

FEDERAL RESERVE BANK OF DALLAS

DALLAS, TEXAS 75222

**Circular No. 79-73
April 11, 1979**

PROPOSED AMENDMENTS TO REGULATION Q--INTEREST ON DEPOSITS

Creation of New Deposit Categories

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

The Board of Governors of the Federal Reserve System has proposed to amend Regulation Q to permit member banks to provide additional returns for small savers. The Board is considering one or more of the following actions:

- (1) Creation of a new time deposit category with a 5-year maturity and a minimum denomination of \$500.
- (2) Creation of a new 8-year category of rising rate time deposit with a minimum denomination of \$500.
- (3) Authorization for member banks to pay an interest bonus on savings funds held by individuals or certain nonprofit organizations.
- (4) Reduction of the \$1,000 minimum denomination requirements currently imposed on certain time deposits by Regulation Q to \$500.

Printed on the following pages is a copy of the *Federal Register* document announcing these proposals. Comments should be directed to the Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551. Comments should refer to Docket No. R-0215 and must be received by May 4, 1979.

Questions on the proposals or on other aspects of Regulation Q should be directed to our Consumer Affairs Section of the Bank Supervision and Regulations Department, Ext. 6171.

Sincerely yours,
Robert H. Boykin
First Vice President

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

[12 CFR Part 217]

(Docket No. R-0215)

Notice of Proposed Rulemaking

Creation of New Deposit Categories

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Proposed rulemaking.

SUMMARY: In order to provide additional returns to savers, the Board of Governors of the Federal Reserve System is considering one or more of the following four actions concerning the payment of interest on deposits by member banks under Regulation Q:

(1) Creation of a new time deposit category with a 5-year maturity and a minimum denomination of \$500. Member banks would be authorized to pay interest on this new deposit at a ceiling rate of one and one-quarter per cent below the average 5-year rate based on the yield curve for United States Treasury securities as determined by the United States Treasury. The minimum penalty required to be imposed upon the withdrawal of funds prior to maturity from this category of time deposit would be a forfeiture of six-months interest.

(2) Creation of a new 8-year category of rising rate time deposit with a minimum denomination of \$500. The ceiling rate of interest on this time deposit would increase periodically over the life of the instrument from an initial rate of six per cent during the first year to a rate of eight per cent during the final 3 years. The penalty for early withdrawal during the first year would be a forfeiture of three-months interest. There would be no penalty for withdrawals after the first year.

(3) Authorization for member banks to pay an interest bonus on savings funds held by individuals or certain nonprofit organizations. Member banks would be permitted to pay on such savings funds a lump sum interest bonus of up to one-half of one per cent on the minimum balance on deposit for a 12-month period.

(4) Reduction of the \$1,000 minimum denomination requirements currently imposed on certain time deposits by Regulation Q to \$500. The \$10,000 minimum denomination requirement on the 26-week money market time deposit, however, would be retained.

DATE: Comments must be received by May 4, 1979.

ADDRESS: Theodore E. Allison, Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551. All material submitted should include the Docket Number R-0215.

FOR FURTHER INFORMATION, CONTACT: Gilbert T. Schwartz, Assistant General Counsel (202/452-3623) or Anthony F. Cole, Attorney (202/452-3711), Legal Division, Board of Governors of the Federal Reserve System, Washington, D.C. 20551.

SUPPLEMENTARY INFORMATION: The Board of Governors proposes to amend its regulations concerning the payment of interest on deposits (Regulation Q, 12 CFR 217) to permit member banks to provide additional returns for small savers. Public comment is requested by May 4, 1979, on the following four proposed actions:

