BANKING REGULATORY REFORM

As of the second quarter of 2014, the regulated banking sector—comprising over 5,700 banks—held assets of over $15 trillion, including deposits totaling more than $10 trillion, and had $8 trillion worth of loans outstanding, according to Federal Deposit Insurance Corporation (FDIC) data. Although that picture might appear healthy at first glance, it conceals several problems. The number of people without a bank account in the United States rose by about 1 million between 2009 and 2013, owing to increased bank fees. An as-yet-unquantifiable number of businesses have had their bank accounts canceled as a result of Operation Choke Point, an aggressive Justice Department–led campaign to choke off financing for politically disfavored businesses. Individual immigrants are finding it more difficult to make money transfers, known as remittances, to their families abroad. Those problems need to be addressed to ensure renewed growth in the banking sector and the smooth running of a reliable financial system.

Congress should:

- Repeal the Durbin Amendment, Subtitle G, Section 1075, of the Wall Street Reform and Consumer Protection Act, better known as the Dodd-Frank Act.
- Amend Section 335 of Dodd-Frank to reduce the current standard maximum deposit insurance amount to $100,000.
- Repeal Section 1073 of Dodd-Frank to alleviate burdensome restrictions on remittance transfers to foreign countries.

Durbin Amendment. Interchange fees are the fees merchants pay to banks when a consumer uses a credit or debit card to pay for an item. The Durbin Amendment to the Dodd-Frank Act imposed price controls on transaction fees for debit cards for which the user's bank has assets of over $10 billion, affecting 64 percent of all debit card transactions issued in the United States. Those price controls reduced the average fee per transaction from about $0.50 to $0.24, which has resulted in a decrease in bank revenue of about $8 billion, with a similar increase to merchant revenue. The amendment was justified on the grounds that retailers would pass on the savings to consumers, but that has not in fact transpired. Instead, all the costs of the fee increase have been passed on to *bank* customers. In a June 2014 study, George Mason University law professor Todd Zywicki, International Center for Law and Economics Executive Director Geoffrey J. Manne, and Reason Foundation Vice President Julian Morris found the bank actions had the following effects:

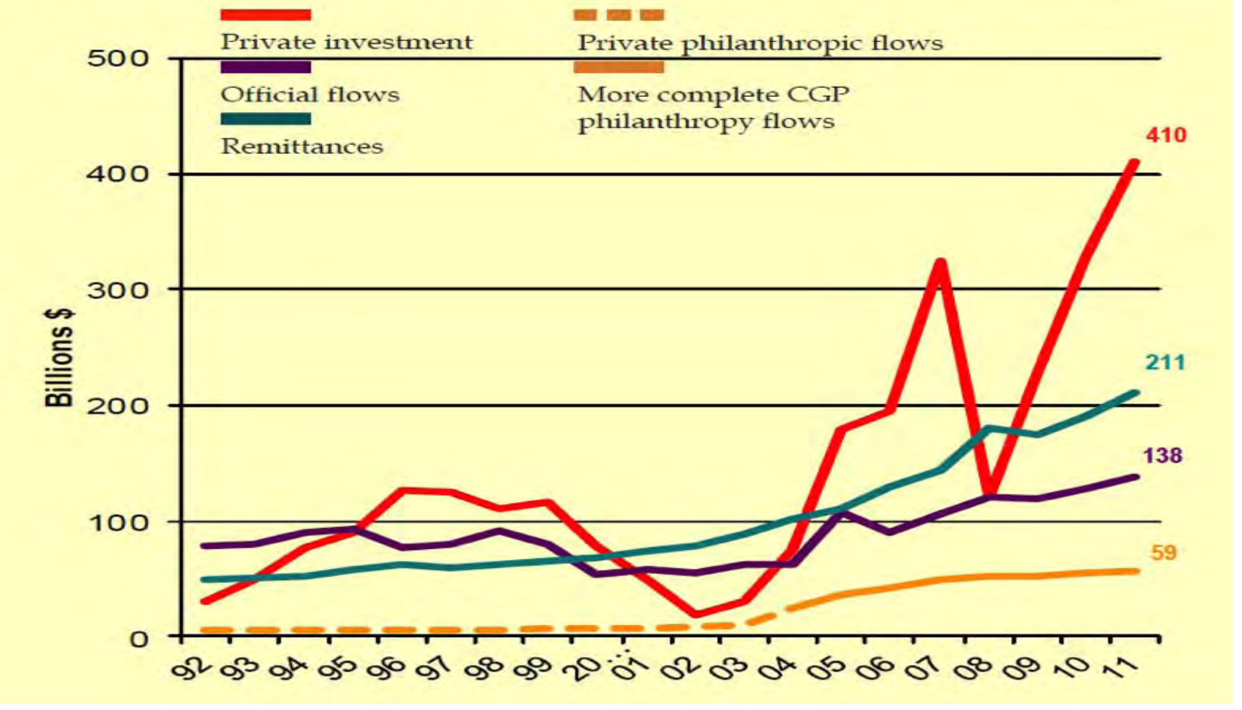
- Banks began to offer fewer free checking accounts. "The total number of banks offering free current accounts fell by 50% between 2009 and 2013," they note. "In comparison, fee-free banking actually increased at banks not subject to the Durbin Amendment."
- The minimum monthly balance requirement for free current accounts tripled between 2009 and 2012, increasing from about $250 to over $750.
- Average monthly fees on nonfree current accounts also doubled between 2009 and 2013, from about $6 to more than $12.
- Fee increases and loss of access to free checking led to an addition 1 million Americans, mainly among low-income households, joining the nation's unbanked population.
- Because of the increased fees, consumers have changed their behavior in relation to the banking products they use, increasing use of credit and prepaid cards, while decreasing use of debit cards. Credit and prepaid cards are not subject to the Durbin fee caps.

