FEDERAL RESERVE BANK OF DALLAS

DALLAS, TEXAS 75222

Circular No. 78-111
August 17, 1978

FURTHER EXPLANATION OF AMENDMENT TO REGULATION Q

Two New Categories of Time Deposits

TO ALL MEMBER BANKS
AND OTHERS CONCERNED IN THE
ELEVENTH FEDERAL RESERVE DISTRICT:

Effective June 1, 1978, the Board of Governors of the Federal Reserve System amended section 217.7 of Regulation Q to authorize member banks to offer to depositors two new categories of time deposits. The first new category permits member banks to pay interest at a maximum rate of 7 3/4 percent on time deposits of $1,000 or more with maturities of eight years or more. The second new category authorizes member banks to pay interest on nonnegotiable time deposits of $10,000 or more with maturities of exactly 26 weeks at a maximum rate equal to the discount rate on the most recently issued six-month United States Treasury bills (auction average). Since the Board's action, questions have been received by the Board's staff concerning the new 26-week instrument. This letter responds to the most frequently raised questions and provides general guidelines for advertising the new 26-week time deposit.

How is the ceiling rate on the certificate determined?

The ceiling rate for new 26-week time deposits equals the discount rate (auction average) for United States Treasury bills with maturities of six months issued on or immediately prior to the date of deposit. The ceiling rate is not established with reference to the coupon-equivalent or effective yield on Treasury bills. Should a member bank desire to round off the ceiling rate, such rate may only be rounded down. For example, if the discount rate on Treasury bills is 6.4638 percent, a member bank may round this ceiling rate to 6.463 percent, 6.46 percent, or 6.4 percent. Interest may be computed in accordance with any of the methods authorized by § 217.3(e) of Regulation Q and ¶ 3010 of the Board's *Published Interpretations* (12 CFR 217.151), and, in accordance with § 217.3(a) of Regulation Q, in ascertaining the ceiling rate of interest that may be paid, the effects of compounding of interest may be disregarded. A member bank may round the effective yield arrived at by compounding to the nearest one hundredth of one percent. For example, an effective yield of 6.568 percent may be rounded to 6.57 percent.

When does the ceiling rate on new deposits change?

United States Treasury bills maturing in six months (26 weeks) are auctioned weekly by the Treasury Department, normally on Monday, and normally are issued the following Thursday. Beginning on the date the Treasury bills are issued, member

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.

banks may pay interest on new time deposits with 26-week maturities at a ceiling rate not to exceed the discount rate (auction average) established for Treasury bills and may continue to pay such rate on new 26-week time deposits until the next issue of six-month Treasury bills. At that time, the average discount rate on the new issue of six-month Treasury bills becomes the ceiling rate for new time deposits. For example, the ceiling rate payable on Thursday, August 3, would be fixed at the discount rate (auction average) established on Monday, July 31. That ceiling rate would remain in effect for new time deposits through Wednesday, August 9. On Thursday, August 10, the ceiling rate on new time deposits would change to correspond to the discount rate (average auction) established on Monday, August 7.

Must the maturity of the certificate be 26 weeks exactly, or may it be six calendar months?

The maturity of the certificate must be exactly 26 weeks (182 days) and not six calendar months. However, where the certificate would mature on a legal holiday, it may be issued with an original maturity in excess of 26 weeks (182 days) so that it would mature on the next succeeding business day. This position is consistent with the similar treatment accorded six-month Treasury bills that would otherwise mature on a holiday and is consistent with ¶ 3349 (12 CFR 217.134) of the Board's *Published Interpretations* which generally provides that a member bank may pay interest on a certificate that matures on a legal holiday until the next succeeding business day. However, upon renewal, such certificate must be issued for exactly 26 weeks.

How is the early withdrawal penalty rule applied to the certificate?

The 26-week certificate is treated like other time deposits for purposes of the Regulation Q early withdrawal penalty. In accordance with § 217.4(d) of Regulation Q (12 CFR 217.4(d)), if the deposit or any portion is paid before maturity, a member bank may pay interest on the amount withdrawn at a rate not to exceed that prescribed for a savings deposit (currently five percent) and, in addition, a forfeiture of three months' interest at such rate is required. However, if the amount withdrawn has been on deposit for three months or less, the minimum penalty consists of the forfeiture of all interest for the period of time the funds were on deposit. As is the case with other time deposits, as an alternative to payment before maturity, member banks are permitted to lend on the collateral of such time deposit so long as the rate charged on the loan is at least one percent higher than the rate paid on the deposit pledged.

May the certificate be issued in denominations of $10,000 only?

The $10,000 requirement is a minimum denomination requirement and a member bank may issue the certificate in any denomination of $10,000 or more. As with other time deposits, banks may offer this certificate in discount form where the face amount of the certificate is received by the depositor at maturity, so long as the bank initially receives at least $10,000 from the depositor and the rate paid on the net amount deposited does not exceed the applicable six-month Treasury bill discount rate. See ¶ 3365 of the Board's *Published Interpretations* (12 CFR 217.149).

How may the rate of interest be advertised?

The Board's staff has received a number of questions regarding the appropriate methods of advertising the rate of interest that may be paid on the new 26-week certificate. In particular, questions have been raised concerning advertisements that compare a rate or yield on the certificate with a rate or yield on six-month Treasury bills.

