

FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 7837]
March 12, 1976

PROPOSED AMENDMENT TO REGULATION Q
Interest on Pooled Funds

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

Following is the text of a statement issued March 9 by the Board of Governors of the Federal Reserve System:

The Board of Governors of the Federal Reserve System today proposed to prohibit member banks from paying interest on pooled funds of \$100,000 or more at a rate above Regulation Q ceilings on deposits of less than \$100,000.

The Board invited comment on its proposal through May 10, 1976.

Regulation Q establishes interest rate ceilings that member banks may pay on time deposits of less than \$100,000. Time deposits of \$100,000 or more are not subject to rate ceilings. In high interest rate periods the practice has grown of pooling funds of less than \$100,000 to make up deposits of \$100,000 or more, in order to gain interest rates higher than would otherwise be available. The Board believes that this practice could lead to disruptive shifts of funds among financial institutions.

The Board's proposal would apply to such situations when a member bank knows or has reason to know that the objective of pooling is to circumvent Regulation Q rate ceilings. The proposed regulatory amendment would take the place of prior Board statements to the same effect.

The proposal made exceptions for four types of pooling not intended primarily for the purpose of achieving a higher rate of interest and that do not interfere with the regulation of interest rates. These are:

1. Combination of funds by member bank trust department officers to make use of temporarily idle funds from a number of trust accounts, where the pooling is incidental to a *bona fide* trust relationship.
2. A similar combination of funds by an attorney or other person acting in a custodial or fiduciary capacity for funds held in a member bank in escrow.
3. Consolidation of funds by an individual or organization that previously held its funds in various accounts.
4. The offering of large (\$100,000) certificates of deposit by member banks to mutual funds which have a stated investment objective of investing in other than deposit obligations and whose deposit obligations normally constitute a minimal percentage of the fund's portfolio.

Printed on the reverse side is the text of the proposed amendment to Regulation Q. Comments thereon should be submitted by May 10, and may be sent to our Bank Regulations Department.

PAUL A. VOLCKER,
President.

(OVER)

PART 217—INTEREST ON DEPOSITS

(Docket No. R-0024)

Pooling of Funds

The Board of Governors proposes to amend Regulation Q (12 CFR 217) to prohibit member banks from paying interest on time deposits of \$100,000 or more at rates in excess of those established by Regulation Q for deposits of less than \$100,000, where the bank knows or has reason to know that such time deposits consist of funds acquired or solicited for the purpose of pooling such funds primarily to obtain the exemption from interest rate ceilings provided in § 217.7(a).

In 1968 and again in 1970 the Board considered whether the interest rate limitations set forth in § 217.7 of Regulation Q prohibit member banks from issuing a Certificate of Deposit of \$100,000 or more when funds to establish the deposit have been pooled. The Board stated that pooling primarily to obtain a higher rate of interest was an evasion of its interest rate regulations and expressed the view that a bank which pays a rate in excess of the applicable Regulation Q rate on a deposit that it knows or has reason to know results from pooling principally for the purpose of obtaining a higher rate of interest would be acting contrary to the spirit of the interest rate limitations. In proposing this amendment to Regulation Q, the Board intends to clarify the application of its policy regarding pooling.

Public Law 93-123 directs the Board to establish the maximum interest rates which may be paid by member banks on time deposits of less than \$100,000. However, the statutory requirement does not apply to time deposits in excess of \$100,000 and the interest rates on such deposits may be determined by negotiation between the bank and the depositor. In periods when high rates of interest are available on money market instruments, including bank Certificates of Deposit of \$100,000 or more, individuals, including money brokers, banks, as well as financial intermediaries such as open and closed end funds have in the past actively solicited funds from the public in order to purchase Certificates of Deposit in denominations of \$100,000 or more. In light of the potentially adverse effects that pooling may have on member and nonmember financial institutions due to potentially disruptive shifts of funds, the Board believes it appropriate to amend Regulation Q to specifically prohibit the payment of interest in excess of the rate established for deposits of less than \$100,000 of pooled deposits.

Section 217.3(a) of Regulation Q prohibits the payment of interest on a time or savings account at a rate in excess of the applicable maximum rate established by the Board. The Board proposes to add a new sentence to this section prohibiting the payment of interest at a rate in excess of that prescribed in § 217.7(b) or (d) on a time deposit where the bank knows or has reason to know that such time deposit consists of funds acquired or solicited for the purpose of pooling primarily to achieve such higher rate.

In proposing this amendment, the Board does not intend to disrupt certain well-established practices which incidentally involve pooling of funds but which

are not intended primarily for the purpose of achieving a higher rate of interest and do not interfere with the regulation of interest rates. For example: (1) For purposes of economy and administrative efficiency, trust department officers frequently combine temporarily idle balances from a number of trust accounts. Provided such pooling activity is only an incidental part of a *bona fide* trust relationship, it would not violate the Board's policy on pooling. (2) A related situation occurs when an attorney or other person acting in a custodial or fiduciary capacity holds funds in escrow. The Board would not consider the combination of funds held in escrow to be a violation of its pooling policy where such pooling is only an incidental part of the custodial or fiduciary relationship. (3) An individual or an organization may consolidate its funds previously held in various accounts into a single large account. (4) Mutual funds which have a stated investment objective of investing in other than deposit obligations and whose deposit obligations normally constitute a minimal percentage of the fund portfolio may be offered a large denomination Certificate of Deposit by a member bank.

To assist the Board in its consideration of this matter, 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, and should be received not later than May 10, 1976. All material submitted should include the docket number R-0024. Such information 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.

This amendment is proposed pursuant to the Board's authority under § 19 of the Federal Reserve Act (12 U.S.C. 371b and 461) to prescribe rules governing the payment of interest on deposits including limitations on the rates of interest which may be paid by member banks and to prescribe such regulations as it may deem necessary to effectuate the purposes of § 19 and to prevent evasions thereof. To implement its proposal, the Board proposes to amend § 217.3(a) of Regulation Q (12 CFR 217.3(a)) by adding the following new sentence at the end thereof.

SECTION 217.3—INTEREST ON TIME AND SAVINGS DEPOSITS

(a) **Maximum rate.** * * * No member bank shall pay interest at a rate in excess of that prescribed in § 217.7(b) or § 217.7(d) on a time deposit where the bank knows or has reason to know that the time deposit consists of or represents funds obtained or solicited by the bank, a depositor, or any other person, for the purpose of pooling such funds primarily to achieve the exemption from interest rate ceilings provided in § 217.7(a).

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By order of the Board of Governors, March 8, 1976.