FEDERAL RESERVE BANK OF DALLAS

DALLAS, TEXAS 75222

Circular No. 79-96
June 4, 1979

AMENDMENT TO REGULATION Q

Early Withdrawal Penalty and Maximum Rates of Interest

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

The Board of Governors of the Federal Reserve System has amended, effective July 1, 1979, its Regulation Q, "Interest on Deposits," to incorporate a series of regulatory changes that will help small savers obtain higher returns in their deposits. In addition, the Board has adopted a new early withdrawal penalty for all deposit categories for new certificates issued or renewed after July 1. Further, the Board has adopted an interpretation to Regulation Q which provides that member banks may accept funds pooled by depositors but may not solicit pooled funds through advertisement, announcement, or other notice if the purpose of such pooling is to pay higher rates of interest on deposits.

Enclosed is a copy of the text of the Board's order with regard to the amendments and the interpretation as submitted for publication in the *Federal Register*. Copies of the new amendment will be sent to you as soon as they become available.

Any questions concerning 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

Enclosure

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.

TITLE 12--BANKS AND BANKING

CHAPTER II--FEDERAL RESERVE SYSTEM

SUBCHAPTER A--BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

[Regulation Q]

(Docket No. R-0215)

Part 217--INTEREST ON DEPOSITS

Early Withdrawal Penalty and Maximum Rates of Interest

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final Rule.

SUMMARY: On April 3, 1979, the Board of Governors of the Federal Reserve System invited public comment on proposals to amend Regulation Q to provide additional returns to savers (44 FR 21023).
The period for receipt of public comment on the proposed amendments expired on May 5, 1979. After consideration of the comments submitted and the views expressed therein, the Board has determined to take the following actions:

(1) Creation of a new time deposit category with a maturity of 4 years or more and no required minimum denomination. Member banks are authorized to pay interest on this new nonnegotiable deposit at a ceiling rate of one and one-quarter per cent below the average 4-year yield 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 is a forfeiture of six months interest. The amendment adopted differs

slightly from the proposal in that the minimum required maturity of the time deposit has been shortened from five years to four years or more and the proposed $500 minimum denomination requirement has been eliminated.

(2) Elimination of the $1,000 minimum denomination requirements currently imposed on certain time deposits by Regulation Q. (The $10,000 minimum denomination requirement on the 26-week money market time deposit, however, is retained.) The amendment adopted differs from the proposal which would have reduced the $1,000 minimum denomination requirements to $500.

(3) Modification of the interest forfeiture penalty required to be imposed when funds are withdrawn from time deposits prior to maturity. As amended, the minimum required early withdrawal penalty is a forfeiture of three months interest on time deposits with original maturities of one year or less and a forfeiture of six months interest on time deposits with original maturities of more than one year. The new penalty rule will apply to all time deposit contracts entered into on or after July 1, 1979. Preexisting time deposit contracts will be subject to the Board's current penalty rule which requires a reduction of the rate of interest paid on the funds withdrawn to the savings rate, less three months interest at that rate.

(4) Increase the ceiling rate of interest payable on savings deposits by member banks from five per cent to five and one-quarter per cent. This action is being taken in lieu of the proposal to authorize member banks to pay an interest bonus on savings funds.

EFFECTIVE DATE: July 1, 1979.

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

SUPPLEMENTARY INFORMATION: In response to notice published in the Federal Register (44 FR 21023), the Board has received and reviewed over 900 comments on its proposals to provide additional returns to savers. A majority of those responding generally favored action to provide savers with higher rates of return but opposed certain operational aspects of the proposals as unnecessarily complex, costly to administer and difficult for member banks and depositors to understand. With reference to the specific proposals, a majority of respondents commenting favored adoption of the proposed 5-year time deposit. The proposed six-month interest forfeiture penalty for early withdrawals and application of such a penalty to all time deposits also were favored by a majority of respondents. A substantial number of respondents commented that a maturity shorter than five years for the proposed instrument was preferable. A majority of respondents commenting opposed adoption of the proposed 8-year rising rate time deposit and the bonus savings proposal. The respondents generally commented that these two proposals would create costly operational problems and would be confusing to customers. Reduction of the minimum denomination requirements currently imposed on certain time deposits under Regulation Q (12 CFR 217.7) from $1,000 to $500 was favored by a majority of respondents commenting. In addition, a substantial number of respondents favored totally eliminating the minimum

denomination requirements for all certificates of deposit, other than the 26-week money market certificate. A detailed summary of comments received is available upon request from the Board's Office of Public Affairs, telephone (202)452-3215.

