



FEDERAL RESERVE BANK
OF DALLAS

ROBERT D. McTEER, JR.
PRESIDENT
AND CHIEF EXECUTIVE OFFICER

May 6, 1991

DALLAS, TEXAS 75222

Notice 91-35

TO: The Chief Executive Officer of each
member bank and others concerned in
the Eleventh Federal Reserve District

SUBJECT

**Proposed and Final Amendments to Regulation D
(Reserve Requirements of Depository Institutions)**

DETAILS

The Federal Reserve Board has issued for comment proposed amendments and interpretations to Regulation D (Reserve Requirements of Depository Institutions) to prevent erosions of the reserve base for transaction accounts. Also, the Board has approved some final technical amendments and corrections to the regulation.

The proposed amendments and interpretations would

- classify certain sweep arrangements, including commingled time deposits, as transaction accounts;
- require depository institutions to maintain transaction account reserves against teller's checks;
- classify certain multiple money market deposit accounts (MMDAs) as transaction accounts;
- prohibit netting of individual trust balances in determining the balance of a commingled transaction account;
- preclude the creation of "due from" deductions when the "due from" arises from a transaction between a larger depository institution and a smaller depository institution that is designed to reduce the combined reserves of these institutions through use of the smaller institution's low reserve tranche.

- amend the definition of "cash items in the process of collection" to refer to "matured" rather than "redeemed" bonds and coupons; and
- amend the definition of "time deposit" to limit the use of time deposits to fund transaction accounts.

Additionally, the final technical amendments to Regulation D approved by the Board will combine the separate definitions of "savings deposit" and "money market deposit account" to simplify the regulation.

The Board must receive comments by June 24, 1991. Comments should be addressed to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, D.C. 20551. All correspondence should refer to Docket No. R-0729.

ATTACHMENTS

Copies of the Board's notices as they appear on pages 15493-95 and 15522-29, Vol. 56, No. 74, of the Federal Register dated April 17, 1991, are attached.

MORE INFORMATION

For more information, please contact Stephen Welch at (214) 698-4247. For additional copies of this Bank's notice, please contact the Public Affairs Department at (214) 651-6289.

Sincerely yours,

Robert D. McTeer, Jr.

(202/452-3513), Legal Division; or Thomas Brady, Chief, Banking and Money Market Statistics Section (202/452-2469), Division of Monetary Affairs. For the hearing impaired only, Telecommunications Device for the Deaf ("TDD"), Dorothea Thompson (202/452-3544).

SUPPLEMENTARY INFORMATION: The Board is making a number of technical amendments to Regulation D, including simplifying the definition of savings deposit by merging paragraphs 204.2(d)(2) (i) and (ii). These paragraphs previously provided separate descriptions of savings deposits subject to limited withdrawals and transfers and money market deposit accounts ("MMDAs") with additional withdrawal and transfer capabilities. This amendment is intended to reduce confusion resulting from the separate descriptions and limitations on the two types of accounts. Currently, "savings deposit" includes accounts from which no more than three withdrawals per statement cycle are permitted for the purpose of making transfers to another account at the same institution or to a third party, as well as MMDAs, on which six such withdrawals are permitted, of which no more than three may be by check, draft, debit card or similar order. The consolidation of these two paragraphs will clarify that a depository institution may allow up to six such withdrawals from a savings account even if the account does not have a check-writing feature. This amendment does not require that depository institutions increase the transaction limits on such accounts, but is intended only to clarify that they may do so if desired. Other technical changes are made to reflect this simplification.

Reporting requirements are not being changed as a result of this amendment at the current time. MMDAs and other savings deposits should continue to be reported separately where called for according to the reporting instructions for the specific reports.

Other amendments clarify that early withdrawals without penalty for 401(k) plans as well as Keogh plans are permissible within the first seven days after establishment if all interest is forfeited, and will revise the provisions concerning reserve deficiencies in § 204.7 by changing the term "penalties" to "charges" to more accurately reflect the nature of these charges.

Conforming amendments and corrections are also included.

Notice and public participation. The provisions of the Administrative Procedure Act relating to notice and public participation (5 USC 553(b)) have

FEDERAL RESERVE SYSTEM

12 CFR Part 204

[Docket No. R-0728]

Regulation D—Reserve Requirements of Depository Institutions

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule.

SUMMARY: The Board is making a number of technical amendments to Regulation D, including simplifying the definition of "savings account" by merging paragraphs 204.2(d)(2) (i) and (ii), which previously had separate descriptions of savings accounts and money market deposit accounts, and revising § 204.7(a) to change the term "penalties" to "charges," where appropriate, to more accurately reflect the nature of these payments.

EFFECTIVE DATE: April 24, 1991.

FOR FURTHER INFORMATION CONTACT: Patrick McDivitt, Attorney (202/452-3818), or Lawranne Stewart, Attorney

not been followed in connection with the adoption of these amendments because the amendments involve technical rather than substantive changes to Regulation D. The amendments will not increase and may decrease the regulatory burdens on depository institutions, as they are designed to clarify certain provisions of Regulation D. Accordingly, a request for comments would serve no purpose. The Board therefore finds good cause for determining, and so determines, that notice and public participation are unnecessary and contrary to the public interest.

The provisions of the Act relating to notice of the effective date of a rule (5 USC 553(d)) have not been followed in connection with the adoption of these amendments. The amendments are designed to make the regulation easier to understand, but will have no effect on depository institutions. For these reasons, the Board finds there is good cause to determine, and so determines, that such notice is not necessary. These technical amendments have therefore been published in final with an immediate effective date.

Regulatory Flexibility Act. Because the Board finds that no notice of proposed rulemaking is required, a statement concerning the effects of the rule on small entities is also not required under the Regulatory Flexibility Act, 5 USC 604. The Board notes, however, that the proposed amendments impose no additional reporting or recordkeeping requirements. The amendments are intended to simplify and clarify the amended provisions of the regulation. The amendments concerning savings deposits may be helpful to small institutions, as it clarifies that the higher transaction limits may be offered on savings accounts regardless of whether the account provides a checking feature or is a true "money market" investment.

List of Subjects in 12 CFR Part 204

Banks, Banking, Currency, Federal Reserve System, Penalties, Reporting and recordkeeping requirements.

Pursuant to the Board's authority under section 19 of the Federal Reserve Act, 12 USC 461 *et seq.*, the Board is amending 12 CFR part 204 as follows:

PART 204—RESERVE REQUIREMENTS OF DEPOSITORY INSTITUTIONS

1. The authority citation for part 204 continues to read as follows:

Authority: Sections 11(a), 11(c), 19, 25, 25(a) of the Federal Reserve Act (12 USC 248(a), 248(c), 371a, 371b, 461, 601, 611); section 7 of the International Banking Act of 1978 (12 USC 3105); and section 411 of the *Garn St-Germain*

Depository Institutions Act of 1982 (12 USC 461).

