out of Regulation Q and to set maximum rates that depository institutions may pay under Regulation Q until it is abolished completely in 1986.

20. 47 Fed. Reg. 53,710 (1982) (to be codified at 12 C.F.R. § 1204.122).

21. *Id.* § 1204.122(a). Pursuant to 12 U.S.C. § 3503(c), the DIDC established the Garn-St. Germain account at its November 6, 1982, meeting. At its December 15, 1982, meeting, tbe DIDC, under the same authority that permits NOW accounts, 12 U.S.C. § 3503(a), authorized banks and thrifts to offer another new account, the "Super NOW" account, beginning January 5, 1983. 12 U.S.C. § 3503(a) provides:

> The [DIDC] shall . . . provide for the orderly phase-out and the ultimate elimination of the limitations on the maximum rates of interest and dividends which may be paid on deposits and accounts as rapidly as economic conditions warrant. The phase-out of such limitations may be achieved by the [DIDC] by the gradual increase in such limitations applicable to all existing categories of accounts, the complete elimination of the

The DIDC's regulations for the account, which the Deregulation Committee promulgated pursuant to the Garn-St. Germain amendment to the DIDA, have ignited controversy in the financial industry. Critics of the amendment argue that the account's features favor depository institutions over the money market mutual funds in the competition for investors' funds. Proponents of the account, on the other hand, insist that it enhances the ability of depository institutions to compete for funds to ensure their profitability and a sufficient supply of credit for businesses, government entities, and consumers. This Note examines the features of the new money market deposit account relative to the objectives of the Garn-St. Germain Act and the current financial institutions' competitive and regulatory environments. Part II traces the evolution of the new money market deposit account. Part III then examines the DIDC's design for the new account and evaluates the account's features in light of the Garn-St. Germain Act, its legislative history, and the competitive and policy considerations underlying the legislation. Part IV concludes that the account proposed by the DIDC unfairly favors depository institutions over money market mutual funds and proposes recommendations for altering the features of the new money market deposit account so that it will be competitive with money market mutual funds.

> limitations applicable to particular categories of accounts, the *creation of new categories of accounts* not subject to limitations or with limitations set at current market rates, any combination of the above methods, or any other method.

12 U.S.C. § 3503(a) (West Supp. 1982) (emphasis added).

Unlike the Garn-St. Germain account, which limits telephone transfers and third-party drafts to six per month, the Super NOW account does not limit the number of transactions. The Garn-St. Germain amendment exempts the money market deposit account from transaction reserve requirements; the 12% reserve requirement, however, applies to Super NOW deposits. Both accounts require a $2500 minimum balance, although institutions may require a higher balance and may pay interest at any rate. Federal Reserve Board Chairman Paul Volcker voted against the Super NOW account at the DIDC's November 6 meeting and "told fellow banking regulators that combining unlimited transactions with savings in one account will complicate the central bank's efforts to control the nation's money supply." American Banker, Dec. 7, 1982, at 25, col. 2. The DIDC made the Super NOW account available only to consumers, but invited comments on whether to offer it to business firms; business firms are eligible for the Garn-St. Germain account. At least one commentator has stated that because Congress authorized NOW accounts only for consumers, sole proprietorships, and not-for-profit corporations, the DIDC has no authority to establish Super NOW accounts for corporations. Scott, *Legislation Needed on Corporate Money Market Accounts*, American Banker, Dec. 6, 1982, at 4, col. 2. The effect that the Super NOW account will have on the money market deposit account is not clear and is beyond the scope of this Note. This Note will focus on the money market deposit account's competitive stance relative to the money market mutual funds.

II. The Evolution of the Garn-St. Germain Money Market Account

A. The Glass-Steagall Act

Fifty years ago Congress enacted the Banking Act of 1933[22] and decreed the segregation of the securities and investment banking business from the commercial banking business.[23] The four sections of the Banking Act that legislate this separation constitute what has become known as the Glass-Steagall Act.[24] The 1929 stock market collapse and the subsequent bank failures[25] during the Depression prompted Congress to enact these Glass-Steagall provisions.[26] Section 21 of the Glass-Steagall Act[27] establishes the

22. 48 Stat. 162 (1933).

23. Congress passed several pieces of financial reform legislation during the early 1930's. In addition to the provisions applying to investment and commercial banking, the Banking Act of 1933 established the Federal Deposit Insurance Corporation (FDIC) and provided for the regulation of interest rates on deposit. The Securities Acts of 1933 and the Securities and Exchange Act of 1934 established a complex regulatory system for the securities markets distinct from that established for commercial banking. *See generally* Golembe Associates, Inc., *supra* note 4.

24. 12 U.S.C. §§ 24, 78, 377, 378 (1976). The principal authors of the Banking Act of 1933 were Senator Carter Glass of Virginia and Representative Henry Steagall of Alabama. The term "Glass-Steagall Act" usually refers to these four sections concerning commercial banking activities.

25. "During the three years 1930 through 1932 over 5,000 commercial banks had failed; during tbe single month of January 1933 there were 241 failures, while another 148 failures occurred in February — a rate which, if continued, seemed likely to make 1933 the cataclysmic year of the Great Depression." Golembe Associates, Inc., *supra* note 4, at 51. Legislative history indicates tbat securities affiliates of banks had used bank resources to engage in highly speculative investment banking activities. *See* S. Rep. No. 77, 73d Cong., 1st Sess. 10 (1933); *see also* Board of Governors v. Investment Co. Inst., 450 U.S. 46, 61-62 (1981).

26. Both Adam Smith's eighteentb century "real-bills" doctrine, which described the "proper" function of commercial banking as one of accepting deposits and making short-term, self-liquidating loans, and Great Britain's practice of separating commercial and investment banking influenced Senator Glass and Congress. *See* H.R. Rep. No. 1593, 62d Cong., 3d Sess. (1932); Golembe Associates, Inc., *supra* note 4, at 51-53. *See generally* Perkins, *The Divorce of Commercial and Investment Banking: A History*, 88 Banking L.J. 483 (1971).

27. Section 21 provides:

> [I]t shall be unlawful — (1) For any person, firm, corporation, association, business trust, or other similar organization, engaged in the business of issuing, underwriting, selling or distributing, at wholesale or retail, or through syndicate participation, stocks, bonds, debentures, notes, or otber securities, to engage at the same time to any extent whatever in the business of receiving deposits subject to check or to repayment upon presentation of a passbook, certificato of deposit, or other evidence of debt, or upon request of the depositor . . . .

12 U.S.C. § 378(a) (1976). This section is the only part of tbe Glass-Steagall Act that applies on its face to depository institutions that are not members of the Federal Reserve System. The other three sections — sections 16, 20, and 32 — apply only to member banks of tbe

"wall" between investment banking and commercial banking activities by absolutely prohibiting firms engaged in the investment banking business from simultaneously engaging in the business of accepting deposits. Although member banks may underwrite and "deal in" certain limited classes of securities—principally U.S. Government and municipal securities—section 16 of the Glass-Steagall Act restricts member banks to buying and selling stocks "without recourse, solely upon the order, and for the account of customers . . . ."[28]

In *Investment Company Institute v. Camp*,[29] the Supreme Court held that the Glass-Steagall Act prohibits commercial banks from offering open-end investment accounts, which are virtually equivalent to money market mutual funds.[30] In *Camp* the Comptroller of the Currency in 1970 had authorized national banks to offer collective investment funds.[31] First National City Bank of New York then established a fund pursuant to the Comptroller's regulation. Under this plan the customer would tender funds to the bank and authorize the bank to act as his managing agent. The bank would pool the funds for investment purposes and issue "units of participation" to the customer based on his proportionate interest. The customer could redeem or transfer these units by executing a managing agency agreement with the bank. The Supreme Court found the Comptroller's regulation invalid because it violated sections 16 and 21 of the Glass-Steagall Act.[32]

The account in *Camp* was an open-end investment fund arrangement. Under Glass-Steagall a bank may pool or commingle trust assets, act as managing agent for individuals with their permission, or purchase stock "upon the order, and for the account of, customers."[33] Each of these activities individually is permissible

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Federal Reserve System.

28. Section 16 provides:

> The business of dealing in securities and stocks . . . shall be limited to purchasing and selling sucb securities and stock without resource, solely upon the order, and for the account of, customers, and in no place for its own account, and the [bank] shall not underwrite any issue of securities or stock: Provided, that the [bank] association may purchase for its own account investment securities under such limitations and restrictions as the Comptroller of the Currency may by regulation prescribe.

12 U.S.C. § 24 (1976).

29. 401 U.S. 617 (1971).

30. *Cf.* Board of Governors v. Investment Co. Inst., 450 U.S. 46 (1981) (Glass-Steagall Act held not to prohibit a bank from acting as an advisor to a closed-end investment fund).

31. *See* 12 C.F.R. § 9 (1970).

32. 401 U.S. at 639; *see supra* notes 27-28 and accompanying text.

