FEDERAL RESERVE BANK OF DALLAS

DALLAS, TEXAS 75222

Circular No. 79-210
December 20, 1979

AMENDMENTS TO REGULATION Q

A New 2½ Year Deposit Category, an Increased Ceiling Rate, And a Competitive Rate Change for IRA/Keogh and Governmental Unit Deposits

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

The Board of Governors of the Federal Reserve System has adopted three amendments to Regulation Q, "Interest on Deposits", each of which will be effective January 1, 1980. The amendments are as follows:

1. The Board has created a new category of time deposit with a maturity of 2½ years or more at a ceiling rate tied to the average 2½ year yield on United States Treasury securities. The ceiling rate for the time deposit will vary from month to month, but once a particular time deposit is purchased, the rate being paid on it will be fixed for the full maturity. There is no federally required minimum denomination for the new category of deposit, but it must be issued in a nonnegotiable form. Member banks are permitted to compound and compute interest on this deposit in accordance with any of the methods authorized under Regulation Q.

   In connection with the first amendment, the Board is eliminating effective January 1, 1980, the four year or more time deposit category with a ceiling rate tied to the average yield on four year United States Treasury securities, which was first offered July 1, 1979. Please note that outstanding deposits of this type are <u>not</u> affected by this action.

2. The Board has amended Regulation Q to increase the maximum rate of interest payable by member banks on time deposits with maturities of more than 90 days but less than one year from 5 1/2 % to 5 3/4%. The new ceiling rate may be paid only on certificates of deposit entered into or renewed on or after January 1, 1980.

   Please note that those member banks who offer 90 day to one year deposits on a time deposit open account basis may pay interest on these funds at a rate of 5 3/4% beginning January 1.

3. Finally, the Board has amended Regulation Q effective January 1, 1980, so that IRA/Keogh depositors and governmental unit depositors may receive the same ceiling rate on the 26-week money market certificate and the new $2\frac{1}{2}$ year certificate as is availabe at any federally insured savings and loan association or mutual savings bank.

   Previously, for these depositors when the Treasury bill rate fell below 9%, as much as a $\frac{1}{4}$% differential was in existence in favor of the savings and loan depositor. Now, for the IRA/Keogh deposit and the governmental unit deposit whether it be in the new $2\frac{1}{2}$ year or more form or the 26-week, $10,000 minimum deposit money market form, member banks may pay interest at a ceiling rate equal to the ceiling rate payable by any savings and loan or mutual savings bank. Please note that the terms of existing IRA/Keogh and governmental unit time deposits may not be modified until such deposits mature.

Enclosed is a copy of the text of these amendments as it was submitted for publication in the Federal Register. As soon as they are available, copies of the formal text of the new amendments will be sent to you for insertion in your Regulations Binder.

Questions concerning the new changes or any aspect 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

Enclosure

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-0267)

Part 217 -- INTEREST ON DEPOSITS

Maximum Rates of Interest Payable

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final Rule.

SUMMARY: The Board of Governors of the Federal Reserve System has adopted three amendments to Regulation Q. The first amendment creates a new time deposit category with a maturity of 2 1/2 years or more. Member banks are authorized to pay interest on this new nonnegotiable time deposit at a ceiling rate of three quarters of one per cent below the average 2 1/2 year yield for United States Treasury securities as determined monthly by the United States Treasury. No minimum denomination is required for this new deposit category. As part of this action, the Board is eliminating the four-year or more time deposit with a ceiling rate tied to the average yield on four-year United States Treasury securities which member banks were authorized to offer effective July 1, 1979. The second amendment increases the ceiling rate of interest payable by member banks on time deposits with maturities of 90 days or more, but less than one year from 5 1/2 per cent to 5 3/4 per cent. The third amendment permits members to pay interest on Individual Retirement Account/Keogh (H.R. 10) Plan and governmental unit funds at the same rate permitted mutual savings banks and savings and loan associations when such funds are invested in 26-week $10,000 money market time deposits or the new 2 1/2 year time deposit. These actions are being taken to provide additional returns to savers.

EFFECTIVE DATE: January 1, 1980.

FOR FURTHER INFORMATION CONTACT: Gilbert T. Schwartz, Assistant General Counsel (202/452-3625) or Anthony F. Cole, Senior Attorney (202/452-3612), Legal Division, Board of Governors of the Federal Reserve System, Washington, D.C. 20551.

