

**FEDERAL RESERVE BANK
OF DALLAS**

Dallas, Texas, April 1, 1966

REVISED PROPOSAL TO AMEND REGULATIONS D AND Q

**To All Member Banks in the
Eleventh Federal Reserve District:**

The Board of Governors has revised its proposed definition of the term "deposit" as set forth in the proposal of January 20, 1966, shown in our letter of January 21, 1966. There follows the text of a statement released to the press by the Board on March 29, 1966, concerning the revised proposed definition.

The Board of Governors has announced that it has revised its proposed definition of the term "deposit" for purposes of Regulation D, "Reserves of Member Banks", and Regulation Q, "Payment of Interest on Deposits".

Comments on the revised proposal should be submitted to the Board not later than April 20, 1966.

The principal change in the proposal is the exclusion from the category of "deposits" of transactions in "Federal funds" between member banks and nonbank dealers in Government securities.

The text of the notice regarding the revised proposal, as it will be published in the Federal Register, is shown inside of this folder.

Yours very truly,

Watrous H. Irons
President

FEDERAL RESERVE SYSTEM

[12 CFR Parts 204, 217]

[Regs. D, Q]

RESERVES OF MEMBER BANKS; PAYMENT OF INTEREST ON DEPOSITS

Notice of Proposed Rule Making

The Board of Governors announced on January 20, 1966 (published in the Federal Register of January 26, 1966, 31 F.R. 1010) that it was considering amending § 204.1 of Regulation D ("Reserves of Member Banks") and § 217.1 of Regulation Q ("Payment of Interest on Deposits") by inserting at the beginning of each a new paragraph defining the term "deposit" for purposes of those regulations.

The Board has now revised its proposal in the light of comments received from interested persons. The revised proposal would amend § 204.1 and § 217.1 as follows:

(a) **Deposit.** — The term "deposit" means any indebtedness¹ of a member bank that arises out of a transaction in the ordinary course of its banking business with respect to either funds received or credit extended by the bank, except

- (1) indebtedness due to a Federal Reserve Bank;
- (2) indebtedness due to another bank for its own account that is not reflected on books or reports of the debtor as a deposit or of the creditor as a bank balance;
- (3) indebtedness arising from a transfer of direct obligations of the United States that the bank is obligated to repurchase;
- (4) indebtedness that (A) is due to a Government securities dealer that makes primary markets in obligations of the United States and reports its activities regularly to the Federal Reserve Bank of New York, and (B) arises from a loan, for one business day, of proceeds of a transfer of deposit credit in a Federal Reserve Bank (or of other immediately available funds) in connection with payment on that day for obligations of the United States or any agency thereof;² and
- (5) indebtedness with an original maturity of more than two years that is subordinated to the claims of depositors and general creditors.

This paragraph shall not affect the status, for purposes of this part, of any indebtedness incurred prior to January 20, 1966.

(b) By redesignating the present paragraphs (a), (b), (c), (d), (e), (f), (g), (h), and (i) and footnotes 1, 2, 3, 4, 5, 6, and 7 of § 204.1 as paragraphs (b), (c), (d), (e), (f), (g), (h), (i), and (j) and footnotes 3, 4, 5, 6, 7, 8, and 9, respectively.

(c) By redesignating the present paragraphs (a), (b), (c), (d), and (e) and footnotes 1, 2, 3, 4, and 5 of § 217.1 as paragraphs (b), (c), (d), (e), and (f) and footnotes 3, 4, 5, 6, and 7, respectively.

The following are illustrations of the effects of the amendments, from the standpoint of rules governing payment of interest on deposits.

(a) In consideration of the receipt of funds, a member bank issues to an industrial corporation its promissory note (either negotiable or nonnegotiable) to mature in six months. The bank's liability is a deposit. Consequently the rate of interest on the note may not lawfully exceed that permitted on a certificate of deposit.

¹ For the purpose of this definition, indebtedness does not include (1) an obligation to deliver securities sold, (2) a contingent liability such as arises from the issuance of a letter of credit or a commitment to make a loan, or (3) a liability such as arises from the creation of a bank acceptance.

² This exemption is applicable to an entire account of this type, even though it may include relatively insignificant transactions in other money market assets.

(b) A member bank issues to an industrial corporation its note payable on demand or within less than 30 days, either negotiable or nonnegotiable. The bank's liability constitutes a demand deposit, and it may not lawfully pay any interest thereon.

(c) A member bank purchases stationery and office supplies on credit. Such indebtedness does not arise from "funds received or credit extended by the bank", and consequently it is not a deposit.

(d) A member bank borrows funds on its note, secured by a mortgage on the bank premises, and uses the proceeds to pay for renovation. Although this indebtedness arises from "funds received" by the bank, the transaction is not "in the ordinary course of its banking business", and therefore the indebtedness does not constitute a deposit.

(e) A member bank lends funds to a customer and credits the proceeds to his account. The amount so credited is, as heretofore, a deposit.

(f) A member bank receives funds, in the ordinary course of its banking business, from a correspondent bank — whether member or nonmember, domestic or foreign. Consistent with traditional practice and understanding of the parties, the liability of the recipient bank is a deposit. The definition of "deposit", however, excepts from its coverage an interbank indebtedness that is entered and reported by both banks as a loan transaction. A loan of what are commonly termed "Federal funds" is an example of an indebtedness that falls within such exception.

(g) A member bank issues debentures or notes to provide additional "capital" funds. By contract, the claim of the security holders against the assets of the bank is subordinated to the claims of depositors and all other creditors. Such notes are excepted from the definition of deposit if they have an original maturity of more than two years.

(h) A Government securities dealer that reports to the New York Reserve Bank has an arrangement with a member bank whereby the bank maintains a running account of "Federal funds" debits and credits with respect to the dealer's purchases and sales of Government and Federal agency securities that are settled in such funds. The indebtedness of the bank to the dealer in connection with such account is not a deposit.

(i) A member bank contracts to sell securities to a customer. Instead of making immediate delivery of such securities, the bank gives the customer a "due bill", promising to make delivery at a subsequent time. Such an obligation to deliver securities is not a money transaction and is not a deposit, unless the "due bill" procedure was used by the bank primarily as a method of raising funds.

(j) A member bank accepts a draft drawn on it in connection with the importation of goods into the United States. Since the bank's obligation is not an "indebtedness" as defined in the regulations, the transaction does not give rise to a deposit. (Of course, if the acceptance procedure was used primarily as a device for procuring funds for the bank's use, the bank's obligation would constitute an "indebtedness" and, accordingly, a deposit.)

The purpose of these proposed amendments is to prevent evasions of laws and regulations governing payment of interest on and maintenance of reserves against deposits. They are based upon the premise that, with few exceptions, indebtedness of member banks must be considered and treated as deposits subject to Regulations D and Q in order to effectuate Congressional directives and policies, as expressed in section 19 of the Federal Reserve Act (12 U.S.C. 461, 462, 371a, and 371b).

Data, views, or arguments on the proposal as revised should be submitted in writing to the Secretary, Board of Governors of the Federal Reserve System, Washington, D. C., 20551, to be received not later than April 20, 1966.

Dated at Washington, D. C., this 29th day of March, 1966.
By order of the Board of Governors.

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.