[6714-01-P]

FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Parts 329, 330

RIN 3064-AD78

Interest On Deposits; Deposit Insurance Coverage

AGENCY: Federal Deposit Insurance Corporation (FDIC).

ACTION: Final rule.

SUMMARY: The FDIC is issuing a final rule amending its regulations to reflect section 627 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the DFA),[1] repealing the prohibition against the payment of interest on demand deposit accounts effective July 21, 2011.

DATES: The final rule is effective July 21, 2011.

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[1] Pub. L. 111-203, 124 Stat.1376.

SUPPLEMENTARY INFORMATION:

I. Background

Section 627 of the DFA repealed the statutory prohibition against the payment of interest on demand deposits, effective one year from the date of the DFA's enactment, July 21, 2011. Section 343 of the DFA amended section 11(a)(1) of the Federal Deposit Insurance Act, 12 U.S.C. 1821(a)(1), to provide full insurance coverage for depository institution noninterest-bearing transaction accounts from December 31, 2010, through December 31, 2012.

In light of the prospective repeal of the demand deposit interest prohibition, the FDIC proposed to rescind 12 CFR Part 329, the regulation which implements that prohibition with respect to state-chartered, nonmember (SNM) banks to be effective on the same date as the statutory repeal, July 21, 2011. 76 *Fed. Reg.* 21265 (Apr. 15, 2011) (NPR). At the same time, however, a regulatory definition of the term "interest" would still be useful in interpreting the requirements of section 343 of the DFA providing temporary, unlimited deposit insurance coverage for noninterest-bearing transaction accounts. For this reason, in the NPR the FDIC also proposed to transfer the definition of "interest" found at 12 CFR 329.1(c) to Part 330, specifically the definitions section at 12 CFR 330.1. The FDIC also specifically solicited comment on whether other parts of Part 329 could also prove useful and therefore should be moved into Part 330 as well. In addition, the FDIC sought comment on every other aspect of the proposed rule.[2]

[2] In counterpart to this rulemaking, the Board of Governors of the Federal Reserve System (the Federal Reserve) have issued a notice of proposed rulemaking to repeal 12 CFR Part 217, Prohibition Against Payment of Interest on Demand Deposits (Regulation Q). See 76 Federal Register 20892 (Apr. 14, 2011).

II. Comment Summary and Discussion

The FDIC received eight comments on the NPR. Three were from community banks, one was from a large depository institution, two were from depository institution trade groups, one from a financial consulting firm, and one was from a legal representative for a money market fund.

The chief points were:

1. The FDIC should stop or delay repeal of the prohibition (four commenters);
2. Community banks will be harmed by repeal of the prohibition (four commenters);
3. The FDIC should add the Part 329 section concerning premiums to Part 330 (three commenters); and
4. The FDIC should adopt or incorporate all Federal Reserve interpretations and advisory opinions pertaining to Regulation Q (two commenters).

Repeal or Delay Prohibition

Commenters opposed to immediate implementation of the repeal of the prohibition made several arguments. All four commenters stated that repeal would result in increased deposit volatility as depository institutions competed for an increased share of business deposits by offering continually higher rates of interest. Three of the four contended this would severely affect community banks. One commenter called for delay until the safety and soundness consequences of repeal are understood, arguing that the FDIC and the Federal Reserve have the authority to issue a statement of policy that

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Regulation Q implements the prohibition against the payment of interest on demand deposits with respect to member banks.

would prevent interest payments on deposits. Another commenter recommended a phase-in with immediate implementation of the repeal followed by a twelve- to eighteen-month grandfather for Federal Reserve interpretations and advisory opinions concerning Regulation Q. Another commenter stated that efforts to repeal the prohibition should either cease or be delayed until its impact is understood.

In response to these comments, the FDIC notes that, as previously observed, pursuant to section 627 of the DFA, as of July 21, 2011, the prohibition against the payment of interest on demand deposits will be repealed by operation of statute, as a matter of law.