2. Section 204.2 is amended by revising paragraph (b)(3)(ii)(A), footnote 1 to paragraph (c)(1)(i), and paragraphs (d)(2), (e)(2), the first two sentences of (e)(4), and (f)(2); by removing paragraph (b)(3)(iv) and redesignating paragraphs (b)(3)(v) and (b)(3)(vi) as (b)(3)(iv) and (b)(3)(v), respectively, to read as follows:

§ 204.2 Definitions

* * * * *

(b) * * *

(3) * * *

(ii) * * *

(A) Is subject to check, draft, negotiable order of withdrawal, share draft, or similar item, such as an account authorized by 12 USC 1832(a) ("NOW account") and a savings deposit described in § 204.2(d)(2), provided that the depositor is eligible to hold a NOW account; or

* * * * *

(c) * * *

(1) * * *

(i) * * * 1

* * * * *

¹ A time deposit, or a portion thereof, may be paid before maturity without imposing the early withdrawal penalties specified by this part:

(a) Where the time deposit is maintained in an individual retirement account established in accordance with 26 U.S.C. 408 and is paid within seven days after establishment of the individual retirement account pursuant to 26 CFR 1.408-6(d)(4), where it is maintained in a Keogh (H.R. 10) plan, or where it is maintained in a "401(k) plan" under 26 U.S.C. 401(k); provided that the depositor forfeits an amount at least equal to the simple interest earned on the amount withdrawn;

(b) Where the depository institution pays all or a portion of a time deposit representing funds contributed to an individual retirement account or a Keogh (H.R.10) plan established pursuant to 26 U.S.C. 408 or 26 U.S.C. 401 or to a "401(k) plan" established pursuant to 26 U.S.C. 401(k) when the individual for whose benefit the account is maintained attains age 59½ or is disabled (as defined in 26 U.S.C. 72(m)(7)) or thereafter;

(c) Where the depository institution pays that portion of a time deposit on which federal deposit insurance has been lost as a result of the merger of two or more federally insured banks in which the depositor previously maintained separate time deposits, for a period of one year from the date of the merger;

(d) Upon the death of any owner of the time deposit funds;

(e) When any owner of the time deposit is determined to be legally incompetent by a court or other administrative body of competent jurisdiction; or

(f) Where a time deposit is withdrawn within ten days after a specified maturity date even though the deposit contract provided for automatic renewal at the maturity date.

(d) * * *

(2) The term *savings deposit* also means: A deposit or account, such as an account commonly known as a passbook savings account, a statement savings account, or as a money market deposit account ("MMDA"), that otherwise meets the requirements of § 204.2(d)(1) and from which, under the terms of the deposit contract or by practice of the depository institution, the depositor is permitted or authorized to make no more than six transfers and withdrawals, or a combination of such transfers and withdrawals, per calendar month or statement cycle (or similar period) of at least four weeks, to another account (including a transaction account) of the depositor at the same institution or to a third party by means of a preauthorized or automatic transfer, or telephonic (including data transmission) agreement, order or instruction, and no more than three of the six such transfers may be made by check, draft, debit card, or similar order made by the depositor and payable to third parties. A "preauthorized transfer" includes any arrangement by the depository institution to pay a third party from the account of a depositor upon written or oral instruction (including an order received through an automated clearing house (ACH)) or any arrangement by a depository institution to pay a third party from the account of the depositor at a predetermined time or on a fixed schedule. Such an account is not a "transaction account" by virtue of an arrangement that permits transfers for the purpose of repaying loans and associated expenses at the same depository institution (as originator or servicer) or that permits transfers of funds from this account to another account of the same depositor at the same institution or permits withdrawals (payments directly to the depositor) from the account when such transfers or withdrawals are made by mail, messenger, automated teller machine, or in person or when such withdrawals are made by telephone (via check mailed to the depositor) regardless of the number of such transfers or withdrawals.^{5 6}

* * * * *

⁵ In order to ensure that no more than the permitted number of withdrawals or transfers are made, for an account to come within the definition in § 204.2(d)(2), a depository institution must either:

(a) prevent withdrawals or transfers of funds from this account that are in excess of the limits established by § 204.2(d)(2), or

(b) adopt procedures to monitor those transfers on an *ex post* basis and contact customers who exceed the established limits on more than an occasional basis.

Continued

(e) * * *

(2) Deposits or accounts on which the depository institution has reserved the right to require at least seven days' written notice prior to withdrawal or transfer of any funds in the account and that are subject to check, draft, negotiable order of withdrawal, share draft, or other similar item, except accounts described in § 204.2(d)(2) (savings deposits), but including accounts authorized by 12 U.S.C. 1832(a) (NOW accounts).

(4) Deposits or accounts on which the depository institution has reserved the right to require at least seven days' written notice prior to withdrawal or transfer of any funds in the account and under the terms of which, or by practice of the depository institution, the depositor is permitted or authorized to make more than six withdrawals per month or statement cycle (or similar period) of at least four weeks for the purposes of transferring funds to another account of the depositor at the same institution (including "transaction account") or for making payment to a third party by means of a preauthorized transfer, or telephonic (including data transmission) agreement, order or instruction, except accounts described in § 204.2(d)(2). An account that authorizes more than six such withdrawals in a calendar month, or statement cycle (or similar period) of at least four weeks, is a "transaction account" whether or not more than six such transfers are made during such period. * * *

(f) * * *

(2) *Nonpersonal time deposit* does not include nontransferable time deposits to the credit of or in which the entire beneficial interest is held by an individual pursuant to an individual retirement account or Keogh (H.R. 10) plan under 26 U.S.C. 408, 401, or non-transferable time deposits held by an employer as part of an unfunded deferred-compensation plan established pursuant to subtitle D of the Revenue Act of 1978 (Pub. L. 95-600, 92 Stat.

For customers who continue to violate those limits after they have been contacted by the depository institution, the depository institution must either close the account and place the funds in another account that the depositor is eligible to maintain, or take away the transfer and draft capacities of the account.

An account that authorizes withdrawals or transfers in excess of the permitted number is a transaction account regardless of whether the authorized number of transactions are actually made. For accounts described in § 204.2(d)(2), the institution at its option may use, on a consistent basis, either the date on the check, draft, or similar item, or the date the item is paid in applying the limits imposed by that section.

* Reserved.

2783), or a "401(k) plan" under 26 U.S.C. 401(k).

3. Section 204.7(a) is revised to read as follows:

§ 204.7 Reserve deficiencies.

(a) *Charges for deficiencies*—(1) *Assessment of charges.* Deficiencies in a depository institution's required reserve balance, after application of the 2 percent carryover provided in § 204.3(h) are subject to reserve deficiency charges. Federal Reserve Banks are authorized to assess charges for deficiencies in required reserves at a rate of 2 percent per year above the lowest rate in effect for borrowings from the Federal Reserve Bank on the first day of the calendar month in which the deficiencies occurred. Charges shall be assessed on the basis of daily average deficiencies during each maintenance period. Reserve Banks may, as an alternative to levying monetary charges, after consideration of the circumstances involved, permit a depository institution to eliminate deficiencies in its required reserve balance by maintaining additional reserves during subsequent reserve maintenance periods.

(2) *Waivers.* (i) Reserve Banks may waive the charges for reserve deficiencies except when the deficiency arises out of a depository institution's gross negligence or conduct that is inconsistent with the principles and purposes of reserve requirements. Each Reserve Bank has adopted guidelines that provide for waivers of small charges. The guidelines also provide for waiving the charge once during a two-year period for any deficiency that does not exceed a certain percentage of the depository institution's required reserves. Decisions by Reserve Banks to waive charges in other situations are based on an evaluation of the circumstances in each individual case and the depository institution's reserve maintenance record. If a depository institution has demonstrated a lack of due regard for the proper maintenance of required reserves, the Reserve Bank may decline to exercise the waiver privilege and assess all charges regardless of amount or reason for the deficiency.

