

Compliance for Deposit Operations
Regulations D: Reserve Requirements
for Depository Institutions

Pennsylvania Association of Community Bankers
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Section 1: Regulation D: Reserve Requirements of Depository Institutions [12 C.F.R. § 204]

Background

The purpose of Regulation D is to assist in the implementation of the Federal Reserve's national monetary policy. This is accomplished by requiring reserves of certain types of deposits (primarily transaction accounts) to be set aside so that they cannot be reinvested by financial institutions.

Part of this regulation imposes limits regarding ownership and transaction restrictions for certain deposit types.

Section 2: NOW Account Eligibility

Overview [12 C.F.R. § 204.130]

Regulation D restricts the types of entities that may maintain a negotiable order of withdrawal account (NOW account). It does this through the use of definitions and the Federal Reserve Board's interpretations of the regulation. Negotiable order of withdrawal (NOW) accounts are considered transaction accounts according to the guidelines of the regulation.

Certain types of designated entities are eligible to maintain a NOW account. If a potential account owner does not meet one of the following criteria, that person is not eligible to own or open a NOW account.

Individuals

Any individual may maintain a NOW account regardless of the purposes that the funds will serve. Thus, an individual using deposits in his or her business including a sole proprietorship or an individual doing business under a trade name is eligible to maintain a NOW account in the individual's name or in the DBA name. However, other entities organized or operated to make a profit such as corporations, partnerships, associations, business trusts, or other organizations may not maintain NOW accounts.

Pension funds, escrow accounts, security deposits, and other funds held under various agency agreements may also be classified as NOW accounts if the entire beneficial interest is held by individuals or other entities eligible to maintain NOW accounts directly. These accounts are considered similar in nature to trust accounts and should be accorded identical treatment. Therefore, such funds may be regarded as eligible for classification as NOW accounts.

Non-profit Organizations

A non-profit organization that is operated primarily for religious, philanthropic, charitable, educational, political, or other similar purposes may maintain a NOW account. The following are examples of the kinds of organizations that are eligible for NOW accounts under this standard if they are not operated for profit:

- Political organizations
- Homeowners and condominium owners associations, including housing cooperative associations that perform similar functions

Governmental Units

Governmental units are generally eligible to maintain NOW accounts. NOW accounts may consist of funds in which the entire beneficial interest is held by the United States, any state of the United States, county, municipality, or political subdivision thereof, the District of Columbia,

the Commonwealth of Puerto Rico, American Samoa, Guam, any territory or possession of the United States, or any political subdivision thereof.

Federal law provides that only domestic governmental units are eligible to maintain NOW accounts. Therefore, agencies of a foreign government may not maintain NOW accounts because the beneficial interest in their funds remain with the foreign government, which is organized primarily for foreign government purposes. A consulate or embassy of a foreign government may not maintain a NOW account because the beneficial interest in the funds is with the government the consulate or embassy represents.

Funds Held by a Fiduciary

Funds held in a fiduciary capacity (either by an individual fiduciary or by a corporate fiduciary such as a bank trust department or a trustee in bankruptcy), including those awaiting distribution or investment, may be held in the form of NOW accounts if all of the beneficiaries are otherwise eligible to maintain NOW accounts. This is acceptable since fiduciaries are required to invest even temporarily idle balances to the greatest extent feasible in order to responsibly carry out their fiduciary duties. The availability of NOW accounts provides a convenient vehicle for providing a short term return on temporarily idle trust funds of beneficiaries eligible to maintain accounts in their own names.

Interest on Lawyer Trust Accounts (IOLTAs)

Attorney trust funds may be deposited into a NOW account when the funds are maintained under the IOLTA provisions. The account must consist solely of funds in which the entire beneficial interest is held by one or more individuals or other NOW-eligible entities. In these instances, the interest earned on the account is transferred to a non-profit organization described in section 501(c)(3) of the Internal Revenue Code.

Grandfather Provision

To avoid unduly disrupting account relationships, a NOW account established at a bank on or before August 31, 1981, that represents funds of a non-qualifying entity that previously qualified to maintain a NOW account may continue to be maintained in a NOW account.

Ineligible Entities

All organizations that are operated for profit are not eligible to maintain NOW accounts at depository institutions. Examples include corporations, limited liability companies, partnerships, and for-profit associations.

