FEDERAL RESERVE BANK OF DALLAS

DALLAS, TEXAS 75222

Circular No. 82-43
April 15, 1982

DEPOSITORY INSTITUTIONS DEREGULATION COMMITTEE

March 22, 1982 Meeting and Final Rule Concerning Premiums

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

The Depository Institutions Deregulation Committee (DIDC) took the following action at its March 22 meeting:

(1) Election of chairman and vice chairman

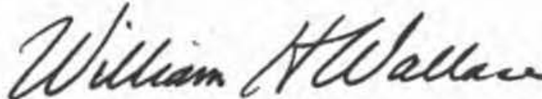
(2) Adoption of a deregulation plan for interest rate ceilings including authorizaton of a new time deposit category

(3) Creation of a new short-term deposit instrument

Enclosed are copies of the press release, the material as submitted for publication in the Federal Register and the March 9, 1982, Federal Register notice concerning a final rule on the use of premiums. Questions regarding the material contained in this circular should be directed to this Bank's Legal Department, Ext. 6171.

Additional copies of this circular and enclosure will be furnished upon request to the Department of Communications, Financial and Community Affairs, Ext. 6289.

Sincerely yours,



William H. Wallace
First Vice President

Enclosure

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DEPOSITORY INSTITUTIONS DEREGULATION COMMITTEE

[Docket No. D-0018]

Interest on Deposits, Premiums, Finders Fees, and the Payment of Interest

AGENCY: Depository Institutions Deregulation Committee.

ACTION: Final Rule

SUMMARY: The Depository Institutions Deregulation Committee ("Committee") is adopting in final form a temporary amendment to its rule concerning the use of premiums by depository institutions (12 C.F.R. § 1204.109). This temporary amendment of the premium rule was published for comment on February 26, 1981 (46 FR 15131); it prohibits depository institutions from soliciting the opening of multiple accounts from a depositor in order to provide for more than one premium at a time to such depositor. The purpose of the rule is to eliminate the circumvention of the objectives of the premium rule by depository institutions that advertise premium programs in which lump sum deposits brought in by a depositor would be broken up by the institution and placed in multiple accounts for the purpose of enabling the institution to give a premium for each account.

EFFECTIVE DATE: (Thirty days after Federal Register Publication Date).

FOR FURTHER INFORMATION CONTACT: Rebecca Laird, Senior Associate General Counsel, Federal Home Loan Bank Board (202/377-6446), David Ansell, Attorney, Office of the Comptroller of the Currency (202/447-1880), F. Douglas Birdzell, Counsel, Federal Deposit Insurance Corporation

(202/389-4261), Veryl V. Miles, Attorney, Board of Governors of the Federal Reserve System (202/452-3611), or Allan Schott, Attorney-Advisor, Treasury Department (202/566-6798).

SUPPLEMENTARY INFORMATION: The Committee's rule concerning the use of premiums (12 C.F.R. § 1204.109), effective December 31, 1980, provides that premiums, whether in the form of merchandise, credit or cash, will not be regarded as a payment of interest if: (1) the premium is given to a depositor only when a new account is opened, an existing account is renewed, or funds are added to an existing account; (2) no more than two premiums *per account* are given in any 12-month period; and (3) the value of the premium, or, if merchandise is given, its total cost to the institution, is no more than $10 for deposits of less than $5,000 or $20 for deposits of $5,000 or more. After the rule was adopted, an increasing number of depository institutions advertised programs in which a lump sum brought in by a depositor could be broken up by the institution and placed in multiple accounts for the purpose of enabling the institution to give a premium for each account. These programs made it possible for the depository institutions to provide more premiums than would otherwise be permitted if the funds had been placed in one account. These programs had the capacity for undermining and circumventing the objectives of the Committee in adopting the rule.

In its efforts to curtail the practice of opening multiple accounts for a depositor in order to receive multiple premiums and

to clarify its original intent in adopting the premium rule, the Committee adopted a temporary amendment, effective February 26, 1981, prohibiting depository institutions from soliciting or promoting deposits from customers on the basis that the funds would be divided into more than one account by the institution for the purpose of providing more than two premiums per deposit within a 12-month period. The Committee also asked for public comments by April 1, 1981, on the temporary amendment and on alternative methods to deal with this problem on a permanent basis.

The Committee received 215 comments: 92 commentators were in favor of the amendment and 29 were in opposition to the amendment. The remaining 94 commentators did not express definitive positions in favor of the amendment or in opposition to the amendment. Their comments were included in the specific comments considered by the Committee regarding alternative methods to achieve compliance with the premium rule and general comments made regarding premiums.

Many of the commentators in favor of the temporary amendment also expressed the opinion that it would not be sufficient in curtailing the opening of multiple accounts by those depositors who are aware that multiple premiums can be obtained by opening multiple accounts. Others in favor of the amendment indicated that such an amendment was not objectionable, so long as it did not prohibit depository institutions from giving multiple premiums if the depositor independently decides to open multiple accounts.