(ii) In individual cases, where a federal supervisory authority waives a liquidity requirement, or waives the penalty for failing to satisfy a liquidity requirement, the Reserve Bank in the District where the involved depository institution is located shall waive the reserve requirement imposed under this part for such depository institution when

requested by the federal supervisory authority involved.

5. Footnote 14 is § 204.8(a)(2)(i)(B)(5) is revised to read as follows:

¹⁴ The designated entities are specified in 12 CFR 204.125.

6. Above the heading of § 204.121 the following is added:

Interpretations

7. In § 204.125, the heading of the section, the introductory text, and the first entry under the heading "ASIA" are revised to read as follows:

§ 204.125 Foreign, international, and supranational entities referred to in §§ 204.2(c)(1)(iv)(E) and 204.8(a)(2)(i)(B)(5).

The entities referred to in § 204.2(c)(1)(E) and § 204.8(a)(2)(i)(B)(5) are:

Asia

Asia and Pacific Council.

By order of the Board of Governors of the Federal Reserve System, April 12, 1991.

William W. Wiles,
Secretary of the Board.

[FR Doc. 91-8991 Filed 4-16-91; 8:45 am]
BILLING CODE 6210-01-01

Proposed Rules

Federal Register

Vol. 58, No. 74

Wednesday, April 17, 1991

FEDERAL RESERVE SYSTEM

12 CFR Part 204

[Docket No. R-0729]

Regulation D—Reserve Requirements of Depository Institutions

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Board is publishing for comment a number of amendments to its Regulation D relating to the definition of "transaction account" and concerning the calculation of reserve requirements. The Board proposes to add "teller's checks" to the definition of "transaction account" and to clarify the definition of "cash items in the process of collection." The Board is also publishing for comment several interpretations concerning the definition of "transaction account" and arrangements used to avoid transaction account reserve requirements. The proposed amendments and interpretations are intended to prevent evasions of reserve requirements and erosion of the reserve base.

DATES: Comments should be received by June 24, 1991.

ADDRESS: Comments, which should refer to Docket No. R-0729, may be mailed to the Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW., Washington, DC 20551, to the attention of Mr. William W. Wiles, Secretary; or delivered between 8:45 a.m. and 5:15 p.m. to room B-2223. Comments may be inspected in room B-1122 between 9 a.m. and 5 p.m., except as provided in § 261.8 of the Board's Rules Regarding the Availability of Information, 12 CFR 261.8.

FOR FURTHER INFORMATION CONTACT: Oliver Ireland, Associate General Counsel (202/452-3825), Patrick J. McDivitt, Attorney (202/452-3818), or Lawranne Stewart, Attorney (202/452-3513), Legal Division; or Thomas Brady,

Chief, Banking and Money Market Statistics Section (202/452-2469), Division of Monetary Affairs. For the hearing impaired only, Telecommunications Device for the Deaf ("TDD"), Dorothea Thompson (202/452-3544).

SUPPLEMENTARY INFORMATION: The Board is proposing for public comment revisions to its Regulation D, Reserve Requirements of Depository Institutions, 12 CFR part 204, and a number of interpretations to the Federal Reserve Act and that regulation relating to the definition of "transaction account." Under Regulation D, transaction accounts generally are subject to a 12 percent reserve requirement.

The Board last made substantial revisions to the definitions in Regulation D in March 1986. 51 FR 9636 (March 20, 1986). Those revisions reflected the expiration, on March 31, 1986, of the Depository Institutions Deregulation Committee and its regulations and generally preserved the prior scheme of reserve requirements for transaction accounts and nonpersonal time deposits. The definition of "nonpersonal time deposits" was revised at that time to include early withdrawal penalties, in part to maintain the distinction between time deposits and transaction accounts. In December 1990 the Board reduced reserve requirements on nonpersonal time deposits with a maturity of less than 18 months and net Eurocurrency liabilities from three percent to zero percent. 55 FR 50540 (Dec. 7, 1990).

Since 1986, the Board has identified a number of practices that result in depository institutions: (1) Issuing nonreservable instruments in place of functionally equivalent reservable instruments; (2) classifying accounts as time deposits when the accounts are used to provide funds directly or indirectly for the purpose of making payments or transfers to third persons or others and are therefore the functional equivalent of transaction accounts; (3) taking inappropriate "due from" or "cash item in the process of collection" deductions from their gross demand deposits in calculating required reserves; or (4) inappropriately netting negative account balances against positive account balances in order to reduce reserve requirements on transaction accounts. The incentive to engage in some of these practices is increased by the Board's recent action

to reduce reserves on nonpersonal time deposits.

The ability to structure transactions and account relationships to avoid or reduce transaction account reserve requirements reduces the reserve base available for the conduct of monetary policy, and often does so in a manner that results in inequitable treatment of similar transactions among depository institutions. Permitting reductions in the reserve base in this manner favors depository institutions with the resources to develop reserve avoidance practices, and that are willing to implement such practices, over depository institutions that cannot afford the legal or automation resources necessary to implement these reserve avoidance practices or that are reluctant to implement practices that are inconsistent with the purposes of reserve requirements. The Board believes that, to the extent that a reduction in reserve requirements on transaction accounts is appropriate, it should be accomplished by the Board through changes in the ratio of transaction account reserves under section 19(b)(2)(B) of the Federal Reserve Act rather than through the growth of arrangements and accounts designed to avoid or reduce reserve requirements. Accordingly, the Board is proposing for public comment a number of amendments and interpretations to Regulation D to treat certain transaction account substitutes as transaction accounts subject to a 12 percent requirement, and to clarify the deductions that may be made in computing required reserves, and the proper computation of account balances.

Transaction Account Definition

Amendments

Teller's Checks

Under the current Regulation D, the term "transaction account" includes demand deposits. 12 CFR 204.2(e)(1). "Demand deposit" includes certified, cashier's, and officer's checks (including checks issued by the depository institution in payment of dividends) (12 CFR 204.2(B)(1)(ii)) but does not include checks or drafts drawn by a depository institution on a Federal Reserve Bank, a Federal Home Loan Bank, or on another

depository institution. 12 CFR 204.2(b)(3)(v).¹

Many depository institutions use checks drawn by the depository institution on accounts at or payable through or at other depository institutions, Federal Home Loan Banks, or Federal Reserve Banks as a substitute for reservable cashier's checks. These checks are often referred to as teller's checks. Teller's checks are effective substitutes for cashier's checks drawn by a depository institution because they bear some of the legal characteristics of cashier's checks (See section 3-413(2) and section 3-802(1)(a) of the Uniform Commercial Code, Pre 1990 Official Text ("UCC")). Under section 3-413(2), of the UCC a bank drawing a teller's check is liable on the check if the check is dishonored by the drawee. Under section 3-802(1)(a) of the UCC payment by either cashier's check or teller's check results in *pro tanto* discharge of the underlying obligation. Thus, both cashier's checks, i.e., checks drawn by a depository institution on itself, and teller's checks, i.e. checks drawn by a depository institution on another depository institution or payable at or through another depository institution, including on, at or through a Federal Home Loan Bank or Federal Reserve Bank, are ultimately backed by the credit of the drawing depository institution.²

The migration from cashier's checks to teller's checks appears to be motivated by at least two considerations. First, there are economies of scale in the tracking, reconciliation, and payment of cashier's checks and teller's checks. The Board has recognized these economies in the past. (See Board Policy Statement on Delayed Disbursement of Teller's Checks and Cashier's Checks. Federal Reserve Regulatory Service ("FRRS") 9-752). Second, by switching from cashier's to teller's checks, an issuing depository institution's reserve requirements are reduced because it does not have to maintain reserves against the balances of teller's checks outstanding after it has funded the bank

¹ Under a staff interpretation, this exclusion only applies to such checks when they are drawn against a positive balance. Checks drawn by a depository institution against a zero balance account are considered demand deposits at the drawing institution until the amount of the checks is remitted to the drawee institution. See Federal Reserve Regulatory Service ("FRRS") 2-36a.7.