33. 12 U.S.C. § 24 (1976); *see* Brief for Respondent, *Camp*, *reprinted in* 28 L. Ed. 2d

and a common banking practice. In *Camp*, however, when the bank combined these three permissible activities, the Supreme Court concluded that "the union of these powers gives birth to an investment fund . . . . The operation of an investment fund of the kind approved by the Comptroller involves a bank in the underwriting, issuing, selling and distributing of securities in violation of §§ 16 and 21 of the Glass-Steagall Act."[34] Thus, the Court has determined that Glass-Steagall prohibits banks from offering the equivalent of a money market mutual fund.

Section 21 of the Glass-Steagall Act[35] also bars investment banking firms from receiving deposits.[36] Although consumers may view as functionally equivalent a deposit account and a money market mutual fund account, the regulators perceive clear legal distinctions.[37] The Comptroller of the Currency has stated: "Money market fund shares . . . are not deposits. Investors in money market funds become part owner of the funds and, unlike insured depositors, their return of both principal and interest depends upon the performance of the funds."[38] Consequently, the Justice Department has concluded, "It is patent from [section 21 of the Glass-Steagall Act] that a depositor is only a *creditor* of his depository. . . . It is equally patent that one who invests in a money market fund is an *owner* pro tanto of the fund."[39] In addition to

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1010, 1013.

34. 401 U.S. at 639.

35. 12 U.S.C. § 378(a) (1976); *see supra* note 27.

36. *Id.*

37. *See* Adams, *supra* note 5, at 22-27.

38. *Money Market Mutual Funds: Hearings Before the Subcomm. of the Senate Comm. on Banking, Housing and Urban Affairs*, 96th Cong., 2d Sess. 231-32 (1980) (statement of John G. Heimann) [hereinafter cited as *1980 Hearings*], *reprinted in* Adams, *supra* note 5, at 26 n.81.

39. Justice Department opinion letter from Philip B. Heymann and Lawrence Lippe to Martin Lybecker (Dec. 19, 1979) (emphasis added), *reprinted in* Adams, *supra* note 5, at 26.

The Securities and Exchange Commission has also noted the distinction:

> It appears that the superficial similarity of these money market fund services to services which have traditionally been offered by depository institutions has led some to assert the necessity for "bank type" regulation of money market funds. Yet, however similar the services may appear to be, there are significant legal and practical distinctions to be emphasized: money market funds and bank deposits are not interchangeable products.
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> A money market fund share is an equity product: it is common stock upon which dividends are declared and capital gains are distributed only to the extent of the investment company's net income or net capital gains. The value of an investor's interest in such a fund necessarily fluctuates as the fund's portfolio of investments rises or falls. A bank deposit is a debt product: it represents a liability of the bank and provides a

the debtor-creditor relationship, the regulators also stress the fixed yield and insurance features of the deposit relationship.[40] These narrow interpretations of "deposits" under Glass-Steagall allow investment companies to offer limited transaction accounts that earn a market rate of interest, but technically are not deposit accounts. On the other side of the Glass-Steagall wall, however, the *Camp* decision prevented commercial banks from offering accounts that combined transaction features with a market rate yield.[41]

B. *The Conflict Between Bank Deposits and Money Market Mutual Funds*

Commercial banks and thrifts direct their competitive efforts toward the money market mutual funds because these funds threaten the oldest and most basic function of banking — accepting deposits. Deposits provide the base for channelling capital to businesses, government entities, and consumers in the form of loans and investments. Any decrease in an institution's capacity to

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> fixed rate of return in the form of interest. The value of deposits in bank accounts do not fluctuate and, generally, these amounts are insured up to specified amounts.

1980 Hearings, *supra* note 38, at 7-8 (statement of Irving M. Pollack, and SEC commissioner), *reprinted in* Adams, *supra* note 5, at 26-27.

40. One member of the Board of Governors of the Federal Reserve System has distinguished the instruments in terms of their risk and insurance characteristics:

> Deposits at federally insured institutions offer the saver assets that are absolutely free of risk of loss of principal, up to the $40,000 [now $100,000] insurance limit per account, and that bear a fixed yield to maturity. Money-market fund shares, on the other hand, are uninsured investments that offer no certainty with respect to the yield that will be earned over time. . . . [Money-market funds] do entail some uncertainties not shared by deposits . . . .

1980 Hearings, *supra* note 38, at 245 (statement of J. Charles Partee, member of the Board of Governors of the Federal Reserve System), *reprinted in* Adams, *supra* note 5, at 26 n.81; *see also* Adams, *supra* note 5, at 27.

41. To compete for funds, commercial banks have attempted to evade Glass-Steagall restrictions by structuring various products — retail repurchase agreements (retail repos) and sweep accounts, for example — that technically are not open-end investment accounts under the *Camp* interpretation of Glass-Steagall. A retail repo is a sale by a financial institution of an individual fractional interest in an underlying government security, or pool of securities, subject to the financial institution's obligation to repurchase the interest in the security for a set amount within a specified period of time. The premium between the sale and repurchase prices represents the investor's yield. Under sweep account arrangements, the bank sweeps a customer's deposits above a threshold amount (from $1000 to $20,000 for corporate accounts) from his account and with those funds purchases Treasury bills or bank certificates of deposit, for example, that provide a market yield to the customer. The Securities Industry Association, a trade organization for brokers, and the Investment Company Institute usually file suits to prevent commercial banks from marketing these products. The banks dispute the securities industry's contentions that these arrangements are securities under the Glass-Steagall Act. In *Camp* the Court broadly interpreted the term "security." The subsequent trend narrowed the definition and created the current fluid situation.

make loans translates into a loss of profits because the depository institution's primary source of income is the interest and fees earned on the loans it makes. In early 1978 money market mutual funds held less than $4 billion in assets;[42] by November 1982 they held $230 billion.[43] Many of these dollars drained out of deposits at commercial banks and thrift institutions, where Regulation Q limited the rate of return, and into the higher yielding money market mutual funds.[44] This drain has affected seriously the credit allocation function and the profitability of the banking system. Banks and thrifts put deposit dollars directly to work by making loans to consumers and to all types and sizes of business and by investing in local, state, and United States Government obligations. Thrifts and regional commercial banks concentrate these loans and investments in their communities and regions. Although money mutual funds also channel their investors' dollars to businesses and governments, the route to businesses may be an indirect one because many of the investments are in stocks and bonds of large corporations purchased through the secondary market. Therefore, dollars that have flowed out of the depository institutions are not available for direct loans to individuals and businesses.

C. *Regulation Policies*

While depository institutions have argued that excessive regulation inhibits their ability to compete in the financial marketplace, the historical justifications for regulating the commercial banking system have been to preserve its safety and soundness, to guard against concentration of financial power, and to allocate credit appropriately.[45] Prior to the Garn-St. Germain Act, the absolute prohibition against a bank's offering a money market deposit-type account did not further any of these objectives. Nor does the Garn-St. Germain Act's directive for an account "directly equivalent to and competitive with money market mutual funds" contravene any of these important regulatory goals.

Federal deposit insurance combined with examinations by the regulators and relaxed restrictions on mergers and acquisitions involving financially troubled institutions are the best safeguard

42. Adams, *supra* note 5, at 8.

43. American Banker, Nov. 26, 1982, at 4, col. 1.

44. Banks and thrift institutions in November 1982 held just under $700 billion in demand, savings, and NOW account balances. *Id.*

45. *See* Golembe Associates, Inc., *supra* note 4, at 3-6.

against bank failures. As long as banks act responsibly in offering the new account and regulators accurately assess and monitor the risks, the new account will not be a threat to the safety and soundness of the banking system.

Critics have argued that permitting banks to compete in the investment banking business by offering money market accounts will further concentrate banking power. Statistics refute this argument — in fact, domestic deposit concentration among commercial banks has declined since 1940.[46] The one hundred largest banks now hold less than forty percent of commercial bank domestic deposits while the ten largest banks hold only about seventeen percent of commercial bank domestic deposits.[47] The securities industry, by comparison, is far more concentrated. The twenty-one largest investment banking firms account for over one-half of the industry's total revenue and total capital, and between 1971 and 1980 concentration increased substantially.[48] In its money market fund, Merrill Lynch, Pierce, Fenner & Smith, Inc. holds over $35 billion subject to checking privileges.[49] If it were a bank, Merrill Lynch wonld be among the nation's three largest banks in terms of domestic deposits.[50] Thus, the fear of a disproportionate concentration of economic power among the banks does not justify prohibiting banks from offering money market deposit accounts competitive with the mutual funds.

Both commercial banking and investment banking channel funds from depositors or investors to businesses, governments, and consumers through loans and investments.[51] This credit allocation function, however, follows a less direct channel through an investment banking firm than it does through a commercial bank.[52] Without an account competitive with the money market mutual funds, banks and thrifts would continue to lose deposits to money

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46. *See id.* at 98.