With respect to the request for alternative methods of preventing the circumvention of premiums rules, 73 institutions suggested that premiums be banned completely. Another alternative recommended by 53 institutions was that premiums be permitted on a per depositor/per household basis instead of a per account basis. In addition to the recommendation that premiums be permitted on a per depositor/per household basis, 41 institutions pointed out that this alternative would be too costly and too difficult to monitor and administer. Several of these institutions also expressed the opinion that this alternative would create depositor disloyalty, prompting depositors to deposit their funds at several different depository institutions in order to obtain additional premiums. It was also suggested that premiums be limited to branch openings, bank openings, anniversaries, mergers and consolidations; 20 institutions recommended this alternative.

Based upon the comments received and the Committee's experience with the temporary rule, the Committee concluded that the final adoption of the rule would be the most effective means of curtailing the circumvention of the premium rule and would enable depository institutions to provide premiums to customers in the manner the Committee intended. With respect to the alternatives suggested by the commentators to prevent further abuses of the objectives of the premium rule, the Committee believes that making the temporary rule permanent would be more effective in advancing its objectives. This is based on the view that adoption of a per depositor/per household rule would be both a financial and

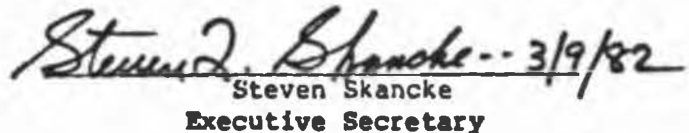
administrative burden for depository institutions to implement and would not directly address the immediate problem of soliciting the opening of multiple accounts by depository institutions.

Pursuant to its authority under the Depository Institutions Deregulation Act (12 U.S.C. § 3501 *et seq.*), the Committee amends Part 1204 (Interest on Deposits) by adding the following sentence to section 109(a):

A depository institution is not permitted directly or indirectly to solicit or promote deposits from customers on the basis that the funds will be divided into more than one account by the institution for the purpose of providing more than two premiums per deposit within a 12-month period.

* * * * *

By order of the Committee,



Steven Skancke
Executive Secretary

DEPOSITORY INSTITUTIONS DEREGULATION COMMITTEE
Washington, D.C. 20220

PRESS RELEASE

March 25, 1982

Depository Institutions Deregulation Committee
March 22, 1982 Meeting

The Depository Institutions Deregulation Committee took the following actions at its March 22 meeting.

° Election of Chairman and Vice Chairman. The Secretary of the Treasury, Donald T. Regan, and the Chairman of the Board of Governors of the Federal Reserve System, Paul A. Volcker, were reelected as Chairman and Vice-Chairman of the DIDC.

° Deregulation Plan. The Committee adopted a plan for deregulating interest rate ceilings on time deposits and authorized a new time deposit category for Federally regulated commercial banks, savings and loan associations and mutual savings banks. The new account category will be available on May 1, 1982 and will have the following characteristics:

(1) no Federally regulated interest rate ceiling.

(2) an initial minimum maturity of 3-1/2 years that wil be reduced by one year on April 1, 1983, 198 and 1985 and will be reduced on March 31, 198 to the minimum maturity for all time deposits, currently fourteen days.

(3) a required denomination of $500 but no specified minimum.

(4) additions to the account permitted during the first year without extending its maturity at the option of the institution.

(5) optional negotiability.

(6) an early withdrawal penalty as required by the current DIDC regulations.

In addition to creating the new account category the Committee also adjusted the maturity range of the Small Saver Certificate (SSC) to be 2-1/2 to 3-1/2 years effective, May 1, 1982, and 1-1/2 to 2-1/2 years, effective April 1, 1983. The SSC ceiling rate will remain indexed to the 2-1/2 year constant maturity Treasury yield until April 1, 1983 when it will be indexed to the 1-1/2 year yield. The 25 basis point differential in favor of thrift institutions is retained.

° Short-Term Deposit Instrument. The Committee also authorized for use by the institutions, effective May 1, 1982, a new short-term time deposit with the following characteristics:

(1) a $7500 minimum denomination.

(2) a 91-day maturity.

(3) the ceiling rate tied to the 91-day Treasury bill discount rate for thrift institutions and the discount rate minus 25 basis points for commercial banks. This rate differential ends in 1 year and is suspended at any time the Treasury bill discount rate is 9% or below for the four most recent consecutive Treasury bill auctions. It is reinstated during the one-year period if the rate should rise above 9%, and it is not suspended again until it falls to 9% or below for another four auction period.

(4) the minimum early withdrawal penalty will be the loss of earned interest.

(5) no compounding of interest.

(6) no four-auction averaging of the Treasury bill rate as is permitted for the six-month Money Market Certificate.

In addition, the Committee directed the DIDC staff to report within 30 days on alternative short-term deposit instruments.

Chairman Regan announced that the next quarterly scheduled meeting of the DIDC will be on Tuesday, June 29 at 3:30 in the Treasury Cash Room. Depository institutions should contact their primary Federal regulators for further information.

