



FEDERAL RESERVE BANK  
OF DALLAS

WILLIAM H. WALLACE  
FIRST VICE PRESIDENT

April 19, 1985

DALLAS, TEXAS 75222

Circular 85-51

**TO:** All depository institutions in the  
Eleventh Federal Reserve District

**SUBJECT**

**Final interpretation of Regulations D, H, and Q regarding money  
market mutual funds**

**DETAILS**

The Board of Governors has issued an interpretation of the definition of deposit in Regulation D -- Reserve Requirements of Depository Institutions, and Regulation Q -- Interest on Deposits, to exclude from the definition of the term "deposit" repurchase agreements involving shares of a money market mutual fund whose portfolio consists wholly of United States Treasury and federal agency securities.

The Board of Governors also has issued an interpretation to Regulation H -- Membership of State Banking Institutions in the Federal Reserve System, to permit state member banks to purchase shares in a money market mutual fund whose portfolio consists entirely of assets that the bank may purchase directly. The change will become effective with the reserve computation period beginning June 4, 1985.

**ATTACHMENTS**

Attached is the text of the Board's Federal Register document.

**MORE INFORMATION**

For further information, please call Robert Feil, at extension 6690, or Evelyn Thomas, at extension 6132 for Regulation D; Marvin McCoy, at extension 6657 for questions regarding Regulation H, and Frances Bentsen, at extension 6171 for questions regarding Regulation Q.

Sincerely yours,

FEDERAL RESERVE SYSTEM

Regulations D, H, and Q

[12 C.F.R. PARTS 204, 208, and 217]

[Docket No. R-0542]

RESERVE REQUIREMENTS OF DEPOSITORY INSTITUTIONS

MEMBERSHIP OF STATE BANKING INSTITUTIONS  
IN THE FEDERAL RESERVE SYSTEM

INTEREST ON DEPOSITS

Repurchase Agreement Involving Shares of a Money Market Mutual Fund Whose Portfolio Consists Wholly of United States Treasury and Federal Agency Securities.

State Member Bank Purchase of Shares of a Money Market Mutual Fund Whose Portfolio Consists Wholly of Securities that the Bank May Purchase Directly.

AGENCY: Board of Governors of the Federal Reserve System

ACTION: Final Interpretation

SUMMARY: The Board of Governors has issued an interpretation of the definition of deposit in Regulation D--Reserve Requirements of Depository Institutions (12 CFR Part 204) and Regulation Q--Interest on Deposits (12 CFR Part 217) to exclude from the definition of the term "deposit" repurchase agreements involving shares of a money market mutual fund whose portfolio consists wholly of United States Treasury and federal agency

securities. The Board of Governors has also issued an interpretation to Regulation H--Membership of State Banking Institutions in the Federal Reserve System (12 CFR Part 208) to permit state member banks to purchase shares in a money market mutual fund whose portfolio consists entirely of assets that the bank may purchase directly.

EFFECTIVE DATE: The reserve computation period beginning June 4, 1985.

FOR FURTHER INFORMATION CONTACT: J. Virgil Mattingly, Associate General Counsel (202/452-3430), or Elaine M. Boutilier, Attorney (202/452-2418), Legal Division, Board of Governors of the Federal Reserve System, Washington, D.C. 20551

SUPPLEMENTARY INFORMATION: List of Subjects in 12 CFR Part 204  
Banks, banking; currency; Federal Reserve System; penalties, reporting requirements.

Pursuant to its authority under sections 9 and 19 of the Federal Reserve Act (12 U.S.C. §§ 321 et seq. and 461 et seq.), the Board amends 12 CFR Part 204, Regulation D, 12 CFR Part 208, Regulation H and 12 CFR Part 217, Regulation Q as follows:

1. Regulation D (12 CFR Part 204) is amended by adding a new section 204.124 as follows:

§204.124 -- Repurchase Agreement Involving Shares of a Money Market Mutual Fund Whose Portfolio Consists Wholly of United States Treasury and Federal Agency Securities

(a) The Federal Reserve Act, as amended by the Monetary Control Act of 1980 (Title I of Pub.L. 96-221) imposes Federal reserve requirements on transaction accounts and nonpersonal time deposits held by depository institutions. The Board is empowered under the Act to determine what types of obligations shall be deemed a deposit (12 U.S.C. § 461). Regulation D--Reserve Requirements of Depository Institutions exempts from the definition of "deposit" those obligations of a depository institution that arise from a transfer of direct obligations of, or obligations that are fully guaranteed as to principal and interest by, the United States government or any agency thereof that the depository institution is obligated to repurchase (12 CFR § 204.2(a)(1)(vii)(B)). A parallel exemption in Regulation Q--Interest on Deposits exempts from the definition of "deposit" obligations that evidence an indebtedness arising from a transfer of direct obligations of, or obligations that are fully guaranteed as to principal and interest by, the United States or any agency thereof that the bank is obligated to repurchase (12 CFR § 217.1(f)(2)).