Also, the following types of organizations are among those not eligible to maintain NOW accounts:

- Credit unions and other mutual depository institutions
- Mutual insurance companies

- Crop financing organizations
- Organizations created to function as part of a qualified group legal services plan
- Farm cooperatives

Section 3: Transaction Restrictions

Note Regarding Recent Events

On April 24, 2020, the Federal Reserve Board, using an interim final rule, made the transaction restrictions optional. We will discuss the current status of this regulation during the seminar.

Overview

Regulation D also contains specific guidelines for acceptable transaction activity to savings and money market deposit accounts (MMDAs). If the transaction restrictions are not applied to savings deposit accounts, they in essence become transaction accounts without the proper reserve requirement and undermine the intent of the regulation.

All transfers and withdrawals from a savings deposit that are subject to a monthly limit are subject to no more than six per month.

Applicable Accounts

The transaction restrictions of Regulation D apply to “savings deposits.” Technically, this is any deposit or account meeting both of the following conditions:

- Which the customer is not required by the deposit contract, but may at any time be required by the bank, to give a seven-day written pre-notification of an intended withdrawal
- That is not payable on a specific date or at the end of a specified time frame

A bank should review its deposit contracts to determine which of its accounts contain this type of pre-notification of withdrawal clause and do not have a specific due date. The most common savings deposits are known as passbook savings accounts, statement savings accounts, or money market deposit accounts.

Restricted Transactions

The number of certain types of transfers or withdrawals from a savings deposit account is restricted. The types of transfers or withdrawals from a savings deposit account that are restricted are those to another account of the depositor at the same institution or to a third party by means of a preauthorized or automatic transfer or telephonic agreement, order or instruction, or by check, draft, debit card, or similar order payable to a third parties.

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.

The following are examples of restricted transfers or withdrawals from a savings deposit account:

- Third-party payment made by check, draft, debit card, or similar method
- Any type of telephone order or instruction to pay a third party from a customer's account
- Any type of telephone order or instruction to transfer money from a customer's account to another of his or her accounts at the same bank
- Written instructions to pay a third party from a customer's account at a certain time or according to a certain schedule
- Verbal instructions to pay a third party from a customer's account at a certain time or according to a certain schedule
- Written instructions to transfer money from a customer's account to another of his or her accounts at the same bank at a certain time or according to a certain schedule
- Verbal instructions to transfer money from a customer's account to another of his or her accounts at the same bank at a certain time or according to a certain schedule
- Automated clearinghouse (ACH) payments or debits

The above types of transactions are restricted to no more than a total of six per calendar month or statement cycle of at least four weeks.

An arrangement in which a bank sends an employee to a customer's place of business to receive authorization to make a transfer from a savings deposit account to another account of the depositor at the bank is regarded as a transfer subject to the limit of six transfers. This type of transaction is considered as a preauthorized transfer and, therefore, subject to limitation.

Unrestricted Transactions

The regulation provides specific examples of transactions that are not considered preauthorized, automatic, or telephonic transfers or withdrawals from an account. In addition, there are certain types of preauthorized, automatic, or telephonic transfer or withdrawal from an account that may be excluded from the six per month restriction.

The following are examples of the types of transfers or withdrawals from a savings deposit account that are not restricted by Regulation D:

- Withdrawals (direct payment to the customer via check, cash, etc.) from a customer's account made in person

- Transfers of money from a customer's account to another of his or her accounts at the same bank made in person
- Preauthorized or automatic transfers from an account to make a loan payment at the same bank
- Withdrawals from a customer's account made at an ATM
- Transfers of money from a customer's account to another of his or her accounts at the same bank made at an automated teller machine (ATM)
- Requests for a transfer of money from a customer's account to another of his or her accounts at the same bank received in the mail or from a messenger
- Requests for a withdrawal for direct payment to the customer (via check, cash, etc.) received in the mail or from a messenger
- Request for a withdrawal for direct payment to the customer (via check mailed to the customer) received over the telephone

The above types of transactions can occur an unlimited number of times per month and not violate the transaction restrictions of Regulation D.

Deposits into a savings or money market account are not restricted. An unlimited amount of any type of deposit may be made into a savings deposit account without violating the regulation.

Monitoring System

In order to ensure that no more than the permitted number of withdrawals or transfers is made, a depository institution must either:

- Prevent withdrawals or transfers of funds from the account that are in excess of the limits; or
- Adopt procedures to monitor those transfers on an ex post basis and contact the customers who exceed the established limits on more than an occasional basis.