I Five-year fixed rate, variable ceiling time deposits

The Board proposes to create a new category of time deposit. The new time deposit would be nonnegotiable and would have a maturity of exactly five years from the date of deposit. The ceiling rate on this new time deposit would be established monthly for new deposits at one and one-quarter per cent below the average 5-year rate based on the yield curve for United States Treasury securities. Beginning the first Thursday of every month, a member bank would be permitted to pay interest at a ceiling rate of one and one-quarter per cent below the average 5-year rate based on the yield curve for the preceding week. This ceiling rate would remain in effect for all instruments issued during the month until the first Thursday of the next month when a new ceiling rate would go into effect for instruments issued on or after that date. The rate of interest established at the time of issue would

not change during the five years the deposit is outstanding. A minimum denomination of \$500 would be required for this deposit. Member banks would be permitted to compound and compute interest on this deposit in accordance with any of the methods currently authorized by § 217.3 of Regulation Q. The average 5-year rate based on the yield curve for United States Treasury securities would be determined by the United States Treasury, and the ceiling rate for member banks would be announced monthly generally on the Monday preceding the Thursday effective date.

Regulation Q currently provides that where a member bank agrees to pay a time deposit prior to maturity, the bank must impose an early withdrawal penalty on the funds withdrawn (12 CFR 217.4(d)). The minimum required penalty is a reduction in the rate of interest paid on the funds withdrawn to a rate not to exceed the rate currently prescribed for a savings deposit (5 per cent) plus a forfeiture of three-months interest at such rate. Under the current structure, the amount of the early withdrawal penalty increases significantly the longer the deposit is maintained. In order to alleviate the severity of this penalty with respect to the new 5-year time deposit category, the Board proposes to create a new early withdrawal penalty that would require member banks to impose a minimum penalty of six-months forfeiture of interest at the rate being paid on the deposit. No reduction of interest to the savings rate would be required. If the amount withdrawn has been on deposit for less than six months, however, all interest would be forfeited. This penalty would apply only to the new 5-year time deposit category, and, with the exception of the proposed rising rate time deposit, the current penalty would continue to apply to all other time deposit categories.

The Board believes that this proposed penalty would encourage depositors to agree to leave funds on deposit for longer periods of time.

The Board believes that the ceiling rate on this new deposit category, in conjunction with the proposed amendment of the early withdrawal penalty, offers substantial additional benefits to small savers over existing deposit options available at this time.

Public comment is requested on the following aspects of the proposed new deposit category:

- (1) the five-year maturity; would a shorter maturity, such as four years, be preferable;
- (2) tying the ceiling rate to the average 5-year rate based on the yield curve for United States Treasury securities;
- (3) establishing the ceiling rate at one and one-quarter per cent below the average 5-year yield curve;
- (4) establishing the new ceiling rate monthly as opposed to weekly or quarterly;
- (5) permitting compounding of interest;
- (6) the \$500 minimum denomination; and
- (7) the six-month interest penalty for early withdrawals.

Public comment also is requested concerning whether the proposed six month early withdrawal interest penalty should be adopted for all categories of time deposits.

II Rising rate time deposits

The Board proposes to amend Regulation Q to create a nonnegotiable time deposit with a maturity of exactly eight years and a minimum denomination of \$500. Member banks would be authorized to pay interest on this deposit in accordance with the following schedule:

<u>Period of time from date of issuance</u>	<u>Ceiling rate during the period indicated</u>
1 year or less	6 per cent
over 1 year to 2 1/2 years	6 1/2 per cent
over 2 1/2 years to 4 years	7 per cent
over 4 years to 5 years	7 1/2 per cent
over 5 years to 8 years	8 per cent

Additional funds could be deposited to the account only during the first year. Consequently, during the first year a member bank could pay interest at a rate of up to 6 per cent on the original deposit and on any additions to the account. For the period over 1 to 2 1/2 years from the date of issuance only, a member bank could pay interest at a ceiling rate of 6 1/2 per cent on all the funds in the account. The rate of interest that a member bank could pay on funds remaining on deposit thereafter would increase in accordance with the above schedule. Interest at the scheduled ceiling rates would be payable only during the appropriate holding periods as indicated above. Member banks would be permitted to compound and compute interest on this deposit in accordance with any of the methods currently authorized by § 217.3 of Regulation Q.

