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Via Electronic Delivery

Jennifer J. Johnson
Secretary of the Board
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington D.C. 20051

Re: Docket No. R-1307: Reserve Requirements of Depository Institutions

Ladies and Gentlemen:

We are pleased to comment on the Board of Governors' (the "Board's") proposed amendments to Regulation D, Reserve Requirements of Depository Institutions.[1] Schwartz & Ballen LLP is a financial services law firm that provides advice to depository institutions regarding the effect of Regulation D on products and services they offer to customers. Accordingly, we have a keen interest in the Board's the proposed amendments and their impact on depository institutions.

In summary, we believe that a change should be made to the language of the proposed "clarification" of the early withdrawal penalty to avoid an unintended effect on time deposit open accounts ("TDOAs"). While we support the increase in the number of withdrawals that may be made by checks or debit card to six per month, we believe that the Board should increase the number to at least eight per month. We also urge the Board not to incorporate detailed guidance as to what constitutes vault cash. Finally, we believe that the Board should not change the current policy that directs Reserve banks to waive the penalty charge once during a two-year period for any reserve deficiency that does not exceed a certain percentage of the depository institution's required reserves.

EARLY WITHDRAWAL PENALTY AND TDOAS

Summary

The Board's proposed amendment to the definition of "time deposit"' to clarify the application of early withdrawal penalties when there has been more than one partial

[1] 73 *Fed. Reg.* 8009 (February 12, 2008).

early withdrawal from a time deposit will have an unintended adverse effect on depository institutions that use TDOAs as repositories for the temporary investment of funds maintained by trust departments in the institutions' commercial departments.
In order to preserve the ability of depository institutions to continue to use TDOAs for the benefit of trust customers, we recommend that the Board modify the proposed amendment by retaining the word "early" in the second sentence of § 204.2(c)(1)(i) of Regulation D. As a result, the second sentence of § 204.2(c)(1)(i) of Regulation D should be amended to read as follows:

> A time deposit from which partial **early** withdrawals are permitted within six days after the date of the last withdrawal must impose early withdrawal penalties of at least seven days' simple interest on amounts so withdrawn. (Emphasis added.)

If the Board is not inclined to change the language of Regulation D, it should, at a minimum, indicate in the *Federal Register* preamble to the final rules that the Board's clarification does not require imposition of an early withdrawal penalty when funds are withdrawn from a TDOA so long as the funds that are withdrawn have been on deposit for at least seven days. Either of these actions will ensure that the Board's proposed change to Regulation D does not have the unintended consequence of requiring the imposition of an early withdrawal penalty on balances in a TDOA every time a withdrawal is made from the account before seven days has elapsed from the previous withdrawal.

Discussion

Regulation D currently provides that an early withdrawal penalty must be imposed on any amount withdrawn from a time deposit "from within six days after the date of deposit." If part of the time deposit is withdrawn within six days after the date of the initial deposit, an early withdrawal penalty must be imposed on the amount withdrawn. In addition, § 204.2(c)(1(i) of Regulation D provides as follows:

> A time deposit from which partial **early** withdrawals are permitted must impose **additional** early withdrawal penalties of at least seven days' simple interest on amounts withdrawn within six days after each partial withdrawal. (Emphasis added.)

The Board proposes to clarify that withdrawals from a time deposit cannot be made more frequently than every seven days unless a penalty of at least seven days' simple interest is imposed on the amount withdrawn. To accomplish this clarification, the Board proposes to remove the words "early" and "additional" in the second sentence of the definition of "time deposit" in § 204.2(c)(1)(i), as indicated in boldface above. The Board also proposes to "clarify" that withdrawals that are made within six days of the last withdrawal are also early withdrawals, and therefore are subject to an early withdrawal penalty.

We believe that this proposed "clarification" is not consistent with prior Board determinations with regard to TDOAs because it requires the imposition of an early withdrawal penalty on funds maintained in TDOAs when such funds are withdrawn within six days of a prior withdrawal from the account even though the funds withdrawn have been on deposit for at least seven days. Such a result would destroy the ability of depository institutions to use TDOAs for legitimate purposes relating to temporary investments of trust balances.