47. *Id.* at 106 (citing C. Golembe & D. Holland, Federal Regulation of Banking 174 (1981) (published by the American Bankers Association and the American Institute of Banking, Washington, D.C.)).

48. Golembe Associates, Inc., *supra* note 4, at 106-07 (citing SECURITIES AND EXCHANGE COMMISSION, THE SECURITIES INDUSTRY IN 1980 34, 66 (Sept. 1981)(Staff Report)).

49. *See* Golembe Associates, Inc., *supra* note 4, at 130. Unlike a commercial bank, Merrill Lynch's "deposits" are not insured against the company's bankruptcy. Thus, the same public interest considerations apply to the regulation of Merrill Lynch. Yet Merrill Lynch engages in a full range of investment banking activities in which commercial banks, because they offer transaction accounts, cannot engage.

50. *Id.*

51. *See supra* part II.B.

52. *Id.*

market mutual funds,[53] and this loss would stifle their credit allocation function as well as their continued viability as profitable institutions. Thus, the ability to offer the new account will enable depository institutions to fulfill their historically protected objectives.

D. Remedial Legislation

The Banking Act of 1933[54] authorized the Board of Governors of the Federal Reserve System to establish ceilings on the rate of interest that member banks could pay on time and savings deposits.[55] The Banking Act of 1935[56] authorized the FDIC to do the same for insured nonmember banks. Congress enacted these restrictions at the request of commercial banks because they maintained that banks failed in the 1930's because of excessive competition during the preceding decade.[57] In 1966, Congress enacted the Interest Rate Adjustment Act[58] authorizing the Federal Home Loan Bank Board (FHLBB) to regulate the rates of interest that savings and loan institutions could pay on time and savings deposits. Congress passed the Interest Rate Adjustment Act to protect the thrift industry from the threat created by depositors' apparent preference for commercial banks. This Act authorized the FHLBB to allow ceiling rates for savings and loans that are slightly higher than those permitted by the Federal Reserve Board and the FDIC for corresponding accounts at commercial banks.[59] The purpose of the interest rate ceilings set out in Regulation Q[60] was to protect depository institutions by restricting competition, first among commercial banks and then between commercial banks and savings and loans. The persistence of high inflation rates and high interest rates in the late 1960's and the 1970's, however, led many investors to withdraw their deposits from commercial banks and thrift institutions and to invest them in Treasury bills or other instruments offered by institutions that could pay market interest rates because they were not subject to Regulation Q. One of these other instru-

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53. *See* American Banker, Nov. 26, 1982, at 4, col. 1.
54. 12 U.S.C. §§ 371(a), (b)(1976).
55. *See supra* note 3.
56. 12 U.S.C. § 389 (1976).
57. *See supra* notes 25-26 and accompanying text.
58. 12 U.S.C. §§ 371(b), 1425b(a), 1828(g)(1976).
59. The Interest Rate Adjustment Act allowed savings and loans to pay a rate ¼% higher than commercial banks on time and savings deposits.
60. 12 C.F.R. § 217.7 (1982).

ments, the money market mutual funds, emerged as the premier investment vehicle in the late 1970's.[61]

Continued high interest rates and disintermediation[62] of capital to the mutual funds plagued commercial banks and thrifts. In addition to protesting the competitive disadvantage imposed by Regulation Q's interest rate ceilings, the commercial banking industry argued that money market mutual funds enjoyed a competitive advantage because they were not subject to reverse requirements. The Federal Reserve Board required banks and thrifts to comply with reserve requirements on demand, NOW, and savings accounts.[63] In March 1980 the Federal Reserve Board imposed reserve requirements on new money invested in mutual funds; but in July of the same year the Board rescinded the requirements, probably because they were inconsistent with the trend toward deregulation of the financial services industry.[64] The depository institu-

61. *See supra* part II.B.

62. "Disintermediation" refers to the flow of funds from commercial banks and thrifts, which Regulation Q prohibited from paying market rates of interest to small savers, to Treasury bills or institutions offering market return.

63. Reserve requirements set a percentage of deposits, from 3% for savings to 12% for transactions balances, that depository institutions must hold on account at the Federal Reserve Bank. These reserve deposits are idle balances and the institutions cannot invest them or make loans from them.

64. *See generally* G. SMITH, *supra* note 4, at 114-15. Historically, the Federal Reserve Board has focused on Ml in administering monetary policy. Ml, the narrow definition of the nation's money supply, takes two forms: MlA includes currency and domestic demand deposits at commercial banks; and MlB includes MlA plus otber checkable deposits such as NOW accounts, ATS accounts, credit union share draft accounts, and mutual savings bank demand deposits. In January 1982 the Federal Reserve Board adopted MlB as the official narrow definition of the nation's money supply. *See* J. PRAGER, FUNDAMENTALS OF MONEY, BANKING, AND FINANCIAL INSTITUTIONS 38-39 (1982). Ml includes neither mutual funds nor the new money market deposit account, which are subject to zero or minimal reserve requirements. M2, however, does include these money market instruments. Economists define M2 as Ml plus savings and time deposits under $100,000 at all depository institutions plus money market mutual fund shares plus other short-term deposits. M2 embraces those assets that can be converted quickly into cash or transactions balances. *Id.* at 39-43. Thus, as more transactions-oriented instruments not subject to reserve requirements have evolved, M2 has become a more accurate measure of the money supply. Federal Reserve Board Chairman Paul Volcker announced the Board's intention to use M2 as its official measure of the money supply because it accounts for the new money market deposit account funds. Volcker cautioned, however, that because of the very low or zero reserve requirements on most of these funds, the Board may not be able to implement monetary policy as proficiently using M2 as it can using Ml. American Banker, No. 26, 1982, at 3, col. 2. The rapid growth of the mutual funds frustrated monetary policy to the extent that Ml became a poorer measure of the money supply and to the extent that the effects of monetary policy on M2, as opposed to Ml, are more difficult to predict. Although the absence of reserve requirements on the new money market accounts may create monetary control problems attributable to the funds shifted from accounts subject to reserve requirements into accounts not subject to

tions' problems induced Congress to enact the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA).[65] The primary objective of the DIDMCA was "to deregulate the deposit taking function of financial institutions."[66] Title II of the DIDMCA, captioned "Depository Institutions Deregulation Act of 1980" (DIDA), provides for the "orderly phase-out and the ultimate elimination of" limitations on maximum rates of interests and dividends that depository institutions may pay on deposits."[67] The DIDA empowered the Deregulation Committee to achieve these ends through various means including the creation of new account categories "not subject to limitations or with limitations set at current market rates."[68]

In late 1981 the House Banking Committee established a subcommittee to conduct hearings on the significant issues concerning the financial services industry. The hearings focused on

> issues revolving around expanded lending powers [of depository institutions], improved delivery of credit and other financial services to consumers and the economy, interstate banking, the Glass-Steagall Act, usury and other statutes affecting consumer lending, and questions concerning the competitive balances throughout the financial community.[69]

The rapid pace of change in the financial marketplace appeared to be "eroding the justification for this system of specialized financial institutions and its regulatory framework."[70] The gradual elimination of Regulation Q interest rate ceilings under DIDA had not provided commercial banks and thrifts with enough flexibility to compete for funds because the rates the government permitted them to pay remained uncompetitive with the market rates offered by mutual funds.

Although depository institutions' loss of deposits to mutual funds caused them the greatest competitive concerns, commercial banks also wanted to underwrite state and local revenue bonds and engage in all types of investment banking activities, especially un-

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reserve requirement, the Federal Reserve Board's change to M2 as the official measure of the nation's money supply will mitigate those problems.

65. 12 U.S.C. § 3503(a) (Supp. V 1981).

66. STAFF OF HOUSE COMM. ON BANKING, FINANCE, AND URBAN AFFAIRS, 97TH CONG., 1ST SESS., FINANCIAL INSTITUTIONS IN A REVOLUTIONARY ERA, [1981-1982 Transfer Binder] FED. BANKING L. REP. (CCH) ¶ 98,931 [hereinafter cited as FINANCIAL INSTITUTIONS IN A REVOLUTIONARY ERA].

67. 12 U.S.C. § 3503(a) (Supp. V 1981).

68. *Id.*; *see supra* note 19.

69. FINANCIAL INSTITUTIONS IN A REVOLUTIONARY ERA, *supra* note 66, at 85, 678 (Letter of Transmittal from Representatives St. Germain & Stanton).