Press Contact: Robert Don Levine
(202) 566-2041

DEPOSITORY INSTITUTIONS DEREGULATION COMMITTEE

(12 CFR Part 1204)

[DOCKET NO. D-0022]

Time Deposits of Less Than $100,000 with
Original Maturities of 3-1/2 Years or More

AGENCY: Depository Institutions Deregulation Committee

ACTION: Final Rule

SUMMARY: The Depository Institutions Deregulation Committee ("Committee") has established a new deposit category with a minimum original maturity of 3-1/2 years and no interest rate ceiling. Under a schedule established by the Committee, the maturity of the new instrument will be reduced annually by one year until March 31, 1986, at which time it will have the minimum maturity for time deposits (currently 14 days). The schedule will also reduce the minimum and maximum maturities of the small saver certificate (SSC), but other existing categories of time deposits will not be changed by the plan.

EFFECTIVE DATE: May 1, 1982.

FOR FURTHER INFORMATION CONTACT: F. Douglas Birdzell, Counsel, or Joseph DiNuzzo, Attorney, Federal Deposit Insurance Corporation (202) 389-4147; Paul S. Pilecki, Senior Attorney, Board of Governors of the Federal Reserve System (202)452-3281; Elaine Boutilier, Attorney-Advisor, Department of the Treasury (202) 566-8737; Rebecca Laird, Senior Associate General Counsel, Federal Home Loan Bank Board (202) 377-6446; or Mark Leemon, Attorney, Office of the Comptroller of the Currency (202) 447-1880.

SUPPLEMENTARY INFORMATION: On October 6, 1981, the Committee requested public comments on two related proposals to help accomplish the Committee's statutorily-required objective of an orderly phaseout of deposit interest rate ceilings giving due regard to the safety and soundness of depository institutions (see 46 Federal Register 49137). The Committee requested comment on whether to establish a new time deposit account category that would have the following principal characteristics: (1) an initial minimum original maturity of 3-1/2 years or more; (2) no interest rate limitation; (3) a minimum denomination of $250; (4) an early withdrawal penalty equal to 9 months' simple interest; and optional features that would allow additions to the account during the first year without increasing the maturity and would permit the instrument to be negotiable. The proposal also would have established two new deposit categories in 1984 and 1985. The Committee also requested comments on a schedule that would reduce each year the minimum maturity of this new deposit category by one year.

In response to its request, the Committee received 580 letters from the public on the new deregulation plan and the proposed new account. Of the 121 savings and loan associations and 27 mutual savings banks responding, about 79 percent indicated they did not want a deregulation schedule that included a ceilingless deposit instrument. Accordingly, most of them did not respond to the specific questions regarding the characteristics of the proposed new instrument.

Of the 375 commercial banks that responded, over 80 percent favored a scheduled phaseout but disagreed over the characteristics of the proposed new instrument. The 9 regulatory agencies and Federal Reserve Banks and most of the 28 commercial bank trade associations wrote in support of the proposed plan while the 10 thrift trade associations expressed opposition. Ten individuals and non-depository institutions offered comments and half of them were opposed to the plan.

Those opposed to the proposals questioned the authority of the Committee to introduce a deregulation schedule at this time that authorizes new ceilingless instruments. They argued that such action is contrary to the Congressional mandate that the Committee phase out interest rate ceilings only if economic conditions warrant and only after due regard for the safety and soundness of depository institutions.

Those favoring the proposals expressed the view that a schedule will provide institutions with an opportunity to plan for the legislated goal of ceilingless deposit accounts. By beginning with long-term accounts, they argued it will permit financial institutions to better control their asset-liability risk and to attract longer-term deposits that are most appropriate for longer-term lending.

After considering all of the comments, the Committee has established a new deposit category to become effective on May 1, 1982. The new category will have the following characteristics: (1) no interest rate ceiling, (2) a minimum original maturity of 3-1/2 years, (3) no minimum denomination but the account must be made available in a $500 denomination, (4) permits additions to an account during the first year without extending its maturity (optional), and (5) permits the instrument to be negotiable (optional). 1/ The existing penalty for early withdrawal will apply to the new instrument. The

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1/ The Federal Home Loan Bank Board adopted on March 24, 1982 a regulation permitting institutions insured by the Federal Savings and Loan Insurance Corporation to offer certificates of deposit in negotiable form. Prior to this action which will take effect April 25, 1982 savings and loan associations were not generally permitted to offer negotiable certificates except for large denomination ($100,000) certificates.

maturity of the new instrument will be reduced annually by one year, and the new deposit category will be used in conjunction with a schedule designed to phaseout interest rate ceilings on time deposits. In addition, the minimum maturity of the SSC will be adjusted downward by the schedule to complement the new deposit category. The schedule adopted by the Committee is as follows:

Step 1 (May 1, 1982)

1. The new 3-1/2 year or longer, ceilingless deposit category becomes effective.
2. The maturity for SSCs is adjusted to 2-1/2 years to less than 3-1/2 years.