As the Board is aware, TDOAs are deposits with respect to which there is in force a written contract with the depositor that neither the whole nor any part of the deposit may be withdrawn prior to the date of maturity, which shall not be less than seven days after the date of deposit, or prior to the expiration of the notice period which must be given by the depositor in writing not less than seven days in advance of withdrawal.[2]

In 1991, the Board proposed to amend the Regulation D early withdrawal penalty as applied to amounts withdrawn from a time deposit within the first six days after deposit.[3] The Board proposed that the six-day period run from the date of last deposit into the account rather than the date that the deposit was initially deposited into the account. As a result, depository institutions would have been required to apply a last-in first-out ("LIFO") approach rather than a first-in first-out ("FIFO") approach to determining what constitutes an early withdrawal.[4] After receiving public comments opposed to the proposal, the Board concluded to retain the use of the FIFO method.[5] In its announcement, the Board stated as follows:

> One type of time deposit, known as a "time deposit open account," does not have a stated maturity and may be payable any time after the expiration of a specified time not less than seven days after the date of deposit. See 12 C.F.R. 204.2(c)(1)(i)(A). 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. . . . Depository institutions have asked whether the six-day period runs from the date of the last deposit or the date that an amount corresponding to the amount of the withdrawal was initially deposited. Under a 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. Such withdrawals would not be subject to an early withdrawal penalty . . .

[2] Instructions for the Report of Transaction Accounts, Other Deposits and Vault Cash (FR 2900) at 83.
[3] 56 *Fed. Reg.* 15522 (April 17, 1991).
[4] 56 *Fed. Reg.* at 15524-5.
[5] 57 *Fed. Reg.*38417 (August 25, 1992).

> Four commenters contended that the proposal would freeze funds in the accounts and would be inconsistent with the expectation of customers that the customers can have access to their funds as long as an amount equal to the amount withdrawn had been on deposit for six days. Another commenter claimed that that the proposal would preclude the use of time deposits for investing idle trust funds. . . [T]he Board wishes to avoid imposing unnecessary costs on depository institutions that do not use time deposits for this purpose. Accordingly, the Board is not adopting the proposed amendment at this time.[6]

As evidenced from prior regulatory proposals and final actions, the Board recognizes the importance of TDOAs to depository institutions. TDOAs provide a convenient method for trust departments to aggregate funds of their customers and invest them for short periods. Depository institutions require that each deposit into a TDOA remain on deposit for at least seven days, and that the trust department provide a notice of withdrawal at least seven days prior to withdrawal. Accordingly, a trust department may withdraw a portion of the balance from a TDOA as frequently as every day without penalty as long as the trust department has provided a notice of withdrawal at least seven days in advance of the withdrawal or if the funds have matured.

The Board's proposed amendment to Regulation D would have the effect of requiring that when a portion of the balance of a TDOA is withdrawn, the remaining balance in the TDOA must re-age and remain on deposit for at least seven days from the date of the last withdrawal before a penalty-free withdrawal of all or a portion of the remaining balance may be made. It is difficult to believe that the Board intended for depository institutions to restart a seven-day clock for the balance in a TDOA. Such a result would be inconsistent with the Board's previous statements as well as the banking industry's long-standing use of TDOAs for the temporary investment of trust balances as well as the industry's understanding of how the early withdrawal penalty applies to TDOAs. Accordingly, we recommend that the Board amend the second sentence of § 204.2(c)(1)(i) of Regulation D to read as follows:

> A time deposit from which partial **early** withdrawals are permitted within six days after the date of the last withdrawal must impose early withdrawal penalties of at least seven days' simple interest on amounts so withdrawn. (Emphasis added.)

TRANSFERS FROM SAVINGS DEPOSITS

The Board proposes to permit depositors to make up to six withdrawals per month from a savings deposit by checks or debit cards. We believe that the Board's proposal makes a great deal of sense. Eliminating the distinction between checks and debit cards and other types of "convenient" transfers will end depositor confusion. Depositors find it

[6] 57 *Fed. Reg.* at 38424.

to understand the reasons for the distinction between checks, debit cards and other types of automatic or preauthorized withdrawals. The confusion is compounded further by the fact that depositors may make unlimited withdrawals from savings accounts via use of ATMs.

However, we do not believe that that proposal goes far enough. As the Board is aware, the purpose of the six "convenient" withdrawals per month limitation is to distinguish savings deposits from transaction accounts. We recommend that the Board increase the number of "convenience" withdrawals to at least eight per month, and perhaps more.[7] This would provide greater convenience to depositors by permitting them to make two withdrawals each week from savings accounts via "convenient" methods.

