

FEDERAL RESERVE BANK OF DALLAS
DALLAS, TEXAS 75222

Circular No. 68-191
September 3, 1968

To All Member Banks
in the Eleventh Federal Reserve District:

The Board of Governors of the Federal Reserve System has revised its interpretation of reserve requirements for dealers' reserves and differential accounts.

The interpretation is being submitted to the Federal Register for publication and the text of the interpretation will also be published in the September 1968 issue of the Federal Reserve Bulletin.

For your information we are enclosing a copy of the interpretation.

Yours very truly,

P. E. Coldwell
President

Attachment

TITLE 12 - BANKS AND BANKING

CHAPTER II - FEDERAL RESERVE SYSTEM

SUBCHAPTER A - BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

[Reg. D]

PART 204 - RESERVES OF MEMBER BANKS

Dealers' Reserve and Differential Accounts

Section 204.106 is revised to read as follows:

§ 204.106 Member bank reserve requirements for dealers' reserves and differential accounts.

(a) The Board of Governors has reviewed its interpretations on the "deposit" status of so-called "dealers' reserves" and "differential accounts" (especially 1942 Federal Reserve Bulletin 302 and 1960 Federal Reserve Bulletin 265) and has concluded that the distinctions previously drawn between such accounts are not warranted and should be abandoned.

(b) A dealer's reserve or differential account usually arises when a merchant ("dealer") enters into an arrangement with a bank under which the bank furnishes the dealer with financing of his instalment accounts receivable on the basis of a sale of such receivables to the bank. Despite language to the contrary in many of the sale agreements, the proceeds of the credit that the dealer receives upon the purchase of contracts by the bank is only a portion (such as 90 per cent) of the amount due on such contracts. Depending on the results of collections on the contracts purchased, some (or all) of the remainder may be realized by the dealer later.

(c) The establishment of a dealer's reserve account or differential account does not arise from the receipt of funds by the bank but rather from a bookkeeping entry to reflect a contingent obligation of

the bank to make funds available to the dealer in the future, in specified circumstances. (Typical accounting entries by the bank are a debit to "Loans and discounts" for the principal due on the contracts purchased, a credit to the dealer's checking account for 90 per cent of such amount, and a credit to a "Dealer's reserve" or "Differential account" for the remainder.) As instalment payments are made on the contracts purchased, the funds received reduce the amount due on the contracts (a credit to "Loans and discounts") and may, at a time or times specified in the bank-dealer agreement and in amounts calculated in accordance therewith, result in the bank making additional credit available to the dealer (a debit to the "Dealer's reserve" or "Differential account" and credit to the dealer's checking account). Until such time, ownership of the funds is in the bank, as in the case of any other funds received in repayment of an obligation owned by the bank. If collections are made by the dealer on behalf of the bank, the dealer may, in accordance with the terms of the agreement, remit to the bank less than the full amount collected, retaining an amount equal to the additional credit that the bank would be obliged to make available to the dealer if collections were made by the bank itself.

(d) In 1966, the Board reversed a long-standing position that member banks must maintain reserves against payments received by a bank from a borrower on an instalment loan that are not immediately used to reduce the amount due on the loan but are held by the bank until the sum of such payments equals the entire amount of principal and interest (so-called "hypothecated deposits"). In holding that such payments are not

deposits against which reserves must be maintained (1966 Federal Reserve Bulletin 808; § 204.111), the Board concluded that "where the agreement between the bank and the borrower is such that instalment payments on loans are irrevocably assigned to the bank and can not be reached by the borrower or his creditors, such payments are not 'deposits' regardless of the terms used . . . in the bank's books and records".

(e) The Board believes that, with respect to "deposit" status, the considerations relating to dealers' reserves and differential accounts are similar to those relating to hypothecated deposits. As in the case of hypothecated deposits, a customer of the bank (the dealer) may not make withdrawals from credit to his name (in a dealer's reserve or differential account). Nor does the dealer have access to the funds received by the bank in payment on the instalment contracts purchased from the dealer, unless and until, pursuant to the provisions of the bank-dealer agreement, the bank becomes liable to the dealer for an amount representing a portion thereof.

(f) For the purposes of section 19 of the Federal Reserve Act (12 U.S.C. 461) and Federal Reserve Regulation D (12 CFR 204), the Board considers that a deposit liability exists only when there is an indebtedness on the part of a bank with respect to either funds received or credit extended by the bank, and that "indebtedness" for this purpose does not include a contingent liability of the kind represented by a dealer's reserve or differential account. A similar contingent liability that does not constitute such an indebtedness arises in connection with a commitment to make a loan.

(g) Accordingly, the Board has concluded that, when a member bank furnishes a dealer with financing of his instalment accounts receivable on the basis of a "sale" of such receivables to the bank, no deposit liability arises as a result of an account created as a margin of security for the bank, whether described as a "dealer's reserve", "differential account", or otherwise, unless and until, and then only to the extent that, the bank becomes actually (as distinguished from contingently) obligated to make credit or funds available to the dealer. Stated in another way, such credit or funds constitute a deposit liability for the purposes of section 19 and Regulation D only to the extent that they could be reached immediately by the dealer's creditors in the event of his insolvency.

(h) This ruling supersedes all previous rulings of the Board relating to the "deposit" status of dealers' reserve accounts and differential accounts.

(Interprets and applies 12 U.S.C. 461.)

Dated at Washington, D. C., the 12th day of August, 1968.

By order of the Board of Governors.