Step 2 (April 1, 1983)

1. The minimum maturity on the ceilingless deposit category is reduced to 2-1/2 years.

2. The maturity on the SSC is reduced to 1-1/2 years to less than 2-1/2 years, and the rate is tied to the average yield for 1-1/2 year Treasury securities with the 25 basis point differential retained.

Step 3 (April 1, 1984)

1. The minimum maturity for the ceilingless deposit category is reduced to 1-1/2 years.

Step 4 (April 1, 1985)

1. The minimum maturity for the ceilingless deposit category is reduced to 6 months.

Step 5 (March 31, 1986)

1. The minimum maturity for the ceilingless deposit category is reduced to the minimum maturity for time deposits in effect on that date.

The new rules apply only to new time deposits issued on or after each of the relevant dates; the rates payable on existing time and savings deposits are unaffected by the new rules. Moreover, ceiling rates for new time deposits with maturities other than those specified in the phaseout schedule on each of the relevant implementation dates will remain unchanged unless specifically acted upon in the future by the Committee.

In taking this action, the Committee concluded that the plan is necessary to provide additional returns to savers and to provide

depository institutions and their customers with a specific schedule so that institutions may better plan their asset and liability strategies in anticipation of an environment without deposit interest rate ceilings. Nonetheless, the Committee will monitor the schedule at least annually, taking into account economic conditions and with due regard for the safety and soundness of depository institutions.

The Committee asked for public comment on two other new account categories that would be established as part of the deregulation schedule. These accounts, like the SSC, would be indexed to Treasury securities but would have no thrift differential and would have a reduced minimum and maximum maturity. 2/ However, since these new accounts would not become effective until April 1984 and April 1985, the Committee determined that it should consider the necessity of such accounts at that time instead of authorizing them now. This is in keeping with the public comments, which indicated that most depository institutions would prefer fewer rather than more new accounts.

In its proposed rulemaking, the Committee requested comments on a number of features, including a minimum denomination of $250, a 9-month early withdrawal penalty, and allowing additional deposits during the first year of an account without extending its maturity. The public comments on a minimum denomination of $250 were mixed. Some respondents commented that no minimum denomination should be required, thereby allowing the institution to set whatever it believed was appropriate. However, most respondents indicated that $250 was acceptable. The Committee concluded that the institutions should be allowed the maximum flexibility possible to set a minimum denomination on the new category of time deposit without disadvantaging the small saver, and, therefore, adopted the provision currently used with the All Savers Certificate: no minimum denomination is mandated, but the account must be made available in $500 denominations. This leaves the institutions free to accept deposits of any amount, as long as a $500 account is also available.

In commenting on the feature of additional deposits during the first year, most respondents indicated that it would be feasible only if an institution offered it in conjunction with a floating rate instrument. Many opposed this feature as too complicated and confusing to the depositor. The Committee has authorized additional deposits during the first year as an optional feature of the new

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2/ The account proposed to be established in 1984 would have a maturity of 6 months to 1-1/2 years and could be offered at a rate not to exceed the 26-week U.S. Treasury rate (auction average on a discount basis). The account proposed to be established in 1985 would have a maturity of 14-days to six months and could be offered at a rate not to exceed the 13 week U.S. Treasury bill rate (auction average on a discount basis).

deposit category. Under this feature (which an institution is not required to offer) the institution may accept additional deposits at any time during the first year of the account without extending the maturity of the account. The deposit contract shall specify the method to be used for determining the rate of interest to be paid on additions to an account during that first year.

The comments received on the proposed 9-month early withdrawal penalty primarily opposed the proposal as adding confusion and making the account less attractive to depositors. Furthermore, they noted that an early withdrawal penalty longer than 6 months can be required by an institution under the existing regulation. The Committee has determined that the existing early withdrawal penalty of a forfeiture at least 6 months' interest on the amount withdrawn will apply to the new account. It should be noted, however, that under the schedule, the minimum maturity of the new account will be less than one year effective April 1, 1985. At that time the early withdrawal penalty would be that which applies to accounts of less than one year, i.e. 3 months' interest.

The minimum early withdrawal penalty for a floating rate time deposit (for which the interest rate varies during the term of the deposit) with a maturity of more than one year is an amount equal to six months' simple interest. If a depository institution ties the interest rate on its new account to an index that is beyond its control (_e.g._, Treasury security rate, commercial paper rate, Federal funds rate, Federal Reserve discount rate) for the _entire_ term of the deposit, the institution may base the simple interest rate, for purposes of calculating the minimum early withdrawal penalty, on the rate in effect on the date the account is opened, or on the date of withdrawal, or on an average of the rates in effect during the term of the deposit. The institution must specify, however, whether it will use the initial interest rate, the rate on the date of withdrawal, or the average rate. For example, if the rate on the account is set at the twenty-six week Treasury bill discount rate plus 100 basis points and it changes weekly with the most recent auction results, the early withdrawal penalty rate could be the discount rate (plus 100 basis points) in effect on the date the account was opened, or the date of the withdrawal, or an average of all the rates in effect during the term of the deposit; but the method to be used must be specified in the deposit agreement.

