

FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 7990]
November 12, 1976

KEOGH PLAN RETIREMENT ACCOUNTS
Amendments to Regulation Q

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

Following is the text of a statement issued November 8 by the Board of Governors of the Federal Reserve System:

The Board of Governors of the Federal Reserve System today amended its Regulation Q—Interest on Deposits—to improve the terms under which member banks may offer Keogh plan retirement accounts.

The amendments extend to Keogh (H.R. 10) plan retirement accounts the conditions established last December for Individual Retirement Accounts (IRAs). The amendments are:

1. Member banks may pay all, or a part, of a Keogh plan time deposit (as with an IRA) prior to its maturity, without the usual penalty for early withdrawal from a time deposit, when the depositor reaches the age of 59½ or becomes disabled.
2. In the case of Keogh plan time deposits (as with IRAs) it is not necessary to have on deposit a minimum of \$1,000 in order to earn the 7¼ per cent interest rate available for four-year time deposits, or the 7½ per cent available for six-year deposits.

Similar actions will be taken by the Federal Deposit Insurance Corporation (FDIC) for banks it supervises and by the Federal Home Loan Bank Board (FHLBB) for savings and loan associations.

The first of the amendments to Regulation Q announced today allows avoidance of the loss of interest usually required when funds are withdrawn before a time deposit matures (say, when funds in a five-year time deposit are withdrawn after four years). As a result of the amendment, member banks may distribute the full proceeds of a Keogh account in a single payment, or in a series of annuity-like payments, without penalty, when the distribution is made in accordance with the Keogh plan agreement between the bank and the depositor.

The second amendment allows payment of maximum interest rates on amounts smaller than \$1,000, in recognition of the fact that some depositors may not have that much money to start an account.

The Board believes these amendments of Regulation Q serve the intent of Congress to encourage self-employed individuals to save for their retirement.

Keogh (H.R. 10) plan accounts were authorized under the Self-Employed Individuals Tax Retirement Act of 1962, to encourage, by tax benefits, saving for retirement by self-employed persons. The Keogh plan provisions as amended permit a self-employed individual to establish a retirement savings plan with a depository institution, and deposit up to 15 per cent of earned income, or \$7,500 a year, whichever is less, in the account. The amount deposited may be deducted from the individual's income subject to Federal tax.

The Employee Retirement Income Security Act of 1974 permits individuals not covered by a retirement plan to deposit in Individual Retirement Accounts (IRAs) up to \$1,500, or 15 per cent of gross income, whichever is less.

Keogh plans already in existence may be amended to incorporate today's changes in Regulation Q requirements.

Keogh plan accounts must be established before the end of 1976 in order to be eligible for tax benefits for the whole year.

In submitting the amendments for publication in the *Federal Register*, the Board of Governors made the following additional statement:

The Board of Governors has amended Regulation Q, effective immediately, to permit member banks to pay all or a portion of a time deposit prior to maturity without imposing the early withdrawal penalty when the deposit represents funds deposited to a Keogh (H.R. 10) plan and when the individual for whose benefit the account is maintained attains age 59½ or becomes disabled.

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The Board has also amended Regulation Q, effective immediately, to permit member banks to waive the \$1,000 minimum denomination requirement for time deposits with 4- and 6-year maturities at ceiling rates of $7\frac{1}{4}$ and $7\frac{1}{2}$ per cent when such deposits are made pursuant to Keogh plans. The purpose of these amendments is to facilitate the establishment of Keoghs pursuant to Congress's intent to encourage self-employed individuals to save for their retirement and to provide a convenient means for payout of such funds to Keogh participants in the future.

Similar amendments applicable to Individual Retirement Accounts were adopted by the Board in December 1975 (40 FR 57663), in order to encourage the establishment of IRAs by persons not participating in other pension plans and to provide for the orderly administration of IRAs by member banks. At that time, the Board announced that it was continuing to study the statutory differences relating to the administration and operation of Keoghs and IRAs in order to determine whether the IRA amendments should be made applicable to deposits held by member banks pursuant to Keogh plans. After consideration of this matter, the Board has determined that it is appropriate to extend the exceptions from the early withdrawal penalty and from the \$1,000 minimum denomination requirement to deposits made pursuant to Keogh arrangements.

The Board has determined that imposition of the Regulation Q penalty for withdrawals prior to the maturity of the time deposit in instances where withdrawals of Keogh funds are legislatively authorized (upon the individual's attaining the age of $59\frac{1}{2}$ or upon disability or death) is generally inappropriate in view of Congress's intent to encourage self-employed individuals to save for their future needs. As a result of this amendment, member banks will be permitted to distribute the Keogh deposit balance in a single sum payment without penalty when such distribution is made in accordance with the terms of the Keogh agreement between the banks and the participants. In addition, member banks may establish Keoghs from which participants may receive periodic, annuity-like payments with no reduction in the rate of interest paid where funds are paid prior to maturity of the underlying time deposit.