² The Board recognizes that under section 3-413 of the current U.C.C. a depository institution drawing a teller's check may avoid liability on the check in the event of dishonor by drawing the check without recourse. Such teller's checks would not be reservable under the Board's proposal. However, under Section 3-414 of the 1990 Official Text of the Uniform Commercial Code a check may not be drawn without recourse.

or other drawee of the teller's checks.³ Because of this reserve avoidance aspect of teller's checks, the Board has conditioned approval of bank holding companies' applications to provide large denomination teller's check services through nonbank subsidiaries of the holding company on the subsidiaries' placing the amount that they received from the issuers of the checks in a reservable transaction account in a depository institution.⁴ Providers of teller's check services that are not subsidiaries of bank holding companies are not subject to this requirement. Promotional material issued by some such providers of teller's check services have stressed their cost advantage relative to providers of teller's check services that are subject to reserve requirements.

Because of the cost savings attributable to shifting from the use of cashier's checks to teller's checks where the teller's check service provider is not subject to reserve requirements, either under the terms of Regulation D or otherwise, the Board is concerned that this shift could materially affect the reserve base. Further, current practices result in competitive inequities between depository institutions issuing cashier's checks and those issuing teller's checks through arrangements with service providers that are subject to reserve requirements, on the one hand, and service providers for teller's check services that are not subject to reserve requirements, on the other. These competitive inequities create market pressures that could lead to an erosion of the reserve base beyond that which might otherwise occur due to efficiencies in the services provided by teller's check service providers.

For these reasons, the Board is proposing to amend Regulation D to change the manner in which reserve requirements apply to teller's checks, including checks drawn on Federal Home Loan Banks and Federal Reserve Banks. Under the proposal, a teller's check would be considered a reservable deposit of the depository institution issuing the check until the check had been paid by the drawee. To the extent that the check was covered by immediately withdrawable funds of the issuer on deposit at a depository institution on which the check was drawn or at or through which the check was payable, the issuing depository

³ The Board understands that providers of teller's check services that are not depository institutions generally pay interest on amounts that are forwarded to them by their issuing bank customers.

⁴ e.g. Wells Fargo & Company, 72 Federal Reserve Bulletin 148 (1986).

institution would be able to take a "due from" deduction under § 204.3(f) of Regulation D.⁵ The Board believes that this reserve treatment of teller's checks is appropriate because the teller's checks are used to provide funds directly or indirectly for the purpose of making payments to third persons. Further, the teller's checks remain a secondary liability of the drawing depository institution until they are paid.

The proposal would: (1) Amend Regulation D to include a definition of teller's checks; (2) amend § 204.2(a)(iii) of Regulation D to define "deposit" to include teller's checks; (3) amend § 204.2(b)(1)(ii) of Regulation D to define "demand deposit" to include teller's checks; and (4) delete § 204.2(b)(3)(iv)⁶ of Regulation D, which currently excludes teller's checks from the definition of demand deposit. The Board requests comments on these proposed amendments.

Reference to Interpretations

The definition of "transaction account" includes "[a]ll deposits other than time and savings deposits." 12 CFR 204.2(e)(6). This subparagraph would be amended to refer also to accounts that may be nominally time or savings accounts, but that the Board has determined, by rule or order, to be transaction accounts. This amendment is intended to provide a reference to the Board's interpretations on transaction accounts.

Interpretations

The Board has identified two practices involving the use of time deposits that it believes are designed to provide funds directly or indirectly for the purpose of making payments or transfers to third persons or others. The Board believes, that these time deposits should be considered to be transaction accounts under Regulation D. Accordingly, the Board is proposing for comment two interpretations identifying as transaction accounts certain deposits that would otherwise be considered to be time deposits.

Linked Savings Accounts

In some cases, a depository institution may establish a number of savings

⁵ This would not be true of balances held at a Federal Reserve Bank, or of pass-through reserves held at a Federal Home Loan Bank correspondent, against which a "due from" deduction may not be taken. 12 CFR 204.3(f)(3).

⁶ This citation is to Regulation D as amended by the technical amendments approved concurrently with this proposal. See "Final Rules" published in this issue of the FEDERAL REGISTER. The language cited was previously found at section 204.2(b)(3)(v).

accounts for individuals in order to avoid the transfer limitations on these accounts. Under section 204.2(d)(2) of Regulation D, as amended by the Board,⁷ the holder of a savings account may make no more than six transfers per calendar month or statement cycle (or similar period of at least four weeks) to another account of the depositor at the same institution or to a third party by means of a preauthorized or automatic transfer or telephonic (including data transmission) agreement, order or instruction. No more than three of the six transfers may be made by check, draft, debit card or similar order made by the depositor to third persons.⁸ Because of their limited transfer capabilities, these accounts are classified as time deposits and currently are reservable at zero percent.

When a depository institution opens a number of savings accounts for a depositor, the depositor can often use the multiple accounts to evade the transfer restrictions. For example, the depositor may open a number of accounts, place all of its funds in the first account and draw three checks on that account. Then the depositor could transfer the remaining funds in the first account to the second account by telephone transfer and draw three more checks. By repeating this process, the depositor could draw up to three checks a month per account with the total number of checks limited only by the number of accounts. Such an arrangement is an effective substitute for a transaction account. This process may be facilitated by the depository institution treating the separate accounts as sub-accounts of a master account. Although the Board believes that there may be legitimate purposes for a depositor to open multiple savings accounts, including certain accounting purposes, the Board believes that the opening of multiple savings accounts solely in order to increase depositors' transfer capabilities is an evasion of reserve requirements and permits these accounts to provide funds directly or indirectly for the purpose of making payments or transfers to third persons or others. In those circumstances, the Board believes that the savings accounts should be considered to be transaction accounts and reserved accordingly.

The Board recognizes that in some cases depositors may establish multiple

accounts on their own without informing the depository institution that it is opening multiple accounts. In these cases the depository institution may not be aware of the multiple accounts or their purposes and, therefore, may not be able to identify them as accounts used to circumvent the transfer limits. The Board does not expect depository institutions to conduct a comprehensive analysis of existing accounts or to adopt special procedures to identify multiple accounts established by customers where a customer opening a savings account with transfer capabilities indicates that it does not have an existing savings account with transfer capabilities with the depository institution. Where depository institutions are aware of existing multiple savings accounts established in order to increase transfer limits or where new multiple accounts are established for a depositor that does not have a legitimate purpose for establishing multiple accounts, the accounts should be considered to be transaction accounts.

