

FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 8271]
February 8, 1978]

AUTOMATIC TRANSFERS OF FUNDS
FROM SAVINGS ACCOUNTS TO CHECKING ACCOUNTS

Revised Proposal To Amend Regulation Q

*To All Member Banks, and Others Concerned,
in the Second Federal Reserve District:*

Following is the text of a statement issued February 2 by the Board of Governors of the Federal Reserve System:

The Board of Governors of the Federal Reserve System today issued for comment a revised proposal to permit the automatic transfer of funds from an individual's savings account to the depositor's checking account to cover checks drawn by the depositor or to ensure a minimum balance in the depositor's checking account.

Comment should be received by the Board by March 20.

The proposal revises an earlier proposal made in March of 1976 in two main respects; namely, the minimum forfeiture of interest would be the amount earned in the previous 30 days and no minimum amount for transfer would be required.

The proposed new service would be available only to individuals — not to businesses or governments — and would be entirely voluntary. Depositors could not be required to enter into automatic transfer agreements nor could such transfers be made unless previously authorized by the depositor.

The proposal is aimed at increasing the convenience and efficiency of savings accounts and lowering the cost — both to individual depositors and to the public — of making payments by check. Banks usually charge depositors a substantial fee when it is necessary to return checks written on accounts with insufficient funds. Also, the Federal Reserve System incurs additional costs when such checks are presented to it for clearance because they involve hand processing and multiple handling.

The difference in cost to individual depositors would be the difference between the charge made by the customer's bank for a returned check — generally several dollars — and forfeiture of interest, which would normally be substantially less. The proposed transfer service would be an alternative to plans that protect depositors from overdrafts by automatic extensions of credit by their bank.

Depositors who entered into automatic transfer agreements with their bank would avoid the embarrassment and cost of having checks "bounce." Merchants and others to whom such checks are written would likewise avoid embarrassment and expense.

The proposed new service would be added to two other services previously authorized by the Federal Reserve to increase banking convenience to the public. These permit customers to withdraw or transfer funds from savings accounts at member banks by telephoned instructions and authorize member banks to pay bills for their customers according to a plan preauthorized by the customer.

The proposal announced by the Board today would end a current prohibition in Regulation Q — payment of interest on deposits — against automatic transfers from savings deposits.

Under the proposal, a member bank and an individual depositor, acting voluntarily, would agree on a plan authorizing the bank to draw upon the customer's savings account in the bank to cover checks written, or to keep funds in the customer's checking account from falling below a certain level.

The proposal has two features not in the previous proposal:

1 — The minimum forfeiture of interest would be the amount actually earned during the previous 30 days. The earlier proposal would have required forfeiture of 30 days' interest on the amount transferred from

a savings account to a checking account. This would have resulted in an interest penalty even where no interest had actually been earned during the 30 days before the funds were transferred.

The Board does not believe that such transfers should result in an interest penalty greater than the amount of interest actually earned on the funds transferred. Consequently, the rule as now proposed would require forfeiture of interest amounting to no more than interest actually earned on the amount transferred during the 30 days before the transfer. This would include interest accrued but not yet paid, or credited to an account.

If no interest had been earned during that 30 days — where, for example, a bank pays interest only on funds left with it for at least a quarter — no interest would be forfeited. Further, if the funds had been on deposit for less than 30 days the interest forfeited would be no more than the amount earned during the time the funds were on deposit.

Thus, the amount of interest forfeited on funds transferred from a savings account would depend on the rules of the depositor's bank. The text of the Board's proposal provided five examples of how interest forfeiture could be calculated under different sets of rules and circumstances. These showed interest penalties on transfers of amounts up to \$200 ranging from zero to 84 cents.

The Board requested comment on whether there should be any interest penalty.

2—The revised proposal does not require a minimum amount for transfer. The earlier proposal would have permitted transfers only of \$100 or multiples of \$100.

