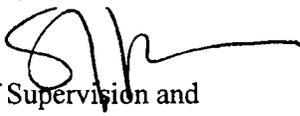


October 26, 2010

MEMORANDUM TO: The Board of Directors

FROM: Sandra L. Thompson 
Director, Division of Supervision and
Consumer Protection

Richard J. Osterman, Jr. 
Acting General Counsel

SUBJECT: Final Rule on Deposit Insurance of
Noninterest-Bearing Transaction Accounts

RECOMMENDATION:

We recommend that the Board of Directors authorize the Executive Secretary to publish in the *Federal Register* the attached final rule amending the FDIC's deposit insurance regulations to provide for the unlimited deposit insurance of noninterest-bearing transaction accounts from December 31, 2010, through December 31, 2012, as provided for in section 343 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank" Act).¹

DISCUSSION:

The Proposed Rule

On September 30, 2010, the FDIC published a proposed rule ("proposed rule") to implement section 343 of the Dodd-Frank Act ("Section 343").² In summary, the proposed rule: followed the Section 343 definition of *noninterest-bearing transaction account*; identified and discussed the differences between Section 343 and the FDIC's Transaction Account Guarantee Program ("TAGP"); explained the separate deposit insurance available for noninterest-bearing transaction accounts under Section 343; proposed disclosure and notice requirements as part of the implementation of Section 343; announced that, because of this Congressional action, the FDIC would not be extending the TAGP beyond its sunset date of December 31, 2010; and requested comments on all aspects of the proposed rule.

¹ Pub. L. No. 111-203 (July 21, 2010).

² 75 Fed. Reg. 60341 (Sept. 30, 2010)

Comment Summary³

The comment period on the proposed rule ended on October 15, 2010. The FDIC received ninety-three comments from trade associations, insured depository institutions (“IDIs”) and law firms, among others. In particular, the FDIC received eighty-four comments from state-bar affiliated associations and five comments from banking and other associations. The remaining four comments were from individual IDIs.

Trade associations and bankers commented that the proposed rule reflects an accurate interpretation of Section 343. Numerous IDIs and state bar associations, as well as others, commented that the exclusion of Interest on Lawyer Trust Accounts (“IOLTAs”) from Section 343 was the result of an inadvertent omission on the part of Congress. These comments referenced a pending bi-partisan Senate bill to include IOLTAs in the Section 343 definition of noninterest-bearing transaction account. The commenters oppose the proposed rule’s requirement that IDIs notify IOLTA and negotiable order of withdrawal (“NOW”) account holders of changes in the deposit insurance scheme before Congress has the opportunity to amend Section 343 to include IOLTAs. Their comments reflect a concern that the exclusion of IOLTA and NOW accounts from the definition of noninterest-bearing transaction account will cause large IOLTA and NOW account depositors to either spread these deposits across multiple IDIs to ensure full deposit insurance coverage or place their deposits with institutions deemed “too big to fail.” Their comments also reflect a concern that failure to provide unlimited insurance to IOLTA and NOW accounts will significantly restrict community lending.

One commenter requested that the final rule clarify whether the notice requirements apply to all depositors who hold NOW accounts in IDIs participating in the TAGP, or only to depositors who may be affected by the change in deposit insurance coverage. According to this comment letter, most NOW account holders will not be affected by the change because they have less than the standard maximum deposit insurance amount of \$250,000 (“SMDIA”) and remain fully insured should an IDI default.

Several commenters expressed concerns over the unintended consequences of providing unlimited deposit insurance coverage for noninterest-bearing transaction accounts, contending that providing such coverage for these accounts promotes moral hazard. Four commenters suggested charging a separate assessment, in addition to the normal assessment rates, to address what they deem to be disproportionately high assessment rates on banks with relatively low levels of noninterest-bearing transaction accounts.