All savings and money market deposit accounts are to be monitored on an ongoing basis to determine whether an accountholder has exceeded the transaction limitations for covered transfers or withdrawals. This is usually possible through a system-generated report, which flags accounts exceeding the limitations.

Upon identification of accountholders who have exceeded the covered transaction limitations, the customer will be notified of the activity. Such notifications may continue if the customer commits excess activity over a 12-month period. This is commonly referred to as the "three strike rule." Notifications to customers usually elevate the importance of continued excess activity with each subsequent notification. Bank staff should track those customers who exceed transaction limitations in order to monitor multiple instances of excess activity.

Any accountholder who exceeds the transfer or withdrawal limitations in three separate statement periods in a 12-month period should be notified that the account type will be changed to a transaction account or the account will be closed.

Inadequate Monitoring Procedures

A bank must have a system in place to monitor savings and money market accounts on a frequency schedule that would allow customer notification in a timely manner. If an institution monitors a savings account during a month and notifies a customer of transfers in excess of the transfer limits promptly after the excess transfers are discovered, the customer may take appropriate steps to prevent additional excess transfers during the remainder of the month, and the institution may not need to close the account or take other remedial action. On the other hand, if monitoring is performed and notice is given only after the close of the month, the customer who has exceeded the transfer limits early in the statement cycle might have a significant number of additional transfers during the month that will far exceed the transfer limits.

The monitoring and notice provisions of Regulation D are intended to be used by depository institutions to give customers an opportunity to revise their transfer practices before the institution must take remedial action. They are not intended to expand the number of transfers that could be made from a savings deposit.

As noted above, the Federal Reserve Board has applied a general rule (commonly known as the “three strike rule”) that an institution may continue to consider an account a savings account even if there are excess transfers so long as those excess transfers are not the result of an attempt to evade the transfer limits, and if the excess transfers occur in not more than three months during any 12-month period. However, regulators will review the facts and circumstances in each case, and will not apply this rule if the bank does not have adequate and appropriate monitoring procedures in place.

Section 4: Excess Activity on Savings Deposits

Note Regarding Recent Events

On April 24, 2020, the Federal Reserve Board, using an interim final rule, made the transaction restrictions optional. We will discuss the current status of this regulation during the seminar.

Reference Sheet

Purpose

The purpose of this reference sheet is to provide guidance on the types and number of limited withdrawals and transfers permitted for savings deposit accounts. For purposes of the limitations discussed below, the term “savings deposit” includes both savings accounts and money market deposit accounts.

General Rule

A depositor may make no more than six covered transfers or withdrawals per calendar month or statement cycle.

Unless otherwise mandated by a bank’s deposit contract, a depositor may make an unlimited number of non-covered transfers or withdrawals. In addition, deposits or credits to the covered accounts are unlimited.

Transaction Type	Limited to Six (6)	Unlimited
Preauthorized transfer/debit (ACH) (EFT)	X	
ATM withdrawal		X
ATM transfer		X
ATM point of sale	X	
Debit card	X	
Internet transfer to another account	X	
Bill payment (online banking)	X	
Telephone, fax or computer transfer to another account at the same bank	X	
Repayment on loan account (at same bank)		X

Check to third party	X	
Check to account holder by mail		X
Transfer/debit made in person or by the customer's messenger		X
Transfer into an account		X

Section 5: Retail Sweep Programs

Retail Sweep Programs

In May 2007, the Federal Reserve's Board of Governors issued a staff opinion on the use of retail sweep programs. The Board's Legal Division established three key criteria for retail sweep programs to comply with Regulation D:

- A depository institution must establish by agreement with its transaction account customer two legally separate accounts: a transaction account (NOW or DDA) and a non-transaction account (usually a savings deposit account or a money market account);
- The swept funds must actually be moved from the customer's transaction account to the customer's savings deposit account on the official books and records of the depository institution as of the close of the business day(s) on which the depository institution intends to report the funds in question as savings deposits and not transaction accounts, and vice versa; and
- The maximum number of preauthorized or automatic funds transfers ("sweeps") from a savings deposit account into a transaction account in a retail sweep program is limited to not more than six (6) per month.

If the institution's retail sweep program does not meet the criteria above, the Board does not consider the program to be an acceptable retail sweep program for purposes of Regulation D.