In addition, David Evans, Howard Chang, and Steven Joyce of the University of Chicago's Coase-Sandor Institute for Law and Economics found that the net decrease in consumer welfare as a result of the Durbin Amendment was between $22 billion and $25 billion annually, which equates to a loss of $200 per household.

The potential harm caused by interchange fee regulation has been known for some time. In a paper from 2002, Jean Tirole, who won the 2014 Nobel Prize for Economics, warned that regulators could not know the appropriate level of any cap. To increase consumer welfare, to reduce the number of the unbanked population, and to promote lower banking fees, Congress should repeal the Durbin Amendment in its entirety.

Deposit Insurance Reform. Deposit insurance was introduced in the United States in response to a series of Great Depression-era

Figure 2.1 Official, Private Investment, Philanthropic, and Remittance Flows from Donor Countries to Developing Countries, 1991–2011 (Billions of $)



Source: Carol Adelman, Jeremiah Norris, and Kacie Marano, "The Index of Global Philanthropy and Remittances 2013," Hudson Institute, 2013.

banking crises. The Banking Act of 1933 created the Federal Deposit Insurance Corporation to restore confidence in the banking system by providing that a certain amount of every bank customer's deposits would be guaranteed by the insurance system. In 1950, the amount insured was $10,000, which translates to about $80,000 today. The amount was raised through a series of steps to $100,000 in 1980, despite reservations by the FDIC itself.

During the financial crisis, the collapse of Washington Mutual and other banks raised concern among policy makers that ordinary consumers with banking assets, such as certificates of deposit, valued over $100,000 could lose out in the event of a string of bank collapses. The amount insured by the FDIC was therefore temporarily raised to $250,000 before the Dodd-Frank Act permanently increased it to that level.

Deposit insurance at such levels introduces a significant degree of moral hazard into the banking system. That means that bankers, knowing their customers' deposits are not at risk because they are backstopped by the FDIC, are more likely to engage in risky behavior with those deposits. They are also less likely to object to government rules that increase risk, such as the Community Reinvestment Act.