The Final Rule

Definition of noninterest-bearing transaction account

As in the proposed rule, the recommended final rule follows the definition of noninterest-bearing transaction account in Section 343. Section 343 defines a noninterest-bearing transaction

³ A more complete comment summary is provided in the attached Federal Register notice.

account as “a deposit or account maintained at an IDI with respect to which interest is neither accrued nor paid; on which the depositor or account holder is permitted to make withdrawals by negotiable or transferable instrument, payment orders of withdrawal, telephone or other electronic media transfers, or other similar items for the purpose of making payments or transfers to third parties or others; and on which the IDI does not reserve the right to require advance notice of an intended withdrawal.” One commenter on the proposed rule suggested that the FDIC define a depositor’s balance in a noninterest-bearing transaction account as the “average balance collected within the insured account over the past 30 days” prior to the date of failure of the IDI. Staff believes this definition would be inconsistent with the definition of noninterest-bearing transaction account in Section 343 and would lead to depositor confusion and uncertainty as to the extent of deposit insurance coverage available on noninterest-bearing transaction accounts.

The Section 343 definition of noninterest-bearing transaction account is similar to the definition of that term in the TAGP, but it includes no interest-bearing accounts. The Section 343 definition of noninterest-bearing transaction account encompasses only traditional, noninterest-bearing demand deposit (or checking) accounts that allow for an unlimited number of deposits and withdrawals at any time, whether held by a business, an individual or other type of depositor. Unlike the definition of noninterest-bearing transaction account in the TAGP, the Section 343 definition of noninterest-bearing transaction account does not include NOW accounts (regardless of the interest rate paid on the account) or IOLTAs. Therefore, under the recommended final rule, neither NOW accounts nor IOLTAs are within the definition of noninterest-bearing transaction account.

In response to the numerous comments that the FDIC either postpone issuance of the final rule or exclude from the final rule the requirement that IDIs currently participating in the TAGP notify IOLTA customers that, beginning January 1, 2011, IOLTAs no longer will be eligible for full deposit insurance coverage, the preamble to the recommended final rule notes the importance of depositors having a clear understanding of the deposit insurance rules before placing or retaining deposits at an FDIC-insured institution. It also notes if, as the commenters suggest, Congress acts to add IOLTAs to Section 343, thus providing temporary full coverage for these accounts, the FDIC will act quickly to notify IDIs of the statutory change and explain how to respond to this change in complying with the disclosure requirements in the final rule.

The preamble also explains that, under the FDIC’s general deposit insurance rules, IOLTAs may qualify for “pass-through” deposit insurance coverage, so long as the regulatory requirements are met. That means that each client for whom a law firm holds funds in an IOLTA may be insured up to \$250,000 for his or her funds. In addition, the accrued interest to which a legal services entity or program is entitled may be separately insured for \$250,000. Thus, even absent the availability of unlimited coverage for IOLTAs under either the TAGP or Section 343, a generous amount of deposit insurance coverage is potentially available for IOLTAs.

One commenter on the proposed rule asked that the FDIC clarify that “rewards programs” offered by IDIs on non-interest checking accounts would not prevent an account from meeting the definition of noninterest-bearing transaction account under the final rule. The preamble explains that, generally, the FDIC will look to current requirements and interpretations under Part 329 of its regulations (*Interest on Deposits*, 12 CFR Part 329) and such interpretations under

Regulation Q of the Board of Governors of the Federal Reserve System (12 CFR Part 217) to determine whether rewards provided in connection with transaction accounts will be considered interest paid on the account and, thus, disqualify an account from treatment as a noninterest-bearing transaction account.

Insurance coverage

As noted in the proposed rule, pursuant to Section 343, all funds held in noninterest-bearing transaction accounts will be fully insured, without limit. As also specifically provided for in Section 343, this unlimited coverage is separate from, and in addition to, the coverage provided to depositors with respect to other accounts held at an IDI. This means that funds held in noninterest-bearing transaction accounts will not be counted in determining the amount of deposit insurance on deposits held in other accounts, and in other rights and capacities, at the same IDI.

One issue raised during the comment period is how the FDIC will apply the new Dodd-Frank coverage provision to situations in which account owners have revocable trust accounts in the form of both interest-bearing and noninterest-bearing transaction accounts. The preamble to the recommended final rule explains how the FDIC will insure revocable trust accounts under Section 343.

No separate assessment

The FDIC imposes a separate assessment on IDIs that participate in the TAGP.⁴ The proposed rule indicated that the FDIC will not charge a separate assessment for the insurance of noninterest-bearing transaction accounts pursuant to Section 343. Four comments from trade groups and IDIs suggested that the FDIC charge more for the additional coverage on noninterest bearing transaction accounts similar to the way additional coverage is charged for under the TAGP. The preamble to the recommended final rule explains that the proposed rule was not intended to address assessment issues, but notes that the FDIC will take this comment into consideration when considering future changes to the assessment rate system.

