

FEDERAL RESERVE BANK  
OF NEW YORK

[ Circular No. 7934 ]  
August 12, 1976

INDIVIDUAL RETIREMENT ACCOUNTS

Review of Interest Rate Ceilings

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

Following is the text of a statement issued July 23 by the Board of Governors of the Federal Reserve System:

The Board of Governors of the Federal Reserve System said today it will give further consideration early next year to the question whether commercial banks should be permitted to pay the same ceiling rate of interest on Individual Retirement Accounts as thrift institutions.

Further consideration of possible action to permit member banks to offer IRAs on a fully competitive basis with thrift institutions will be appropriate in early 1977 when Congress is considering an extension of interest rate ceilings for financial institutions, the Board added.

There is some evidence, as yet inconclusive, indicating that member banks may be at a competitive disadvantage in competing with thrift institutions for IRA deposits, the Board said. Savings institutions generally may pay rates of interest on such deposits one quarter of a per cent higher than commercial banks. The Board will continue to monitor the growth of IRA accounts at all financial institutions.

The Board indicated that under the provisions of Public Law 94-200, passed in December 1975, any action by the Board to eliminate or reduce an interest rate differential for any category of deposit that was in effect on December 10, 1975, would require approval by Congress before it could become effective.

Individual Retirement Accounts are retirement savings deposits that may be established under the Employee Retirement Income Security Act of 1974 by individuals not covered by an employer retirement plan. Individuals may deposit up to \$1,500 a year, or 15 per cent of gross income, whichever is less, under special tax arrangements in IRAs. Member banks may pay up to 7¼ per cent interest on such deposits if they are made as four year time deposits or up to 7½ per cent if they are made as time deposits of six years or more. Thrift institutions may pay one quarter of one per cent more.

In June 1975 the Board requested public comment on the question whether there should continue to be a differential in interest rates paid on IRAs by member banks and thrift institutions. A survey early this year of IRA accounts at all Federally-insured commercial banks, savings and loan associations and mutual savings banks showed generally that thrift institutions held more IRA accounts than commercial banks.

Printed below is an excerpt from the *Federal Register* of July 29, 1976, containing the text of the Board's statement. Any questions regarding this matter may be directed to our Bank Regulations Department.

PAUL A. VOLCKER,  
*President.*

FEDERAL RESERVE SYSTEM

[ 12 CFR Part 217 ]

[ Reg. Q; Docket No. R-0017 ]

INTEREST ON DEPOSITS

Individual Retirement Accounts

On June 26, 1975, the Board and the Federal Deposit Insurance Corporation ("FDIC") invited public comment on several issues relating to Individual Retirement Accounts ("IRAs") and possible amendments to Regulation Q (Interest on Deposits) (40 FR 28644). This action was taken in view of the enactment of the Employee Retirement Income Security Act of 1974 (Pub. L. 93-406), which provides, in part, for the establishment of IRAs by individuals not covered by employer pension plans.

Among the issues presented for comment at that time was the question of whether existing restrictions of Regula-

tion Q relating to withdrawal of time deposits prior to maturity unnecessarily interfere with the administration of IRAs maintained at banks in time deposit form. Comment was also requested on whether these restrictions interfere with the orderly distribution of IRA funds to an individual who has reached age 59½ or has become disabled. In addition, comment was requested on whether the existing schedule of ceiling interest rates that member banks are permitted to pay on IRA deposits should be increased and whether member banks should be permitted to pay interest on IRA deposits at rates that are equal to those that may be paid by savings and loan associations and mutual savings banks.

Numerous comments were received by the Board and the FDIC on the issues presented. Ninety financial institutions and organizations commented on the question of raising interest rate ceilings.

Forty-eight commercial banks favored action to increase the interest rate ceiling on funds deposited in IRAs. Twenty-eight banks, ten thrift institutions, and four organizations representing thrift institutions opposed such action. Three hundred nine comments were received on the question of elimination of the existing differential in interest rate ceilings between commercial banks and thrift institutions for IRA deposits. Two hundred forty-three commercial banks and banking organizations favored the elimination of the differential. Sixty thrift institutions and thrift organizations and six banks opposed elimination of the differential.

Those institutions and organizations commenting in favor of elimination of the interest rate differential stated that the existing differential in rate ceilings places commercial banks at a serious competitive disadvantage with thrift in-

stitutions in attracting and retaining IRA deposits. Additional arguments presented were that the effect of the ¼ percent differential over time and the effect of compounding result in a significant difference in earnings over the life of an IRA. These comments assert that, since IRAs constitute an entirely new type of service available at financial institutions, it is inequitable for federal regulations to permit a rate advantage to exist based solely upon the nature of the regulated institution in which the IRA is established. It is argued that in enacting the IRA provisions, Congress intended to provide an incentive for individuals to save for their retirement and did not indicate an intent to favor any one category of financial institution. Consistent with this Congressional intent, an individual should be permitted to obtain the highest rate of return possible on his or her retirement savings. It is further argued that to restrict individuals from obtaining the highest earnings possible on these retirement funds by limiting the ceiling rate for commercial banks to a rate below that permitted to be paid by thrift institutions would be contrary to Congress's intent that IRAs are to be encouraged as a vehicle for accumulating retirement savings.