70. *Id.* at 85, 679.

derwriting and distributing corporate debt and equity issues. Prior to the Garn-St. Germain Depository Institution Act of 1982, Congress considered various other proposals that reflected these business objectives.[71] In October 1981 Senator Garn introduced S. 1720, entitled the "Financial Institutions Restructuring and Services Act of 1981." Title III of that bill concerned securities activities and proposed to amend Glass-Steagall in two ways. First, the Act would permit national banks to underwrite municipal revenue bonds, and second, any depository institution or bank holding company or subsidiary could organize, sponsor, operate, control, or render investment advice to an investment company or could underwrite, distribute, sell, or issue securities of any investment company.[72]

The Administration through Secretary of the Treasury Donald T. Regan also submitted a proposal, entitled the "Bank Holding Company Deregulation Act of 1982." The Administration's proposal would have amended the Glass-Steagall Act by permitting depository institutions to sponsor mutual funds, underwrite revenue bonds, and engage in other securities activities through subsidiaries of bank holding companies. These separate corporate affiliates, primarily regulated by the Investment Company Act of 1940, would have been subject to the rules, regulations, and tax treatment of investment companies. The Securities and Exchange Commission supported the Administration's proposal. In his statement before the Senate Committee on Banking, John S.R. Shad, Chairman of the Securities and Exchange Commission, said: "[T]he challenge we face is clear: to eliminate unnecessary restrictions on competition while, at the same time, (1) preserving the investor protections which are so important to capital raising in this nation, (2) protecting the solvency of our banking institutions, and (3) avoiding the creation of unfair competitive advantages."[73] Chairman Shad added that the Administration's proposal was consistent with the Commission's functional approach to regulation.[74]

Rather than directly amend the Glass-Steagall Act under either S. 1720 or the Administration's proposal, by expressly permitting banks to engage in traditionally nonbank activities, Congress

71. These proposals represented the legislative embodiment of the competitive institution-designed products discussed *supra* note 40.

72. S. 1720, 97th Cong., 1st Sess. §§ 302(h)(1)(A), (B) (1981).

73. *Hearings Before the Subcomm. on Securities of the Sen. Comm. on Banking, Housing and Urban Affairs*, 97th Cong., 2d Sess. 35 (1982).

74. *Id.*

chose indirectly to amend the Glass-Steagall Act by amending the section of the DIDA that provides for the "orderly phase-out and the ultimate elimination of" maximum interest rates on deposits.[75] Section 327 of the Garn-St. Germain Depository Institutions Act of 1982 amends the DIDA by requiring the DIDC to authorize a new deposit account "directly equivalent to and competitive with money market mutual funds registered with the Securities and Exchange Commission under the Investment Company Act of 1940."[76] Because Congress created a totally new product, instead of redefining the permissible activities of depository and nondepository institutions, the securities industry and banks will continue to debate the meanings of "security"[77] under the Glass-Steagall Act.[78] In addition, the new money market deposit account, which the DIDC authorized pursuant to section 327 of the Garn-St. Germain Act, poses another question for debate: does the account comply with the congressional directive that it "be directly equivalent to and competitive with money market mutual funds"?

III. The Garn-St. Germain Money Market Deposit Account

Section 327[79] of the Garn-St. Germain Depository Institutions Act of 1982, an amendment to the Depository Institutions Deregulation Act of 1980,[80] authorizes a new money market deposit account.[81] The provision states:

(c)(1) The [Depository Institutions Deregulation] Committee [DIDC] shall is-

75. 12 U.S.C. § 3503 (Supp. V 1981).

76. 12 U.S.C.A. § 3503(c) (Supp. 1983).

77. *E.g.* A. G. Becker v. Bd. of Governors, 693 F.2d 136 (D.D.C. 1982); *see also supra* note 7.

78. On July 12, 1983, congressmen introduced identical bills in the Senate and in the House of Representatives "[t]o authorize depository institution holding companies to engage in activities of a financial nature, insurance underwriting and brokerage, real estate development and brokerage, and certain securities activities including dealing in, underwriting and purchasing government and municipal securities, sponsoring and managing investment companies and underwriting the securities thereof . . . ." S. 1609, 98th Cong., 1st Sess. (1983); H.R. 3537, 98th Cong., 1st Sess. (1983).

79. 12 U.S.C.A. § 3503(c) (West Supp. 1983) (emphasis added).

80. 12 U.S.C. § 3503 (Supp. V 1981).

81. In addition to authorizing this new deposit account, these 1982 amendments expanded FDIC and FSLIC powers to assist troubled institutions and relaxed merger requirements for these institutions, broadened the lending and investment powers of federal thrift institutions, preempted—with some exceptions—prohibitions against the enforcement of due on sale clauses on mortgages, amended various statutory provisions affecting commercial banks' lending and borrowing limits, exempted small depository institutions from reserve requirements, broadened the lending powers of credit unions, and restricted the insurance activities of bank holding companies. S. Rep. No. 97-536, 97tb Cong., 2d Sess.

> sue a regulation authorizing a new deposit account, effective not later than 60 days after October 15, 1982. Such account shall be *directly equivalent to and competitive with money market mutual funds* registered with the Securities and Exchange Commission under the Investment Company Act of 1940. (2) *No limitation on the maximum rate or rates of interest payable* on deposit accounts shall apply to the account authorized by this subsection.[82]

Section 327 exempts the account from transaction reserve requirements,[83] but leaves other features of the account to the DIDC's[84] discretion.[85] In requesting comments on the new accounts, the DIDC stated that the Garn-St. Germain Act and its legislative history required certain features, including no interest rate limitation and federal deposit insurance.[86]

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82. 12 U.S.C.A. § 3503(c) (West Supp. 1983) (emphasis added). Section 327 also provides:

> (3) For purposes of section 19(b) of the Federal Reserve Act, accounts established pursuant to this subsection which are not 'transaction accounts' as defined by the reserve requirement regulations of the Board of Governors of the Federal Reserve System as those regulations existed on August 1, 1982, shall not be subject to transaction account reserves, even though no minimum maturity is required, and even though up to three preauthorized or automatic transfers and three transfers to third parties are permitted monthly.

Id.

83. *Id.*

84. *See supra* note 19 and accompanying text.

85. On October 19, 1982, the DIDC issued a notice of a 15 day period during which interested parties could comment on features of the proposed account. 47 Fed. Reg. 46,530 (1982). The Committee stated that the short comment period was necessary because "the Garn-St. Germain Act required the new account to be available within sixty days of enactment. Because the Committee desires to give depository institutions adequate time to prepare and market the account, time for comment must be limited to allow time for computation and consideration of the comments, a Committee vote on the features and publication of the final rule." *Id.* at 46,531. Although the Committee did not limit issues for comments, it particularly requested comments on the following aspects: The minimum initial denominations; the "maintenance" balance; payment of a lower interest rate on accounts falling below the maintenance balance; requirement of a minimum denomination for drafts; the requirement of notice prior to withdrawal; availability of loans to meet the minimum initial denomination; restrictions on additional deposits, e.g., sweeps from other accounts; limitation of the time period for which an institution can guarantee an interest rate; monitoring and enforcement of the limitation on the number of withdrawals per month; restrictions on overdraft credit arrangements in connection with this account; limitations on withdrawals by mail, telephone, messenger, or in person; and adequacy of lead time for implementing operation changes for the account. *Id.*

86. The DIDC notice enumerated the following requirements:

> (1) No minimum maturity; (2) no interest rate ceilings; (3) an initial minimum denomination no greater than $5,000; (4) allow up to three pre-authorized or automatic transfers and three other third-party payments (including drafts) per month without being subject to transaction account reserve requirements; (5) available to all depositors; and (6) insured by the FDIC or FSLIC.

Id.

Senator Garn issued a report[87] in which he discussed the Depository Institutions Amendments of 1982. He noted that the period since the enactment of the DIDMCA[88] had been one of "unprecedented high interest rates that have caused havoc to depository institutions . . . ."[89] Citing statistical evidence of the competitive imbalance between depository and nondepository institutions,[90] Senator Garn explained that the new deposit account would permit regulated depository institutions to compete directly with money market mutual funds.[91] Senator Garn also noted that the account would be an FDIC or FSLIC insured deposit account.[92]

A. *The DIDC's Regulation*

The DIDC promulgated rules for the new account on December 14, 1982.[93] According to these rules depository institutions may pay interest at "any rate" on this account. The initial balance must be greater than or equal to $2500 and the minimum average balance for a period not to exceed one month must be greater than or equal to $2500. If the minimum average balance falls below $2500, then the amount of interest paid on the account may not exceed the ceiling rate for NOW accounts.[94] A depository institution may not guarantee or obligate itself to pay a rate of interest for a period exceeding one month, and the institution must reserve the right to require seven days notice of withdrawal. Restrictions on transfers are minimal: no minimum denomination amount is required; and no restrictions apply to the number of transfers directly to the depositor,[95] but transfers to third parties or preauthorized transfers

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87. S. REP. No. 97-536, 97th Cong., 2d Sess. (1982).

88. Pub. L. No. 96-221, 94 Stat. 142 (1980); *see supra* note 65 and accompanying text.

89. S. REP. No. 97-536, 97th Cong., 2d Sess. 18 (1982). Senator Garn stated:

> The continuing existence of Regulation Q disadvantages depository institutions subject to it in competing for consumer savings with less regulated intermediaries. Thus, the Committee is directing DIDC to create a new type of deposit instrument that will provide regulated depository institutions with the ability to compete directly with the money market mutuals.

Id.