A member bank's advertising that the rate of interest paid on its 26-week time deposits "equals" the Treasury bill rate may confuse depositors since Treasury bills are sold at a discount and the effective yield on Treasury bills is higher than the discount rate. Accordingly, any general comparison to Treasury bill rates that conveys the impression that the rate paid by the bank equals the coupon-equivalent or effective yield on Treasury bills would be inappropriate.

In addition, a bank's advertising an annual effective rate based on compounding for the entire year may imply an agreement to pay that rate for the entire year. In fact, such rate may not be available since the certificate matures in 26 weeks and can only be renewed at a rate no more than the ceiling rate in effect at the time of renewal.

In view of these considerations, the following advertising guidelines are provided. These guidelines amplify the specific disclosure and advertising requirements contained in Regulation Q that are applicable generally to all deposits. See § 217.6 of Regulation Q (12 CFR 217.6). These guidelines are applicable to every member bank advertisement, announcement, or solicitation relating to the 26-week certificate.

Guidelines

1. Any advertisement, announcement, or solicitation that states an annual effective yield based on compounding for a period in excess of 182 days must contain a clear and conspicuous statement that the rate stated is an annual rate and that this rate is subject to change upon renewal. Such a statement could be expressed in the following manner:

This is an annual rate and is subject to change at renewal.

It is believed appropriate to impose this requirement on advertisements, announcements, and solicitations relating to the 26-week certificate, but not on other time deposits with original maturities of less than one year, because the ceiling rates applicable to such other time deposits change infrequently and such deposits are typically renewed by the bank at the same rate.

2. In any advertisement, announcement, or solicitation, the following guidelines also apply:

(a) If a member bank's advertisement, announcement, or solicitation makes any reference to U.S. Treasury bills, it must prominently disclose that the rate of interest paid on Treasury bills is the discount rate. Such advertisement, announcement, or solicitation must also contain a statement that the effective yield on Treasury bills is higher than the discount rate.

(b) If a member bank's advertisement, announcement, or solicitation makes any reference to U.S. Treasury bills and expresses any specific rate (bank's rate or Treasury's rate), it must prominently disclose the coupon-equivalent or effective yield on U.S. Treasury bills and the effective yield on its certificate computed on a comparable basis. If such disclosures are made, the required statement in (a) above that the effective yield on Treasury bills is higher than the discount rate need not appear.

1. If a member bank advertises an effective yield based on compounding for a 26-week (182 day) period and makes any reference to Treasury bills, the bank's yield must be compared with the coupon-equivalent or effective yield on a six-month Treasury bill.

2. If a member bank advertises an effective yield based on compounding for a period in excess of 26 weeks (182 days) and makes any reference to Treasury bills, the bank's yield must be compared with an effective yield on six-month Treasury bills that is compounded for a similar time period.*

These guidelines also apply in any advertisement, announcement, or solicitation in which a bank compares the rate it pays on the certificate with the rates paid on competing instruments of others. Guidelines 2(a) and 2(b) need not apply to advertisements, announcements, or solicitations that contain no reference to Treasury bills or other competing instruments.

The above guidelines have been adopted after consultation with the Comptroller of the Currency and the Department of Treasury. Similar action is being taken by the Federal Deposit Insurance Corporation and the Federal Home Loan Bank Board for depository institutions subject to their jurisdiction.

If you have any additional questions, you may contact the Bank Supervision and Regulations Department, Consumer Affairs Section, at Ext. 6169 or 6171.

Sincerely yours,
Robert H. Boykin
First Vice President

---

* For your convenience, methods of calculation are provided in the enclosed appendix.

APPENDIX

This appendix provides information for member banks that wish to advertise comparisons between yields offered on the new 26-week certificate and yields on six-month Treasury bills.

1. As noted in the accompanying letter, if a member bank advertises an annual effective yield arrived at by compounding over 26 weeks (182 days) or less and refers to Treasury bills, it should compare this rate to the coupon-equivalent yield on Treasury bills. The coupon-equivalent yield on Treasury bills is widely published and is made available by the Treasury and the Federal Reserve Banks.

2. If a member bank advertises an annual effective yield arrived at by compounding over more than 26 weeks (182 days) and refers to Treasury bills, it should compare its rate to the Treasury bill coupon-equivalent yield adjusted to make the yields comparable. For example, if a member bank advertises an annual effective yield arrived at by compounding over 365 days, the appropriate effective yield on Treasury bills would be calculated as follows:

$$\text{Treasury Bill Yield} = \left(1 + \text{CEY}\left(\frac{182}{365}\right)\right)^{365/182} - 1$$

where CEY is the coupon-equivalent yield for Treasury bills. For six-month Treasury bills issued on June 1 (coupon-equivalent yield of 7.532 percent), the adjusted yield on Treasury bills would be 7.674 percent:

$$.07674 = \left(1 + .07532\left(\frac{182}{365}\right)\right)^{365/182} - 1$$

If a member bank advertises an annual effective yield arrived at by compounding over 360 days rather than 365 days, the comparable Treasury bill yield must also be adjusted to a 360-day basis. The adjusted effective yield on Treasury bills would be calculated as follows:

$$\text{Treasury Bill Yield} = \left(1 + \text{CEY}\left(\frac{182}{365}\right)\right)^{360/182} - 1$$

Note that no adjustment should be made to the fraction (182/365), since the coupon-equivalent yield on Treasury bills is expressed on the basis of a 365-day year.