The Board said it anticipated deferring the effective date of the proposed revision of Regulation Q for 60 days after the date of adoption, and requested comment as to whether this would be sufficient time for member banks to advertise the new service and make operational adjustments.

The proposed amendment to Regulation Q would not affect existing arrangements under which thrift institutions agree with their customers to transfer funds automatically, or as otherwise specified by the customer, to the customer's checking account at a commercial bank.

Printed below is the text of the revised proposal. Comments thereon should be submitted by March 20, and may be sent to our Consumer Affairs and Bank Regulations Department.

PAUL A. VOLCKER,
President.

[Reg. Q]

PART 217 — INTEREST ON DEPOSITS

(Docket No. R-0027)

Automatic Transfers of Savings Deposits

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Proposed rule.

SUMMARY: This proposed rule would permit member banks to arrange with their depositors for the automatic transfer of funds from depositors' savings accounts to their demand deposit (checking) accounts to cover checks drawn by depositors or to replenish depositors' checking accounts. Such transfers are now prohibited by Board regulations. The proposed transfer service rule is entirely voluntary; member banks could not require depositors to accept the service, and automatic transfers could not be made unless previously authorized by the depositor. The

proposed automatic transfer service would be available only to individuals and not to business organizations or governmental units. Comments on the proposal may be submitted until March 20, 1978. The proposed amendment is intended to increase the efficiency of the Federal Reserve's check clearing operations and provide depositors with added customer convenience.

DATE: Comments must be received by March 20, 1978.

ADDRESS: Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551. All material submitted should include the Docket Number R-0027.

FOR FURTHER INFORMATION, CONTACT: Allen L. Raiken, Associate General Counsel, Legal Division, Board of Governors of the Federal Reserve System, Washington, D.C. 20551, telephone (202) 452-3625.

SUPPLEMENTARY INFORMATION: In March, 1976, the Board solicited comments on a proposed amendment to Regulation Q to permit member banks to provide their depositors with the automatic transfer of savings deposits to cover checks drawn by depositors on their demand deposit (checking) accounts or to replenish their demand deposit accounts (41 FR 12039). The Federal Deposit Insurance Corporation proposed a similar amendment to its regulations applicable to Federally insured banks that are not members of the Federal Reserve System.

On April 29, 1976 the Board issued a clarification of the proposal indicating that the automatic transfer service would be completely voluntary and that depositors could not be required to obtain the service (41 FR 18523). Similarly, member banks would not be authorized to transfer a depositor's funds from a savings account unless the depositor voluntarily had entered into an agreement previously with the bank specifically authorizing the transfer service. This provision, however, would not affect the ability of a member bank to use a depositor's savings deposit in satisfaction of a debt where the bank is authorized to do so under local law.

The automatic transfer service is intended to increase the efficiency of the Federal Reserve's check clearing operations by reducing the number of return items processed by the System as well as to provide depositors with the convenience of a deposit transfer service that would be available in addition to the telephone and bill payment transfer services that member banks currently are authorized to offer to depositors. This service would provide an alternative to existing procedures where there are insufficient funds in depositors' checking accounts. Generally, if a customer's check is presented to the bank and there are insufficient funds in the customer's checking account the check is returned to the payee with the term "insufficient funds" indicated on the check. As a result, the bank usually charges a fee to the customer when it is necessary to return these checks. As an alternative to returning checks, many banks currently advance funds to customers in accordance with overdraft loan agreements. Under such overdraft loan agreements, depositors usually incur interest charges on the funds advanced.

