FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 5645
April 27, 1965]

INTERPRETATION OF REGULATION Q

To All Member Banks in the Second Federal Reserve District:

Printed below is an excerpt from the *Federal Register* of April 20, 1965, containing an interpretation, issued by the Board of Governors of the Federal Reserve System, of Regulation Q, Payment of Interest on Deposits, with respect to loans by a member bank secured by time deposits of such bank.

Additional copies of this circular will be furnished upon request.

ALFRED HAYES,
President.

Title 12—BANKS AND BANKING

Chapter II—Federal Reserve System

SUBCHAPTER A—BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

[Reg. Q]

PART 217—PAYMENT OF INTEREST ON DEPOSITS

Loan on Security of Time Deposit

§ 217.140 Reduction in rate of interest on time deposit during period of loan made on security of such deposit.

(a) The opinion of the Board of Governors has been requested with respect to loans by a member bank secured by time deposits in such bank. It is stated that many banks are now paying interest on time deposits at the maximum rate of 4½ percent, and the legal rate of interest in some States for ordinary bank loans is fixed by statute at 6 percent. The specific question is whether the bank may make the loan as § 217.4 (e) requires a member bank to charge a rate of interest not less than 2 percent in excess of the rate of interest paid on its time deposit when such deposit is used as security for a loan.

(b) Section 19 of the Federal Reserve Act (12 U.S.C. 371b) prohibits member banks from paying any time deposit before its maturity, except upon such conditions and in accordance with such rules and regulations as may be prescribed by the Board. The above-mentioned § 217.4 (e) is intended to implement the law and prevent evasion thereof. The specified 2 percent penalty is designed to discourage loans on time deposits that would, in effect, enable the depositor to obtain his funds before maturity. For this reason, retention of the 2 percent differential seems desirable.

(c) Since banks in some States are prohibited from charging more than 6 percent on loans, a member bank in such States that pays 4½ percent on a time deposit may not make a loan on such deposit without violating this part. However, there is nothing in the regulation to prevent a bank and its customer from agreeing to the payment of a lesser rate of interest on the deposit while a loan on the deposit is outstanding. Therefore, by agreement, the rate of interest paid on the deposit could be reduced to 4 percent during the period of the loan, with interest on the loan fixed at 6 percent. This would not be a circumvention of this part as the customer would still be paying 2 percent more interest on the loan than he would receive on the deposit. The rate of interest that the bank could pay on the deposit before and after the loan would not be affected. (12 U.S.C. 248(i). Interprets or applies 12 U.S.C. 371b)

Dated at Washington, D.C., this 2d day of April 1965.

BOARD OF GOVERNORS OF
THE FEDERAL RESERVE
SYSTEM,

[SEAL] MERRITT SHERMAN,
Secretary.

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