90. Senator Garn stated that "[t]he statistical evidence of the competitive imbalance . . . is measurable by the fact that the asset size of the money market mutual funds grew from $60.9 billion in March 1980 to $203.3 billion in June 1982, an increase of over 230 percent." *Id.*

91. *Id.*

92. *Id.* at 19.

93. 12 C.F.R. § 1204.122 (1983).

94. *Id.* The ceiling rate for NOW accounts is currently 5¼%.

95. *Id.* The depositor's unlimited privileges for direct transfer apply to transfers made in person, by mail, by messenger, or by automated teller machine. *Id.*

may not exceed six per month. The rules permit overdrafts on the account if the rate of interest charged is not less than that imposed on overdrafts for customers of other accounts. No restrictions apply regarding additional deposits and sweeps from other accounts into the money market account. Finally, the depository institution may not lend to the customers to meet the $2500 initial balance or the $2500 minimum average balance requirement.

B. Comparison Between Money Market Deposit Accounts and Money Market Mutual Fund Accounts

Although different types of financial institutions administer the money market deposit accounts and the money market mutual fund accounts, the institutions market the accounts to appeal to similar needs and to provide similar services. Consequently, both types of accounts offer similar features. An institution may vary the characteristics of the account it offers according to market and regulatory constraints. The characteristics of different institutions' money market mutual funds vary more than those of money market deposit accounts, perhaps because the money market mutual funds are not regulated as strictly as the money market deposit accounts for which the DIDC has promulgated express guidelines.[96]

Most commercial banks require a minimum initial investment and a maintenance balance of $5000 for the money market deposit account; savings and loans and mutual savings banks generally have set their minimum and maintenance balance requirements at $2500.[97] The initial deposit requirements for money market mutual funds accounts range from less than $500 to $10,000, with over three-quarters of the funds falling in the $1000 to $3000 range.[98] The money market mutual fund investor's return is the yield on the assets held by the mutual fund less administrative costs. Retail-oriented money market mutual funds allow the account balance to fall substantially below the initial investment requirement while continuing to pay the investor the market rate of return.[99] If

96. *See supra* part III.A.

97. Commercial banks chose the higher figure because it would result in fewer internal transfers from lower cost deposits to the higher cost account.

98. Depository Institutions Deregulation Committee, Staff Memorandum 12 (Nov. 10, 1982) [hereinafter cited as DIDC Memorandum] (citing *Donaghue's Money Fund Directory* (spring-summer 1982)). Ninety-eight percent of the sample 125 funds require an initial minimum investment of $5000 or less. *Id.*

99. *Id.* at 13. The DIDC staff surveyed 20 large retail-oriented funds and found none with a maintenance balance requirement greater than $1000. *Id.*

the balance falls below the required minimum, however, the institution restricts the interest to the rate paid on NOW accounts—currently 5¼ percent.

The money market deposit account usually earns the "money market rate," a rate entirely within the discretion of the depository institution. While most banks have not disclosed their formulas for computing the money market rate, many banks have set the rate at least one hundred basis points[100] above the Donaghue money market index.[101] By setting the rates at this level during the introductory period of the money market deposit accounts, the banks have hoped to attract depositors away from mutual funds.

Transaction priviledges offered by the two types of accounts also vary. Money market mutual funds typically do not restrict the number of withdrawals an investor may make,[102] but the mutual funds usually require a minimum draft amount of $500.[103] By comparison, the money market deposit account customer may make an unlimited number of withdrawals in person for any dollar amount.[104] The customer also may preauthorize withdrawals and write up to three checks per month as long as the total number plus preauthorized withdrawals does not exceed six per month. Both accounts are available to individual and corporate investors.[105]

100. A basis point equals .01% so that 100 basis points is 1.0%.

101. The Donaghue money market index is published by William Donaghue in a money fund newsletter on a weekly and a monthly basis.

102. The average number of redemptions and checks on a money market mutual fund account is 12 per year. DIDC Memorandum, *supra* note 98, app. D.

103. *Id.* at 19.

104. The money market deposit account customer also may have access to his account through automated teller machines.

105. The NOW account is not available to corporations. *See supra* note 21.

The following table summarizes the features of the two accounts:

IV. Analysis

A. The DIDC's Position

Following the passage of Section 327 of the Garn-St. Germain Act,[106] the DIDC requested comments on the design of the new money market deposit instrument on October 19, 1982.[107] Relying on the language of section 327, the DIDC adopted the position that the account should be "directly equivalent to and competitive with" money market mutual funds, should not be subject to any limitation on the maximum interest rate payable, should not be subject to transaction account reserve requirements, and should be available on or before December 14, 1982.[108] In addition, the DIDC interpreted the Senate Report[109] on the amendment to reflect congressional intent that the account have federal insurance at the discretion of the FDIC and FSLIC.[110] In designing the new account, the DIDC divided the possible features of the account into two categories: those features "either specifically mandated by the language of Section 327 of the [Garn-St. German] Act or suggested

	Money Market Deposit Accounty	Money Market Mutual Fund
Initial Minimum Investment	$2500 or $5000	$500 to $10,000, with 98% less than or equal to $5000
Maintenance Balance	$2500 or $5000	generally under $1000
Rate	"any rate," typically up to 100 basis points over Donaghue index	yield on fund assets less administrative costs
Transfers per month	6 plus unlimited withdrawals in person	no limit but average of 1 per month
Minimum denomination for drafts	none	typically $500
Insurance	up to $100,000	not insured

106. *See supra* note 79.

107. 47 Fed. Reg. 46,530 (1982). As of November 3, 1982, the Committee had received 1227 responses: 752 from commercial banks, 297 from savings and loan associations, 57 from mutual savings banks, 3 from credit unions, 5 from money market mutual funds and affiliated institutions, 36 from industry trade associations, 12 from regulators, and 65 from individuals and other businesses. DIDC Memorandum, *supra* note 98, at 2-3.

108. DIDC Memorandum, *supra* note 98, at 2.

109. S. Rep. No. 97-536, 97th Cong., 2d Sess. (1982); *see supra* notes 87-89 and accompanying text.

110. DIDC Memorandum, *supra* note 98, at 6 & app. E. The FDIC and FSLIC have insured the new accounts consistent with the section 327 directive.

by the Act's legislative history";[111] and those features not expressly mandated by the Act or suggested by its legislative history that nevertheless must be incorporated in the new account.[112] For those characteristics in the latter category, including "minimum denomination, specific transaction capabilities, withdrawal features, reservation notice period, and other miscellaneous items,"[113] the DIDC staff recommended that "the guiding principle should be to create an account 'directly equivalent to and competitive with' [money market mutual funds]."[114] On these matters within the DIDC's discretion, the staff recommended that the DIDC set as few restrictions as possible in order to enhance the depository institutions' ability to compete.[115] The DIDC staff, however, indicated that the DIDC had no discretion about incorporating the characteristics falling within the first category. Thus, the staff determined that the new account must "have no minimun maturity; have no interest rate ceiling; have an initial denomination no greater than $5000; allow three preauthorized or automatic transfers per month; be made available to all classes of depositors; be an FDIC — or FSLIC — insured deposit; and be effective no later than December 14, 1982."[116]

The controversy about the new account centered on the statutory provisions that the account "shall be directly equivalent to and competitive with money market mutual funds,"[117] that "no limitation on the maximum rate or rates of interest payable . . . shall apply to the account,"[118] and that the account receive insurance. The DIDC staff rejected the suggestion that a ceilingless account would be inconsistent with the Act's requirement that the account be " 'directly equivalent to and competitive with money market mutual funds.' "[119] Peter Walleson, General Counsel of the Treasury, has asserted that because Congress expressly included the ceilingless rate langauge in section 327, Congress believed that the two provisions are consistent.[120] Mr. Walleson concluded that

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111. *Id.* at 7.
112. *Id.*
113. *Id.*
114. *Id.*
115. *Id.*
116. *Id.*
117. Garn-St. Germain Act, 12 U.S.C.A. § 3503(c)(1)(West Supp. 1983).
118. *Id.* § 3503(c)(2).
119. DIDC Memorandum, *supra* note 98, at 4-5.
120. Mr. Walleson addressed the DIDC panel at its Novemher 15, 1982, meeting on the issue of Congress' intent in the "directly equivalent to and competitive with money

Congress authorized the DIDC to design an insured, ceilingless rate account that would be directly equivalent to and competitive with money market mutual funds.[121] After very little discussion the DIDC voted to approve the first category of features that section 327 and the legislative history of the Garn-St. Germain Act mandated: no minimum maturity, no interest rate ceiling, required initial investment not greater than $5000, certain limited transactions features, availability to all investors, and federal deposit insurance coverage.[122] Because the DIDC perceived no conflict between the "directly equivalent to and competitive with money market mutual funds" language and the ceilingless rate and insurance provisions, it did not indicate how it would have resolved any conflict.