Moreover, the increased limits appear to have changed the FDIC's behavior. It has issued to banks guidance aimed at reducing its exposure to risky behavior by banks. One example was a 2011 FDIC guidance document aimed at increasing monitoring of relationships with third-party payment processors dealing with "high-risk" industries. That guidance was used by the Department of Justice to help initiate Operation Choke Point, whereby the department used its subpoena power to investigate such relationships. In many cases, banks responded to the increased level of scrutiny by terminating the banking relationship with the processor or industry in question—regardless of the bank's history with its customers. As a result, legal businesses have been left without access to banking services.

To reduce moral hazard in the banking industry, to reduce the incentives on the FDIC to impose unduly heavy-handed regulation, and to return deposit insurance to levels at which it was originally intended to protect working people's accounts, Congress should amend the Dodd-Frank Act to reduce deposit insurance to the previous level of $100,000 per account.

Remittances. Some of the world's poorest people depend on money they receive from relatives working in developed countries. In fact, that money dwarfs the world's official foreign aid budget, and the gap is increasing. In 2011, total private flows of aid totaled $680 billion—almost five times the official figure of $138 billion, according to the Hudson Institute. However, an argument that the industry facilitating those transfers is exploitative has gained currency and was enshrined in the Dodd-Frank Act, even though remittances had nothing to do with the financial crisis.

As a result, the Consumer Financial Protection Bureau, an agency set up by Dodd-Frank, has issued a rule (Remittance Transfer Rule—Subpart B of Regulation E) that imposes certain constraints on international money transfers. Its most important provision is the right to cancel a money transfer within 30 minutes of its being initiated. Proposals to reduce fees charged by remittance firms have also been advanced internationally by the World Bank in partnership with the G-8 and G-20.

Critics claim that high transfer fees are the result of an alleged market failure that calls for greater regulation. Yet markets in remittances are frequently overregulated. Many African governments have exclusive deals with money transfer companies, which operate as national monopolies, free from competitive discipline. And there are other regulatory pitfalls that drive up prices. A Western Union spokesperson told the *Guardian*:

> Our pricing varies between countries depending on a number of factors, such as consumer protection costs, local remittance taxes, market distribution, regulatory structure, volume, currency volatility and other market efficiencies. These factors can impact the fees and foreign exchange rates offered by corridor and service type.

All that suggests the remittance market needs less regulation. Proper competition, lower taxes, less restrictive "consumer protection" measures (which quickly become outdated), and less red tape in general would all likely increase the flow of funds between individuals.

Moreover, the 30-minute cancellation window would technically ban remittances using Bitcoin, whose transactions are irreversible. Yet Bitcoin is increasingly the vehicle of choice for remittances as its transaction costs are essentially zero.

Therefore, Congress should repeal or amend the section of Dodd-Frank dealing with remittance transfers to allow for Bitcoin transactions and a more flexible and competitive remittance market.

Experts: Durbin Amendment: John Berlau, Iain Murray, Todd Zywicki

FDIC Reform: Iain Murray

Remittances: Iain Murray

For Further Reading

Carol Adelman, Jeremiah Norris, and Kacie Marano, "The Index of Global Philanthropy and Remittances 2013," Hudson Institute, 2013, http://www.hudson.org/content/research-attachments/attachment/1229/2013_indexof_global_philanthropyand_remittances.pdf.

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Federal Deposit Insurance Corporation, "Statistics at a Glance," June 30, 2014, https://www.fdic.gov/bank/statistical/stats/2014jun/industry.html.

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Iain Murray, "Operation Choke Point: What It Is and Why It Matters," *Issue Analysis* 2014 No. 1, Competitive Enterprise Institute, July 2014, https://cei.org/content/operation-choke-point.

Jean-Charles Rochet and Jean Tirole, "Cooperation among Competitors: Some Economics of Payment Card Associations," *RAND Journal of Economics,* Vol. 33, No. 4 (Winter 2002): 549–570, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=338220.

Todd Zywicki, Geoffrey J. Manne, and Julian Morris, "Price Controls on Payment Card Interchange Fees: The U.S. Experience," Research Paper No. 14-18, George Mason University School of Law, June 4, 2014, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2446080##.