The Board proposes to create a special early withdrawal penalty for the new 8-year time deposit. As previously indicated, the current minimum penalty is a reduction in the rate of interest paid on the funds

withdrawn to a rate not to exceed the rate prescribed for a savings deposit plus a forfeiture of three-months interest at such rate. The proposed penalty for the new 8-year time deposit would require member banks to impose a minimum penalty of three-months forfeiture of interest on funds withdrawn during the first year from date of issuance. If the funds withdrawn have been on deposit for less than three months, all interest would be forfeited. No reduction of interest to the savings rate would be required, and withdrawals after the first year could be made without penalty, although a member bank would be permitted to impose a penalty on such withdrawals.

Public comment is requested on the following aspects of the proposed new deposit category:

- (1) the eight-year maturity;
- (2) the rising rate ceiling schedule;
- (3) the \$500 minimum denomination;
- (4) permitting additions to the account during the first year;
- (5) operational difficulties, if any, associated with the proposed deposit category; and
- (6) the three-month early withdrawal interest penalty; should the penalty be six-months loss of interest as proposed for the new five-year time deposit.

III Bonus savings deposits

The Board proposes to amend Regulation Q to create a new category of savings deposit on which member banks would be authorized to pay a lump sum interest bonus of up to one-half of 1 per cent on the minimum balance held in the savings deposit for the preceding 12-month period. Member banks could pay the bonus of up to one-half of 1 per cent annually in addition to other interest payable at a rate of up to a 5 per cent ceiling. Consequently, under this proposal a depositor could earn up

to 5 1/2 per cent on savings deposits held for one year.

The bonus would be available only on savings funds in which the entire beneficial interest is held by individuals or by nonprofit corporations, associations or other organizations operated primarily for religious, philanthropic, charitable, educational, fraternal, or other similar purposes. Member banks would be authorized to modify the terms of existing savings accounts in which the entire beneficial interest is held by individuals or qualifying nonprofit organizations to incorporate the interest bonus feature. Under the proposal, a member bank could inform the depositor that it will pay such bonus once every 12 months on savings funds that will remain on deposit continuously for a subsequent 12-month period. The member bank could pay the bonus only at the end of the 12-month period. Examples of how the new bonus savings plan could operate follow:

Example 1

The bank notifies depositors that it will pay a bonus of one-half of 1 per cent on all qualifying savings deposits maintained for a one-year period beginning July 1. On July 1, the depositor's existing savings account balance is \$500. During the next 12 months, the depositor makes several additional deposits to the account totaling \$250 and no withdrawals are made. As of June 30 of the following year, the account balance is \$750. The member bank, as of July 1, may pay a bonus of one-half of 1 per cent on \$500, the minimum balance on deposit during the period July 1 to June 30.

Example 2

A depositor opens a new bonus savings account on December 1 with a deposit of \$500. It is understood that the 12-month holding period will begin on January 1. During the month of December, the depositor

adds \$250 to the account. As of January 1 the account balance is \$750, which remains on deposit through December 31. As of January 1 of the following year, the member bank may pay a bonus of one-half of 1 per cent on \$750, the minimum balance on deposit during the period January 1 to December 31.

Example 3

A depositor opens a new bonus savings account on September 1 with a deposit of \$500. The bank has informed depositors that the 12-month holding period will begin on September 1. On October 1 the depositor withdraws \$200 from the account leaving a balance of \$300. On November 1 the depositor places \$300 in the account, raising the balance to \$600. As of September 1 of the following year, the member bank may pay a bonus of one-half of 1 per cent on \$300, the minimum balance on deposit during the period September 1 to August 31.

Public comment is requested on the following aspects of the proposed new bonus savings deposit category:

- (1) Should the bonus be an annual payment of one-half of 1 per cent on savings deposits held for a one-year period, or should the bonus be a semi-annual payment of one-quarter of 1 per cent for deposits held for a six-month period;
- (2) Should the bonus rate be increased if the savings funds are held for periods in excess of one year;
- (3) Should member banks be authorized to permit depositors to withdraw funds from such accounts by automatic transfer, telephone transfer, third-party bill payor service and by negotiable order of withdrawal (where authorized by law). Under the Board's regulations such withdrawals are currently authorized from regular savings accounts;
- (4) Should member banks be permitted, as proposed, to modify the terms of existing savings accounts to incorporate the interest bonus feature; and
- (5) What operational difficulties may be encountered if the proposed new savings deposit category is adopted, including an estimate of the time necessary to implement appropriate changes.

