Interest on Deposits — Part 329

Introduction

The procedures and guidance in this section apply to demand deposits and negotiable orders of withdrawal (NOW) accounts held at banks. Banks are prohibited from paying interest on demand deposits. However, NOW accounts are not considered "demand deposits" when the entire beneficial interest of the deposit is held by certain eligible depositors.

Regulation Overview

Part 329 of the FDIC regulations prohibits the payment of interest by banks on any demand deposit.

A demand deposit includes any deposit payable on demand; or any deposit with an original maturity or required notice period of less than seven days; or any deposit representing funds for which the bank does not reserve the right to require at least seven days' written notice of intended withdrawal; or any other deposit which the depositor is authorized to make more than six preauthorized or automatic transfers.

NOW accounts are interest bearing accounts from which depositors are permitted to make withdrawals by negotiable or transferable instruments for funds transfers to third parties. NOW accounts can be maintained by the following entities, and would not be considered demand deposits under the regulation:

- One or more individuals, including sole-proprietorships.
- A not-for-profit organization operated primarily for religious, philanthropic, charitable, educational, political, or other similar purpose.
- Officers, employees, or agents of public entities (public funds).
- Funds held in a fiduciary capacity (bank trust department, individual fiduciary, or trustee in bankruptcy), provided that all beneficiaries are natural persons.

The regulation also provides guidance on allowable transfers for nondemand deposits, interest and premiums, and interest and ten-day grace period for time and savings deposits.

Definitions

"Cash Management Arrangements" Cash management services provided by financial institutions sometimes include offering sweep accounts and repurchase agreements. Regulatory compliance for these activities is generally reviewed during risk management examinations and during nondeposit product reviews. However, examiners should be aware that Section 329.2 concerning the prohibition of paying interest on demand deposits could be violated based on the definitions of Money Market Deposit Accounts (MMDA) and savings accounts for excessive transactions.

"Money Market Deposit Account (MMDA)" An MMDA is a savings deposit that permits, under the terms of the deposit contract or by practice of the financial institution, the depositor to make no more than six transfers and withdrawals per calendar month or statement cycle of at least four weeks to another account of the depositor or to a third party.

All six transfers can be made by check, draft, debit card, or similar order to a third party. The following transfers are not included in the six transfer limitation:

- Transfers to the financial institution for the purpose of repaying loans and associated expenses (as originator or servicer).

NOTE: This exemption "does not apply to transfers to the financial institution that are made for the purpose of repaying loans that are made by the financial institution to the depositor's demand deposit account for the purposes of covering overdrafts." (§329.1(b)(3))

- Transfers to another account of the depositor made by mail, messenger, automated teller machine (ATM), or in person.
- Withdrawals made by mail, messenger, telephone (via check mailed to the depositor), ATM, or in person.

Refer to §204.2(d) of Regulation D and the Interpretative Rule found in Section 329.101 for more guidance on MMDAs.

NOTE: Personal computer (PC) transfers should be treated just like telephone transactions and would be included in the "six" transfers and withdrawals if the PC transfer was preauthorized or automatic.

"NOW Account" NOW Accounts are deposit accounts which consist solely of funds in which the entire beneficial interest is held by:

- One or more individuals, including sole-proprietorships.
- A not-for-profit organization operated primarily for religious, philanthropic, charitable, educational, political, or other similar purpose.
- Officers, employees, or agents of public entities (public funds).
- Funds held in a fiduciary capacity (bank trust department, individual fiduciary, or trustee in bankruptcy), provided that all beneficiaries are natural persons.

The following types of entities **are not** eligible to maintain NOW accounts:

- Corporations
- For-profit partnerships, including a husband and wife partnership

- Individuals who have incorporated, such as Professional Associations (PA)
- Trust accounts where the beneficial interest is held by two or more unrelated parties, such as realty trusts

Refer to the following regulatory provisions for guidance on the definition of a NOW account:

- 12 USC 1832(a), NOW accounts (This citation is the Act which created NOW accounts.)
- Section 329.1(b)(3), footnote 1 (This footnote quotes 12 USC 1832(a) in its entirety.)
- Regulation D, Section 204.2
- Regulation D, Section 204.130
  (This is an interpretative section providing further guidance on the eligibility of certain entities to maintain NOW accounts.)