The Board is of the view that the costs incurred by consumers, banks, merchants, other businessmen, and the Federal Reserve System, because of the existence of return items, can be reduced as a result of the proposed automatic transfer amendment. Because of the special handling procedures required to process customer overdrafts, many banks impose a substantial charge to their customers for checks and drafts that

must be returned because of insufficient funds. The existence of return items also has a substantial effect upon the speed and efficiency of the check clearing operations of the Federal Reserve System. As a result, the Federal Reserve System incurs a substantial expense in the handling of returned checks and drafts. The Board's proposed amendment is intended to permit an alternative to the existing practice of returning checks and drafts drawn on insufficient funds. The Board believes that the proposed amendment represents a reasonable accommodation that may be offered by member banks to their depositors in order to reduce the likelihood that depositors' checks will be returned to the presenting parties because of insufficient funds in depositors' checking accounts. It is anticipated that the proposed service would reduce the number of checks that are returned through the check clearing operations of the banking system, thereby resulting in substantial savings for all parties concerned.

This proposed amendment would not affect existing arrangements whereby a thrift institution has agreed with its customer to transfer funds automatically or otherwise to the customer's demand deposit account at a commercial bank in accordance with a pre-authorized agreement. Transfers of funds from a thrift institution to a commercial bank would not be subject to the proposed minimum interest penalty forfeiture provision.

In view of the comments received in response to the Board's previous automatic transfer proposal, the Board has modified the proposed amendment and again requests public comment on the proposed automatic transfer service. Under the proposed amendment, member banks could make the proposed transfer service available only to individuals, and not to business organizations, governmental units or other organizations.

The proposed amendment reflects two additional modifications from the proposal originally announced by the Board. The proposal does not require a minimum denomination for funds that may be transferred pursuant to this proposed amendment. As originally proposed, the amendment would have required that transfers be made in multiples of no less than \$100. The Board believes that a minimum transfer amount requirement may unduly penalize depositors that may incur overdrafts in amounts less than the required minimum denomination resulting in a transfer from savings of more than the amount needed to cover the check or to replenish the account. The Board believes therefore, that it may be inappropriate to establish a requirement that could result in a transfer of more than the amount necessary to cover the check, especially since member banks would be required to impose an interest penalty as described below. Nothing in the proposal, however, would prohibit a member bank from establishing minimum transfer amounts if they so desired in view of internal bank operational procedures.

The second modification relates to the minimum amount of interest that must be forfeited by the depositor on funds transferred. As originally proposed, a depositor would have been required to forfeit a minimum of 30 days' interest on the funds transferred. Depositors, therefore, would have incurred an interest penalty even if no interest actually had been earned during the previous 30 days on the funds transferred. The Board believes it is unnecessary to require a minimum interest penalty that may result in forfeiture of an amount that is more than the amount of interest actually earned on the funds transferred during the previous 30 day period. Consequently, the amendment proposed by the Board would require a forfeiture of interest in an amount no less than the amount of interest *actually earned* during the previous 30 days on the funds that are transferred from savings to checking. Public comment also is requested on whether any interest forfeiture should be required.

Interest actually earned during the previous 30 days would include interest that has been accrued but not yet paid (credited to the account or paid to the depositor or other party) as well as interest that had been paid on the funds transferred.

Member banks would continue to be required to reserve the right to impose at least a 30-day notice period on intended withdrawals of savings deposits as presently required in § 217.1(e) of Regulation Q.

Under the terms of the proposed amendment, if in accordance with the bank's usual methods of computing interest, no interest has been earned on the funds on deposit during the previous 30 day period, no interest need be forfeited if funds are transferred automatically to cover checks. Similarly, if the funds transferred had been on deposit for less than 30 days, only the amount of interest earned for the period of time the funds had been on deposit need be forfeited. It is recognized that application of this forfeiture requirement may result in forfeiture of varying amounts of interest based on differences in bank rules regarding computing and calculating interest. For example, a bank's use of the last-in, first-out method in determining which deposits are being transferred could alter the minimum penalty amount that must be imposed. The following are examples of how the required penalty provision may be applied:

Example 1.

