

**FEDERAL RESERVE BANK
OF NEW YORK**

[Circular No. **9381**
October 13, 1982]

TEMPORARY AMENDMENT TO REGULATION D
Reserve Requirements on Certain Time Deposits Linked to Lines of Credit

*To All Depository Institutions in the Second
Federal Reserve District, and Others Concerned:*

Following is the text of a statement issued October 7, 1982 by the Board of Governors of the Federal Reserve System:

The Federal Reserve Board today made time deposits linked to a line of credit on which checks or similar third party transfers can be drawn subject to the reserve requirements of transaction accounts.

The Board made the rule — a temporary amendment to Regulation D, Reserve Requirements of Depository Institutions — effective immediately, but requested comment on the technical aspects of the rule pending adoption on a permanent basis.

The Board asked for comment by December 3, 1982.

The ruling affects a growing number of arrangements being offered by depository institutions whereby depositors maintaining time deposits are able to obtain a loan — secured by the time deposit — by means of writing a check or similar draft provided by the institution as part of the arrangements establishing the time deposit. The Board regards such arrangements as circumventing the reserve requirements of Regulation D and the regulations of the Depository Institutions Deregulation Committee.

Reserve requirements for transaction and time deposits are spelled out in the attached notice of the Board's actions. In general, transaction accounts are subject to a reserve requirement of 12 percent, and those time deposits held by other than individuals are subject to a 3 percent reserve requirement.

Enclosed is a copy of the text of the amendment to Regulation D, effective October 5, 1982, which includes an explanation of the Board's action and request for comment.

Comments on the amendment, which is being adopted on a temporary basis by the Board in order to allow for a comment period on the technical aspects of the ruling, should be submitted by December 3, 1982, and may be sent to our Consumer Affairs and Bank Regulations Department. Questions regarding the amendment may also be directed to that Department (Tel. No. 212-791-5914).

ANTHONY M. SOLOMON,
President.

Board of Governors of the Federal Reserve System

RESERVE REQUIREMENTS OF DEPOSITORY INSTITUTIONS

AMENDMENT TO REGULATION D

(effective October 5, 1982)

TRANSACTION ACCOUNTS

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Temporary rule; request for public comment.

SUMMARY: The Board of Governors is adopting a temporary amendment to Regulation D--Reserve Requirements of Depository Institutions (12 CFR Part 204) to define as transaction accounts, time deposits issued in connection with an agreement that permits the depositor to obtain credit, directly or indirectly, through the drawing of a check, draft or similar device on the issuing institution that can be used for the purpose of making payments or transfers to third persons or others. Accordingly, these deposits are subject to transaction account reserve requirements. The Board also requests public comment on the technical aspects of this rule prior to its permanent adoption. The Board also determined that in making a loan to a depositor upon the security of his or her time deposit, a member bank must charge 1 per cent above the annual effective rate being paid on the time deposit.

EFFECTIVE DATE: October 5, 1982. Comments must be received by December 3, 1982.

ADDRESS: Comments, which should refer to Docket No. R-0424, 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, or should be delivered to room B-2223 between 8:45 a.m. and 5:15 p.m. Comments may be inspected in room B-1122 between 8:45 a.m. and 5:15 p.m. except as provided in section 261.6(a) of the Board's Rules Regarding Availability of Information (12 CFR 261.6(a)).

FOR FURTHER INFORMATION CONTACT: Gilbert T. Schwartz, Associate General Counsel (202/452-3625), Paul S. Pilecki, Senior Attorney (202/452-3281), or Beverly A. Belcamino, Legal Assistant (202/452-3623), Legal Division, Board of Governors of the Federal Reserve System, Washington, D. C. 20551.

For this Regulation to be complete, retain:

- 1) Regulation D, pamphlet, amended effective December 31, 1981.
- 2) Amendments effective April 28, April 29, and September 1, 1982.
- 3) This slip sheet.

SUPPLEMENTARY INFORMATION: The Monetary Control Act of 1980 ("MCA") (Title I of P.L. 96-221; 94 Stat. 132) defines "transaction account" as a deposit or account on which the depositor or account holder is permitted to make payments or transfers to third persons or others (12 U.S.C. § 461(b)(1)(C)). The Board is empowered to determine that deposits or accounts are transaction accounts for reserve requirement purposes if such accounts may be used to provide funds directly or indirectly for the purpose of making payments or transfers to third persons or others (12 U.S.C. § 461(b)). The Board's Regulation D currently defines "transaction account" as "a deposit or account on which the depositor or account holder is permitted to make withdrawals by negotiable or transferable instrument, payment orders of withdrawal, telephone transfers, or other similar device for the purpose of making payments or transfers to third persons or others." (12 CFR § 204.2(e)).