Linked Time Deposits and Transaction Accounts

Depository institutions are offering or planning to offer account arrangements under which depositors maintain transaction accounts and time deposits with a depository institution in an arrangement that permits each depositor to draw checks up to the aggregate amount held by that depositor in these accounts. The time deposits may be held directly by the depositor or indirectly through a trust or other arrangement that generally contains the commingled funds of a number of depositors. The depositor's interest in time deposits may be identifiable, with an agreement by the depositors that balances held in the arrangement may be used to pay checks drawn by other depositors participating in the arrangement, or the depositor may have an undivided interest in a series of time deposits. The time deposits have staggered maturities so that one of the time deposit matures each business day. At the end of each day, funds over a specified balance in the depositors' transaction accounts are swept from the transaction accounts into one or more time deposits. New deposits made each day as well as funds from any maturing time deposits are available each day to pay checks or other charges to the transaction accounts of depositors participating in the arrangement.

The depository institution's decision whether to pay checks drawn on an individual depositor's transaction account is based on the aggregate

amount of funds that the depositor has invested in the arrangement, including any amount that may be invested in unmatured time deposits. Only if checks drawn by all depositors participating in the arrangement exceed the total balance of funds available that day is a time deposit withdrawn prior to maturity so as to incur an early withdrawal penalty. Because the aggregate of individual participants' deposits tend to equal the aggregate of individual participants' withdrawals on any day, the total balance maintained in the arrangement is highly stable and an early withdrawal of time deposits is rarely, if ever, necessary. The arrangement may be marketed as an arrangement to provide the customers unlimited access to their funds with a high rate of interest.

The Board believes that these arrangements substitute time deposit balances for transportation accounts balances with no meaningful reductions in the depositors' access to their funds in practice. Accordingly, the Board believes that the time deposits in such arrangements are used to provide funds indirectly for the purposes of making payments or transfers to third persons. The Board is proposing for comment an interpretation that would require that the time deposit be considered to be transaction accounts for the purposes of Regulation D.

Time Deposit Definition

Amendment

A number of depository institutions have raised questions as to the proper accounting for time deposits under § 204.2(c)(1)(i) of Regulation D. "Time deposit" is defined generally to include a deposit that the depositor does not have a right and is not permitted to make withdrawals from within six days after the date of deposit unless the deposit is subject to an early withdrawal penalty of at least seven days' simple interest on amounts withdrawn within the first six days after deposit. Unlike savings deposits, this type of time deposit may have no restrictions on the number of transfers from the account that can be made each statement period. If the early withdrawal penalty is not imposed on a time deposit, the account becomes a savings deposit if it meets the requirements for a savings deposit, that is, if it is subject to appropriate limitations on withdrawals and transfers; otherwise, it becomes a transaction account.

Depository institutions have asked whether the six-day period runs from

⁷ See "Final Rule" published in this issue of the Federal Register.

⁸ These accounts have generally been known as money market deposit accounts ("MMDAs"). See 12 CFR 204.2(d)(2)(ii) (1990). The separate definitions of "savings deposit" and "MMDA" have been consolidated in the Final Rule published in this issue of the Federal Register.

the date of the last deposit or the date that an amount representing the amount of the withdrawal was initially deposited. The Board believes that the six-day period should begin to run from the last deposit. This treatment might be analogized to last-in first-out, or "LIFO" accounting treatment. Under contrary approach, which might be analogized to first-in first-out, or "FIFO" accounting treatment, depositors could regularly withdraw funds from the account if a like amount had been on deposit for more than six days. These withdrawals would not be subject to an early withdrawal penalty and would not be limited by the transfer limits on savings deposits.

A FIFO rule would facilitate the use of a time deposit open account to make transfers in excess of those permissible for a savings deposit from the time deposit to a transaction account for the purpose of making payments to third persons, thus avoiding transaction account reserves. Accordingly, the Board is requesting comment on a proposal to adopt a LIFO rule by amending § 204.2(c)(1)(i) by adding the words "the last" before the word "deposit" at the end of the first sentence of that paragraph. This clarification should have little or no effect on time deposits other than time deposit accounts from which frequent withdrawals are made by preauthorized or automatic transfer, telephonic order or instruction, or by other means subject to the savings deposit withdrawal limitations.⁹

Computation of Reserve Requirements

Amendments

Cash Items in the Process of Collection

Section 204.2(i)(1) of Regulation D defines the term "cash items in the process of collection" to include redeemed bonds and coupons. Section 204.3(f) provides that, in determining the reserve balance required by Regulation D, a depository institution may deduct the amount of cash items in the process of collection from its gross transaction accounts. The reference to redeemed bonds and coupons in § 204.2(i)(1)(iii)(B) caused confusion, as bonds and coupons that have been redeemed by the paying agent for the bonds or coupons have no further need for

collection. However, the term "redeemed" can be interpreted to refer to the receipt for redemption of bonds or coupons by a depository institution in order to send them for collection, regardless of when the bonds or coupons mature, if the depository institution has given credit for the items.

Such an interpretation could allow a depository institution to send coupons for redemption and extend credit on the security of the bonds and coupons while receiving a "cash item in the process of collection" deduction until the bonds and coupons were redeemed by the paying agency on maturity. This practice would materially reduce the amount of reserves held against transaction accounts in a way that the Board believes is inappropriate and inconsistent with the purpose of the "cash items in the process of collection" deduction.

In order to avoid this potential, the Board believes that the "cash item in the process of collection" deduction should be available only for bonds or coupons that have actually matured or for bonds that have been called and are payable immediately upon presentation. Accordingly, the Board is proposing for comment an amendment to the definition of the term "cash item in the process of collection" in § 204.2(i)(1)(iii)(B) of Regulation D to delete the term "redeemed" and replace it with the term "matured." Bonds that have not reached the original maturity date, but that have been called and are payable immediately upon presentation, would be considered matured for the purposes of this provision.

Interpretations

Due from Deduction

Recently, a number of depository institutions have been engaging in practices designed to reduce their reserve requirements by increasing the use of the low reserve tranche among the affiliated depository institutions. Under § 204.9(a)(2) of Regulation D, a depository institution is exempt from reserve requirements on its first \$3.4 million in reservable liabilities and is subject to three percent reserves on its transaction account balances of up to \$41.1 million. Under § 204.3(f)(1) of Regulation D, balances subject to immediate withdrawal due from other depository institutions located in the United States may be deducted from gross transaction accounts in computing reserve requirements. Further, under § 204.2(a)(1)(vii)(A)(1) of Regulation D, Federal funds transactions with other offices located in the United States of depository institutions and certain other

entities are exempt from reserve requirements, although this exemption does not extend to deposit accounts, including correspondent transaction accounts. In a number of cases, depository institutions have used the relationship between these provisions to reduce their reserve requirements through a series of transactions entered into solely for that purpose.