B. *The Investment Company Institute's Position*

Immediately after the DIDC's Notice of Proposed Rule-making issued on October 19, 1982,[123] the ICI[124] filed suit[125] in federal court, asking the court to declare the notice null and void. The United States District Court for the District of Columbia denied the ICI's request and found that the DIDC's actions were not reviewable until promulgation of a final rule.[126] The ICI then issued to the DIDC a memorandum setting forth its position.[127] The ICI's two main concerns were that the rate of interest on the money market deposit account might exceed current market rates, and that federal deposit insurance would cover this new account. ICI maintained that these features would allow an institution to effect a predatory pricing scheme or to develop a speculative pricing plan in order to raise money, with the FDIC guaranteeing the venture in the event of failure.[128] The ICI stated that "this represents bad public policy and, of more immediate concern to the [DIDC], is contrary to the statutory directives which govern the Committee in

market mutual funds" language. Tape Recording of DIDC meeting, Nov. 11, 1982 (available from DIDC offices, Washington, D.C.).

121. *Id.*

122. *Id.*

123. *See supra* notes 79-86 and accompanying text.

124. *See supra* note 6.

125. Complaint, Investment Co. Inst. v. Depository Institutions Deregulation Comm., No. 82-3037 (D.D.C. Oct. 27, 1982). The ICI alleged that the notice as promulgated violated the due process clause, U.S. CONST. amend. V, and the Administrative Procedure Act.

126. Investment Co. Inst. v. Depository Institutions Deregulation Comm., No. 82-3037 (D.D.C. Oct. 27, 1982).

127. ICI Memorandum, *supra* note 6. This memorandum was in response to the DIDC's request for comments. *See supra* notes 85-86 and accompanying text.

128. ICI Memorandum, *supra* note 6, at 3.

structuring the [money market deposit] account."[129] The ICI argued that the DIDC should have focused on money market mutual funds when designing the new money market deposit account. Features of the money market mutual funds to which the ICI directed the DIDC's attention included a market-related yield, availability to all investors, extensive disclosure concerning the nature of the investment to all investors, no regulatory minimum investment requirements, and no insurance.[130]

The ICI first addressed the problem created by the DIDC's permitting the new account to pay interest "at any rate." The ICI maintained that an account which has no ceiling on the rate paid does not satisfy the objectives of section 327, the Garn-St. Germain Act, and the DIDA, because if the rate is not a market rate, the account would not be equivalent to a money market mutual fund.[131] A deposit and a mutual fund share are inherently different because the interest payable on a deposit is not derived directly from the return on a pool of assets, like that of a mutual fund share.[132] To accommodate this difference, the ICI suggested that the rate of return on the account could be referenced to an appropriate market rate. For example, the appropriate rate of interest for an insured account could be indexed to the rate of return on a riskless investment, such as a short-term Treasury bill. Section 327, however, specifically provided that "no limitation on the maximum rate or rates of interest payable on deposit accounts shall apply to the account authorized by this subsection."[133] The ICI urged that this language must mean that the Regulation Q ceilings do not apply to the account — the account should pay a competitive *market* rate of interest — if the result is to be consistent with the purposes of section 327, the Garn-St. Germain Act, and the DIDA.[134]

The ICI next expressed two concerns about the new account's insurance feature. First, an insured account that pays a rate higher than the market Treasury bill rate inherently is not equivalent to a money market mutual fund. Second, such an account would encourage risk-taking by depository institutions and thus would threaten the deposit insurance agencies. The ICI argued:

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129. *Id.*
130. *Id.*
131. *Id.*
132. *Id.* at 21.
133. 12 U.S.C.A. § 3503(c) (West Supp. 1983).
134. ICI Memorandum, *supra* note 6, at 22-26.

> It is axiomatic that an account that pays the same rate of interest as an uninsured money market mutual fund, but which is also federally insured, is an account that is not 'directly equivalent to' a money market mutual fund investment. The value of federal deposit insurance is quantifiable and has been recognized — repeatedly — by the Committee's own staff . . . in numerous Committee staff memoranda.[135]

The ICI offered persuasive evidence that insurance on a money market deposit account that pays a rate of interest as high or higher than mutual funds would give depository institutions a competitive advantage unless the DIDC referenced the interest rate paid of these insured accounts to the Treasury bill rate.[136] Market research indicated that money market mutual funds which invested solely in United States Government securities, regarded as essentially riskless instruments, increased approximately ninety percent during the period from December 1981 through September 1982. Investments in other types of mutual funds, however, increased by only 13.6 percent[137] during approximately the same period, although the yield on Treasury securities mutual funds ranged from 260 to 80 basis points below the average yield on money market mutual funds invested in other securities.[138] These findings indicate that investors are willing to accept a lower return for the security of a riskless investment. The money market de-

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135. *Id.* at 39. The value of deposit insurance might he approximated by comparing short-term rates on government securities against the rates for commercial banks' certificates of deposit. From the period August 6 through October 15, 1982, the average difference between the three-month Treasury bill rate and the ninety-day certificate of deposit rate was 2.30%. Federal Reserve Bank of St. Louis, United States Financial Data (Oct. 15, 1982), *reprinted in* ICI Memorandum, *supra* note 6, app. table 3.

In one memorandum the DIDC's staff advised the DIDC: "[t]he insurance and convenience aspects of a deposit instrnment are valued by many individuals, suggesting that a ceiling somewhat below these alternative yields [on money market mutual funds and other open money market instruments] would still enable the new account to attract funds." Staff Memorandum to DIDC, Design of Short-Term Deposit Instrument (June 23, 1982), *quoted in* ICI Memorandum *supra* note 6, at 39-40. In another memorandum, the staff noted that a "slight discount from the Treasury bill rate would only marginally alter the interest spread between the new instrument and [money market funds] . . . and the advantages of convenience and deposit insurance might offset such a reduction in yield advantage . . . ." Staff Memorandum to DIDC, More Competitive Short-Term Deposits 15 (June 12, 1981) *quoted in* ICI Memorandum, *supra* note 6, at 40-41.

Professor Paul M. Horvitz also has recognized the value of federal deposit insurance: "It is interesting to speculate on how much below the money market fund rate the bank could offer and still draw funds away from mutual funds. Two hundred basis points is not an unreasonable guess, but even one hundred basis points is sufficient for profitability." Horvitz, *Deregulation and Financial Products and Services*, Am. Banker, Sept. 24, 1982, at 4, *quoted in* ICI Memorandum, *supra* note 6, at 41.

136. ICI Memorandum, *supra* note 6, at 42-44.

137. *Id.* at 27-28.

138. *Id.*

posit account's competitive advantage of insurance creates a riskless investment whose yield may exceed the comparable Treasury bill rate. Thus, unlike a mutual fund investment, an insured deposit account permits the insured depositor not "to concern himself or herself with the quality of the credit decision that he or she is making by depositing funds in the institution."[139] If the deposits were not insured, the depositors would consider the degree of risk in the institution's portfolio. The risk, in turn, would affect the rate of interest that the institution must pay to attract and retain deposits.[140] The ICI also noted that the insurance feature is a disincentive for financial institutions to invest in Treasury bills because the insurance will protect the depositors while the institution attempts to earn higher yields on speculative loans and risky nongovernment securities. These provisions, therefore, in effect might restrict the demand for government obligations and require the Treasury to offer a higher rate for its securities, which would increase the cost of servicing the federal debt.[141] This system further invites abuse because the FDIC and the FSLIC do not adjust depository institutions' deposit insurance premiums to reflect the degree of risk of these institutions.[142]

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139. *Id.* at 43.

140. *Id.*

141. *Id.* at 43-44.

142. The ICI also objected to the establishment of the $2500 minimum initial deposit requirement by the DIDC. It maintained that this requirement prevents the money market deposit account from being "available to all depositors." Money market mutual funds offer

> differing (and, in some cases, no minimum) investment requirements. . . . [S]mall investors would be subject to a regulatorally-mandated [sic] exclusion from investing in the [money market deposit] [a]ccount not experienced by money market mutual fund investors, a result which is also contrary to the purposes of DIDA to make market rates of interest available to small investors.

Id. at 45. This requirement also makes the playing field unlevel, again in favor of commercial banks.

> Money market mutual funds may not properly agree among themselves to establish an industry-wide minimum investment comparable to an initial minimum denomination requirement of a [money market deposit] [a]ccount, and the imposition of a minimum investment requirement would act as an industry-wide subsidy of the [money market deposit] [a]ccount, rendering the Account *not* directly equivalent and *not* fairly competitive with money market funds — both results contrary to the intent of section 327.

Id. at 45-46 (emphasis in the original). The ICI also urged that "safeguards comparable to those of the Investment Company Act which insure that members of the investing public receive accurate and complete information concerning the nature of their investment should be adopted by the Committee concurrently with the Committee's authorization of the [money market deposit] [a]ccount." *Id.* at 46-47.