(b) The National Bank Act provides that a national bank may purchase for its own account investment securities under limitations and restrictions as the Comptroller may prescribe (12 U.S.C. § 24, ¶ 7). The statute defines investment securities to mean marketable obligations evidencing indebtedness of any person in the form of bonds, notes, and

debentures. The Act further limits a national bank's holdings of any one security to no more than an amount equal to 10 percent of the bank's capital stock and surplus. However, these limitations do not apply to obligations issued by the United States, general obligations of any state and certain obligations of federal agencies. In addition, generally a national bank is not permitted to purchase for its own account stock of any corporation. These restrictions also apply to state member banks (12 U.S.C. § 335).

(c) The Comptroller of the Currency has permitted national banks to purchase for their own accounts shares of open-end investment companies that are purchased and sold at par (i.e., money market mutual funds) provided the portfolios of such companies consist solely of securities that a national bank may purchase directly (Banking Bulletin B-83-58). The Board of Governors has permitted state member banks to purchase, to the extent permitted under applicable state law, shares of money market mutual funds ("MMMF") whose portfolios consist solely of securities that the state member bank may purchase directly (12 C.F.R. § 208.123).

(d) The Board has determined that an obligation arising from a repurchase agreement involving shares of a MMMF whose portfolio consists wholly of securities of the United States government or any agency thereof<sup>1/</sup> would not be a

---

<sup>1/</sup> The term "United States government or any agency thereof" as used herein shall have the same meaning as in section 204.2(a)(1)(vii)(B) of Regulation D, 12 C.F.R. § 204.2(a)(1)(vii)(B).

"deposit" for purposes of Regulations D and Q. The Board believes that a repurchase agreement involving shares of such a MMMF is the functional equivalent of a repurchase agreement directly involving United States government or agency obligations. A purchaser of shares of a MMMF obtains an interest in a pro rata portion of the assets that comprise the MMMF's portfolio. Accordingly, regardless of whether the repurchase agreement involves United States government or agency obligations directly or shares in a MMMF whose portfolio consists entirely of United States government or agency obligations, an equitable and undivided interest in United States and agency government obligations is being transferred. Moreover, the Board believes that this interpretation will further the purpose of the exemption in Regulations D and Q for repurchase agreements involving United States government or federal obligations by enhancing the market for such obligations.

List of Subjects in 12 CFR Part 208

Banks, banking; Federal Reserve System; reporting requirements; securities.

2. Regulation H (12 CFR Part 208) is amended by adding a new section 208.123 as follows:

§ 208.123 -- Purchase of Shares of a Money Market Mutual Fund  
Whose Portfolio Consists Wholly of Securities that  
the Member Bank May Purchase Directly

(a) The National Bank Act provides that a national bank may purchase for its own account investment securities under limitations and restrictions as the Comptroller may prescribe (12 U.S.C. § 24, ¶ 7). The statute defines investment securities to mean marketable obligations evidencing indebtedness of any person in the form of bonds, notes, and debentures. The Act further limits a national bank's holdings of any one security to no more than an amount equal to 10 percent of the bank's capital stock and surplus. However, these limitations do not apply to obligations issued by the United States, general obligations of any state and certain obligations of federal agencies. In addition, with certain limited exceptions, a national bank is not permitted to purchase for its own account stock of any corporation. These restrictions also apply to state member banks (12 U.S.C. § 335).

(b) The Comptroller of the Currency has permitted national banks to purchase for their own accounts shares of open-end investment companies that are purchased or sold at par (i.e., money market mutual funds) provided the portfolios of such companies consist solely of securities that a national bank may purchase directly.

(c) The Board of Governors has determined to permit state member banks to purchase shares of money market mutual funds ("MMMF") whose portfolios consist solely of securities that the state member bank may purchase directly. The purchase by a state member bank of shares of such a MMMF is functionally equivalent to the bank's purchase of the securities that

comprise the portfolio of the MMMF. A bank that purchases shares of a MMMF acquires an undivided equitable ownership interest in the securities that comprise the MMMF portfolio. Moreover, purchase of shares of such a MMMF would not result in speculative risks or wide fluctuations because the bank currently may purchase directly the assets comprising the MMMF portfolio and because of the rules of the Securities and Exchange Commission concerning MMMFs. Indeed, by providing greater scope for diversification, particularly for smaller banks, allowing the purchase of such MMMF shares may contribute to lower risk than purchase by the state member bank of the assets comprising the MMMF portfolio directly.

(d) The Board has adopted the following conditions, similar to those adopted by the Comptroller of the Currency for national banks, to ensure that in those cases in which a state member bank may purchase securities in limited amounts, the bank does not exceed the limitations indirectly through the purchase of MMMF shares:

1. The fund is an open-end investment company registered with the Securities and Exchange Commission under the Investment Company Act of 1940 and Securities Act of 1933 or a privately offered fund sponsored by an affiliated commercial bank.<sup>2/</sup>

---

<sup>2/</sup> This provision concerning a privately offered fund sponsored by an affiliated commercial bank is a limited provision applicable only to a privately sponsored fund of a subsidiary of a holding company whose shares may be purchased only by other subsidiaries of the holding company.