For example, when small depository institutions in an affiliated family of depository institutions do not take full advantage of the low reserve tranche in § 204.9(a)(1) of Regulation D (i.e. the three percent reserve ratio on transaction accounts up to \$41.1 million), these small depository institutions may accept deposits from larger affiliates to increase their total transaction accounts up to the \$41.1 million limit. These deposits are subject to immediate withdrawal by the larger depository institution, thereby generating a "due from" deduction for the larger depository institution. The transaction account balances at the small depository institutions are subject to a 3 percent reserve requirement rather than the full 12 percent requirement. The small depository institutions will then return the funds to the larger depository institution, less an amount equal to the three percent reserve requirements that the small depository institutions must hold against the larger depository institution's deposit. The funds are returned by means of a federal funds transaction at low or zero interest. This transaction is exempt from reserve requirements under § 204.2(a)(1)(vii)(A)(1). The larger depository institutions may then invest or lend the funds. The net effect of these transactions is to reduce the reserve requirements of the larger depository institution by nine percentage points on the amount transferred to the smaller depository institutions at a cost of a few bookkeeping entries and funds transfers.

The Board believes that these transactions are designed solely to avoid reserve requirements, and are not consistent with the purpose for which Congress provided the low reserve tranche. The Board therefore has determined that the "due from" deduction may not be taken by the larger depository institution in these circumstances, and is proposing for comment an interpretation to eliminate the due from deduction in these cases.

Commingled Trust Deposit Netting

Depository institutions' trust departments often commingle the idle cash balances of the individual trusts that they manage and place those funds

⁹ Under the proposal, a depository institution with time deposits that allow withdrawals without penalty within six days of the last deposit could reclassify such accounts as savings deposits without including a separate reservation of their right to require seven days' notice of withdrawal as long as the deposit contract does not authorize, and the institution does not permit, transfers in excess of the limits on savings deposits.

in a single transaction account in the depository institution. This account is subject to reserve requirements as a transaction account. In some cases, the trust department nets negative balances in some trust accounts against positive balances in other trust accounts in order to arrive at net amount that it credits to the commingled transaction account. The Board believes that this practice generally understates the balances in the transaction account. Individual trust instruments generally do not authorize the trustee to use the funds in one trust to lend to another trust. Consequently, in effect, any overdraft in a trust is covered by a loan from the bank when the bank makes a payment on behalf of the trust. These negative trust balances should be reflected as zero balances and should not be netted against positive trust balances in computing the amount in the transaction account each day. The Board is proposing for comment an interpretation to prohibit netting of negative balances against positive balances in these situations, for the purpose of Regulation D.

Regulatory Flexibility Act

Pursuant to section 605(b) of the Regulatory Flexibility Act (Pub. L. No. 96-354, 5 U.S.C. 601 *et seq.*), the Board certifies that the proposed amendment will not have a significant economic impact on a substantial number of small entities. The Board does not believe that the proposed amendments or interpretations would impose any additional reporting or recordkeeping requirements. Although the proposed amendments and interpretations may increase required reserves for some depository institutions, there should not be a disproportionately adverse impact on small institutions, because Regulation D provides an exemption from reserve requirements for the first \$3.4 million of transaction account balances and a low reserve tranche from transaction account balances above this limit up to \$41.1 million, on which a lowered rate of three percent rather than the full 12 percent is required. Although one of the proposed interpretations (see proposed § 204.135) would reduce the use of the low reserve tranche in some circumstances, this interpretation relates to the use of the low reserve tranche by larger depository institutions affiliated with a small depository institution, and does not affect the ability of the small institutions to use the low reserve tranche for their own deposits. The Board does not anticipate that the proposals will have a netative impact on the ability of small institutions to attract deposits. Further, the Board believes that the proposed

amendments will improve the ability of small institutions to compete in some areas, as many small institutions do not have the resources available to develop and maintain reserve avoidance practices of the kind this proposal addresses. Disallowing such practices will therefore improve the ability of small institutions to compete with larger institutions that would otherwise be able to use these reserve avoidance techniques.

List of Subjects in 12 CFR Part 204

Banks, Banking, Currency, Federal Reserve System, Penalties, Reporting and recordkeeping requirements.

Pursuant to the Board's authority under section 19 of the Federal Reserve Act, 12 U.S.C. 461 *et seq.*, the Board is amending 12 CFR part 204 as follows:

PART 204—RESERVE REQUIREMENTS OF DEPOSITORY INSTITUTIONS

1. The authority citation for part 204 continues to read as follows:

Authority: Sections 11(a), 11(c), 19, 25, 25(a) of the Federal Reserve Act (12 U.S.C. 248(a), 248(c), 371a, 371b, 461, 601, 611); section 7 of the International Banking Act of 1978 (12 U.S.C. 3105); and section 411 of the Garn St-Germain Depository Institutions Act of 1982 (12 U.S.C. 461).

2. Section 204.2 is amended by revising paragraphs (a)(1)(iii), (b)(1)(ii), the first sentence of the introductory text of (c)(1)(i), and paragraphs (e)(6) and (i)(1)(iii)(B); by removing paragraph (b)(3)(iv) and redesignating paragraph (b)(3)(v) as (b)(3)(iv); and by adding paragraph (u), to read as follows:

§ 204.2 Definitions.

- (a)(1) * * *
- (iii) An outstanding draft, certified check, cashier's check, money order, or teller's check drawn by the depository institution on itself or on another depository institution, Federal Reserve Bank, Federal Home Loan Bank, or payable through or at another depository institution, Federal Reserve Bank, or Federal Home Loan Bank;
- (b)(1) * * *
- (ii) Certified, cashier's, teller's, and officer's checks (including checks issued by the depository institution in payment of dividends);
- (c)(1) * * *
- (i) A deposit that the depositor does not have a right and is not permitted to make withdrawals from within six days after the date of deposit unless the deposit is subject to an early withdrawal penalty of at least seven

days' simple interest on amounts withdrawn within the first six days after the last deposit.¹ * * *

(e) * * *

(6) All deposits other than time and savings accounts, including those accounts that are time and savings deposits in form but that the Board has determined, by rule or order, to be transaction accounts.

(i) * * *

(1) * * *

(iii) * * *

(B) Matured bonds and coupons;

(u) *Teller's check* means a check drawn by the depository institution on another depository institution, a Federal Reserve Bank, or a Federal Home Loan Bank, or payable at or through another depository institution, a Federal Reserve Bank, or a Federal Home Loan Bank, and which the drawing depository institution may engage or be obliged to pay upon dishonor.

3. Section 204.133 is added to read as follows:

§ 204.133 Multiple savings deposits treated as a transaction account.

(a) *Authority.* Under section 19(a) of the Federal Reserve Act, the Board is authorized to define the terms used in section 19, and to prescribe regulations to implement and prevent evasions of the requirements of that section. Section 19(b) establishes general reserve requirements on transaction accounts and non personal time deposits. Under section 19(b)(1)(F), the Board also is authorized to determine, by regulation or order, that an account or deposit is a transaction account if such account is used directly or indirectly for the purpose of making payments to third persons or others.

(b) *Background.* Under Regulation D, 12 CFR part 204 at 204.2(d)(2), the term "savings deposit" includes a deposit or an account that otherwise meets the requirements of § 204.2(d)(1) and from which the depositor is permitted or authorized to make up to six transfers or withdrawals per month or statement cycle of at least four weeks. The depository institution may authorize up to three of these six transfers to be made by check, draft, debit card, or similar order drawn by the depositor and payable to third parties. If more than six transfers (or more than three

¹ Footnote unchanged from technical amendments approved concurrently with this proposal. See "Final Rule" published in this issue of the Federal Register.

third party transfers by check, etc.) are permitted or authorized per month or statement cycle, the depository institution may not classify the account as a savings deposit. If the depositor, during the period, makes more than six transfers or withdrawals (or more than three third party transfers by check, etc.), the depository institution may, depending upon the facts and circumstances, be required by Regulation D (Footnote 5 at § 204.2(d)(2)) to reclassify or close the account.