Harm to Community Banks

As noted previously, several commenters contended repeal would result in heightened competition for deposits. They reasoned that large banks will offer high rates of interest and lure away business depositors previously content to do business with community banks based on personal services (relationship deposits). Community banks would then be pressured to offer higher rates of interests in order to stay competitive, further cutting already thin marginal rates of return. Increased deposits might also mean added pressure for depository institutions to loan these new funds out, possibly leading to unsafe and unsound lending and further weakening depository institutions' fiscal health.

As potential responses to these anticipated negative consequences, one commenter recommended that the FDIC take a number of steps: a) the FDIC should consider issuing a statement of policy to warn depository institutions about the need for interest rate risk management; b) interest rate risk should be quantified and an increased capital charge should be imposed on depository institutions with heightened risk due to repeal of the statutory prohibition; c) stress tests should be performed on depository institutions before they are allowed to pay interest on business checking accounts; d) call reports should be modified to provide for the reporting of interest rate risk; and e) reserve requirements should be increased to reduce competition for deposits.

Another commenter recommended that the FDIC hold roundtables prior to the July 21, 2011, repeal date, urged the FDIC and the Federal Reserve to work together to clarify issues in connection with the repeal, and requested that the FDIC provide more time for compliance by depository institutions. This commenter noted that while the FDIC has no authority to delay or to phase in the statutory repeal, efforts still need to be made to provide depository institutions with clarity. The commenter noted the need to revise call reports and thrift financial reports to indicate interest-bearing demand deposit accounts. It also noted the need for clarity with respect to so-called "hybrid products," deposit accounts that both pay interest and offer earnings credits.

A third commenter urged that the Financial Stability Oversight Council (the FSOC) should address the systemic threat which the upcoming repeal poses to the "U.S. banking and financial system and the economy as a whole."[3]

After carefully considering these comments, the FDIC has concluded that the commenters raise valid concerns about potential risks arising from the repeal of the prohibition against paying interest on demand deposits. Based on currently available information, however, there are also potential benefits which may balance out or outweigh those risks. While it is true that depository institutions may incur added

[3] Created by section 111 of the DFA, the FSOC is charged with identifying threats to the financial stability of the U.S., promoting market discipline, and responding to emerging risks to the stability of the U.S. financial system.

expense by offering interest payments to accounts where it was previously unavailable (such as business checking), they may also save funds by no longer having to waive expenses on such accounts (e.g., courier service), as an inducement to retain accountholders. Moreover, many institutions offer products to business customers that serve as a substitute for paying interest on demand deposit accounts. The most notable example is a repo sweep account in which funds are swept overnight from a demand deposit account to a repo account and swept back to the demand deposit account the next morning. The institution pays interest on the funds while they are in the repo account. Thus, for some institutions the repeal of the prohibition against paying interest on demand deposits will result in the replacement of indirect payments of interest on demand deposits with explicit, direct interest-bearing demand deposit accounts.

Repeal of the prohibition might directly benefit community banks by allowing them to attract more potentially stable deposits which could reduce their need for higher-cost, more volatile funding. This could lower community banks' funding costs and also allow them to plan business growth more dependably and rigorously. Interest rates are currently at a historic low. This should provide depository institutions with an adjustment period. If the cost of funds should increase, depository institutions should have time to make the necessary adjustments to protect profits and manage interest rate risk through measures such as changes to fee structures and rates to balance out increased interest expense. With regard to interest rate risk and potential liquidity issues, the FDIC and the other federal banking agencies have already provided depository institutions with detailed guidance which those institutions are expected to follow.

Add Part 329 Section on Premiums to Part 330

Three commenters stated that the Part 329 section pertaining to premiums should be added to Part 330 along with the definition of "interest." Section 329.103 describes the circumstances under which a depository institution's provision of a premium to a depositor will not be considered a payment of interest. It is substantially identical to section 217.101 in Regulation Q. Commenters contended that retaining this section along with the definition of interest might prove useful in determining whether an account qualifies for unlimited insurance coverage as a noninterest-bearing transaction account.

