

FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 5764]
January 20, 1966

NOTICE OF PROPOSED RULE MAKING
Definition of "Deposit" in Regulations D and Q

To All Banks, and Others Concerned, in the Second Federal Reserve District:

The following statement was made public today by the Board of Governors of the Federal Reserve System:

The Board of Governors today announced proposed amendments to its Regulation D, relating to reserve requirements of member banks, and its Regulation Q, relating to the payment of interest on deposits by member banks. The amendments would in effect define "deposits" for purposes of those regulations as including promissory notes and other forms of indebtedness of member banks with certain exceptions.

In general, the exceptions would exclude from coverage (1) borrowings from Federal Reserve Banks, (2) borrowings from other banks, including so-called "Federal funds transactions," (3) borrowings in the form of transfers of United States obligations under repurchase agreements, and (4) borrowings with maturities of more than two years that are subordinated to claims of depositors and general creditors.

The proposed amendments have been prompted by the development over the past year of the practice among some banks of issuing short-term promissory notes to corporate customers and others in order to obtain loanable funds. This practice has tended to lessen the effectiveness of provisions of the Federal Reserve Act that prohibit the payment of interest on demand deposits, limit the rate of interest payable on time deposits, and require reserves against deposits.

The proposed amendments would apply to any indebtedness within their coverage that is incurred after today (January 20, 1966) and that is outstanding after the effective date.

Comments on the proposed amendments should be submitted by February 25, 1966. The amendments would not be made effective until approximately 60 days after their adoption by the Board.

The text of the notice regarding the proposed amendments, as it has been sent to the *Federal Register*, is printed below. The notice includes illustrative examples of the manner in which the amendments would affect particular types of transactions.

FEDERAL RESERVE SYSTEM

[12 CFR Parts 204, 217]
Regs. D, Q

**RESERVES OF MEMBER BANKS; PAY-
MENT OF INTEREST ON DEPOSITS**

Notice of Proposed Rule Making

The Board of Governors is considering amending section 204.1 of Regulation D

("Reserves of Member Banks") and section 217.1 of Regulation Q ("Payment of Interest on Deposits") by inserting at the beginning of each the following new paragraph:

"(a) Deposit. — The term 'deposit' means any indebtedness of a member bank that arises out of a transaction in the ordinary course of its business with respect to either funds received or credit extended by the bank, except (1) indebtedness due to a Federal Reserve Bank, (2) indebtedness due to another bank for its own account that is not reflected on books or reports of the debtor as a deposit or of the creditor as a

bank balance, (3) indebtedness arising from a transfer of direct obligations of the United States that the bank is obligated to repurchase, and (4) indebtedness subordinated to the claims of depositors and general creditors that has an original maturity of more than two years; provided, however, that this paragraph shall not affect the status, for purposes of this part, of any indebtedness incurred prior to January 20, 1966."

The present paragraphs (a), (b), (c), (d), (e), (f), (g), (h), and (i) of section 204.1 would be redesignated as paragraphs

(OVER)

(b), (c), (d), (e), (f), (g), (h), (i), and (j), respectively. The present paragraphs (a), (b), (c), (d), and (e) of section 217.1 would be redesignated as paragraphs (b), (c), (d), (e), and (f), respectively.

If adopted by the Board, it is contemplated that the amendments would be made effective approximately 60 days after the date of their adoption. The amendments would apply not only to any indebtedness within their coverage incurred after the effective date but also to any such indebtedness outstanding on the effective date that was incurred after January 20, 1966.

During the past year, a number of banks have issued promissory notes as a means of obtaining additional funds. It is now apparent that this practice results in avoidance of laws and regulations governing payment of interest on deposits and maintenance of reserves against deposits.

The proposed amendments to Regulations Q and D are designed to prevent evasions of those laws and regulations and are based upon the premise that, with few exceptions, indebtedness of member banks must be considered and treated as deposits subject to Regulations Q and D in order to effectuate congressional directives and policies, as expressed in section 19 of the Federal Reserve Act.

The amendments are intended principally to bring promissory notes within the definition of deposits. However, the Board would be prepared to adopt similar amendments with respect to other forms of indebtedness that were being used as a means of avoiding laws or regulations relating to payment of interest on deposits and maintenance by member banks of reserves against deposits.

The following are illustrations of the effects of the presently proposed definition of deposits, from the standpoint of rules governing payment of interest on deposits:

(1) In consideration of the receipt of funds, a member bank issues its promissory note (either negotiable or nonnegotiable) to mature in six months. The bank's liability would be a deposit. Consequently, the rate of interest on the note could not lawfully exceed that permitted on a certificate of deposit.

(2) A member bank issues its note payable on demand or within less than 30 days, either negotiable or nonnegotiable. The bank's liability would constitute a demand deposit, and it could not lawfully pay any interest thereon.

(3) A member bank purchases stationery and office supplies on credit. Such indebtedness would not arise from "funds received or credit extended by the bank," and consequently it would not be a deposit.

(4) A member bank borrows funds on its note, secured by a mortgage on the bank premises, and uses the proceeds to pay for renovation. Although this indebtedness would arise from "funds received" by the bank, the transaction would not be "in the ordinary course of its business," and therefore the indebtedness would not constitute a deposit.

(5) A member bank lends funds to a customer and credits the proceeds to his account. The amount so credited would, as heretofore, be a deposit.

(6) A member bank receives funds, in the ordinary course of its business, from a correspondent bank—whether member or nonmember, domestic or foreign. Consistent with traditional practice and understanding

of the parties, the liability of the recipient bank would be a deposit. The proposed definition of "deposit," however, would except from its coverage an interbank indebtedness that is entered and reported by both banks as a loan transaction. A loan of what are commonly termed "Federal funds" is an example of an indebtedness that would fall within such exception.

(7) A member bank issues debentures or notes to provide additional "capital" funds. By contract, the claim of the security holders against the assets of the bank is subordinated to the claims of depositors and all other creditors. Such notes are excepted from the definition of deposit if they have an original maturity of more than two years.

This notice is published pursuant to section 4 of the Administrative Procedure Act and section 1(b) of the Rules of Procedure of the Board of Governors of the Federal Reserve System (12 CFR 262.1(b)).

To aid in the consideration of this matter by the Board, interested persons are invited to submit relevant data, views, or arguments. Any such material should be submitted in writing to the Secretary, Board of Governors of the Federal Reserve System, Washington, D. C., 20551, to be received not later than February 25, 1966.

Dated at Washington, D.C., this 20th day of January, 1966.

BOARD OF GOVERNORS OF
THE FEDERAL RESERVE
SYSTEM

MERRITT SHERMAN,
Secretary.

Additional copies of this circular will be furnished on request.

ALFRED HAYES,
President.