(c) *Use of multiple savings deposits.* Depository institutions have asked for guidance as to when a depositor may maintain more than one savings deposit and be permitted to make all the transfers or withdrawals authorized for savings deposits under Regulation D from each savings deposit. The Board has determined that, if a depository institution opens more than one savings deposit for a depositor that authorizes or permits transfers and withdrawals so that the total transfers and withdrawals from these accounts may be in excess of those permitted by Regulation D for an individual savings account, the accounts generally should be considered to be transaction accounts. This determination applies regardless of whether the deposits have entirely separate account numbers or are subsidiary accounts of a master deposit account. Multiple savings accounts, however, should not be considered to be transaction accounts if the depositor establishes a business purpose, other than increasing the number of transfers or withdrawals, for maintaining more than one savings deposit.

(d) *Examples.* The distinction between appropriate and inappropriate uses of multiple accounts is illustrated by the following examples:

Example (1). (i) X wishes to open an account that maximizes his interest earnings but also permits X to draw up to ten checks a month against the account. X's Bank suggests an arrangement under which X establishes four savings deposits at Bank. Under the arrangement, X deposits funds in the first account and then draws three checks against that account. X then instructs Bank to transfer all funds in excess of the amount of the three checks to the second account and draws an additional three checks. Funds are continually shifted between accounts when additional checks are drawn so that no more than three checks are drawn against each account each month.

(ii) The use of four savings accounts in the name of X in this example is designed solely to exceed the transfer

limitations on savings accounts. Accordingly, the savings accounts should be classified as transaction accounts.

Example (2). (i) X is trustee of separate trusts for each of his four children. X, as trustee, opens a savings deposit in a depository institution for each of his four children in order to ensure an independent accounting of the funds held by each trust.

(ii) The use of four savings deposits in the name of X in this example is appropriate, and the third party transfers from one account should not be considered in determining whether the transfer and withdrawal limit was exceeded on any other account. X established a business purpose, the segregation of the trust assets, for each account separate from the need to make third party transfers. Furthermore, there is no indication, such as by the direct or indirect transfer of funds from one account to another, that the accounts are being used for any purpose other than to make transfers to the appropriate trust.

Example (3). (i) E, an escrow company, maintains a savings deposit and a checking account at Bank. When E takes funds in escrow for its customers, E deposits the funds in the master savings deposit under an agreement by which Bank will account for the funds in a subsidiary account under the master savings deposit. Under the terms of the agreement between each customer and E, and under the applicable state law, the funds that are placed in each subsidiary account at Bank are owned by the appropriate customer. Bank pays interest in the subsidiary account, reports that information to the appropriate taxing authorities as interest earned by each customer, and records all transactions relating to the subsidiary account. When disbursements are to be made to or on behalf of a customer under the terms of the escrow agreement, E submits disbursement instructions to Bank by means of an electronic data transmission. In accordance with those instructions, Bank will transfer funds from the master savings deposit to the checking account, and will make the appropriate entries to the appropriate subsidiary account. For each subsidiary account, Bank has authorized not more than six electronic data transmission transfers to be made in a month, and E makes not more than six such transfers per month. Because E has numerous customers, however, such transfers from the master savings deposit may number in the thousands each month.

(ii) For purposes of Regulation D, the use of a master savings deposit and

subsidiary accounts in this example results in the creation of a separate savings deposit for each subsidiary account. Accordingly, the Board will look through the master savings deposit in determining whether the transfer and withdrawal limit has been exceeded. By the terms of the agreements and the applicable state law, the funds and any accrued interest belong to the customers of E, even though they are controlled by E. The subsidiary accounts were established for a specific business purpose, that is to maintain and account for the funds of each customer of E, and not for the purpose of permitting E to make excess transfers from the master savings deposit.

(e) *Procedures.* A depository institution should not assist a customer in establishing multiple savings deposits with transfer capabilities unless the customer has a legitimate purpose for the multiple accounts. Depository institutions need not attempt to determine whether depositors have multiple savings deposits by matching names or taxpayer identification numbers on existing deposit accounts or new deposit accounts where the depositor indicates that it does not have other savings deposits with that depository institution.

4. Section 204.134 is added to read as follows:

§ 204.134 Linked time deposits and transaction accounts.

(a) *Authority.* Under section 19(a) of the Federal Reserve Act, the Board is authorized to define the terms used in section 19, and to prescribe regulations to implement and prevent evasions of the requirements of that section. Section 19(b)(2) establishes general reserve requirements on transaction accounts and non personal time deposits. Under section 19(b)(1)(F), the Board also is authorized to determine, by regulation or order, that an account or deposit is a transaction account if such account is used directly or indirectly for the purpose of making payments to third persons or others.

(b) *Linked time deposits and transaction accounts.* (1) Some depository institutions are offering or proposing to offer account arrangements under which a group of participating depositors maintain transaction accounts and time deposits with a depository institution in an arrangement under which each depositor may draw checks up to the aggregate amount held by that depositor in these accounts. Under this account arrangement, at the end of the day funds over a specified balance in each depositor's transaction

account are swept from the transaction account into a commingled time deposit. A separate time deposit is opened on each business day with the balance of deposits received that day, as well as the proceeds of any time deposit that has matured that day. The time deposits, which generally have maturities of seven days, are staggered so that one or more time deposits matures each business day. Funds are apportioned among the various time deposits in a manner calculated to minimize the possibility that the funds available on any given day would be insufficient to pay all items presented.

(2) The time deposits involved in such an arrangement may be held directly by the depositor or indirectly through a trust or other arrangement. The individual depositor's interest in time deposits may be identifiable, with an agreement by the depositors that balances held in the arrangement may be used to pay checks drawn by other depositors participating in the arrangement, or the depositor may have an undivided interest in a series of time deposits.

(3) Each day funds from the maturing time deposits are available to pay checks or other charges to the depositor's transaction account. The depository institution's decision concerning whether to pay checks drawn on an individual depositor's transaction account is based on the aggregate amount of funds that the depositor has invested in the arrangement, including any amount that may be invested in unmatured time deposits. Only if checks drawn by all participants in the arrangement exceed the total balance of funds available that day—i.e. funds that are not invested in unmatured time deposits—is a time deposit withdrawn prior to maturity so as to incur an early withdrawal penalty. The arrangement may be marketed as providing the customer unlimited access to its funds with a high rate of interest.

(c) *Conclusion.* In these arrangements, the aggregate deposit balances of all participants generally vary by a comparatively small amount, allowing the time deposits maturing on any day to safely cover any charges to the depositors' transaction accounts and avoiding any early withdrawal penalties. Thus, this arrangement substitutes time deposit balances for transaction account balances with no practical restrictions on the depositors' access to their funds, and serves no business purpose other than to allow the payment of higher interest through the avoidance of reserve requirements. As the time deposits may be used to

provide funds indirectly for the purposes of making payments or transfers to third persons, the Board has determined that the time deposits should be considered to be transaction accounts for the purposes of Regulation D.

