

FEDERAL RESERVE BANK OF DALLAS

DALLAS, TEXAS 75222

Circular No. 78-43

April 13, 1978

REGULATION Q--INTEREST ON DEPOSITS

Prepayment of Interest on Deposits in the Form of Merchandise

TO ALL MEMBER BANKS IN THE  
ELEVENTH FEDERAL RESERVE DISTRICT:

Attached is an opinion letter from the staff of the Board of Governors of the Federal Reserve System concerning the question of prepayment of interest to depositors in the form of merchandise. The letter treats the payment of such merchandise as interest and sets guidelines for limitations on same under Regulation Q.

You are also referred to Paragraph 3190 of the Published Interpretations of the Board of Governors of the Federal Reserve System which states that such merchandise is not considered payment of interest if (1) it is given to a depositor only at the time of the opening of a new account or an addition to an existing account, (2) it is not given to any depositor on a recurring basis, and (3) the value of the merchandise (measured by the wholesale cost excluding shipping and packaging costs) does not exceed \$5, except that the value or wholesale cost may be not more than \$10 if the amount of the deposit is \$5,000 or more.

Any questions on this matter should be directed to the Bank Supervision and Regulations Department, Consumer Affairs Section, at Ext. 6171 or 6181.

Sincerely yours,

Robert H. Boykin

First Vice President

Attachment

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Banks and others are encouraged to use the following incoming WATS numbers in contacting this Bank: 1-800-492-4403 (intrastate) and 1-800-527-4970 (interstate). For calls placed locally, please use 651 plus the extension referred to above.



BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM

WASHINGTON, D. C. 20551

ADDRESS OFFICIAL CORRESPONDENCE  
TO THE BOARD

Dear

The Board of Governors has considered your request concerning the prepayment of interest on deposits. Your letter indicates that your bank has sponsored deposit programs in which the bank prepays interest to the depositor in the form of merchandise. In determining the maximum amount of interest that may be prepaid, the bank wishes to calculate the amount that may be paid without discounting the interest to its present value. You request the Board's permission to compute interest in this manner. This request is based, in part, on the inability of a depositor to readily sell the merchandise received in order to reinvest the proceeds.

After consideration of the views expressed in your letter, the Board remains of the opinion that under Regulation Q (12 CFR 217), a member bank is required to discount the amount of interest it may pay to its present value regardless of whether the amount is prepaid in the form of merchandise or cash. The Board also has determined that reasonable expenses associated with shipping costs and sales tax generally need not be taken into consideration in determining the maximum amount of interest that may be paid under Regulation Q.

Paragraph 3365 of the Board's Published Interpretations (12 CFR - 217.149) provides that the maximum amount of interest that may be prepaid by a member bank cannot exceed the aggregate amount of interest that could have been paid on the deposit at maturity computed at the applicable maximum rate. The interpretation indicates that the amount the depositor receives at maturity of the time deposit may not exceed the amount actually placed with the bank (the face amount less the amount of prepaid interest) plus interest at the applicable maximum rate for the life of the deposit.

The Board is of the view that this principle should apply regardless of whether interest is prepaid in the form of cash or merchandise. To permit a member bank to pay interest in an amount that exceeds the present value of the future interest would result in the bank paying interest in excess of the maximum permitted by Regulation Q since the depositor would be receiving the same amount of interest at the time the deposit is made as he would have earned if interest had been paid at maturity. The Board sees no valid basis for distinguishing between interest prepaid in the form of merchandise or cash. If such a distinction were authorized, a member bank that prepays interest in the form of merchandise could have a substantial competitive advantage over a financial institution that prepays interest in the form of cash since the member bank could provide merchandise that

has a higher cash value than the interest that is actually prepaid in cash. Accordingly, the Board finds no reasonable basis for permitting such a special exception for merchandise programs. As a result, in the future all programs conducted by your bank that involve the prepayment of interest in the form of merchandise should provide for discounting of interest payable to its present value.

In order to promote a uniform position for all commercial banks, we are informing the Federal Deposit Insurance Corporation and the Comptroller of the Currency of this determination.

Very truly yours,

(signed) Griffith L. Garwood

Griffith L. Garwood  
Deputy Secretary of the Board