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August 8, 2005

John E. Bowman
Chief Counsel
Office of Thrift Supervision
1700 G Street NW
Washington, D.C. 20552

Re: Payment of Referral Fees for Demand Accounts (12 CFR 561.16(b))

Dear Mr Bowman:

The purpose of this letter is to seek an interpretation regarding Section 561.16(b) of the OTS Regulations regarding the payment of referral fees for demand accounts so that federal associations may compete more effectively with state and national banks for such accounts.

Our firm represents a number of federal associations in connection with their deposit activities. Recently, two of our clients asked us whether they may pay referral fees to persons, including existing customers, who refer individuals to them for demand accounts. They noted that state and federal banks in their marketing areas periodically offer nominal referral fees as part of their marketing programs.

In reviewing the regulations applicable to referral fees, we noted that associations are permitted to offer referral fees for demand deposits in two circumstances.[1] The first relates to bonuses given in cash or merchandise to employees. The second circumstance applies to fees that are paid to persons who are "principally engaged" in the brokerage business. It is unclear whether these were intended to be the only circumstances where a referral fee might be paid in connection with demand accounts.[2]

The Federal Reserve Board has had occasion to consider whether the payment of a fee for referring demand deposit customers to a bank constitutes the payment of "interest" within the meaning of Regulation Q[3] and the Federal Reserve Act. The Board takes the position that

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[1] Section 561.16 limits referral fees only for demand accounts. Savings accounts and time deposits are not covered by the rule.

[2] We assume that the rule and these exceptions were created to differentiate demand deposit accounts from other forms of accounts for purposes of 12 U.S.C. §1464(b).

[3] Regulation Q prohibits the direct or indirect payment of interest on demand deposit accounts. "Interest" is defined in Reg. Q as "any payment to or for the account of any depositor as compensation for the use of funds constituting a deposit." 12 C.F.R. § 217.2 (d).

referral fees do not constitute a payment of interest to either the referring person or to the new demand deposit customer.[4] We believe there are two sound reasons for that position. First, the referral fee is not compensation for the "use of funds constituting a deposit." It is a payment for the service of referring a new customer to the institution. Second, the referral fee is not paid to the demand deposit customer, but to the referring party.

Although referred accounts may sometimes constitute "brokered deposits" for purposes of the Federal Deposit Insurance Act and may be subject to limitations for safety and soundness purposes,[5] there does not appear to be any compelling reason why federal associations should be prohibited from marketing demand accounts through referral arrangements with persons other than professional brokers. We believe this places federal associations at a competitive disadvantage in the marketplace without any countervailing regulatory or public policy benefit.

Federal association law[6] does not contain any provision that limits the payment of demand account referral fees to professional brokers. Given that federal association law is not more restrictive on its face than the federal laws that apply to state and national banks, there is no reason why Section 561.16(b) must be given a restrictive interpretation.

We request an interpretation that Section 561.16(b) is not an exclusive listing of the circumstances under which a fee may be paid for referring a customer for a demand account and that associations may pay fees to customers and others for referring persons for such accounts, provided the fees are not intended to be passed on to the depositor (an indirect payment of interest). Our clients would like to offer reasonable fees to customers and other persons for such referrals along the same lines as banks, allowing them to compete more effectively. Such an interpretation also would make federal law and the definition of "interest" more consistent among the federal banking agencies.

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[4] Federal Reserve Bulletin #559 (1939). The FRB's staff attorneys have confirmed this position on several occasions in conversations with our firm. See also OCC Interpretive Letter No. 573 (January 28, 1992)
[5] The interpretation we are requesting would not change this.
[6] 12 U.S.C. §1464(b).

We appreciate your courtesy in evaluating this request. If I can be of further assistance in exploring the reasons and basis for the interpretation, please feel free to give me a call.

Sincerely,

Gene R. Elerding

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