In response to these comments, the FDIC agrees that there would be utility in importing section 329.103 into Part 330. The FDIC will therefore import section 329.103 into Part 330 as an interpretive rule, to be designated as section 330.101. This step is also consistent with the FDIC's decision, as explained in more detail below, to look to Regulation Q and Federal Reserve interpretations of that rule when construing section 343.

Retention of Federal Reserve Regulation Q Staff Opinions and Interpretive Letters

Two commenters called for retention of Federal Reserve staff opinions and interpretive letters concerning Regulation Q. They stated that these materials would continue to be useful in determining whether depository institutions may continue to rely on practices established pursuant to these documents (one example given was third party payment programs). One commenter recommended that, as of July 21, 2011, the materials be retained for a period of eighteen months or more.

As noted previously, section 217.101 of Regulation Q is substantially identical to section 329.103. Moreover, the FDIC, along with other federal banking agencies, has regularly interpreted issues arising from the prohibition against the payment of interest on demand deposits in the same manner as the Federal Reserve. In light of this agency consistency and the continued potential instrumental value of agency interpretations regarding this issue, the FDIC will continue to rely upon Regulation Q and Federal Reserve interpretations of that regulation for purposes of implementing temporary, unlimited deposit insurance coverage pursuant to section 343 of the DFA.

III. Final Rule

For the reasons set forth in the preceding section, the FDIC is issuing the final rule.

IV. Regulatory Analysis and Procedure

A. Effective Date

Absent a showing of "good cause," the Administrative Procedure Act (5 U.S.C. 553(d)(3)) requires a 30-day delayed effective date before a final rule may become effective. The FDIC finds good cause for waiving this requirement because the final rule simply conforms the FDIC's regulations to reflect the statutory repeal of the prohibition against the payment of interest on demand deposit accounts. As discussed, that statutory repeal becomes effective July 21, 2011. Delaying the effective date of the final rule for thirty days would result in a gap between the effective date of the statutory repeal and the effective date of the amendments to the FDIC's regulations reflecting that statutory repeal. Also, the FDIC deems it unnecessary to provide a delayed effective date for the final rule because there are no actions SNM banks must take to implement the final rule;

as noted, the final rule simply conforms the FDIC's regulations to reflect a statutory change.

The Riegle Community Development and Regulatory Improvement Act provides that any new regulations or amendments to regulations prescribed by a Federal banking agency that impose additional reporting, disclosures, or other new requirements on insured depository institutions shall take effect on the first day of a calendar quarter which begins on or after the date on which the regulations are published in final form, unless the agency determines, for good cause published with the rule, that the rule should become effective before such time.[4] The final rule does not impose any additional reporting, disclosures, or other new requirements on insured depository institutions.

The final rule is therefore effective upon July 21, 2011, the date when the statutory prohibition against the payment of interest on demand deposits will be repealed under section 627 of the DFA.

B. Paperwork Reduction Act

No collections of information pursuant to the Paperwork Reduction Act (44 U.S.C. Ch. 3501 et seq.) are contained in the final rule.

C. Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) requires that each federal agency either certify that a proposed rule would not, if adopted in final form, have a significant economic impact on a substantial number of small entities or prepare an initial regulatory flexibility analysis of the rule and publish the analysis for comment. For purposes of the

[4] 12 U.S.C. 4802.

RFA analysis or certification, financial institutions with total assets of $175 million or less are considered to be "small entities." The FDIC hereby certifies pursuant to 5 U.S.C. 605(b) that the final rule will not have a significant economic impact on a substantial number of small entities. This is because the FDIC already applies the Part 329 definition of "interest" and the interpretive rule on premiums for purposes of determining whether an account qualifies for full deposit insurance coverage as a noninterest-bearing transaction account. The FDIC is only transferring the definition from Part 329 to Part 330 because the former regulation will become moot on July 21, 2011, pursuant to section 627 of the DFA and its repeal of the statutory ban on the payment of interest on demand deposits. There will therefore be no significant economic impact on a substantial number of small entities as a result of this change.