"Savings Accounts" Accounts that are subject to the same transaction limitations as MMDAs (including passbook savings accounts and statement savings accounts).

Examination Objectives

The examination objectives are to:

- Determine whether a bank is effectively managing the compliance risks associated with demand deposit accounts and NOW accounts.
- Assess compliance with the applicable law and regulation.
- Implement corrective actions to address compliance deficiencies and ensure future compliance.

Examination Procedures

Evaluate for Compliance with Part 329

1. Determine which of the following accounts the financial institution offers:
   - Demand deposits (non-interest bearing checking accounts)
   - Savings accounts
   - Negotiable Order of Withdrawal (NOW) accounts
   - Money Market Deposit Accounts (MMDA)
   - Time deposits
2. Interview personnel responsible for opening NOW accounts to ensure they know the requirements and prohibitions of Section 329.1.
3. Determine the category of account according to the activity allowed for that particular account.

*NOTE: Even though an account may be classified by the financial institution as one of the above, **the activity allowed within the account** dictates the actual definition. For example, an account which exceeds the monthly transfer or check processing limits should no longer be classified as a savings account but as a DDA or NOW Account by the institution. Refer to Section 204.2 of Regulation D for account definitions.*

NOW Accounts

4. Determine whether the entire beneficial ownership interest of a NOW account is held by one of the following eligible individuals or entities:
   - One or more individuals, including sole proprietorships
   - A not-for-profit organization operated primarily for religious, philanthropic, charitable, educational, political, or other similar purposes
   - A government unit of the United States, or any state, county, or municipality of the United States, or any United States territory or possession
   - A fiduciary (either individual or corporate) if the beneficiary is otherwise eligible to maintain a NOW account
   - Pension funds, escrow accounts, and security deposits if the entire beneficial interest is held by one of the eligible individuals or entities listed above.

   If an account holder(s) does not meet the above definitions, it is ineligible to maintain a NOW account. For example, for-profit partnerships and corporations are ineligible.

   Refer to Section 204.130 of Regulation D for further guidance.

5. Determine if the financial institution has adequate internal controls to ensure that ineligible entities do not maintain NOW accounts.
   - Review the NOW account trial balance:

     Use existing records, but if warranted, request a full name listing of the trial balance as opposed to a short name version. A short name listing may not include certain portions of the account title; therefore, some ineligible accounts could be missed during the review.
   - Select questionable accounts, including but not limited to the examples below, for documentation review:
     - Accounts which include the designations "Inc.," "Corp.," "LLC" (Limited Liability Corporation) or "P.C." (Professional Corporation), which imply an incorporated entity.
     - Accounts which include the designation "partnership," "limited partnership," or "general partnership".
     - Accounts which include the designation "d/b/a" (doing business as).

NOTE: A sole proprietorship using this designation may hold a NOW account. Additionally, the Federal Reserve has taken the position that a husband and wife operating as a family business which is not incorporated and is not a partnership under state law, may also be considered as eligible to hold a NOW account.

- ◦ Any other account having a title which appears to be that of a business.

6. Request the signature cards and the related tax identification numbers of the accounts selected.

NOTE: Be aware that a corporation, partnership, or other formally organized legal entity is generally required under state law to file and have approved articles or a certificate of incorporation (or organization, depending upon the type of legal entity). Furthermore, a non-profit entity, as designated by the Internal Revenue Service (IRS) will have a certificate attesting to their non-profit status issued by the IRS. ***Actual IRS documentation is not required****. However, the institution may have these items on file, or may be able to obtain them from the account holder to assist in the determination of eligibility status. In the absence of any other documentation, if an institution has obtained a signed statement on the signature card attesting to the non-profit status, examiners should consider this when determining account eligibility.*

7. Cite as violations of Section 329.1 accounts held by ineligible entities.

When an ineligible entity is consistently allowed to make more than the permitted number of withdrawals or transfers, the MMDA will be deemed to be a demand deposit account. Accordingly, cite a violation under Section 329.2 for payment of interest on a demand deposit if interest was paid during the statement cycle within which the excessive activity occurred.