After consideration of the comments received, the Board has determined not to adopt the proposals to create an 8-year rising rate time deposit and to authorize the payment of an interest bonus on savings funds. The Board, however, has determined to amend Regulation Q (12 CFR 217) to: (1) create a new time deposit category with a maturity of 4 years or more and with a maximum ceiling rate of interest based on the average 4-year yield on Treasury securities; (2) eliminate the $1,000 minimum denomination requirements currently imposed on certain time deposits; (3) modify the penalty required to be imposed upon the withdrawal of funds from time deposits prior to maturity; and (4) increase the ceiling rate of interest payable on savings deposits to five and one-quarter per cent. The Board believes that these amendments will enable individuals to obtain higher rates of return on their savings without adversely affecting the viability of the nation's financial system. A discussion of the amendments adopted follows.

I <u>Four-year fixed rate, variable ceiling time deposit</u>

Beginning July 1, 1979, member banks will be permitted to offer a nonnegotiable time deposit with a maturity of 4 years or more at a ceiling rate tied to the average 4-year yield on United States Treasury securities. The ceiling rate will be the same even if a member bank issues the new time deposit with maturities in excess of four years.

Although no minimum denomination will be required, member banks are free to establish a minimum denomination requirement for this new category of deposit. The existing fixed ceiling time deposits with maturities of 4, 6 and 8 years at ceiling rates of 7 1/4, 7 1/2 and 8 per cent, respectively, are not affected by this action and will remain in effect.

The ceiling rate on the new deposit category will be established each month for new deposits received during that month at one and one-quarter per cent below the average 4-year yield for United States Treasury securities as determined by the U.S. Treasury Department. Beginning the first day of every month, a member bank will be permitted to pay interest at a ceiling rate of one and one-quarter per cent below the average 4-year yield as announced by the Treasury. This ceiling rate will remain in effect for all instruments issued during the month until the first day of the next month when a new ceiling rate will go into effect for instruments issued on or after that date. The ceiling rate of interest established at the time of issue of any time deposit in this category will not change during the period the deposit is outstanding. Member banks are permitted to compound and compute interest on this deposit in accordance with any of the methods authorized by section 217.3 of Regulation Q. The average 4-year yield will be announced three business days prior to the effective date (the first day of the month) and will represent an average of the 4-year yields for the previous five business days. As explained more fully hereinafter, the minimum penalty required to be imposed upon the withdrawal of funds from this category of time deposit is a forfeiture of six months interest at the rate being paid on the deposit.

With respect to this new deposit category, member banks should maintain data such as rates paid and amounts issued in a manner that facilitates reporting to the Board.

II Elimination of minimum denomination requirements

Effective July 1, 1979, the Board has amended Regulation Q to eliminate the $1,000 minimum denomination requirements currently imposed 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 (12 CFR 217.7(b)(2), (3), and (4)). Although no minimum denomination will be required on such deposits, member banks will be free to impose such requirements. However, the $10,000 minimum denomination required on 26-week money market time deposits by section 217.7(f) of Regulation Q (12 CFR 217.7(f)) will remain in effect. The Board believes that this action will broaden the availability of time deposit categories to all depositors and enable small savers to obtain higher yields on their funds.

III Penalty for early withdrawals

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 current 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 reduce the severity of this penalty, the Board has amended section 217.4(d) of Regulation Q (12 CFR 217.4(d)) to create a new early withdrawal penalty.

Effective July 1, 1979, the minimum required early withdrawal penalty on time deposits with original maturities of one year or less is a forfeiture of three months interest on the amount withdrawn at

the rate being paid on the deposit. If the amount withdrawn has been on deposit for less than three months, however, all interest is forfeited. The minimum required early withdrawal penalty on time deposits with original maturities of more than one year is a forfeiture of six months interest on the amount withdrawn at the rate being paid on the deposit. If the amount withdrawn has been on deposit for less than six months, however, all interest is forfeited. No reduction of interest to the savings rate will be required. This penalty will apply to all time deposit contracts entered into on or after July 1, 1979, and to all existing time deposit contracts that are extended or reviewed on or after July 1, 1979. The new penalty is a minimum required penalty only and a member bank is free to specify in its deposit contract a more severe premature withdrawal penalty as long as such penalty is disclosed to the depositor. Time deposits entered into before July 1, 1979, and not extended or renewed on or after such date, will continue to be subject to the Board's current penalty rule which requires a reduction of the rate of interest paid on the funds withdrawn before maturity to the savings rate, less three months interest at that rate.

