FEDERAL RESERVE BANK OF DALLAS

DALLAS, TEXAS 75222

Circular No. 72-107
June 5, 1972

To All Member Banks and Others Concerned
in the Eleventh Federal Reserve District:

You may recall that on June 10, 1971, I wrote you a brief letter cautioning that the use of individual officers as nominees in bidding for public funds could be a violation of Regulation Q. In addition to the individual bid procedure, it has become evident that some banks are bidding for public funds in a manner which, in effect, reflects payment for demand deposits. After careful study, the Board of Governors has issued a letter regarding one bank in the Eleventh District clearly pointing to the violations of both the spirit and the letter of Regulation Q by such procedures. The relevant section of the Board's letter are reproduced below.

> After reviewing the facts of the case, the Board is of the view that [Name of Bank] should be considered, for the purposes of Regulation Q, to have been a party to the bid between the officer of the bank and the public body. Among the circumstances leading to this conclusion are the facts that the bank recommended the officer to the public body in connection with the bid; the bank has pledged its own securities as collateral for the public funds to fulfill the obligation of the bank officer as Treasurer to secure the funds; all or substantially all of the funds have been channelled to the bank; and the interest paid on the funds by the bank is calculated so as to meet the interest payments promised by the bank officer to the public body.
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> The Board has previously ruled that, where a member bank pays a customer who maintains a demand deposit in a prescribed amount a higher rate of interest on a time deposit than is paid to customers who do not maintain demand deposits, the incremental interest is actually paid as "compensation" for the use of funds constituting the demand deposit and involves a violation of the prohibition against paying interest on a demand deposit.
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> The Board believes that the arrangement involving this bank gives rise to a payment of interest on a demand deposit. The amount of interest paid by the bank on the time deposits is calculated so as to yield a certain rate of return on all

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funds on deposit, both time and demand. An indication that interest is actually being paid on a demand deposit in this situation is that the rate of interest on the time deposits may be computed only after the amount of interest to be paid on all the funds is determined and varies with the amount of the demand deposit.

It also appears that the arrangement entered into by the bank may involve an agreement or understanding (whether or not in writing) that time deposits of the type on which the interest rate ceiling has been suspended will be "rolled over". The Board regards such an agreement or understanding as a violation of the spirit of the interpretation the Board issued at the time it suspended the interest rate ceiling on a 30-89-day single maturity time deposits of at least $100,000. [See Published Interpretations, ¶ 3370(b).] Of course, if there is an underlying instrument or contract or any informal understanding or agreement providing for automatic renewal of the deposits at maturity, the deposits would fall within the definition of "multiple maturity time deposit" [§ 217.1(g) of Regulation Q] and the maximum rate that may be paid on such a deposit would apply.

It is hoped that all banks will carefully avoid such procedures in future public fund bidding and will take immediate steps to bring any present contracts into conformity with Regulation Q.

Very truly yours,

P. E. Coldwell,

President