FEDERAL RESERVE BANK OF NEW YORK

[Circular No. 7607
April 10, 1975]

PROPOSED AMENDMENTS TO REGULATION Q

—Payment of Time Deposits Before Maturity

—Notice of Maturity

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

Following is the text of a statement issued April 4 by the Board of Governors of the Federal Reserve System:

The Board of Governors of the Federal Reserve System announced today the publication, for comment, of two proposed changes in the provisions of its Regulation Q (Interest on Deposits).

These would:

1. Permit member banks to redeem a time deposit without penalty prior to maturity in the case of the depositor's death, if there were no surviving co-depositors. Present rules permit payment of a time deposit before maturity only if a substantial interest penalty is imposed—namely the loss of three-months' interest and the payment of interest on the withdrawn funds at the passbook rate.

2. Require notice on certificates of deposit that the deposit ceases to earn interest after maturity. Require notice on automatically renewable certificates of deposit that the deposit will be renewed upon maturity unless the customer directs otherwise.

Comment on the proposals will be received by the Board through May 5.

Printed below is the text of the proposed amendments to Regulation Q. Comments thereon should be submitted by May 5, 1975, and may be sent to our Bank Regulations Department.

Alfred Hayes,
President.

REGULATION Q—INTEREST ON DEPOSITS

Interest Penalty on Withdrawal

The Board of Governors proposes to amend § 217.4(d) of Regulation Q (Interest on Deposits) to permit member banks to pay time deposits before maturity without imposing an interest penalty in cases where the owner of the time deposit has died. Section 19 of the Federal Reserve Act forbids the payment of interest on demand deposits and also forbids member banks from paying time deposits prior to maturity, except in accordance with such regulations as the Board prescribes. The previous emergency-plus-penalty rule and the current penalty rule were designed to enforce these provisions of the Federal Reserve Act by preserving the distinction between demand and time accounts and preventing time accounts from being utilized as essentially demand or transaction accounts. Since the proposed amendment would apply only in cases where the depositor has died, it is considered unlikely that the amendment will interfere with the Board's regulatory purpose.

The proposed amendment provides that the depositor must have been the sole legal and beneficial owner of the deposit at the time of his/her death. Thus, for example, the death of a trustee acting in that capacity as the depositor of uninvested trust funds, and holding legal title to those funds, would not fall within the proposed amendment. Similarly, the amendment would not apply where beneficial ownership is divided between the settlor and beneficiaries (e.g., an irrevocable express trust with a life estate in the settlor and vested remainder in the beneficiaries). However, the amendment would apply if the trustee is also the settlor of a revocable trust, "Totten" or tentative trust, payable-on-death or similar account, and as such retains sole legal and beneficial ownership of the funds at the time of his/her death. The amendment as proposed would not apply to jointly owned deposits where there is a surviving depositor or depositors who were parties to the deposit contract.

Interested persons are invited to submit their 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 May 5, 1975. Such material will be made available for inspection and copying upon request, except as provided in § 261.6(a) of the Board's Rules Regarding Availability of Information.

(OVER)

Pursuant to its authority under section 19(j) of the Federal Reserve Act (12 U.S.C. 371b), the Board of Governors proposes to amend § 217.4(d) of Regulation Q (12 C.F.R. 217.4(d)) as follows:

SECTION 217.4—PAYMENT OF TIME DEPOSITS BEFORE MATURITY

* * *

(d) **Penalty for early withdrawals.** Where a time deposit, or any portion thereof, is paid before maturity, a member bank may pay interest on the amount withdrawn at a rate not to exceed that currently prescribed in § 217.7 for a savings deposit: Provided, That the depositor shall forfeit three months of interest payable at such rate. If, however, the amount withdrawn has remained on deposit for three months or less, all interest shall be forfeited. Where necessary to comply with the requirements of this paragraph, any interest already paid to or for the account of the depositor shall be deducted from the amount requested to be withdrawn.[6a] *However, upon the death of an individual depositor who at the time of his death is the sole legal and beneficial owner of a time deposit, a member bank may pay such time deposit before maturity to the depositor's representative or successor in interest without a reduction or forfeiture of interest as prescribed by this paragraph.* * * * (New language in italics.)