SUPPLEMENTARY INFORMATION: On May 30, 1979, the Board of Governors adopted amendments to Regulation Q designed to help small savers obtain a higher return on their deposits (44 FR 32646). These amendments included raising the savings deposit ceiling rate by one-quarter of one per cent to 5 1/4 per cent, creation of a new four-year or more time deposit whose ceiling rate is tied to the rate paid on four-year U.S. securities, elimination of minimum denomination requirements (except for the $10,000 minimum required for the 26-week money market certificate), and reduction of the penalties for early withdrawal of time deposit funds. In announcing these actions, the Board stated that consideration would be given toward the end of this year to determine whether further adjustments in interest rate ceilings would be appropriate. After consultation with the other Federal financial regulatory agencies, the Board has amended Regulation Q (12 CFR 217) to: (1) create a new time deposit category with a maturity of 2 1/2 years or more and with a maximum ceiling rate of interest based on the average 2 1/2 year yield on Treasury securities; (2) increase the ceiling rate of interest payable on time deposits with maturities of 90 days or more but less than one year from 5 1/2 per cent to 5 3/4 per cent; and (3) permit member banks to pay interest on IRA/Keogh and governmental unit funds at the same rate permitted mutual savings banks and savings and loan associations when such funds are invested in 26-week $10,000 money market time deposits or the new 2 1/2 year time deposit. The Board believes that these amendments, in conjunction with those adopted by the other Federal financial regulatory agencies, will enable savers to obtain higher rates of return on their savings and will increase the flow of funds to the nation's depository institutions, as well as encourage individuals to save for their retirement.

I. 2 1/2 year fixed rate, variable ceiling time deposit

Beginning January 1, 1980, member banks will be permitted to offer a nonnegotiable time deposit with a maturity of 2 1/2 years or more at a ceiling rate tied to the average 2 1/2 year yield on United States Treasury securities. The ceiling rate in effect during a particular month will apply to all newly issued time deposits of this category even if a member bank issues the new time deposit with maturities in excess of 2 1/2 years. The ceiling rate for new deposits will be determined monthly, but the ceiling rate applicable to outstanding deposits will not change during the life of the deposit. 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 2 1/2, 4, 6 and 8 years or more at ceiling rates of 6 1/2, 7 1/4, 7 1/2 and 7 3/4 per cent, respectively, are not affected by this action and will remain in effect. As part of this action the Board is eliminating, effective January 1, 1980, the 4-year or more time deposit with a ceiling rate tied to the average yield on 4-year United States Treasury securities. Member banks were authorized to offer this deposit effective July 1, 1979 (12 CFR 217.7(g)). However, outstanding deposits of this category are not affected by this action.

Beginning the first day of every month, a member bank will be permitted to pay interest on new deposits with maturities of 2 1/2 years or more at a ceiling rate of three quarters of one per cent (75 basis points) below the average 2 1/2 year yield for U.S. Treasury securities 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. 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 2 1/2 year yield on U. S. Treasury securities will be announced three business days prior to the effective date (the first day of the month) and will represent an average of the 2 1/2 year yields for the previous five business days.

Member banks will be permitted to pay interest on time deposits of this category which consist of funds deposited to the credit of, or in which the entire beneficial interest is held by, a governmental unit or an individual pursuant to an IRA agreement or Keogh (H.R. 10) Plan, at a ceiling rate equal to the ceiling rate payable on the same category of deposit by any Federally insured savings and loan association or mutual savings bank.

The Board believes that this action creating a shorter term time deposit instrument with a ceiling rate tied to market rates of interest will increase the amount of savings maintained by depositors. 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. Ceiling rate on 90-day time deposits

Regulation Q currently provides that no member bank shall pay interest at a rate in excess of 5 1/2 per cent on a time deposit with a maturity of 90 days or more but less than one year (12 CFR § 217.7(b)). This ceiling rate has been equal to the ceiling rate in effect for savings deposits at thrift institutions since July 1, 1979. Prior to the July 1 savings rate increase, the member bank 90-day time deposit ceiling rate was one-quarter of one per cent higher than the maximum rate payable on savings deposits at thrifts.

Commercial banks historically have competed actively in the 90-day time deposit market and hold approximately 14 per cent of their small denomination time deposits in such accounts. In this regard, the agencies did not intend that their actions last July would affect the competitive balance between commercial banks and thrifts. Accordingly, the Board has amended Regulation Q to increase the maximum rate of interest payable by member banks on time deposits with maturities of more than 90 days but less than one year to 5 3/4 per cent, one-quarter of one per cent above the ceiling rate of interest payable on savings deposits by thrift institutions. This action will restore the pre-existing competitive balance and will enable savers to obtain higher returns on their funds. The new ceiling rate may be paid only on certificates of deposit entered into or renewed on or after January 1, 1980. However, for purposes of administrative convenience beginning January 1, member banks may pay interest on all funds in 90-day*

III. IRA/Keogh (H.R. 10) Plan and governmental unit time deposits

The Board amended Regulation Q, effective July 6, 1977, to create a new category of IRA/Keogh Plan time deposit with a maturity of three years or more and no minimum denomination. Member banks are authorized to pay interest on such time deposits at a ceiling rate of 8 per cent, which 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. The Board's action was taken to accommodate the Congressional objective expressed in the Employee Retirement Income Security Act of 1974 (Pub. L. 93-406) of encouraging individuals to save for their retirement by enabling an IRA or Keogh Plan participant to obtain the highest possible return on retirement savings regardless of the type of depository institution selected by the depositor.