NOTE: In some instances, financial institutions may contend that the "grandfather clause" in Section 204.130(f) of Regulation D exempts any ineligible NOW accounts opened on or before August 31, 1981 from violating Part 329. However, the FDIC does not support this position unless the financial institution can demonstrate that the depositor was previously qualified to maintain a NOW account under a state law prior to August 31, 1981.

8. To support violations, copy and keep in the workpapers the following, as applicable:
   - Signature cards
   - Partnership agreements or articles of incorporation/organization
   - Any other identifying documentation

9. When violations of Section 329.1 occur, do the following:
   - Request management to review all NOW accounts to detect other accounts that may be maintained by ineligible entities.
   - Have management move any such depositors' funds to other accounts for which they qualify, such as a demand deposit or MMDA.

Money Market Deposit Accounts (MMDAs)

10. Determine if the financial institution has internal controls in place to monitor excessive MMDA activity. Most institutions monitor MMDA activities through either:
    - Manual procedures (case by case review):
      - ◦ The bank report may identify the total number of transactions made during the month, but individual account transactions may not be listed until a certain number (for example, three or six) have occurred, or
    - An excessive MMDA transaction report:
      - ◦ Request a copy of the excessive MMDA transactions report. If such a report is not available, review MMDA periodic statements for a six month period.

NOTE: Review the report to determine whether it identifies the specific type and number of transactions. Some reports, for example, may not list transactions until a certain trigger number is reached (for example, six). If the report or the account statements do not readily identify the specific type of transaction or whether excessive account activity has occurred, the examiner may need to review individual transaction records.

It may be difficult to determine the specific type of transaction from financial institution documentation and, therefore, to determine if excessive account activity has occurred. For example, certain financial institutions may classify ATM withdrawals and debit card purchases in the same manner. ATM withdrawals ***are not*** *considered to be part of the six allowed transfers, while point of sale transactions* ***are*** *part of the six allowed transfers. As a result, individual transaction records may have to be reviewed.*

NOTE: However, no MMDA will be deemed a demand deposit or cited as a violation merely by virtue of exceeding the six transfer limitation if the depositor is eligible to maintain a NOW account.

Do not cite violations of Regulation D within the Compliance Report of Examination if the financial institution does not have procedures to monitor excessive MMDA activity. Address an absence or weakness of procedures on the Examiner's Comments and Conclusions page, or Supervisory Comments, depending upon the extent of non-compliance with Part 329.

11. For customers who continue to violate the MMDA transfer limits after they have been contacted by the financial institution, the financial institution should either:
    - Eliminate the transfer and draft capabilities of the account, or
    - Close the account(s) and place the funds in another account for which the depositor is eligible
12. Ensure that no more than the permitted number of transfers or withdrawals are made. A financial institution should either:
    - Prevent withdrawals or transfers of funds from the MMDA in excess of the regulatory limits, or
    - Adopt procedures to monitor transfers on an ex post basis and contact customers who exceed established limits on more than an occasional basis

Refer to footnote 5 of Section 204.2(d)(2) of Regulation D for further guidance on the procedures an institution should follow to ensure that MMDAs are properly maintained.

13. Violations of Section 329.2, Payment of Interest on Demand Deposit Accounts, could have reserve requirement ramifications. Additionally, accounts not cited as violations which are incorrectly accounted for by the institution (MMDA accounts that should be classified as NOW accounts) also could have reserve requirement ramifications. If the reclassification of accounts would have a substantial impact on reserve requirements, examiners should follow the procedures below:
    - Prepare a memorandum and forward it to the appropriate Division of Supervision and Consumer Protection (DSC) Regional Director to serve as notification of the issue.
    - Submit a copy of the memorandum to the appropriate DSC Compliance Deputy Regional Director with the Compliance Report of Examination.