IV Reduction of minimum denomination requirements

Regulation Q currently requires a deposit of \$1,000 or more on time deposits with maturities of 4 years or more in order to earn interest at a ceiling rate of 7 1/4 per cent or more (see 12 CFR 217.7(b)(2), (3), and (4)). The Board proposes to reduce these minimum denomination requirements to \$500. A member bank, however, would be permitted to establish higher minimum denomination requirements. At present, a \$10,000 minimum denomination requirement is imposed on 26-week money market certificates by section 217.7(f) of Regulation Q (12 CFR 217.7(f)). This minimum denomination requirement would not be reduced.

After receipt and consideration of public comment, the Board may adopt one or more of the four proposed actions. None of the proposed actions, however, would change the current ceiling rates of interest for existing deposit categories, which would remain in effect. In this connection, Regulation Q currently provides that member banks may pay interest on governmental unit time deposits under \$100,000 with maturities of 30 days or more (12 CFR 217.7(d)) and Individual Retirement Account and Keogh (H.R. 10) Plan time deposits of less than \$100,000 with maturities of 3 years or more (12 CFR 217.7(e)) at a rate of up to 8 per cent. These ceiling rates would remain in effect and would not be determined by the ceiling rates established for the proposed new 5-year fixed rate, variable ceiling and 8-year rising rate time deposit categories. However, member banks would be permitted to offer the two new time deposit instruments to governmental units and to Individual Retirement Account and Keogh (H.R. 10) Plan participants so long as the instruments have maturities of exactly five years and eight years, respectively, and a minimum denomination of \$500.

All comments and information on these four proposals should be submitted in writing to the Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551, to be received by May 4, 1979. All material submitted should include the Docket Number R-0215. Such material will be made available for inspection and copying upon request except as provided in section 261.6(a) of the Board's Rules Regarding Availability of Information (12 CFR 261.6(a)).

Pursuant to its authority under section 19(j) of the Federal Reserve Act to prescribe rules governing the payment of interest on deposits, the Board proposes to amend Regulation Q (12 CFR §§ 217.4 and 217.7) as follows:

(1) Amend § 217.4(d) by adding "(c)" after "§ 217.7" in the first sentence and by deleting the fifth through seventh sentences and substituting in lieu thereof the following:

§ 217.4--PAYMENT OF TIME DEPOSITS BEFORE MATURITY

* * * * *

(d) Penalty for early withdrawals. * * * Notwithstanding the above, where a time deposit issued pursuant to § 217.7(g), or any portion thereof, is paid before maturity, the depositor shall forfeit six months of interest on the amount withdrawn at the rate being paid on the deposit. If the amount withdrawn has remained on deposit for six months or less, all interest on the amount withdrawn shall be forfeited. Where funds are withdrawn from a time deposit issued pursuant to § 217.7(h) within one year from the date of issuance, the depositor shall forfeit three months of interest on the amount withdrawn at the rate being paid

on the deposit. If the amount withdrawn has remained on deposit for three months or less, all interest on the amount withdrawn shall be forfeited. No interest penalty is required on a time deposit issued pursuant to § 217.7(h) for early withdrawals made more than one year after the date of issuance.

* * * * *

(2) Amend § 217.7 as follows:

§ 217.7--MAXIMUM RATES OF INTEREST PAYABLE BY MEMBER BANKS ON TIME AND SAVINGS DEPOSITS

* * * * *

(b) Time deposits of less than \$100,000. Except as provided in paragraphs (a), (d), (e), (f), (g), and (h), no member bank shall pay interest on any time deposit at a rate in excess of the applicable rate under the following schedule:

<u>Maturity</u>	<u>Maximum per cent</u>
30 days or more but less than 90 days	5
90 days or more but less than 1 year	5 1/2
1 year or more but less than 30 months	6
30 months or more but less than 4 years	6 1/2
4 years or more but less than 6 years ^{2/}	7 1/4
6 years or more ^{2/} but less than 8 years ^{2/}	7 1/2
8 years or more ^{2/}	7 3/4

^{2/} A \$500 minimum denomination is required. This minimum denomination requirement does not apply to time deposits representing funds contributed to an Individual Retirement Account or Keogh (H.R. 10) Plan established pursuant to 26 U.S.C. (I.R.C. 1954) §§ 408, 401.