Several depository institutions have recently begun issuing complex time deposit arrangements involving a line of credit that may be accessed by checks drawn on the issuing institution that are payable to third parties. These arrangements have the effect of allowing depositors to earn market rates of interest on funds that may be used for third party payments. The Board believes that these circuitous arrangements both circumvent transaction account reserve requirements under Regulation D since they convert longer term time deposits into deposits that properly should be regarded as transaction accounts, and evade the intent of the interest rate limitations established by the Depository Institutions Deregulation Committee ("DIDC") as part of the phaseout of interest rate ceilings mandated by the Depository Institutions Deregulation Act of 1980 ("DIDA") (Title II of P.L. 96-221; 94 Stat. 132). The Board believes that it is inappropriate for depository institutions to attempt to circumvent Regulation D requirements with arrangements such as those described. Fairness to all depository institutions and orderly administration of the interest rate ceiling phaseout require the Board to take this regulatory action. Consequently, in order to carry out the purposes of the MCA and DIDA and to maintain the distinction between transaction accounts and time deposits, the Board has determined to regard the arrangements described above as transaction accounts and subject them to Regulation D reserve requirements. Currently, all time deposits, as defined in section 204.2(c) of Regulation D (12 CFR § 204.2(c)(1)) are subject to no basic reserve requirements if they are personal time deposits, to a 3 per cent reserve requirement if they are nonpersonal time deposits with a maturity of less than 3-1/2 years, and to a zero per cent reserve requirement if they are nonpersonal time deposits with a maturity of 3-1/2 years or more.

In this connection, the Board notes that the legislation that was recently passed by Congress requiring the DIDC to authorize depository institutions to offer an account that is directly competitive with money market mutual funds should assist banks and thrifts in achieving their objectives in a manner consistent with applicable law and regulation.

Transaction account reserve requirements will be applicable to time deposits issued in connection with an arrangement that permits the depositor to obtain credit by check, draft, nonnegotiable order or instruction or similar device that is used to make payments or transfers to third persons or others, or to a deposit account of the depositor. The Board has also determined that it is appropriate to grandfather the balances in depository institutions for those time deposits subject to arrangements established before October 5, 1982. However, if the deposit maintained in connection with the line of credit is extended, or matures and is renewed, the funds will become subject to transaction account reserve requirements. This amendment does not effect the ability of a depositor to use his or her time deposit as collateral for a loan transaction that does not involve the use of a credit line on which checks or similar instruments may be drawn.

The Board is requesting comment until December 3, 1982, on whether any additional arrangements should be covered by this amendment and whether any arrangements should be eliminated from the scope of the amendment before it is adopted in final form.

Some of these arrangements are structured using a loan secured by a time deposit. Section 217.4(f) of Regulation Q (12 CFR § 217.4(f)) provides that a member bank may make a loan to a depositor upon the security of his time deposit as long as the interest rate on the loan is at least one per cent above the rate being paid on the time deposit. However, these arrangements may provide for interest on the loan to be charged at 1 per cent over the annual simple rate being paid on the deposit when the effective rate on the deposit is higher due to the effects of compounding. For example, a 12 per cent annual simple rate being paid on a deposit yields an annual effective rate of 12.935 per cent with daily compounding on a 365/360 basis. In order to preserve the effectiveness of § 217.4 of Regulation Q, the Board has determined that the interest rate charged on a loan secured by a time deposit must be at least 1 per cent above the effective rate paid on the time deposit, taking into account the effects of compounding. The Board has been advised that a similar position has been adopted by the Federal Deposit Insurance Corporation and the Federal Home Loan Bank Board.

The impact of this proposal on small entities has been considered in accordance with section 604 of the Regulatory Flexibility Act (5 U.S.C. § 604; Pub. L. 96-354). The Board has deferred deposit reporting and reserve requirements for small nonmember banks and thrift institutions in view of pending legislation that would give small depository institutions a permanent exemption from reserve requirements. Finally, no new recordkeeping or reporting requirements will be imposed as a result of the proposal.

To aid in consideration of this matter by the Board, interested persons are invited to submit relevant data, views, comment or argument. All 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 December 3, 1982. All material submitted should include the Docket No. R-0424. 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)).

List of Subjects in 12 CFR Part 204

Banks, banking; Currency; Federal Reserve System; Penalties; Reporting requirements.

Pursuant to its authority under section 19(b) of the Federal Reserve Act (12 U.S.C. § 461(b)), effective October 5, 1982 the Board amends Regulation D (12 CFR Part 204) by revising paragraph (e) of section 204.2 to read as follows:

SECTION 204.2--DEFINITIONS

* * * * *

(e) * * *

(4) deposits or accounts in which payments may be made to third parties by means of an automated teller machine, remote service unit or other electronic device;

(5) deposits or accounts in which payments may be made to third parties by means of a debit card;

(6) deposits or accounts under the terms of which, or which by practice of the depository institution, the depositor is permitted or authorized to make more than three withdrawals per month for purposes of transferring funds to another account or for making a payment to a third party by means of preauthorized or telephone agreement, order or instruction. An account that permits or authorizes more than three 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 three such withdrawals actually are made during such period. 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. An account is not a "transaction account" by virtue of an arrangement that permits withdrawals for the purpose of repaying loans and associated expenses at the same depository institution (as originator or servicer); and

(7) deposits or accounts maintained in connection with an arrangement that permits the depositor to obtain credit directly or indirectly through the drawing of a negotiable or nonnegotiable check, draft, order or instruction or other similar device (including telephone or electronic order or instruction) on the issuing institution that can be used for the purpose of making payments or transfers to third persons or others, or to a deposit account of the depositor. Deposits that were established before October 5, 1982, subject to arrangements will not be regarded as transaction accounts until the deposit issued in connection with the line of credit is extended, or matures and is renewed.

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By order of the Board of Governors, October 6, 1982.

(signed) William W. Wiles

William W. Wiles
Secretary of the Board

[SEAL]