If the depository institution chooses not to tie the interest rate on its new account to an index, but instead chooses to set the precise way in which the rate varies over the term of the deposit, or if it changes the relationship of the rate to the index (_e.g._, the commercial paper rate minus 50 basis points for the first six months of the instrument and the commercial paper rate at minus 100 basis points thereafter), then the early withdrawal penalty must be computed using an average of the simple interest rates on the deposit during the time period that the deposit was outstanding. If the interest rate is established at regular intervals and remains in effect for regular periods (_e.g._, the rate is established once

a month and remains in effect for one month), the average simple interest rate would be the sum of the rates established at each interval while the funds were on deposit, divided by the number of periods the funds were on deposit. Each partial period will be considered a full period for the purpose of this calculation. For example, if a 2-1/2 year time deposit with an interest rate that varies monthly was established on May 15, 1983, and withdrawn on July 7, 1983, the average simple interest rate would be the sum of the May, June, and July rates, divided by three.

If the length of the periods for which rates are effective varies, the average simple interest rate would be calculated by dividing the amount of time a deposit was outstanding into equal periods and then adding the rates that were in effect during those periods and dividing by the number of periods. The period used should be the shortest period for which a rate was in effect. For example, a time deposit might have the following rates in effect for the following periods at the time a depositor wished to withdraw the funds:

six months...............15%
1-1/2 years..............16%
1 year...................14%

The total amount of time the deposit was outstanding was 3 years (6 months + 1-1/2 years + 1 year). This 3-year period would then be divided into 6 periods of 6 months each. Then the rates in effect for each period would be:

1st six month period...............15%
2nd six month period...............16%
3rd six month period...............16%
4th six month period...............16%
5th six month period...............14%
6th six month period...............14%

To calculate the average simple interest rate, the rate in effect during each period would be added together -- 15 + 16 + 16 + 16 + 14 + 14 = 91. The resulting sum would then be divided by the number of periods -- 91 divided by 6 -- to yield an average simple interest rate of 15.17%.

In the case of lump-sum payments of cash that would be regarded as interest (see e.g., 12 C.F.R. 1204.109 and 12 C.F.R. 1204.111), such payments must be taken into account in computing the penalty rate. Any lump-sum payment must be prorated over the life of the deposit. The portion that is attributed to the time period during which the deposit was outstanding must be regarded as interest for purposes of computing the penalty rate. The portion attributable to the remaining life of the deposit is regarded as unearned interest and must be deducted from the principal amount of the deposit and returned to the institution.

For example, assume that cash of $100 that would be regarded as interest were given to a depositor at the opening of a $1,000, 4-year variable rate time deposit, that the entire amount is withdrawn after one year, and that the average of the rates paid on the deposit during the time it was outstanding was 12 percent. The lump-sum of $100 would be regarded by the Committee as a payment of interest and must be taken into account in computing the penalty rate. Because the deposit was outstanding for one-fourth of its expected life, a corresponding amount of the lump-sum must be taken into account in computing the penalty rate. Thus, 2.5 percent (25 divided by 1,000) must be added to the average of the rates paid during the time the deposit was outstanding (12 percent) to achieve a penalty rate of 14.5 percent. The remaining three-fourths of the lump-sum payment ($75) would be regarded as unearned interest and would be returned to the institution. Thus, the amount that the customer would return would be $147.50.

The new rule provides greater flexibility in designing accounts. Depository institutions will be permitted to accept additions in the first year to a new account governed by whatever interest rate structure -- fixed or floating -- they would choose, provided that the method of varying the interest rate is adequately disclosed in the deposit contract.

The Committee also considered the proposal to phaseout interest rate ceilings in terms of its impact on small entities, as required by the Regulatory Flexibility Act (5 U.S.C. §§ 601, _et seq_.). In this regard, the Committee's action does not impose any new regulatory burden, or increase any existing or add any new reporting or record keeping requirements. Instead, this action eliminates regulatory restrictions on the maximum interest rate payable for certain time deposits on May 1, 1982. Small entities that are depositors generally should benefit from the Committee's action because they will be able to earn higher rates of interest on their time deposits. Small entities that are depository institutions could have increased operating expenses as a result of this action, because it is likely that they will be paying higher interest rates on certain time deposits; on the other hand, their competitive position _vis-a-vis_ nondepository institution competitors should be enhanced by their ability to offer higher rates on time deposits, thereby attracting new funds that can be reinvested profitably.

By law, the Committee is required to work towards the ultimate elimination of interest rate ceilings on time deposits. The Committee considered several alternatives to accomplish this objective; an analysis of these alternatives is available from the Executive Secretary of the Committee. In the Committee's view, the plan that was adopted provides the greatest flexibility for all depository institutions during the phaseout period, without having a disproportionately adverse impact on any particular size of depository institution.