6a The provisions of this paragraph apply to all time deposit contracts entered into after July 5, 1973 and to all existing time deposit contracts that are extended or renewed (whether by automatic renewal or otherwise) after such date, and to all time deposit contracts that are amended after such date so as to increase the rate of interest paid. All contracts not subject to the provisions of this paragraph shall be subject to the restrictions of §217.4(d) in effect prior to July 5, 1973, which permitted payment of a time deposit before maturity only in an emergency where necessary to prevent great hardship to the depositor, and which required the forfeiture of accrued and unpaid interest for a period of not less than 3 months on the amount withdrawn if an amount equal to the amount withdrawn had been on deposit for 3 months or longer, and the forfeiture of all accrued and unpaid interest on the amount withdrawn if an amount equal to the amount withdrawn had been on deposit less than 3 months.

Notice of Maturity

The Board of Governors, pursuant to its authority under section 19(j) of the Federal Reserve Act (12 U.S.C. 371b) to prescribe rules governing the payment of interest on deposits, proposes to amend section 217.3(f) of Regulation Q to require member banks to notify owners of time deposits that, upon maturity, their time deposits will become demand deposits and no interest will be paid thereon. Member banks would also be required to notify owners of automatically renewable time deposits that their deposit will be renewed at maturity unless the owner gives the bank other instructions.

Section 217.3(f) of the Board's Regulation Q provides that, after the maturity date, a time deposit becomes a demand deposit and, reflecting the Federal Reserve Act's prohibition of interest on demand deposits, a member bank may not pay interest on a time deposit after maturity. The Board has received a number of letters from owners of time deposits describing circumstances in which they were not aware that their funds would not earn interest after the maturity date or that the maturity date had passed unnoticed.

Another problem which has been brought to the Board's attention involves time deposit contracts which provide for automatic renewal at maturity. Owners of such deposits have complained that, when they unintentionally neglected to advise the bank not to renew the deposit contract, the bank renewed the time deposit for another full term, usually at the same interest rate. If a depositor wished to withdraw his/her funds before the expiration of another full term, and the bank agreed to permit such withdrawal, he/she would be subject to the interest penalty imposed on early withdrawals.

The proposed amendment, if adopted, would apply only to time deposits issued after the effective date of the amendment. The Board's proposal would require member banks to have printed or stamped on certificates, passbooks, or other documents representing time deposits, a conspicuous statement indicating that no interest will be paid on the deposit after the maturity date. In the case of automatically renewable time deposits, the printed notice would advise depositors that, absent contrary instructions, the deposit will be renewed at maturity and state the terms of the renewed deposit contract.

The Board is of the opinion that a statement printed on the certificate or passbook will serve as adequate notice to depositors. However, the Board welcomes comments on any alternative notification methods, including another suggestion which has been made; namely, to require member banks to mail a notice to a depositor's last known address on a date which would provide the depositor with sufficient opportunity to communicate his/her instructions to the bank.

If the proposed amendment to Regulation Q is adopted, these notice requirements would be mandatory for member banks. Upon further consideration, however, the Board may determine to promulgate a policy requiring printed notice and/or mail notice, as discussed herein, in the form of a published interpretation. The Board is aware that, at the present time, many member banks provide such notice on their own initiative as a service to depositors. The Board also solicits comments from the public as to whether continuation of this optional approach is a more appropriate means to ensure depositor awareness of impending maturity.

Finally, after review of all comments, the Board may also consider adopting regulations requiring notice to depositors pursuant to its new responsibilities pertaining to possible unfair and deceptive practices under the Federal Trade Commission Improvements Act (P.L. 93-637).

Interested persons are invited to submit their 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 May 5, 1975. Such material will be made available for inspection and copying upon request, except as provided in § 261.6(a) of the Board's Rules Regarding Availability of Information.

Pursuant to its authority under § 19(j) of the Federal Reserve Act (12 U.S.C. 371b), the Board of Governors proposes to amend § 217.3(f) of Regulation Q (12 C.F.R. 217.3(f)) by adding the following to the end thereof:

SECTION 217.3—INTEREST ON TIME AND SAVINGS DEPOSITS

* * *

(f) * * * On each certificate, passbook, or other document representing a time deposit, the bank shall have printed or stamped a conspicuous statement indicating that no interest will be paid on the deposit after the maturity date or, in the case of a time deposit that is automatically renewable, a conspicuous statement indicating that the contract will be renewed automatically upon maturity, and indicating the terms of such renewal.

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