2. When the fund's assets consist solely of and are limited to obligations that are eligible for investment without limit by a state member bank, there is no limit on the bank's investment. But where the fund contains securities subject to the bank's investment or lending limitations, investment in the MMMF may not exceed these investment or lending limitations. Where the state member bank purchases shares in more than one fund containing securities subject to the bank's investment or lending limitations, the bank's aggregate investment in such funds may not exceed these investment or lending limitations. Where the state member bank purchases such securities directly, the aggregate maximum allowable investment in such MMMF(s) is reduced accordingly.

3. The fund's shares are bought and sold at par (i.e., the fund is a money market fund).

4. The shareholder has an equitable and equal proportionate undivided interest in the underlying assets of the fund.

5. Shareholders are shielded from personal liability for acts or obligations of the fund.

6. The bank's investment policy, as formally approved by its board of directors, specifically provides for such investments; prior approval of the board of

directors is obtained for initial investments in specific funds and recorded in the official board minutes; and procedures, standards, and controls for the implementation of such investments are established.

7. The bank conducts reviews at least monthly of its holdings of investment company shares to ensure that such investments are in accordance with the foregoing principles.

(e) State member banks would also be subject to any other restrictions imposed by applicable state law.

List of Subjects in 12 CFR Part 217

Advertising; banks, banking; Federal Reserve System; foreign banking.

3. Regulation Q (12 CFR Part 217) is amended by adding a new section 217.161 as follows:

§ 217.161 -- Repurchase Agreements Involving Shares of a Money Market Mutual Fund Whose Portfolio Consists Wholly of United States Treasury and Federal Agency Securities

(a) The Federal Reserve Act, as amended by the Monetary Control Act of 1980 (Title I of Pub.L. 96-221) imposes federal reserve requirements on transaction accounts and nonpersonal time deposits held by depository institutions. The Board is empowered under the Act to determine what types of obligations shall be deemed a deposit (12 U.S.C. § 461).

Regulation D--Reserve Requirements of Depository Institutions exempts from the definition of "deposit" those obligations of a depository institution that arise from a transfer of direct obligations of, or obligations that are fully guaranteed as to principal and interest by, the United States government or any agency thereof that the depository institution is obligated to repurchase (12 CFR § 204.2(a)(1)(vii)(B)). A parallel exemption in Regulation Q--Interest on Deposits exempts from the definition of "deposit" obligations that evidence an indebtedness arising from a transfer of direct obligations of, or obligations that are fully guaranteed as to principal and interest by, the United States or any agency thereof that the bank is obligated to repurchase (12 CFR § 217.1(f)(2)).

(b) The National Bank Act provides that a national bank may purchase for its own account investment securities under limitations and restrictions as the Comptroller may prescribe (12 U.S.C. § 24, ¶ 7). The statute defines investment securities to mean marketable obligations evidencing indebtedness of any person in the form of bonds, notes, and debentures. The Act further limits a national bank's holdings of any one security to no more than an amount equal to 10 percent of the bank's capital stock and surplus. However, these limitations do not apply to obligations issued by the United States, general obligations of any state and certain obligations of federal agencies. In addition, generally a

national bank is not permitted to purchase for its own account stock of any corporation. These restrictions also apply to state member banks (12 U.S.C. § 335).

(c) The Comptroller of the Currency has permitted national banks to purchase for their own accounts shares of open-end investment companies that are purchased and sold at par (i.e., money market mutual funds) provided the portfolios of such companies consist solely of securities that a national bank may purchase directly (Banking Bulletin B-83-58). The Board of Governors has permitted state member banks to purchase, to the extent permitted under applicable state law, shares of money market mutual funds ("MMMF") whose portfolios consist solely of securities that the state member bank may purchase directly (12 C.F.R. § 208.123).

(d) The Board has determined that an obligation arising from a repurchase agreement involving shares of a MMMF whose portfolio consists wholly of securities of the United States government or any agency thereof<sup>3/</sup> would not be a "deposit" for purposes of Regulations D and Q. The Board believes that a repurchase agreement involving shares of such a MMMF is the functional equivalent of a repurchase agreement directly involving United States government or agency

---

<sup>3/</sup> The term "United States government or any agency thereof" as used herein shall have the same meaning as in section 204.2(a)(1)(vii)(B) of Regulation D, 12 C.F.R. § 204.2(a)(1)(vii)(B).

obligations. A purchaser of shares of a MMMF obtains an interest in a pro rata portion of the assets that comprise the MMMF's portfolio. Accordingly, regardless of whether the repurchase agreement involves United States government or agency obligations directly or shares in a MMMF whose portfolio consists entirely of United States government or agency obligations, an equitable and undivided interest in United States and agency government obligations is being transferred. Moreover, the Board believes that this interpretation will further the purpose of the exemption in Regulations D and Q for repurchase agreements involving United States government or federal obligations by enhancing the market for such obligations.

By order of the Board of Governors, March 26, 1985.

(signed) William W. Wiles

---

William W. Wiles  
Secretary of the Board