Disclosure and notice requirements

The recommended final rule includes disclosure and notice requirements as part of the implementation of Section 343. As indicated in the proposed rule, the preamble to the recommended final rule notes that these requirements are to ensure that depositors are aware of and understand what types of accounts will be covered by this temporary deposit insurance coverage for noninterest-bearing transaction accounts. As in the proposed rule, the final rule includes three such requirements. As explained in detail below: (1) IDIs must post a prescribed

⁴ 12 CFR 370.7

notice in their main office, each branch and, if applicable, on their Website; (2) IDIs currently participating in the TAGP must notify NOW account depositors (that are currently protected under the TAGP because of interest rate restrictions on those accounts) and IOLTA depositors that, beginning January 1, 2011, those accounts no longer will be eligible for unlimited protection; and (3) IDIs must notify customers individually of any action they take to affect the deposit insurance coverage of funds held in noninterest-bearing transaction accounts.

1. Posted notice

The recommended final rule requires each IDI to post, prominently, a copy of the following notice in the lobby of its main office, in each domestic branch and, if it offers Internet deposit services, on its Website. In response to comments received on the proposed rule, this notice has been revised from the notice in the proposed rule to make it more concise and reader-friendly:

NOTICE OF CHANGES IN TEMPORARY FDIC INSURANCE COVERAGE FOR TRANSACTION ACCOUNTS

All funds in a “noninterest-bearing transaction account” are insured in full by the Federal Deposit Insurance Corporation from December 31, 2010, through December 31, 2012. This temporary unlimited coverage is in addition to, and separate from, the coverage of at least \$250,000 available to depositors under the FDIC’s general deposit insurance rules.

The term “noninterest-bearing transaction account” includes a traditional checking account or demand deposit account on which the insured depository institution pays no interest. It does *not* include other accounts, such as traditional checking or demand deposit accounts that may earn interest, NOW accounts, money-market deposit accounts, and Interest on Lawyers Trust Accounts (“IOLTAs”).

For more information about temporary FDIC insurance coverage of transaction accounts, visit www.fdic.gov.

2. Notice to depositors protected under the TAGP but not under the Dodd-Frank provision

As discussed above, through December 31, 2010, low-interest NOW accounts and all IOLTAs are protected in full at IDIs participating in the TAGP. These accounts, however, are not eligible for unlimited deposit insurance coverage under the Dodd-Frank provision. Thus, starting January 1, 2011, all NOW accounts and IOLTAs will be insured under the general deposit insurance rules and will no longer be eligible for unlimited protection. Because of the potential depositor confusion about this change in the FDIC’s treatment of NOWs and IOLTAs, the recommended final rule requires IDIs currently participating in the TAGP to provide individual notices to depositors with NOW accounts currently protected in full under the TAGP and

IOLTAs that those accounts will not be insured under the new temporary insurance category for noninterest-bearing transaction accounts. IDIs are required to provide such notice to applicable depositors by mail no later than December 31, 2010.

One commenter asked that the FDIC address certain specifics about complying with this notice requirement. In response to that comment, the preamble to the recommended final rule specifies that: (1) as to joint accounts protected under the TAGP as of December 31, 2010, IDIs need only mail the notice to the address designated on the account; (2) if depositors have more than one affected account, one notice is sufficient if it identifies all the applicable accounts; and (3) the notice may be in the form of the “posting” notice in section 330.16(c)(1) of the final rule.

3. Notice to sweep account and other depositors whose coverage on noninterest-bearing transaction accounts is affected by an IDI action

Under the TAGP regulations, if an IDI offers an account product in which funds are automatically transferred, or “swept,” from a noninterest-bearing transaction account to another account (such as a savings account) or bank product that does not qualify as a noninterest-bearing transaction account, it must inform those customers that, upon such transfer, the funds will no longer be fully protected under the TAGP. As in the proposed rule, the recommended final rule contains a similar, though somewhat more expansive, requirement, mandating that IDIs notify customers of any action that affects the deposit insurance coverage of their funds held in noninterest-bearing transaction accounts.

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