> The need for standards in this area is not based upon speculation. For example, in two areas where depository institutions offer investment products which compete directly with mutual fund products, namely collective funds for retirement plans, and

The ICI's third principal complaint about the new account was that it would contravene the purpose of the Garn-St. Germain Act and the DIDA because it would injure thrifts and small banks. The ICI argued that an account whose rate is independent of the market would enable the large money center banks to undercut the thrifts and small banks. Many institutions might choose to pursue a conservative rate-setting strategy[143] with the new account to protect their own core deposits from other institutions. Others, however, might seize an opportunity to increase their asset base to the extent that the profitable assets would compensate for the shifting of their core deposits from low-cost deposits, such as conventional time and saving deposits, to high-cost deposits, such as money market deposit accounts. The large money center banks, either because they do not depend on core deposits for their funding or because they have the advertising and reputation to attract funds from all over the country, many prefer the latter, more aggressive pricing strategy.[144] These institutions have the resources to promote the account more aggressively than smaller institutions. The money center banks also could pay an interest rate similar to the rate they pay for certificates of deposit; this interest rate is higher than the Treasury bill rate. The competitive pressures could force smaller institutions to follow the same pricing strategy despite their preference for a more conservative strategy. The result, in effect, would be predatory pricing.[145]

> 'retail repos,' marketing of these investments by depository institutions has been characterized by exaggerations and, in some cases, misleading descriptions which, among other things, deprive investors of the ability to make a true comparison of competing investments.

Id. at 47 n.1. Additionally, the ICI maintained that the DIDC's regulations should not permit customers to "write overdrafts since the existence of overdraft privileges is tantamount to the extension of a loan secured by the customer's balance in the new Account." *Id.* at 48. Finally, the ICI objected to an institution's ability to guarantee the rate of interest paid on the account. "Such a guarantee is entirely inconsistent with the manner in which money market mutual fund shares are offered to the public." *Id.* Such a guarantee also would place a depository institution in a difficult financial position in times of cbanging market rates of interest.

143. These conservative institutions would react solely because of the threat of competition and probably would choose a relatively safe rate, such as the Treasury bill rate, allowing the institution to earn more profit. They also would impose high minimum initial deposit and average deposit balances on the account and might attach service charges for maintenance and transactions of the account. "Such a policy, *if it could be followed*, would be likely to produce a rational trade-off between long-term benefits and short-term costs derived by deposit institutions from the new account. *Id.* at 33 (emphasis in original).

144. *Id.* at 33-36.

145. *Id.* at 34.

Price wars preceded the introduction of the new money market deposit account and have continued. In California, for example, Home Federal Savings & Loan Association announced that it would offer "a rate bonus of 3 percentage points higher than the average yield on money market funds" to customers who signed up for the account before November 6, 1982, five weeks prior to the account's official opening day.[146] In Atlanta, First National Bank "offered an introductory rate of 18.65%, touching off a rate war involving other major banks in the state. Citizens and Southern National Bank increased its rate to 21% before, like other banks, dropping it to 10% after huge inflows of the new account."[147] The ICI also argues that failing institutions, hoping to obtain growth that would potentially offset past losses,[148] might decide to market the account aggressively. Consequently, the FDIC and FSLIC would bear the risk that these feeble institutions merely are accelerating their demise.

C. *Analysis of the Garn-St. Germain Money Market Deposit Account*

The DIDA[149] and the Garn-St. Germain Act[150] represent Congress' attempt to develop "competitive equity among depository and non-depository institutions that compete for the savings dollar."[151] Congress sought to build a "healthy and competitive financial industry"[152] that would protect the interests of the consumers and enable depository institutions to remain solvent and continue to compete in the industry.[153] The restrictions on interest rates payable by depository institutions deprived consumers, par-

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146. *Id.* at 36 (emphasis omitted).

147. American Banker, Dec. 27, 1982, at 3, col. 3.

148. After all, if management sees near term failure as all but certain in the absence of a successful "great gamble," and if ultimate losses from the failed venture are borne not by the institution (which has very little more to lose in any event), but by a federal deposit insurance agency, then a policy which is irrational from the point of view of public policy may be quite rational from the point of view of the institution's management.

ICI Memorandum, *supra* note 6, at 37.

149. 12 U.S.C. §§ 3501-3509 (Supp. V 1982).

150. 12 U.S.C.A. § 3503(c)(1) (West Supp. 1982).

151. H.R. Rep. No. 842, 96th Cong., 2d Sess. 73 (1980), *quoted in* ICI Memorandum, *supra* note 6, at 7.

152. The measures of the Garn-St. Germain Act to assist the thrifts through emergency assistance measures and broadened asset powers illustrate this intent on the part of Congress. *See* ICI Memorandum, *supra* note 6, at 7.

153. *Id.*

ticularly small savers, of a market rate on their savings dollars. At the same time, the disintermediation from accounts in depository institutions to nondepository institutions, such as mutual funds, that paid a market rate on savings threatened the solvency of nondepository institutions. Congress enacted the DIDA to provide an orderly elimination of Regulation Q's interest rate ceilings[154] and to "provide all depositors with a market rate of return on their savings" as soon as economically feasible.[155] Congress ordered the DIDC to pursue these objectives with regard for the safety and soundness of depository institutions and further directed the DIDC that "[t]he phase-out must be accomplished in a way that . . . insures competitive equity among depository and non-depository institutions that compete for the savings dollar."[156]

Once again emphasizing free and fair competition in the financial market place,[157] Congress enacted the Garn-St. Germain Act of 1982 in an attempt to accelerate the process established under the DIDA. The Act specifically authorized the DIDC to create equitable competitive conditions in the financial marketplace by permitting depository institutions to offer a new deposit account "directly equivalent to and competitive with money market mutual funds . . . ."[158] From the consumer's viewpoint, the new account must be equivalent to a money market mutual fund; from the regulators' and the institutions' perspective, the account must not have threatened the financial soundness of these institutions nor must it have produced new competitive inequities between depository and nondepository institutions.[159]

Section 327 of the Garn-St. Germain Act required that the DIDC set "[n]o limitation on the maximum rate or rates of interest" on the account;[160] the DIDC's regulations allow institutions to "pay interest *at any rate*" on this new account.[161] This provision

154. *See supra* notes 65-68 and accompanying text.
155. 12 U.S.C. §§ 3501, 3503(a), 3503(b) (Supp. V 1981).
156. H.R. REP. No. 842, 96th Cong., 2d Sess. 73 (1980).
157. *See supra* notes 87-91 and accompanying text.
158. U.S.C.A. § 3503(c) (West Supp. 1983).
159. *See* ICI Memorandum, *supra* note 6, at 15-16.
160. 12 U.S.C.A. § 3503(c)(2) (West Supp. 1983).
161. 12 C.F.R. § 1204.122 (1982)(emphasis added). Mutual funds derive yields directly from the returns on the securities in which they invest and deduct their costs of administration in order to compute the individual investor's yield. The investment process is far more complex and the costs more difficult to ascertain for a depository institution. Loans and investments are not traceable to specific deposits and the allocation of administrative costs is hardly a precise science. Consequently, the relationship between the yield on assets and the cost of liabilities is less direct and more difficult to calculate for a depository institu-

enables depository institutions to price the account at rates substantially above or, if competition and market conditions permit, substantially below, prevailing market rates for instruments with similar risk characteristics. Theoretically, a commercial bank or thrift institution could offer a rate higher than the mutual funds rate in order to recapture or enhance its market share and later reduce the rate below the mutual fund rate. This type of rate setting practice amounts to predatory pricing, a result which hardly comports with the policies of the DIDA and the Garn-St. Germain Act. Such predatory pricing conduct is inconsistent with congressional intent to provide a market rate of return to depositors and to create a "level playing field"[162] for financial institutions while preserving the safety and soundness of these institutions. The legislative history for these Acts indicates Congress' intent that banks should index the rate of interest paid on this account to an appropriate market rate.[163] If depository institutions paid such a rate, consumers would receive a market yield on their deposits, the account would be competitive with money market mutual funds, and the institution would be able to lend or invest the funds at a profitable rate to preserve its financial soundness.

The FDIC or the FSLIC insures the new money market deposit account up to $100,000. This feature clearly gives depository institutions a competitive advantage over mutual funds, which are not insured. Thus, if the yields on both types of accounts are the same, and certainly if the yield on the money market deposit account is higher, the consumer will choose the insured money market account because the federal insurance provides an extra measure of security and effectively makes the investment riskless. An equally attractive competitive advantage, especially to small savers, may be that deposit insurance also promotes confidence in the soundness and safety of the banking and thrift industry.[164] The depository institutions, however, should not be permitted to abuse the beneficial features of this new account by shifting undue risk to the insuring agencies and the federal government. The two accounts can be competitively equivalent and the consumer can re-

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tion's money market account than for a mutual fund account. Theoretically, a depository institution should index the yield on the money market account to its cost of funds rather than to an average yield of money market funds.

162. *See supra* note 6.

163. *See* ICI Memorandum, *supra* note 6, at 22-26.

