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made to participating accounts during the day) is a time deposit withdrawn prior to maturity so as to incur an early withdrawal penalty. The arrangement may be marketed as providing the customer unlimited access to its funds with a high rate of interest.

(c) *Determination.* In these arrangements, the aggregate deposit balances of all participants generally vary by a comparatively small amount, allowing the time deposits maturing on any day safely to cover any charges to the depositors' transaction accounts and avoiding any early withdrawal penalties. Thus, this arrangement substitutes time deposit balances for transaction accounts balances with no practical restrictions on the depositors' access to their funds, and serves no business purpose other than to allow the payment of higher interest through the avoidance of reserve requirements. As the time deposits may be used to provide funds indirectly for the purposes of making payments or transfers to third persons, the Board has determined that the time deposits should be considered to be transaction accounts for the purposes of Regulation D.

[57 FR 38428, Aug. 25, 1992]

§ 204.135 Shifting funds between depository institutions to make use of the low reserve tranche.

(a) *Authority.* Under section 19(a) of the Federal Reserve Act (12 U.S.C. 461(a)) the Board is authorized to define terms used in section 19, and to prescribe regulations to implement and to prevent evasions of the requirements of that section. Section 19(b)(2) establishes general reserve requirements on transaction accounts and nonpersonal time deposits. In addition to its authority to define terms under section 19(a), section 19(g) of the Federal Reserve Act also give the Board the specific authority to define terms relating to deductions allowed in reserve computation, including ''balances due from other banks.'' This interpretation is adopted under these authorities.

(b) *Background.* (1) Currently, the Board requires reserves of zero, three, or ten percent on transaction accounts, depending upon the amount of transaction deposits in the depository institution, and of zero percent on nonpersonal time deposits. In determining its reserve balance under Regulation D, a depository institution may deduct the balances it maintains in another depository institution located in the United States if those balances are subject to immediate withdrawal by the depositing depository institution (§ 204.3(f)). This deduction is commonly known as the ''due from'' deduction. In addition, Regulation D at § 204.2(a)(1)(vii)(A) exempts from the definition of ''deposit'' any liability of a depository institution on a promissory note or similar obligation that is issued or undertaken and held for the account of an office located in the United States of another depository institution. Transactions falling within this exemption from the definition of ''deposit'' include federal funds or ''fed funds'' transactions.

(2) Under section 19(b)(2) of the Federal Reserve Act (12 U.S.C. 461(b)(2)), the Board is required to impose reserves of three percent on total transaction deposits at or below an amount determined under a formula. Transaction deposits falling within this amount are in the ''low reserve tranche.'' Currently the low reserve tranche runs up to $42.2 million. Under section 19(b)(11) of the Federal Reserve Act (12 U.S.C. 461(b)(11)) the Board is also required to impose reserves of zero percent on reservable liabilities at or below an amount determined under a formula. Currently that amount is $3.6 million.

(c) *Shifting funds between depository institutions.* The Board is aware that certain depository institutions with transaction account balances in an amount greater than the low reserve tranche have entered into transactions with affiliated depository institutions that have transaction account balances below the maximum low reserve tranche amount. These transactions are intended to lower the transaction reserves of the larger depository institution and leave the economic position of the smaller depository institutions unaffected, and have no apparent purpose other than to reduce required reserves of the larger institution. The larger depository institution places funds in a demand deposit at a small domestic depository institution. The

larger depository institution considers those funds to be subject to the ''due from'' deduction, and accordingly reduces its transaction reserves in the amount of the demand deposit. The larger depository institution then reduces its transaction account reserves by 10 percent of the deposited amount. The small depository institution, because it is within the low reserve tranche, must maintain transaction account reserves of 3 percent on the funds deposited by the larger depository institution. The small depository institution then transfers all but 3 percent of the funds deposited by the larger depository institution back to the larger depository institution in a transaction that qualifies as a ''fed funds'' transaction. The 3 percent not transferred to the larger depository institution is the amount of the larger depository institution's deposit that the small depository institution must maintain as transaction account reserves. Because the larger depository institution books this second part of the transaction as a ''fed funds'' transaction, the larger depository institution does not maintain reserves on the funds that it receives back from the small depository institution. As a consequence, the larger depository institution has available for its use 97 percent of the amount transferred to the small depository institution. Had the larger depository institution not entered into the transaction, it would have maintained transaction account reserves of 10 percent on that amount, and would have had only 90 percent of that amount for use in its business.

(d) *Determination.* The Board believes that the practice described above generally is a device to evade the reserves imposed by Regulation D. Consequently, the Board has determined that, in the circumstances described above, the larger depository institution depositing funds in the smaller institution may not take a ''due from'' deduction on account of the funds in the demand deposit account if, and to the extent that, funds flow back to the larger depository institution from the small depository institution by means of a transaction that is exempt from transaction account reserve requirements.

[57 FR 38429, Aug. 25, 1992]

§ 204.136 Treatment of trust overdrafts for reserve requirement reporting purposes.

(a) *Authority.* Under section 19(a) of the Federal Reserve Act (12 U.S.C. 461(a)), the Board is authorized to define the terms used in section 19, and to prescribe regulations to implement and prevent evasions of the requirements of that section. Section 19(b) establishes general reserve requirements on transaction accounts and nonpersonal time deposits. Under section 19(b)(1)(F), the Board also is authorized to determine, by regulation or order, that an account or deposit is a transaction account if such account is used directly or indirectly for the purpose of making payments to third persons or others. This interpretation is adopted under these authorities.

(b) *Netting of trust account balances.* (1) Not all depository institutions have treated overdrafts in trust accounts administered by a trust department in the same manner when calculating the balance in a commingled transaction account in the depository institution for the account of the trust department of the institution. In some cases, depository institutions carry the aggregate of the positive balances in the individual trust accounts as the balance on which reserves are computed for the commingled account. In other cases depository institutions net positive balances in some trust accounts against negative balances in other trust accounts, thus reducing the balance in the commingled account and lowering the reserve requirements. Except in limited circumstances, negative balances in individual trust accounts should not be netted against positive balances in other trust accounts when determining the balance in a trust department's commingled transaction account maintained in a depository institution's commercial department. The netting of positive and negative balances has the effect of reducing the aggregate of a commingled transaction account reported by the depository institution to the Federal Reserve and reduces the reserves the institution must hold against transaction accounts under Regulation D. Unless the governing trust agreement or state law authorizes the depository institution,