5. Section 204.135 is added to read as follows:

§ 204.135 Shifting funds between depository institutions to make use of the low reserve tranche.

(a) *Authority.* Under section 19(a) of the Federal Reserve Act (12 U.S.C. 461(a)) of the Board is authorized to define terms used in section 19, and to prescribe regulations to implement and to prevent evasions of the requirements of that section. Section 19(b)(2) establishes general reserve requirements on transaction accounts and nonpersonal time deposits. In addition to its authority to define terms under section 19(a), section 19(g) of the Federal Reserve Act also gives the Board the specific authority to define terms relating to deductions allowed in reserve computation, including "balances due from other banks."

(b) *Background.* (1) Currently, the Board requires reserves of zero, three, or twelve percent on transaction accounts, depending upon the amount of transaction deposits in the depository institution, and of zero percent on nonpersonal time deposits. In determining its reserve balance under Regulation D, a depository institution may deduct the balances it maintains in another depository institution located in the United States if those balances are subject to immediate withdrawal by the depositing depository institution (§ 204.3(f)). This deduction is commonly known as the "due from" deduction. In addition, Regulation D at § 204.2(a)(1)(vii)(A) exempts from the definition of "depository" any liability of a depository institution on a promissory note or similar obligation that is issued or undertaken and held for the account of an office located in the United States of another depository institution. Transactions falling within this exemption from the definition of "deposit" include federal funds or "fed funds" transactions.

(2) Under section 19(b)(2) of the Federal Reserve Act (12 U.S.C. 461(b)(2)), the Board is required to impose reserves of three percent on total transaction deposits at or below an amount determined under a formula. Transaction deposits falling within this amount are in the "low reserve tranche." Currently the low reserve tranche runs up to \$41.1 million. Under section 19(b)(11) of the Federal Reserve Act (12 U.S.C. 461(b)(11)) the Board is also

required to impose reserves of zero percent on reservable liabilities at or below an amount determined under a formula. Currently that amount is \$3.4 million.

(c) *Shifting funds between depository institutions.* The Board is aware that certain depository institutions with transaction account balances in an amount greater than the low reserve tranche have entered into transactions with affiliated depository institutions that have transaction account balances below the maximum low reserve tranche amount. These transactions are intended to lower the transaction reserves of the larger depository institution and leave the economic position of the smaller depository institutions unaffected. These transactions have no apparent purposes other than to reduce required reserves. The larger depository institution places funds in a demand deposit at a small domestic depository institution. The larger depository institution considers those funds to be subject to the "due from" exemption, and accordingly reduces its transaction reserves in the amount of the demand deposit. The larger depository institution then reduces its transaction account reserves by twelve percent of the deposited amount. The small depository institution, because it is within the low reserve tranche, must maintain transaction account reserves on the funds deposited by the larger depository institution at three percent. The small depository institution then transfers all but three percent of the funds deposited by the larger depository institution back to the larger depository institution in a transaction that appears to qualify as a fed funds transaction, and charges no interest, or at most, nominal interest on the transaction. The three percent not transferred to the larger depository institution is the amount of the larger depository institution's deposit that the small depository institution must maintain as transaction account reserves. Because the larger depository institution books this second part of the transaction as a fed funds transaction, the larger depository institution does not maintain reserves on the funds that it receives back from the small depository institution. As a consequence, the larger depository institution has available for its use 97 percent of the amount transferred to the small depository institution. Had the larger depository institution not entered into the transaction, it would have maintained transaction account reserves of twelve percent on that amount, and would have had only 88 percent of that amount for use in its business.

(d) *Conclusion.* The Board believes that the practice described above is a device to evade the reserves imposed by Regulation D. Consequently, the Board has determined that in the circumstances described above, the larger depository institution depository funds in the smaller institution may not take a "due from" deduction on account of the funds in the demand deposit account if, and to the extent that, funds flow back to the larger depository institution from the small depository institution by means of a transaction that is exempt from transaction account reserve requirements.

6. Section 204.136 is added to read as follows:

§ 204.136 Treatment of trust overdrafts for reserve requirement reporting purposes.

(a) *Authority.* Under section 19(a) of the Federal Reserve Act, the Board is authorized to define the terms used in section 19, and to prescribe regulations to implement and prevent evasions of the requirements of that section. Section 19(b) establishes general reserve requirements on transaction accounts and non personal time deposits. Under section 19(b)(1)(F), the Board also is authorized to determine, by regulation or order, that an account or deposit is a transaction account if such account is used directly or indirectly for the purpose of making payments to third persons or others.

(b) *Netting of trust account balances.* Not all depository institutions have treated overdrafts in trust accounts administered by a trust department in the same manner when calculating the balance in a commingled transaction account in the depository institution for the account of the trust department of the institution. In some cases, depository institutions carry the aggregate of the positive balances in the individual trust accounts as the balance on which reserves are computed for the commingled account. In other cases depository institutions net positive balances in some trust accounts against negative balances in other trust accounts, thus reducing the balance in the commingled account and lowering the reserve requirements. Except in limited circumstances, negative balances in individual trust accounts should not be netted against positive balances in other trust accounts when determining the balance in trust department transaction accounts maintained in a depository institution's commercial department. The netting of positive and negative balances has the effect of reducing the aggregate of transaction accounts reported by the

depository institution to the Federal Reserve and reduces the reserves the institution holds against transaction accounts under Regulation C. Unless the governing trust agreement or State law authorizes the depository institution, as trustee, to lend money in one trust to another trust, the negative balances in effect, for purposes of Regulation D, represent a loan from the depository institution. Consequently, negative balances in individual trust accounts should not be netted against positive balances in other individual trust accounts, and the balance in any transaction account reflecting commingled trust balances should reflect the aggregate of the positive balances for the individual trusts.

(c) *Example.* For example, where a trust department engages in securities lending activities for trust accounts, overdrafts might occur because of the trust department's attempt to "normalize" the effects of timing delays between the depository institution's receipt of the cash collateral from the broker and the trust department's posting of the transaction to the lending trust account. When securities are lent from a trust customer to a broker that pledges cash as collateral, the broker usually transfers the cash collateral to the depository institution on the day that the securities are made available. While the institution has the use of the funds from the time of the transfer, the trust department's normal posting procedures may not reflect receipt of the cash collateral by the individual account until the next day. On the day that the loan is terminated, the broker returns the securities to the lending trust account and the trust customer's account is debited for the amount of the cash collateral that is returned by the depository institution to the broker. The trust department, however, often does not liquidate the investment made with the cash collateral until the day after the loan terminates, which normally causes a one day overdraft in the trust account. Regulation D requires that, on the day the loan is terminated, the depository institution regard the negative balance in the customer's account as zero for reserve requirement reporting purposes and not net the overdraft against positive balances in other accounts.

(d) *Procedures.* In order to meet the requirements of Regulation D, a depository institution must have procedures to determine the aggregate of trust department transaction account balances for Regulation D on a daily basis. The procedures must consider only the positive balances in individual trust accounts without netting negative

balances except in those limited circumstances where loans from one trust to another or offsetting is permitted pursuant to trust law or written agreement.

By order of the Board of Governors of the Federal Reserve System, April 12, 1991.

William W. Wiles,

Secretary of the Board.

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