(c) Savings deposits. Except as provided in paragraph (i), a member bank may pay interest at a rate not to exceed 5 per cent on any savings deposit including savings deposits that are subject to negotiable orders of withdrawal, the issuance of which is authorized by Federal law.

(d) Governmental unit time deposits of less than \$100,000. Except as provided in paragraphs (a), (f), (g), and (h), no member bank shall pay interest on any time deposit which consists of funds deposited to the credit of, or in which the entire beneficial interest is held by, the United States, any State of the United States, or any county, municipality or political subdivision thereof, the District of Columbia, the Commonwealth of Puerto Rico, the Virgin Islands, American Samoa, Guam, or political subdivision thereof, at a rate in excess of 8 per cent.

(e) Individual Retirement Account and Keogh (H.R. 10) Plan deposits of less than \$100,000. Except as provided in paragraphs (a), (g), and (h), a member bank may pay interest on any time deposit with a maturity of three years or more that consists of funds deposited to the credit of, or in which the entire beneficial interest is held by, an individual pursuant to an Individual Retirement Account agreement or Keogh (H.R. 10) Plan established pursuant to 26 U.S.C. (I.R.C. 1954) §§ 408, 401, at a rate not in excess of 8 per cent.

(f) 26-week money market time deposits of less than \$100,000. A member bank may pay interest on any nonnegotiable time deposit of \$10,000 or more, with a maturity of 26 weeks, at a rate not to exceed the rate established (auction average on a discount basis) for United

States Treasury bills with maturities of 26 weeks issued on or immediately prior to the date of deposit. Rounding such rate to the next higher rate is not permitted. A member bank may not compound interest during the term of this deposit. A member bank may offer this category of time deposit to all depositors.

(g) Five-year money market time deposits of less than \$100,000.

A member bank may pay interest on any nonnegotiable time deposit of \$500 or more with a maturity of exactly five years that is issued on or after the first Thursday of every month at a rate not to exceed one and one-quarter per cent below the average 5-year rate based on the yield curve for United States Treasury securities as determined by the United States Department of the Treasury immediately prior to such first Thursday. The average 5-year rate based on the yield curve will be rounded by the United States Department of the Treasury to the nearest 5 basis points. A member bank may offer this category of time deposit to all depositors.

(h) Rising rate time deposits of less than \$100,000. During

the period indicated below, a member bank may pay interest on any non-negotiable time deposit of \$500 or more with a maturity of exactly eight years at a rate not to exceed the following:

<u>Period of time from date of issuance</u>	<u>Ceiling rate during the period indicated</u>
1 year or less	6 per cent
over 1 year to 2 1/2 years	6 1/2 per cent
over 2 1/2 years to 4 years	7 per cent
over 4 years to 5 years	7 1/2 per cent
over 5 years to 8 years	8 per cent

Additional funds may be deposited to the account during the first year from date of issuance. Any such addition shall not affect the scheduled maturity date of the deposit. A member bank may offer this category of time deposit to all depositors.

(i) Bonus savings deposits. A member bank may pay interest at a rate not to exceed 5 per cent on a bonus savings deposit that consists of funds in which the entire beneficial interest is held by one or more individuals or by a corporation, association, or other organization operated primarily for religious, philanthropic, charitable, educational, fraternal, or other similar purposes and not operated for profit. A member bank may inform such depositors that it will pay, once every 12 months, additional interest at a rate not to exceed one-half of one per cent on savings funds that will remain on deposit continuously for a subsequent 12-month period. However, a member bank may pay such bonus only after such savings funds have been on deposit continuously for the 12-month period.

By order of the Board of Governors, April 3, 1979.

(Signed) Theodore E. Allison

Theodore E. Allison
Secretary of the Board

[SEAL]