Those opposed to elimination of the differential stated that thrift institutions need the ¼ percent differential in order to compete successfully with commercial banks for IRA deposits. These comments stated that Congress was aware of the existence of the differential when it enacted the IRA provisions. It was argued that if Congress intended that IRA participants should be permitted to obtain the same rate of interest on IRA deposits regardless of where the accounts are established, it would have reflected such an intent explicitly in the legislative history of the provision. Since nothing in the legislative history indicates any such explicit Congressional intent to eliminate the favored position of thrift institutions, it was argued, Congress did not intend to affect the existing differential structure when it enacted the IRA provision. Many of those opposed to elimination of the differential also stated that any change in the rate structure should await the outcome of Congress's current review of the powers of financial institutions.

In December, 1975, following consideration of the comments submitted, the Board amended Regulation Q to permit member banks to pay all or a portion of an IRA time deposit prior to maturity

without imposing the Regulation Q interest penalty when the depositor attains age 59½ or becomes disabled (40 FR 57663). The Board also permitted member banks to waive the \$1,000 minimum denomination requirement for IRA time deposits with 4- and 6-year maturities at ceiling rates of 7¼ percent and 7½ percent. Similar actions were taken by the FDIC and by the Federal Home Loan Bank Board for insured nonmember banks and insured savings and loan associations. These actions were taken to facilitate the establishment of IRAs in accordance with Congress's intent to encourage individuals not participating in other pension plans to save for their retirement and to provide a convenient means for payout of IRA funds in the future. At the time these actions were taken, the Board indicated that, in view of Congress's intent to encourage individuals to save for their retirement, the Board would continue to examine the question of whether a differential in interest rate ceilings is appropriate for IRA deposits.

Subsequently, a survey was conducted by the Board in conjunction with the FDIC and Federal Home Loan Bank Board of IRA accounts of all federally insured commercial banks, savings and loans, and mutual savings banks. Among the data obtained were statistics on the amount and distribution of IRA funds among various types of financial institutions, distribution of IRA deposits according to size of institution, and maturity classifications of IRA deposits at commercial banks and mutual savings banks. The results of this survey indicate that as of March 31, 1976, thrift institutions generally possess relatively more IRA deposits than do commercial banks.

The Board has carefully considered the question of an interest rate differential as it applies to IRA deposits at commercial banks and thrift institutions. During the course of this consideration, the Board has given weight to the various arguments presented by those who have commented on the issues raised by the Board's June, 1975, announcement as well as comments received subsequently. Weight has also been given to the results of the Board's survey concerning IRA deposits. Consideration has been given to the intent of Congress in enacting the IRA provisions to encourage individuals to save for retirement and the effect that a differential may have upon the amount of earnings an individual may obtain on his or her retirement savings over the life of the IRA.

The Board believes that in enacting the IRA provisions it was the intent of Congress that individuals whose employers do not have private retirement plans should be encouraged to provide for their retirement needs through the establishment of IRAs. In order to accomplish Congress' intent, as a matter of public policy the Board believes that IRA participants should be permitted to obtain the highest rates of interest permissible on their retirement savings regardless of where the deposits are maintained. In the Board's estimation, a differential on IRA deposits may be viewed as inconsistent with the objective of providing IRA depositors with a means of obtaining the highest earnings possible on funds saved for retirement purposes.

In addition, the Board believes that there is some evidence, as yet inconclusive, which indicates that member banks may be at a disadvantage vis-a-vis thrift institutions in competing for IRA deposits because of the existence of the differential in present interest rate ceilings.

The Board has determined that further monitoring for several months will be proper before a final conclusion is reached. If the present trend in the competitive structure for IRA deposits continues, the Board will then consider taking appropriate steps to restore competitive balance between commercial banks and thrift institutions in the offering of IRAs.

It is anticipated that further consideration of action by the Board to permit member banks to offer IRAs on a fully competitive basis will be appropriate in early 1977 concurrent with Congressional consideration of the extension of the extension of the Board's authority to establish interest rate ceilings for member banks and the Board's recommendations to Congress in connection with that review. In this regard, the Board recognizes that under the provisions of Pub. L. 94-200 (89 Stat. 1124), any action by the Board to eliminate or reduce an interest rate differential for any category of deposits or accounts that was in effect on December 10, 1975, could not become effective until such action was approved by concurrent resolution of the House of Representatives and the Senate.

By order of the Board of Governors,  
July 23, 1976.

THEODORE E. ALLISON,  
Secretary of the Board.

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