Moreover, we do not believe that a modest increase to at least eight "convenient" withdrawals per month will jeopardize the distinction between savings accounts and transaction accounts. In this regard, eight withdrawals per month is well below the average number of withdrawals consumers make for transactions purposes. According to the Board staff, consumer households write 19 checks per month on average.[8] When withdrawals via other convenient methods are included (debit card, preauthorized transfers, bill payment and telephone transfers), it is readily apparent that the number of monthly withdrawals consumers make from their transaction accounts (*e.g.*, demand deposit or NOW accounts) on average each month is well in excess of eight. This provides ample support that a modest increase in the number of permissible withdrawals from savings accounts to at least eight per month would not blur the distinction between transaction and time deposits, nor undermine the integrity of the monetary aggregates. Accordingly, we request that the Board increase the number of permissible withdrawals by "convenient" methods to at least eight per month.

DEFINITION OF VAULT CASH

While we understand the Board's desire to address the issue of what constitutes vault cash for purposes of Regulation D, we believe that it is inappropriate to incorporate into the regulation the requirement that currency and coin must be received by the depository institution no later than 4 p.m. the same day the cash is requested or that the delivery plan must be evidenced by written contractual arrangements.

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[7] We believe that the Board could increase the number of permissible monthly withdrawals without seeking additional public comment. The increase in the number of withdrawals is a logical outgrowth of the Board's seeking comment on increasing the number of withdrawals by check or debit card, and therefore is reasonably foreseeable. Courts permit agencies to adopt changes to regulatory proposals if the final rule is a "logical outgrowth" of the proposed rule. *Long Island Care at Home, Ltd .v. Evelyn Coke*, 127 S. Ct. 2339, 2351 (2007); *South Terminal Corp. v. EPA*, 504 F.2d 646,659 (1st Cir. 1974); *National Mining Association v. Mine Safety and Health Administration*, 512 F.3d 696 (2008).

[8] "The Use of Checks and Other Noncash Payment Instruments in the United States," 2002 *Fed. Res. Bull.* 360, 364.

Choosing 4 p.m. as a cut-off hour seems rather arbitrary in particular because, as the Board is aware, depository institutions often conduct business hours well past 4 p.m. In addition, depositors may make cash withdrawals via ATMs and POS terminals well into the evening hours. Because cash received by a depository institution long after 4 p.m. can be made available to meet depositors' demands, we see no reason why any particular hour should be specified in Regulation D. All that should be required is that the bank take physical possession the cash the same calendar day without specifying a particular time.

In addition, a requirement for written contractual arrangements imposes an unwarranted burden on depository institutions. Such a condition in the rule would require depository institutions to undertake formal arrangements that will be costly notwithstanding the fact that such arrangements will likely never be used. Constantly updating the agreement as offices are opened and closed will impose unnecessary expenses on depository institutions. A better approach is to leave the particular details of the delivery arrangement up to the institution and not lock the Board into a concrete rule that cannot be modified in the future as circumstances evolve without the need for formal rulemaking.

WAIVER OF RESERVE DEFICIENCIES

Section 204.7(a)(2(i) of Regulation D currently provides as follows:

> 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.

The Board proposes to eliminate this provision purportedly to avoid the implication that Reserve Banks must waive charges in certain of the cases described.[9] But that is precisely the point. It has been a long-standing Board policy set forth in Regulation D that a Reserve Bank is to waive a reserve deficiency penalty charge once during a two-year period for any deficiency that does not exceed a certain percentage of the depository institution's required reserves. It is highly inappropriate to eliminate this policy direction to Reserve Banks without acknowledging that its elimination represents a substantive change. The reserve deficiency penalty waiver represents sound policy and should not be eliminated nor changed. Accordingly, we urge the Board to retain the policy of waiving the reserve deficiency charge once during a two-year period for any deficiency that does not exceed a certain percentage of the depository institution's required reserves.

[9] 73 *Fed. Reg.* at 8014.

MISCELLANEOUS

In proposed § 204.4(b), we believe that the term “or agreement corporation” should be added to the end of the sentence so that it reads as follows:

> (b) United States branches and agencies of a foreign bank ,ay not deduct balances due from another United States branch or agency of the same foreign bank, and United States offices of an Edge or agreement corporation may not deduct balances due from another United States office of the same Edge Corporation ***or agreement corporation***.

We appreciate the opportunity to comment on the Board’s proposal.

Sincerely yours,

Gilbert T. Schwartz