IV Ceiling rate on savings deposits

Regulation Q currently provides that no member bank shall pay interest on any savings deposit at a rate in excess of 5 per cent (12 CFR 217.7(c)). Effective July 1, 1979, the Board has amended Regulation Q to increase the ceiling rate of interest payable on savings deposits by member banks, except savings deposits that are subject to negotiable orders of withdrawal, from 5 per cent to 5 1/4 per cent. This action is being taken in lieu of the proposal to authorize member banks to pay an interest bonus on savings funds held by individuals or certain

nonprofit organizations and will provide higher returns to savers. The ceiling rate of interest payable by member banks on savings deposits subject to negotiable orders of withdrawal will remain at 5 per cent.

Pursuant to its authority under section 19(j) of the Federal Reserve Act (12 U.S.C. §371b) to prescribe rules governing the payment of interest on deposits, effective July 1, 1979, the Board amends Regulation Q (12 CFR §§217.4, 217.6, and 217.7) as follows:

(1) Amend §217.4(d) and (e) to read as follows:

§217.4--PAYMENT OF THE TIME DEPOSITS BEFORE MATURITY

* * * * *

(d) Penalty for early withdrawals. Where a time deposit with an original maturity of one year or less, or any portion thereof, is paid before maturity, a depositor shall forfeit at least 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 less than three months, all interest shall be forfeited. Where a time deposit with an original maturity of more than one year, or any portion thereof, is paid before maturity, a depositor shall forfeit at least six months interest on the amount withdrawn at the rate being paid on the deposit. If the amount has remained on deposit for less than six months, all interest shall be forfeited.[11/] Where necessary to comply with the

11/ The provisions of this paragraph apply to all time deposit contracts entered into on or after July 1, 1979, and to all existing time deposit contracts that are extended or renewed (whether by automatic renewal or otherwise) on or after such date. All contracts not subject to the provisions of this paragraph shall be subject to the restrictions of §217.4(d) in effect prior to July 1, 1979, which provided that where a time deposit, or any portion thereof, is paid before maturity, a member bank may pay interest on the amount withdrawn at a rate not to exceed that prescribed in §217.7 for a savings deposit and the depositor shall forfeit three months of interest payable at such rate. If, however, the amount withdrawn has remained on deposit for three months or less, all interest shall be forfeited.

requirements of this paragraph, any interest already paid to or for the account of the depositor shall be deducted from the amount requested to be withdrawn. Any amendment of a time deposit contract that results in an increase in the rate of interest paid or in a reduction in the maturity of the deposit constitutes a payment of the time deposit before maturity. A time deposit may be paid before maturity without a forfeiture of interest as prescribed by this paragraph in the following circumstances:***

(e) Disclosure of early withdrawal penalty. At the time a depositor enters into a time deposit contract with a member bank, the bank shall provide a written statement of the effect of the penalty prescribed in paragraph (d) of this section, which shall (1) state clearly that the customer has contracted to keep his funds on deposit for the stated maturity, and (2) describe fully and clearly how such penalty provisions apply to time deposits in such bank, in the event the bank, notwithstanding the contract provisions, permits payment before maturity. Such statements shall be expressly called to the attention of the customer.

* * * * *

(2) Amend §217.6(e) to read as follows:

§217.6--ADVERTISING OF INTEREST ON DEPOSITS

* * * * *

(e) Penalty for early withdrawals. Any advertisement, announcement, or solicitation relating to interest paid by a member bank on time deposits shall include clear and conspicuous notice that the bank is prohibited from allowing payment of a time deposit before maturity

unless substantial interest is forfeited. Such notice may state that,

"Substantial interest penalty is required for early withdrawal."

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(3) Amend § 217.7 as follows:

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

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

Maturity	Maximum per cent
30 days or more but less than 90 days	5
90 days or more but less that 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	7 1/4
6 years or more but less than 8 years	7 1/2
8 years or more	7 3/4

(c) Savings deposits. No member bank shall pay interest at a rate in excess of 5 1/4 per cent on any savings deposit. Provided, however, that no member bank shall pay interest at a rate in excess of 5 per cent on any savings deposit that is 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), and (g), 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.[2/]

(e) Individual Retirement Account and Keogh (H.R. 10) Plan deposits of less than $100,000. Except as provided in paragraphs (a) and (g), 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.[2/]

(f) 26-week money market time deposits of less than $100,000. Except as provided in paragraph (a), 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

2/ The ceiling rate on this category is the highest fixed ceiling rate that may be paid on time deposits under $100,000 by any Federally insured commercial bank, mutual savings bank, or savings and loan association.