Bank pays interest on savings deposits at an annual rate of 5 per cent from day of deposit to day of withdrawal. Interest is credited quarterly. Depositor establishes a new savings account and deposits \$500 on January 1. On February 28, bank transfers \$100 from savings to demand to cover depositor's overdraft. The minimum interest forfeiture required is \$0.42, which represents 30 days' interest earned on the funds transferred.

Example 2.

Same facts as Example 1 except bank transfers \$100 on January 15 to cover overdraft. Minimum forfeiture

required is \$0.21, which represents 15 days' interest earned on the funds transferred.

Example 3.

Same facts as Example 1 except bank computes interest quarterly, and no interest is paid on funds withdrawn prior to the end of a calendar quarter. No interest forfeiture is required since under the bank's rules no interest was actually earned during the previous 30 days on the funds transferred.

Example 4.

Bank pays interest at an annual rate of 5 per cent from day of deposit to day of withdrawal and uses the last-in, first-out method in computing interest. The depositor deposits \$500 into the savings account on January 1 and deposits an additional \$100 on February 1. Bank transfers \$200 from the depositor's savings account to his checking account to cover overdrafts on February 15. The minimum interest forfeiture required is \$0.63 which is determined as follows: Since the \$100 deposit of February 1 had only been on deposit for 15 days, the depositor need only forfeit a minimum of \$0.21, which represents the actual interest earned on the \$100 during the 15 day period it remained on deposit. The depositor is required to forfeit at least \$0.42 on the remaining \$100 that has been transferred. This amount represents 30 days' interest earned on those funds.

Example 5.

Same facts as Example 4. However, bank uses first-in, first-out method in computing interest. Under those circumstances, the depositor is required to forfeit minimum interest of \$0.84, which is computed as follows: Since the funds transferred are deemed to be those that were deposited first, the depositor actually earned interest on the \$200 transferred for the entire 30 days prior to the date of transfer. Consequently, the depositor is required to forfeit a minimum of \$0.84, which represents the actual interest earned on the funds transferred during the previous 30 day period.

Member banks would be required to maintain data on fund transfers via the automatic transfer service in a manner that will facilitate data collection by the Board.

To aid in the consideration of this matter by the Board, interested persons are invited to submit relevant data, views, or comments. Any such material should be submitted in writing to the Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551, to be received by March 20, 1978. All material submitted should include the Docket Number R-0027. Such material will be made available for inspection and copying upon request except as provided in section 261.6(a) of the Board's Rules Regarding Availability of Information (12 CFR § 261.6(a)).

If, after consideration of the comments received, the Board adopts the proposed amendment, it is anticipated that it would not become effective for a period of at least 60 days following adoption. Public comment is requested on whether a 60 day deferred effective date is sufficient to provide member banks with time to implement operational and marketing procedures necessary to offer the service to depositors.

Pursuant to its authority under § 19 of the Federal Reserve Act (12 U.S.C. §§ 461, 371b), the Board of Governors proposes to amend § 217.5(c) of Regulation Q (12 CFR 217.5(c)) as follows:

SECTION 217.5 — WITHDRAWAL OF SAVINGS DEPOSITS

* * * * *

(c) Manner of payment of savings deposits.

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(2) ***However, withdrawals may be permitted by a member bank to be made automatically from a savings deposit that consists of funds deposited to the credit of and in which the entire beneficial interest is held by one or more individuals through payment to the bank itself or through transfer of credit to a demand or other deposit account of the same depositor pursuant to an agreement between a member bank and its depositor that authorizes such payments or transfers in order to cover checks or drafts drawn by the depositor upon the bank; provided, the depositor shall forfeit an amount no less than the amount of interest actually earned during the previous 30 days on the funds withdrawn and transferred from a savings deposit in the manner described. In accordance with § 217.1(e)(2) of this Part, a member bank must reserve the right to require the depositor to give notice in writing of an intended withdrawal not less than 30 days before such withdrawal is made and may not require a depositor to enter into an agreement providing for such automatic transfer of savings deposits.