While this special category of deposit is available only for IRA and Keogh depositors, IRA and Keogh funds may be deposited in any form of deposit account, including the 26-week $10,000 money market certificate, so long as the Regulation Q minimum maturity and minimum denomination requirements are satisfied. However, where an individual elects to deposit IRA and Keogh funds in a 26-week money market certificate, thrift institutions have a rate advantage over commercial banks in view of the existence of the differential in the ceiling rates payable on such accounts by thrifts and commercial banks when the Treasury bill rate is below 9 per cent. The Board regards the maintenance of this differential with respect to IRA or Keogh funds as inconsistent with the objectives of maximizing the total amount of earnings on retirement savings that Congress sought to encourage through establishment of IRA and Keogh programs. Since preferred tax and interest rate treatment was given to IRA/Keogh plans to encourage savings for retirement, and not to extend a competitive advantage for a particular class of financial institution, the Board has amended Regulation Q (12 CFR § 217.7(f)) to permit member banks to pay interest on new 26-week $10,000 money

*to one-year time deposit open accounts at a rate of 5 3/4 percent.

market certificates which consist of IRA or Keogh funds at a ceiling rate equal to the ceiling rate payable on the 26-week money market certificate by any Federally insured savings and loan association or mutual savings bank regardless of the level of the Treasury bill rate. However, the terms of existing IRA/Keogh time deposits may not be modified until such deposits mature. (As discussed above, similar action is being taken with respect to the new 2 1/2 year certificate.)

The Board amended Regulation Q, effective November 27, 1974, to create a new category of time deposit for funds of public units. Pursuant to section 217.7(d), member banks are authorized to 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, a governmental unit at a ceiling rate of 8 per cent, which 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. This action was taken in light of the increase in 1974 in Federal deposit insurance to $100,000 on governmental unit time deposits. The increased insurance made thrift institutions more competitive with commercial banks. The Board's action to permit member banks to pay interest on such funds at the same rates as thrifts, was intended to maintain the competitive balance among financial institutions, as well as to provide additional depository alternatives for governmental units.

While this special category of deposit is available only for governmental units, public funds may be deposited in any form of deposit account, including the 26-week $10,000 money market certificate, so long as the Regulation Q minimum maturity and minimum denomination requirements are satisfied. However, where a public unit elects to deposit funds in a 26-week $10,000 money market certificate, thrift institutions may have a rate advantage over commercial banks in view of the existence of the differential when the Treasury bill rate is below 9 per cent. The Board regards maintenance of the differential with respect to public unit time deposit funds as inconsistent with the objectives of maintaining competitive equality and maximizing depository alternatives for governmental units. Accordingly, the Board also has amended Regulation Q (12 CFR § 217.7(f)) to permit member banks to pay interest on new 26-week $10,000 money market certificates which consist of public funds at a ceiling rate equal to the ceiling rate payable on the 26-week money market certificate by any Federally insured savings and loan association or mutual savings bank. However, the terms of existing governmental unit time deposits may not be modified until such deposits mature. (As discussed above, similar action is being taken with respect to the new 2 1/2 year certificate.)

The Board's actions were taken at this time after consultation with the other Federal financial institution regulatory agencies. In order to provide increased returns to savers as rapidly as possible, the Board finds that application of the notice and public participation provisions of 5 U.S.C. § 553 to these actions would be contrary to the public interest and that good cause exists for making these amendments effective in less than thrity days.

These amendments are adopted pursuant to the Board's authority under section 19(j) of the Federal Reserve Act (12 U.S.C. § 371b) to prescribe limitations on the rates of interest that may be paid by member banks on time and savings deposits.

Effective January 1, 1980, Regulation Q (12 CFR § 217.7(b), (f) and (g)) is amended as follows:

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

* * * * *

(b) <u>Fixed ceiling time deposits of less that $100,000</u>. 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 1/4
90 days or more but less than 1 year	5 3/4
1 year or more but less than 2 1/2 years	6
2 1/2 years 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

* * * * *

(f) <u>26-week money market time deposits of less than $100,000.</u> Except as provided in paragraphs (a), (b) and (d), 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. However, a member bank may pay interest on any nonnegotiable time deposit of $10,000 or more with a maturity of 26 weeks which consists of funds deposited to the credit of, or in which the the entire beneficial interest is held by:

(1) 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; or

(2) 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 to exceed the ceiling rate payable on the same category of deposit by any Federally insured savings and loan association or mutual savings bank.

(g) <u>Time deposits of less than $100,000 with maturities of 2 1/2 years or more</u>. Except as provided in paragraphs (a), (b), (d) and (e), a member bank may pay interest on any nonnegotiable time deposit with a maturity of 2 1/2 years or more that is issued on or after the first day of each month at a rate not to exceed three quarters of one per cent below the average 2 1/2 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 2 1/2 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. However, a member bank may pay interest on any nonnegotiable time deposit with a maturity of 2 1/2 years or more which consists of funds deposited to the credit of, or in which the entire beneficial interest is held by:

(1) 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; or

(2) 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 to exceed the ceiling rate payable on the same category of deposit by any Federally insured savings and loan association or mutual savings bank.

By order of the Board of Governors, December 14, 1979.

Theodore E. Allison
Secretary of the Board