Pursuant to its authority under Title II of the Depository Institutions Deregulation and Monetary Control Act of 1980, 94 Stat.

142 (12 U.S.C. § 3501 et seq.), to prescribe rules governing the payment of interest and dividends on deposits of Federally insured commercial banks, savings and loan associations, and mutual savings banks, the Committee amends Part 1204 -- Interest on Deposits (12 CFR Part 1204) as follows:

1. Effective May 1, 1982, Section 106 is amended by adding a new paragraph (c) to read as follows:

§ 1204.106 -- Time Deposits of Less Than $100,000 With Maturities of 2-1/2 Years to 4 Years.

* * *

(c)(1) Effective May 1, 1982, this section is amended by striking the term "2-1/2 years to less than 4 years" wherever it appears and inserting in its place "2-1/2 years to less than 3-1/2 years".

(2) Effective April 1, 1983, this section is amended by striking the term "2-1/2 years to less than 3-1/2 years" wherever it appears and inserting in its place "1-1/2 years to less than 2-1/2 years", and by striking the term "average 2-1/2 year yield" wherever it appears and inserting in its place "average 1-1/2 year yield".

2. Effective May 1, 1982, a new section 119 is added that would read as follows:

§ 1204.119 -- Time Deposits of Less Than $100,000 with Original Maturities of 3-1/2 Years or More.

(a) A commercial bank, mutual savings bank, or savings and loan association may pay interest at any rate as agreed to by the depositor on any time deposit with an original maturity of 3-1/2 years or more that has no minimum denomination but is made available in a denomination of $500.

(b) Any time deposit with an original maturity of 1-1/2 years or more issued pursuant to this section may provide by contract that additional deposits may be made to the account for a period of one year from the date that it is established without extending the original maturity date of the account. Deposits made to the account more than one year after the date that it is established shall extend the maturity of the entire account for a period of time at least equal to the original term of the account.

(c) Any time deposit offered pursuant to this section may be issued in a negotiable or nonnegotiable form.

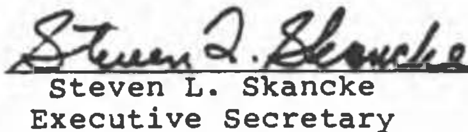
(d) Effective April 1, 1983, this section is amended by striking the term "3-1/2 years" wherever it appears and inserting in its place the term "2-1/2 years".

(e) Effective April 1, 1984, this section is amended by striking the term "2-1/2 years" wherever it appears and inserting in its place "1-1/2 years".

(f) Effective April 1, 1985, this section is amended by striking the term "1-1/2 years" wherever it appears in paragraph (a) and inserting in its place "6 months".

(g) Effective March 31, 1986, this section is amended by striking the term "with an original maturity of 6 months or more" wherever it appears.

By order of the Committee, March 26, 1982.



Steven L. Skancke
Executive Secretary

DEPOSITORY INSTITUTIONS DEREGULATION COMMITTEE

(12 CFR Part 1204)

[DOCKET NO. D-0023]

91-Day Time Deposits of Less Than $100,000

AGENCY: Depository Institutions Deregulation Committee.

ACTION: Final rule.

SUMMARY: The Depository Institutions Deregulation Committee ("Committee") has established a new category of time deposit that will enable depository institutions to compete more effectively with short-term market instruments. The new deposit category has the following principal characteristics: (1) a minimum denomination of $7,500; (2) a maturity of exactly 91 days; (3) a fixed ceiling rate of interest based on the most recent rate established and announced for U.S. Treasury bills with maturities of 91 days (auction average on a discount basis); and (4) compounding of interest is not permitted. The Committee also established a temporary 25 basis point differential in favor of thrift institutions for one year and a separate minimum early withdrawal penalty for this deposit category. The temporary differential will also not apply when the Treasury bill rate is 9 per cent or less for four consecutive auctions.

EFFECTIVE DATE: May 1, 1982.

FOR FURTHER INFORMATION CONTACT: Rebecca Laird, Senior Associate General Counsel, Federal Home Loan Bank Board (202/377-6446), Mark Leemon, Attorney, Office of the Comptroller of the Currency (202/447-1880), F. Douglas Birdzell, Counsel, or Joseph A. DiNuzzo, Attorney, Federal Deposit Insurance Corporation (202/389-4147), Daniel L. Rhoads, Attorney, Board of Governors of the Federal Reserve System (202/452-3711), or Elaine Boutilier, Attorney-Advisor, Department of the Treasury (202/566-8737).

SUPPLEMENTARY INFORMATION: The Depository Institutions Deregulation Act of 1980 (Title II of P.L. 96-221; 12 U.S.C. §§ 3501 *et seq.*) ("Act") was enacted to provide for the orderly phaseout and ultimate elimination of the limitations on the maximum rates of interest and dividends that may be paid on deposit accounts by depository institutions as rapidly as economic conditions warrant and with due regard for the safety and soundness of depository institutions. Under the Act, the Committee is authorized to phase out interest rate ceilings by any one of a number of methods, including the creation of new account categories either not subject to interest rate limitations or with interest rate ceilings set at market rates of interest.