D. Small Business Regulatory Enforcement Fairness Act

The Office of Management and Budget (OMB) has determined that the final rule is not a "major rule" within the meaning of the relevant sections of the Small Business Regulatory Enforcement Act of 1996 (SBREFA) (5 U.S.C. 801, *et seq*.).

As required by SBREFA, the FDIC will file the appropriate reports with Congress and the General Accounting Office so that the final rule may be reviewed.

E. The Treasury and General Government Appropriations Act, 1999—Assessment of Federal Regulations and Policies on Families

The FDIC has determined that the final rule will not affect family well-being within the meaning of section 654 of the Treasury and General Government

Appropriations Act, enacted as part of the Omnibus Consolidated and Emergency Supplemental Appropriations Act of 1999 (Pub. L. 105-277, 112 Stat. 2681).

F. Plain Language

Section 722 of the Gramm-Leach-Bliley Act, Pub. L. 106-102, 113 Stat. 1338, 1471 (Nov. 12, 1999), requires the federal banking agencies to use plain language in all proposed and final rules published after January 1, 2000. No commenter suggested that the NPR was materially unclear, and the FDIC believes that the final rule is substantively similar to the NPR.

List of Subjects in 12 CFR Part 329

Banks, banking, interest rates.

List of Subjects in 12 CFR Part 330

Bank deposit insurance, Banks, Banking, Reporting and recordkeeping requirements, Savings and loan associations, Trusts and trustees.

For the reasons set forth in the preamble, the FDIC amends chapter III of title 12 of the Code of Federal Regulations as follows:

PART 329 — Interest On Deposits

1. Part 329 is removed and reserved.

Part 330 — Deposit Insurance Coverage

2. The authority for part 330 continues to read as follows:

12 U.S.C. 1813(*l*), 1813(m), 1817(i), 1818(q), 1819(Tenth), 1820(f), 1821(a), 1822(c).

3. In § 330.1, paragraphs (k) through (q) of § 330.1 are redesignated as paragraphs (l) through (r) respectively and new paragraph (k) is added to read as follows:

§ 330.1 Definitions

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(k) *Interest*, with respect to a deposit, means any payment to or for the account of any depositor as compensation for the use of funds constituting a deposit. A bank's absorption of expenses incident to providing a normal banking function or its forbearance from charging a fee in connection with such a service is not considered a payment of interest.

4. New § 330.101 is added to read as follows:

§ 330.101 Premiums.

This interpretive rule describes certain payments that are not deemed to be "interest" as defined in § 330.1(k).

(a) Premiums, whether in the form of merchandise, credit, or cash, given by a bank to the holder of a deposit will not be regarded as "interest" as defined in § 330.1(k) if:

(1) The premium is given to the depositor only at the time of the opening of a new account or an addition to an existing account;

(2) No more than two premiums per deposit are given in any twelve-month interval; and

(3) the value of the premium (in the case of merchandise, the total cost to the bank, including shipping, warehousing, packaging, and handling costs) does not exceed $10 for a deposit of less than $5,000 or $20 for a deposit of $5,000 or more.

(b) The costs of premiums may not be averaged.

(c) A bank may not solicit funds for deposit on the basis that the bank will divide the funds into several accounts for the purpose of enabling the bank to pay the depositor more than two premiums within a twelve-month interval on the solicited funds.

(d) The bank must retain sufficient information for examiners to determine that the requirements of this section have been satisfied.

(e) Notwithstanding paragraph (a) of this section, any premium that is not, directly or indirectly, related to or dependent on the balance in a demand deposit account and the duration of the account balance shall not be considered the payment of interest on a demand deposit account and shall not be subject to the limitations in paragraph (a) of this section.

By order of the Board of Directors.

Dated at Washington, DC, this 6th day of July, 2011.

Federal Deposit Insurance Corporation.

Robert E. Feldman,

Executive Secretary.