The Board has determined also that it is appropriate to waive the \$1,000 minimum required to obtain 4- and 6-year time deposits at ceiling rates of $7\frac{1}{4}$ and $7\frac{1}{2}$ per cent for funds deposited pursuant to Keogh plans in view of the long-term nature of Keoghs and in view of Congress's intent to encourage self-employed individuals to save for their retirement. Since virtually all Keoghs will ultimately contain in excess of \$1,000 per account, the Board believes that waiver of the \$1,000 minimum requirement will facilitate the operation of Keoghs by eliminating the need for individuals to maintain Keogh deposits at lower interest rates until the \$1,000 minimum is obtained. Waiver of the minimum requirement will also permit member banks to pay higher rates on Keogh funds at the inception of the Keogh plan, thereby encouraging the establishment of Keoghs in general.

The Board has also determined that member banks may amend Keogh plans established prior to the effective date of these amendments in order to incorporate the benefits of these provisions. Accordingly, the Board will permit member banks to increase the rate of interest that may be paid on existing Keogh time deposits and/or change the maturity of existing Keogh time deposits from the effective date of this action without imposition of the Regulation Q penalty for early withdrawal.

The amendments adopted by the Board are intended to encourage individuals to establish Keoghs. In order to obtain the tax deferral benefits of Keogh deposits for the year 1976, depositors must have established Keogh plans by year-end. In response to the notice published in the *Federal Register* in December 1975, the Board has received and carefully reviewed numerous comments concerning issues raised by member banks offering Keogh plans under the Board's existing regulations. On the basis of these comments, the Board believes that it has obtained a broad and representative sampling of views and recommendations pertaining to the offering of Keoghs by financial institutions. In view of the substantial public benefits resulting from adoption of the Board's amendments as soon as possible, and because the issues involved are indistinguishable from those considered by the Board when similar amendments applicable to IRAs were adopted, the Board finds that notice and public procedure are impracticable and unnecessary (5 U.S.C. 553(b)). Since the amendments are more permissive than existing regulations and relieve existing regulatory restrictions, and because of the need to adopt the amendments before year-end, the Board has determined that good cause exists to make the amendments effective immediately (5 U.S.C. 553(d)).

Enclosed is a copy of the amendments to Regulation Q. Any questions regarding this matter may be directed to our Bank Regulations Department. Additional copies of the enclosure will be furnished upon request.

PAUL A. VOLCKER,
President.

Board of Governors of the Federal Reserve System

INTEREST ON DEPOSITS

AMENDMENTS TO REGULATION Q
(AND ITS SUPPLEMENT)

Effective November 8, 1976—

1. Section 217.4(d) is amended to read as follows:

SECTION 217.4—PAYMENT OF TIME DEPOSITS BEFORE MATURITY

* * *

(d) **Penalty for early withdrawals.** * * *

Where a time deposit representing funds contributed to an Individual Retirement Account or a Keogh (H.R. 10) plan established pursuant to 26 U.S.C. (I.R.C. 1954) §§ 408, 401 is paid before maturity when the individual for whose benefit the account is maintained attains age 59½ or is disabled (as defined in 26 U.S.C. (I.R.C. 1954) § 72(m)(7)) or thereafter, a member bank may pay all or a portion of such time deposit without a reduction or forfeiture of interest as prescribed by this paragraph.

2. The footnote to subparagraphs (b)(2) and (b)(3) of Section 217.7 (the Supplement to Regulation Q) is amended as follows:

SECTION 217.7—MAXIMUM RATES OF INTEREST PAYABLE BY MEMBER BANKS ON TIME AND SAVINGS DEPOSITS

* * *

(b) **Time deposits of less than \$100,000.**

* * *

(2) Member banks may pay interest on any time deposit of \$1,000 or more, with a maturity of four years or more, at a rate not to exceed 7¼ per cent.²

(3) **Investment Certificates**—Member banks may pay interest on any time deposit of \$1,000 or more, with a maturity of six years or more, at a rate not to exceed 7½ per cent.²

* * *

² The \$1,000 minimum denomination requirement does not apply to time deposits representing funds contributed to an Individual Retirement Account or Keogh (H.R. 10) plan established pursuant to 26 U.S.C. (I.R.C. 1954) §§ 408, 401.

For this Regulation to be complete, retain:

- 1) Regulation Q pamphlet, effective December 4, 1975.
- 2) Amendments effective March 1, 1976 and July 26, 1976.
- 3) Supplement effective December 4, 1975.
- 4) This slip sheet (amending the regulation and its Supplement).

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