At its June 25, 1981 meeting, the Committee considered the issue of short-term time deposit instruments and decided to request public comment on the desirability of authorizing a new deposit instrument having characteristics similar to money market mutual funds (MMFs). 46 Fed. Reg. 36712 (July 15, 1981). The Committee did not put forth a specific proposal at that time. Over 400 comments were received by the Committee on this issue. (An analysis of the comments is contained in the DIDC staff paper "Proposals to Change the Method of Calculating the Ceiling Rate of MMCs and Consideration of Creation of a New Short-Term Deposit Instrument", September 16, 1981, which is available upon request from the Executive Secretary of the Committee.) Approximately half of the respondents favored creation of a new short-term instrument and about half were opposed. Those opposing the authorization of a new short-term instrument, generally thrift institutions, argued that the higher costs associated with a new deposit instrument and the potential shifts from savings accounts would add to their current earnings problems.

At its September 22, 1981 meeting, the Committee decided to solicit additional public comment (46 Fed. Reg. 50804, October 15, 1981) on several specific deposit proposals as well as the general features of short-term instruments. The three specific proposals were: (1) a ceilingless, $5,000 minimum denomination account with a transactions feature; (2) a time deposit with an initial maturity of 91 days, and a 14-day notice period thereafter, with a ceiling rate tied to the 13-week Treasury bill rate; and (3) a ceilingless $25,000 minimum denomination 1-day notice account. Comment was requested on several specific account characteristics as well.

The Committee received 844 responses on the three proposals published for comment and considered these comments at its March 22, 1982, meeting. The comments are summarized in the memorandum to the Committee dated December 10, 1981, entitled "Short-Term Investment Proposals." About 58 per cent of all respondents commenting favored a more competitive short-term instrument. The proposal was favored by a majority of commercial banks and was opposed by a majority of the thrift institutions commenting. Many of the respondents, including thrift institutions opposed to any new short-term instrument, stated that competition for short-term funds is no longer limited to competition among depository institutions but now also includes competition with MMFs. Some respondents argued that regulation of MMFs would be preferable to authorizing a new short-term instrument.

While the respondents opposing a new short-term instrument generally declined to comment on the specific proposals, those respondents who did comment preferred a ceilingless, $5,000 minimum denomination deposit with a transaction feature. This proposal was perceived as being the most effective of those proposed for meeting MMF competition. Those opposing the proposal argued that it would cause an increase in the cost of funds, primarily in shifts from passbook and NOW accounts into the new instrument. Commercial banks opposed the establishment of a differential in favor of thrift institutions while thrift institutions were in favor of such a differential.

The second proposal, the $10,000 minimum denomination time deposit with a minimum initial maturity of 91 days and a 14-day notice period thereafter, was the least popular among those favoring a new instrument. About 50 comments favored the adoption of this proposal. The comments were divided on the 14-day notice feature, and proponents were generally satisfied with its other characteristics. Opponents criticized its similarity to 26-week money market certificates and its likely inability to attract new funds, particularly funds held by MMFs.

The third proposal, a ceilingless $25,000 minimum denomination account with a 1-day notice requirement and no transaction feature, was the second-most popular of the three proposals. Proponents stated that the category would allow them to compete for deposits of corporations and individuals, while opponents felt that it would only benefit larger, highly liquid institutions.

One of the more popular of several alternative short-term instruments suggested in response to the Committee's proposal was a 91-day or 30-day instrument with a minimum denomination of $5,000, no transactions feature, and a rate tied to a comparable Treasury bill yield. About 100 respondents favored this suggested category.

At its December 16, 1981, meeting, the Committee postponed consideration of its proposals until its March 22, 1982 meeting. Since the December 16, 1981 meeting, the Committee has received over 2,500 letters (over 90 per cent of which were from commercial banks) urging active pursuit of deregulation.

The impetus behind the Committee's consideration of a short-term instrument has been the continued strong growth of MMFs while growth of small time and savings deposits at commercial banks and at thrift institutions has been weak. MMFs, though uninsured, offer an investment which includes the characteristics of a market return, liquidity, a transaction feature, no early withdrawal penalty, and can be obtained in denominations as low as $1,000. Short-term Treasury and U.S. agency securities also provide competition to depository institutions in that they offer a market return, tax advantages, liquidity, safety, and can be obtained in minimum denominations of $5,000 to $10,000.

In order to assist depository institutions in competing with non-depository institutions that offer alternative short-term instruments, the Committee has determined to authorize a new deposit instrument that will enable depository institutions to attract new funds, will help stem deposit outflows and will enhance the ability of institutions to retain valuable customer relationships.

