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THE CLEARING HOUSE®
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June 24, 2008

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:

The Clearing House Association L.L.C. ("The Clearing House"),[1] an association of major commercial banks, appreciates the opportunity to comment on one of the amendments to Regulation D, Reserve Requirements of Depository Institutions, recently proposed by the Board of Governors' (the "Board").[2] The Clearing House is concerned that 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 early withdrawal from a time deposit will restrict, and quite possibly eliminate, the ability of depository institutions that use time deposit open accounts ("TDOAs") as a vehicle for the temporary investment of balances of the institution's trust department.[3] As explained below, in order to preserve the ability of depository institutions to continue to use TDOAs for the benefit of trust customers, The Clearing House urges the Board to modify the proposed amendment by retaining the word "early" in the second sentence of section 204.2(c)(1)(i) of Regulation D, in which case this sentence would read as follows:

[1] The members of The Clearing House are ABN AMRO Bank N.V.; Bank of America, National Association: The Bank of New York; Citibank, N.A.; Deutsche Bank Trust Company Americas; HSBC Bank USA, National Association; JP Morgan Chase Bank, National Association; UBS AG; U.S. Bank National Association; Wachovia Bank, National Association; and Wells Fargo Bank, National Association.

[2] 73 *Fed. Reg.* 8009 (February 12, 2008).

[3] *See* 73 *Fed. Reg.* at 8011.

> 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of the last withdrawal must impose early withdrawal penalties of at least seven days' simple interest on amounts so withdrawn.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.)

This will ensure that the proposed clarification does not have the consequence of requiring the imposition of an early withdrawal penalty on a withdrawal that is not "early", *i.e.*, not within six days after deposit, but that is made within six days after a partial withdrawal from the account.

Regulation D currently provides that an early withdrawal penalty must be imposed on the actual amount withdrawn from a time deposit "from within six days after the date of deposit." The definition contemplates that an early withdrawal might be an early withdrawal of the entire balance in the account or a withdrawal of only a portion of the total account balance. If only part of the time deposit is withdrawn within six days after the date of the initial deposit, an early withdrawal penalty is imposed only on the amount withdrawn.

The second sentence of section 204.2(c)(1)(i) of Regulation D also currently provides for an additional penalty if more than one early withdrawals are made and the multiple withdrawals are within a seven-day period: "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." If, however, the multiple withdrawals made are not "early" withdrawals because the amount on deposit at the time of any withdrawal always remained at least equal to deposits six days prior to the proposed withdrawal, there is no additional penalty in the event of multiple withdrawals. This is confirmed by both the word "early" and the word "additional". If there cannot be early withdrawals and therefore no penalty under the first sentence, there cannot be an "additional" penalty under the second sentence.

Although the Board describes its proposed amendment as a "clarif[ication]", the result is to change the substance of the rule to impose a penalty on all multiple withdrawals within a seven-day period regardless of whether the first is "early" and results in an initial penalty. The Board's proposal creates this result because it removes both the words "early" and "additional" from the second sentence of section 204.2(c)(1)(i).

The Clearing House believes that this proposed clarification is not consistent with prior Board determinations with regard to TDOAs because it would require 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. This would have the effect of undermining the ability of depository institutions to use TDOAs for legitimate purposes relating to temporary investments of trust balances.

**TDOAs**

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.[4]

In 1991, the Board proposed to amend the manner in which the Regulation D early withdrawal penalty is determined on amounts withdrawn from a time deposit within the first six days after deposit.[5] 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. That is, the Board proposed that institutions apply a last-in first-out ("LIFO") approach rather than a first-in first-out ("FIFO") approach to determining what constitutes an early withdrawal.[6] In 1992, after reviewing the public comments, the Board concluded to retain the use of the FIFO approach.[7] In rejecting the proposed change to LIFO, the Board stated the following:

> 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 . . .[8]

After discussing the proposed change to use of the LIFO approach, the Board continued as follows:

> 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

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4 Instructions for the Report of Transaction Accounts, Other Deposits and Vault Cash (FR 2900) at 83.
5 56 *Fed. Reg.* 15522 (April 17, 1991).
6 56 *Fed. Reg.* at 15524-5.
7 57 *Fed. Reg.*38417 (August 25, 1992).
8 57 *Fed. Reg.* at 38423-4 (emphasis added).

> investing idle trust funds. . . [T]he Board wishes to avoid imposing unnecessary costs on depository institutions that do not use time deposits [to evade reserve requirements]. Accordingly, the Board is not adopting the proposed amendment at this time.[9]

**DISCUSSION**

As evidenced from prior regulatory proposals and final actions, the Board has recognized the important role that TDOAs serve as a repository for temporarily idle funds of trust department customers. 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 as determined on a FIFO basis, 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. These are not "early" withdrawals for purposes of Regulation D.

The language of the Board's proposed amendment would have the effect of requiring that whenever a portion of the balance of a TDOA is withdrawn, irrespective of whether the withdrawal is early on a FIFO basis, the remaining balance in the TDOA must 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. If the Board intended to require depository institutions to restart a seven-day clock for balances in a TDOA, such a result would constitute a substantive and important change. It would be inconsistent with the Board's previous statements as well as the banking industry's long-standing practice of using TDOAs for the investment of trust balances and understanding of how the early withdrawal penalty requirement applies to TDOAs.

Accordingly, in order to avoid the unintended effect of eliminating a long-standing and convenient investment opportunity for uninvested trust funds, The Clearing House recommends that the Board amend the second sentence of section 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.)

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[9] 57 *Fed. Reg.* at 38424.

Thank you for considering the views expressed in this letter. If you have any questions, please contact me at 212-612-9205.

Sincerely yours,

Norman R. Nelson