164. *See generally* Jacobs, *The Framework of Commercial Bank Regulation: An Appraisal*, 1 NAT'L BANKING REV. 343 (1964).

ceive a market return on his investment if the depository institutions pay a market rate on the money market deposit account that reflects the lack of risk to the depositor attributable to the insurance feature. Short-term Treasury bills would indicate an appropriate rate, because as government-backed obligations, the investment in a bill is as safe as an insured deposit. Institutions paying the Treasury bill rate then could lend or invest the funds in assets at a yield sufficient to ensure profitability without assuming undue risk.

A modification of the current federal deposit insurance system to determine an institution's annual premiums according to its risk-taking activities would alleviate further the concern that depository institutions will adopt riskier investment practices. Since the FDIC's inception in 1933,[165] an institution's annual insurance premium has been a flat percentage of its deposits. Thus, the rate bears no relationship to the particular institution's risk characteristics. Although a flat rate system may have been appropriate in 1933 when the primary consideration was to implement insurance coverage for depositors as quickly as feasible, the system perhaps should become more flexible to meet changing conditions of the present financial markets.[166] The current flat rate system provides an incentive for financial institutions to engage in speculative activities, to the extent that regulation permits, because the insurance agencies and ultimately the federal government bear a large portion of the risk for those activities.[167] The insured money market deposit account with no limit to its yield increases the likelihood of risk-taking activities on the part of depository institutions to obtain high yielding assets to cover the cost of the expensive new money market account.

Indexing the new account's yield to the Treasury bill rate is one means of discouraging depository institutions from engaging in unreasonably risky investment practices. The lower yields that the institutions will pay under this limitation will allow them to achieve a satisfactory return by making less risky loans and invest-

165. The Banking Act of 1933 provided FDIC insurance for banks. The National Housing Act of 1934, 12 U.S.C. § 401 (1976), created the Federal Savings and Loan Insurance Corporation (FSLIC) to provide insurance for savings and loan associations. Except for periodic increases in the amount of coverage, the system has not undergone major changes in 50 years. *See* Barnett, Horvitz & Silverberg, *Deposit Insurance: The Present System and Some Alternatives*, 90 BANKING L.J. 304, 304 (1975).

166. *See* Scott & Mayer, *Risk and Regulation in Banking: Some Proposals for Federal Deposit Insurance Reform*, 23 STAN. L. REV. 857, 886-88 (1971).

167. *See supra* note 11 and accompanying text.

ments. Additionally, the risk-taking inclinations of an institution charging deposit insurance premiums commensurate with the risk characteristics of each institution's investment and loan portfolio will suppress the risk-taking inclinations of an institution. Higher insurance premiums will offset the speculative profits possible from higher risk investments. Regulators could use existing reporting and examination procedures to monitor institutions' portfolios. Thus, the insurance feature, with proper administration, can be consistent with the "level playing field"[168] and the industry safety and soundness objectives expressed by Congress.

Section 712 of the Garn-St. Germain Act requires the Federal Deposit Insurance Corporation, the Federal Savings and Loan Insurance Corporation, and the National Credit Union Administration each to conduct a study of the current system of deposit insurance.[169] Specifically included among the topics for study was the feasibility of utilizing a risk-related insurance premium rather than the flat rate assessment.[170] The Federal Deposit Insurance Corporation recently submitted its study in which it proposed "a risk-related premium program . . . limited in scope."[171]

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168. *See supra* note 6.

169. Section 712 specifically provides:

(a) The FDIC, the Federal Savings and Loan Insurance Corporation, and the National Credit Union Administration Board shall each conduct a study of—

(1) the current system of deposit insurance and its impact on the structure and operations of depository institutions;

(2) the feasibility of providing depositors the option to purchase additional deposit insurance covering deposits in excess of the general limit provided by law and the capabilities of the private insurance system, either directly or through reinsurance, to provide risk coverage in excess of the general statutory limit;

(3) the feasibility of basing deposit insurance premiums on the risk posed by either the insured institution or the category or size of the depository institution rather than the present flat rate system;

(4) the impact of expanding coverage of insured deposits upon the operations of the insurance funds, including the possibility of increased or undue risk to the funds;

(5) the feasibility of revising the deposit insurance system to provide even greater protection for smaller depositors while fostering a greater degree of discipline with respect to large depositors;

(6) the adequacy of existing public disclosure regarding the condition and business practices of insured depository institutions, and providing an assessment of changes which may be needed to assure adequate public disclosure;

(7) the feasibility of consolidating the three separate insurance funds; and

(8) other related issues.

Garn-St. Germain Depository Institutions Amendments of 1982, § 712.

170. *Id.*

171. Federal Deposit Insurance Corporation, FDIC Deposit Insurance System Study, *reprinted in* [1982-83 Transfer Binder] FED. BANKING L. REP. (CCH) ¶ 99,544.

V. Conclusion

Section 327 of the Garn-St. Germain Depository Institutions Act amends the DIDA and authorizes an account that banks and thrift institutions have needed to enable them to compete for funds and to continue to provide credit in the financial marketplace. The DIDC's regulation, however, permits these depository institutions to offer a deposit account that is not "directly equivalent to and competitive with money market mutual funds." The regulation in effect created an insured account that is risk-free from the depositor's perspective, and conceivably can pay a higher yield, allow greater customer access, and provide more convenience than mutual fund accounts. Depository institutions, deposits and money market mutual funds' assets suggest that the money market deposit account, when compared with mutual fund accounts, is overly competitive. A recent Federal Reserve study estimates that over $25 billion of the total money market deposits of $183.6 billion as of January, 1983, came from money market mutual funds. Mutual fund assets, which had peaked at over $230 billion in early December, 1982, have fallen by over $25 billion since the introduction of the new account.[172]

Because of the different regulatory frameworks for commercial banking and investment banking, the task of designing a depository institution instrument identical to a money market mutual fund is an impossible one. Within the regulatory boundaries, however, the new account should combine and balance features to produce an instrument that can compete with — but not so handily out compete with — the money market mutual fund account in accordance with congressional intent. Pursuant to the Garn-St. Germain directive, the DIDC should establish parameters within which the depository institutions can set rates. In enacting the DIDA and the Garn-St. Germain Act, Congress intended to provide the consumer a market rate of return on his savings dollars and to preserve the financial soundness of depository institutions by halting the disintermediation of funds to other instruments, especially the money market mutual funds. Consistent with these objectives, depository institutions should be required to offer a market rate of return that reflects the risk characteristics of the instrument. In the case of an insured account, such as the money market deposit account, the best index for that rate is the yield on

172. American Banker, Jan. 7, 1983, at 11.

short-term Treasury bills.

The insurance feature of the new account, particularly when the account is compared to the uninsured mutual funds, significantly enhances the account's attractiveness to depositors. The role of deposit insurance in providing stability and an element of security to the banking system since 1933 indicates that insurance is a desirable feature to depositors, the institutions, and the economy. Certainly, that feature of money market deposit accounts should be maintained if other aspects of the account are adjusted to minimize the competitive advantage that an insured account provides to these institutions. The DIDC can achieve the objectives of the DIDA and the Garn-St. Germain Act — to provide an instrument competitive with money market mutual funds and to promote the financial soundness of depository institutions — by authorizing a yield on the instrument that reflects the value of the insurance on the deposit and by requiring that the federal deposit insurance agencies charge variable rate, risk indexed insurance premiums.[173] The DIDC's current regulations induce institutions to offer high rates to customers to attract deposits, to channel the funds into speculative assets in order to maximize profits, and to place inordinate risk on the federal insurance agencies and the federal government. Clearly, these practices are contrary to congressional intent. Variable rate deposit insurance premiums would encourage institutions to maintain sound investment and loan portfolios and thus would promote the financial soundness of the financial marketplace.[174]

The implementation of these suggested modifications in the DIDC's regulations would create a money market deposit account that successfully balances the concerns of various interested parties: depositors would receive market rate of return on a safe investment; depository institutions could compete with the money market mutual funds on a "level playing field"; and the regulators would have checks and balances in place to ensure the safety and

173. The FDIC and the FSLIC would assess premiums on institutions that would vary with the riskiness of their assets. Examination procedures already are in place to determine risk, although they arguably are not as effective in preventing bank failures as they should be. The idea of variable rate or classified rate premiums is not a new one. *See* Jacobs, *supra* note 164, at 345-46 (1964); Scott & Mayer, *supra* note 166, at 890-94; Barnett, Horvitz & Silverberg, *supra* note 165, at 329-30.

174. The variable rate insurance system also complements the limitation of the yield to the Treasury bill rate because that limitation, by reducing an institution's cost of funds, minimizes the need for the institution to engage in speculative activities in order to cover that cost and turn a profit.

soundness of the institutions. Thus, within the parameters of a complex regulatory framework, the modified version of the money market deposit account would achieve the objectives of the Depository Institutions Deregulation Act of 1980 and the Garn-St. Germain Act of 1982.

BETTY R. TURNER