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) Time deposits of less than $100,000 with maturities of four years or more. Except as provided in paragraphs (a) and (b), a member bank may pay interest on any nonnegotiable time deposit with a maturity of four years or more that is issued on or after the first day of every month at a rate not to exceed one and one-quarter per cent below the average 4-year yield for United States Treasury securities as determined and announced by the United States Department of the Treasury three business days prior to the first day of such month. The average 4-year yield 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.

By order of the Board of Governors May 30, 1979.

(signed) Theodore E. Allison

Theodore E. Allison
Secretary of the Board

[SEAL]

TITLE 12 -- BANKS AND BANKING

CHAPTER II -- FEDERAL RESERVE SYSTEM

SUBCHAPTER A -- BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

[Regulation Q, Docket No. R-0227]

Part 217 - Interest on Deposits

Pooling of Funds to Obtain Higher Interest Rates

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final interpretation.

SUMMARY: This interpretation provides that under Regulation Q member banks may accept funds pooled by depositors but may not solicit pooled funds through advertisement, announcement or other notice where the purpose of such pooling is to pay higher rates of interest on deposits.

EFFECTIVE DATE: Immediately.

FOR FURTHER INFORMATION CONTACT: Gilbert T. Schwartz, Assistant General Counsel (202/452-3623), or Paul S. Pilecki, Attorney (202/452-3281), Legal Division, Board of Governors of the Federal Reserve System, Washington, D. C. 20551.

SUPPLEMENTARY INFORMATION: 12 CFR 217 is amended by adding a new section 217.155 to read as follows:

217.155 Pooling of funds to obtain higher interest rates:

(a) The Board of Governors has reviewed its previous rulings concerning acceptance of pooled funds by member banks. Under these rulings, the Board had expressed the view that a member bank that paid a higher rate on a deposit that it knew or had reason to know resulted from funds aggregated (pooled) principally for the purpose of obtaining

a higher rate of interest would be acting contrary to the spirit of Regulation Q. This interpretation replaces these prior Board rulings that had been issued in the form of letter opinions in 1968 and 1970.

(b) The Board has determined that member banks accepting and paying higher rates of interest on pooled deposits from depositors who themselves have pooled their funds whether or not the bank knows or has reason to know that such funds have been pooled would not be violating Regulation Q. However, member banks are not permitted to solicit, advise or encourage depositors to pool funds for the purpose of paying higher interest rates. In addition, member banks are not permitted to solicit deposits from customers on the basis that the funds will be pooled by the bank for the purpose of paying higher interest rates. The Board believes that participation by member banks in encouraging or establishing pooling arrangements constitutes a device to avoid interest rate limitations. The Board further believes that adopting this new policy will facilitate the administration of Regulation Q interest rate ceilings.

(c) The Board would regard any advertisement, announcement or solicitation by a member bank indicating that it will accept pooled funds or that funds can be pooled to obtain higher rates as a violation of Regulation Q. For example, printed and broadcast advertisements stating that depositors can achieve higher interest rates by pooling their funds with others and depositing them in the bank would be inappropriate. In addition, in responding to inquiries from depositors concerning available deposit instruments and rates, member banks are

not permitted to suggest the practice of pooling as a means of meeting minimum denomination requirements. Similarly, any advertisement, announcement or solicitation, written or oral, by a member bank discussing a policy, practice, program, or procedure for accepting pooled deposits would not be permitted. If, for example, two depositors come into a member bank on their own with checks of $5,000 each seeking to purchase jointly one $10,000 minimum denomination money market time deposit, the bank is permitted to accept such funds in the form of a money market time deposit and to pay the ceiling rate on such deposits. However, a member bank could not arrange to introduce, directly or indirectly, separate depositors that are seeking to pool their funds.

(d) This interpretation is not intended to affect other well-established practices which involve pooling of funds such as money market mutual funds, trust department aggregation of temporarily idle balances of bona fide fiduciary accounts, or combination of funds held in escrow by a person acting in a fiduciary or custodial capacity. In addition, member banks are expected to report interest earned by depositors on pooled funds in accordance with the regulations of the Internal Revenue Service.

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The Board has issued this interpretation based upon its statutory authority under section 19 of the Federal Reserve Act, 12 U.S.C. 461, 371a and 371b.

By order of the Board of Governors of the Federal Reserve System, May 30, 1979.

(signed) Theodore E. Allison

Theodore E. Allison
Secretary of the Board

[SEAL]