    The memorandum should detail the following items:
    - The nature of the apparent violation(s) of Section 329.2
    - The potential impact on reserve requirements

NOTE: Regulation D requires financial institutions to maintain different levels of reserves against transaction accounts versus other account types, such as time or savings. If, for example, a financial institution is reporting an account as a savings account, when the activity within the account defines it as a transaction account, the financial institution's reserve requirement may be understated.

Savings Accounts

14. Determine if the institution allows the types of transactions from savings deposits which are subject to the six transfer limitation.

    Savings deposits, including passbook savings accounts and statement savings accounts, are subject to the same transaction limitations as MMDA accounts and when excess activity is detected, these accounts become demand deposits. Be aware of:
    - Commercial demand deposit accounts linked to savings accounts, where overdrafts in the demand account are covered by transfers from the savings accounts in excess of prescribed limits.
    - ACH (automated clearing house) transfers from passbook savings accounts to third parties to pay, for example, recurring insurance premiums.

      NOTE: Also, like MMDAs, no savings accounts will be deemed a demand deposit account or cited as a violation of Part 329 if the depositor is eligible to maintain a NOW account.
15. If such transactions are permitted, determine, as noted above for MMDAs, if the institution has developed a system to monitor such transactions, and what action is taken against account holders who exceed the limitation.

Cash Management Services

16. Determine if the financial institution offers cash management services.

    If so, determine if the financial institution's procedures regarding cash management services prohibit the payment of interest on demand deposit accounts.

Premiums

17. Determine if the financial institution has provided premiums to depositors in compliance with Section 329.103. Premiums can be in the form of merchandise, credit, or cash.
    - Verify that the premium is not considered "interest" (as defined in Section 329.1(c)), by determining:
        - It was only given to the depositor at the time of a new account opening or an addition to an existing account;
        - No more than two premiums per deposit were given in a twelve-month interval; and
        - The premium's values did not exceed $10 for a deposit of less than $5,000 or $20 for a deposit of $5,000 or more.

          NOTE: In the case of merchandise, the total cost to the bank includes any shipping, warehousing, packaging, and handling costs.
    - Verify that the costs of the premiums were not averaged by the bank (so to avoid the $10/ $20 dollar limitations).

- Verify that the bank did not solicit deposit funds on the premise that they would divide the money into several accounts so that they could pay the depositor more than two premiums within a twelve-month interval (so to avoid the no more than two premiums per deposit in a twelve-month interval limitation).

18. Determine if the bank retained sufficient information to determine that the requirements of Section 329.103 are satisfied.

References

Federal Deposit Insurance Act

NOW Accounts (An Act)

Part 329: Interest on Deposits

Advisory Opinion 95-29: Bank Award of Bonus Points and/or Gift Certificates for Use of a Credit Card Does Not Violate §329 as Long as Credit Card is Not Linked to a Demand Deposit Account

Advisory Opinion 91-86: Deposits of Real Estate Trust Accounts ("RETA") Program Established by State Statute May, Like IOLTA Deposits, be Held in NOW Accounts

Advisory Opinion 91-79: An Electronic Cooperative is Eligible to Hold a NOW Account Under Revised Federal Reserve Board Regulations (12 CFR §204.130)

Advisory Opinion 91-19: Whether ATM Promotion Constitutes Payment of Interest on Demand Deposits in Violation of 12 CFR §329

Advisory Opinion 91-3: FDIC Defers to Federal Reserve Board's Interpretation of NOW Accounts (12 CFR §204.130)

Advisory Opinion 87-43: Eligibility of Rural Electric Association Cooperative to Hold Funds in NOW Account

Advisory Opinion 87-19: Business Partnership and NOW Accounts

FIL 18-98: Prohibition Against Payment of Interest on Demand Deposits

FIL 110-97: Prohibition Against Payment of Interest on Demand Deposits

FIL 78-97: Prohibition Against Payment of Interest on Demand Deposits

DSC RD Memo 2009-025: Interest on Deposits (Part 329) - Examination Procedures

(This page intentionally left blank.)