After consideration of the comments received, the Committee has determined to authorize, effective May 1, 1982, a new category of short-term time deposit as follows:

--minimum denomination of $7,500

--91-day maturity

--a fixed ceiling rate for savings and loan associations and mutual savings banks equal to the 91-day Treasury bill rate (auction average on a discount basis) at the most recent auction. The ceiling rate for commercial banks will be 25 basis points less than the thrift ceiling rate. The rate will become effective the day following the auction.

--no compounding of interest is permitted

--may be offered in either negotiable or nonegotiable form

--the 25 basis points differential in favor of thrift institutions is authorized until May 1, 1983. In addition, the differential will not apply whenever the 13-week Treasury bill rate is at or below 9 per cent for the four most recent consecutive auctions. When the differential is not in effect, commercial banks may pay the thrift ceiling rate.

--a separate minimum early withdrawal penalty of forfeiture only of all interest earned, and

--the account is available to all depositors.

United States Treasury bills maturing in 91 days are auctioned weekly by the Treasury Department, normally on Monday. The 91-day United States Treasury bill rate will be announced by Treasury and is published widely in many newspapers throughout the country. The ceiling rate payable for new deposits, as determined by the most recent auction, will be effective on the day following the auction.

The rate payable on these deposits may not exceed the ceiling rate in effect on the date of deposit. If such deposits are renewed, automatically or otherwise, the maximum rate that may be paid may not exceed the 91-day Treasury bill rate in effect at the time of renewal of the deposits. Unlike the money market certificate, averaging of the four most recent auction rates will not be permitted. Premiums, however, will be permitted in accordance with the Committee's rules.

The temporary 25 basis point ceiling rate differential in favor of thrift institutions will expire on May 1, 1983. In addition, the temporary differential will not apply if the 91-day Treasury bill discount rate (auction average) is at or below 9 per cent for the four most recent auctions of 91-day Treasury bills held immediately prior to the date of deposit. When the differential is not in effect, commercial banks will be permitted to pay the ceiling rate authorized for thrift institutions.

The Committee recognizes that the new deposit category will not be fully competitive with instruments offered by non-depository institutions. Therefore, the Committee has also directed its staff to consider additional short-term deposit categories to enable depository institutions to compete more effectively with non-depository institutions. The staff was requested to present its recommendations to the Committee within 30 days.

The Committee considered the potential effect on small entities of this new category when it established the instrument, as required by the Regulatory Flexibility Act (5 U.S.C. § 603 et seq.). In this regard, the Committee's action would not impose any new reporting or recordkeeping requirements. Small entities which are depositors generally should benefit from the Committee's proposal, since the new instrument would provide them a market rate of return. If low-yielding deposits shift into the new account, small entities which are depository institutions might have increased costs as a result of this action. However, their competitive position vis-a-vis nondepository competitors should be enhanced by their ability to offer a competitive short-term instrument at market rates. The new funds attracted by the new instrument (or the retention of deposits that might otherwise have left the institution) could be invested at a positive spread and would therefore at least partially offset the higher costs associated with the shifting of low-yielding accounts.

Pursuant to its authority under Title II of Public Law 96-221, 94 Stat. 142 (12 U.S.C. § 3501 et seq.), to prescribe rules governing the payment of interest and dividends on deposits of federally insured commercial banks, savings and loan associations, and mutual savings banks, effective May 1, 1982, the Committee amends Part 1204 (Interest on Deposits) by adding section 120 as follows:

§ 1204.120 - 91-Day Time Deposits of Less than $100,000.

(a) Commercial banks, mutual savings banks, and savings and loan associations may pay interest on any negotiable or nonnegotiable time deposit of $7,500 or more, with a maturity of 91 days, at a rate not to exceed the ceiling rates set forth below. Rounding any rate upward is not permitted, and interest may not be compounded during the term of this deposit.

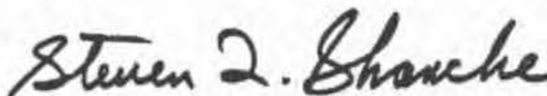
(b)(1) The ceiling rate of interest payable by mutual savings banks and savings and loan associations shall be the rate established and announced (auction average on a discount basis) for U.S. Treasury bills with maturities of 91 days at the auction held immediately prior to the date of deposit ("Bill Rate"). Except as provided in subparagraphs (2) and (3) below, the ceiling rate of interest payable by commercial banks shall be the Bill Rate minus one-quarter of one percentage point (25 basis points).

(2) If the Bill Rate is 9 per cent or below at the four most recent auctions of U.S. Treasury bills with maturities of 91 days held immediately prior to the date of deposit, the ceiling rate of interest payable by commercial banks shall be the Bill Rate.

(3) Effective May 1, 1983, the ceiling rate of interest payable by commercial banks on this category of deposit for deposits issued or renewed on or after that date shall be the Bill Rate.

(c) Section 103 of this Part shall not apply to time deposits issued under this section. Where all or any part of a time deposit issued under this section is paid before maturity, a depositor shall forfeit an amount equal to at least all interest earned on the amount withdrawn.

By order of the Committee, April 1, 1982.



Steven L. Skancke
Executive Secretary