

**FEDERAL RESERVE BANK
OF NEW YORK**

[Circular No. 7999
November 26, 1976]

PROPOSED INTERPRETATION OF THE FEDERAL RESERVE ACT

Member Bank Deposits With Nonmember Banks

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

The Board of Governors of the Federal Reserve System has issued for comment a proposed interpretation of Section 19 of the Federal Reserve Act regarding member bank deposits with nonmember banks.

Printed on the reverse side is an excerpt from the *Federal Register* of November 12, 1976, containing the text of the proposed interpretation and of the Board of Governors' introductory statement thereon. Comments on the proposed interpretation should be submitted by February 7, 1977, and may be sent to our Legal Department.

Additional copies of this circular will be furnished upon request.

PAUL A. VOLCKER,
President.

(Over)

FEDERAL RESERVE SYSTEM

[12 CFR Part 250]

[Docket No. R-0062]

MISCELLANEOUS INTERPRETATION

Proposed Interpretation of Section 19 of the Federal Reserve Act Member Bank Deposits with Nonmember Banks

The Board of Governors is considering the adoption of an interpretation to the Federal Reserve Act to apply the term "deposit" as used in section 19(e) of the Act (12 U.S.C. 463) to include amounts arising out of certain check collection transactions involving banks that are members of the Federal Reserve System and nonmember State banks and trust companies. This action is proposed under the Board's authority to define the terms used in section 19, to determine what shall be deemed a deposit and to prescribe such regulations as it may deem necessary to effectuate the purposes and prevent evasions of section 19.

Section 19(e) provides that

No member bank shall keep on deposit with any State bank or trust company which is not a member bank a sum in excess of ten percentum of its own paid-up capital and surplus.

The Board has reviewed a check collection arrangement under which a nonmember bank collects checks for member banks (hereafter "respondents"). Under that arrangement, at the end of each business day, each respondent informs the nonmember of the total of its incoming transit letter. The nonmember does not deposit the amount of the transit letter to the respondent's account, however. Rather, on a daily basis, the nonmember monitors respondents' cash letters and credits the account of another large member bank (hereafter "correspondent") that is maintained at the nonmember in the amount of the total or some proportion of respondents' transit letters. The nonmember then informs the correspondent of the credit. In turn, the correspondent immediately credits the respondents' accounts maintained at the correspondent and debits the account "due from" the nonmember.

This procedure assures that in no case will the nominal balance of any respondent maintained at the nonmember ever exceed the 10 percent statutory limit imposed by section 19(e). Because of the size of the member correspondent participating in this arrangement, its deposit limit with a nonmember bank under section 19(e) is extremely large. This collection arrangement has been established with the stated purpose of avoiding the limits imposed by section 19(e).

The correspondent has been participating in this check collection arrangement without incurring any additional reserve requirement liability since section 204.2(b) of the Board's Regulation D provides that amounts in the member bank's "due from" account may be deducted from "gross demand deposits" in determining the net deposits subject to reserve requirements. The availability of this deduction makes it attractive for the correspondent to participate in the collection arrangement since it retains some correspondent balances of the respondent member bank and the nonmember and since it has available to it the "due from" deductions from gross demand deposits. The nonmember is attracted to the arrangement since it is able to credit mem-

ber bank deposits to the correspondent's account held by the nonmember, thereby avoiding the limitation imposed by section 19(e). In actuality, the correspondent is merely lending its name to the arrangement for the primary purpose of obtaining artificial compliance with the section 19(e) limitations since the balances that the respondent member banks have at the correspondent are offset by the correspondent's account at the nonmember bank in this transaction.

Under the proposed interpretation of section 19(e), a member bank will be regarded as keeping on "deposit" with a nonmember bank (1) those amounts actually maintained in its account at the nonmember bank, and (2) those additional amounts that are credited to the account of another bank at that nonmember to the extent that such amounts are determined with respect to (a) the total dollar amount of checks that the member has sent to the nonmember for collection and (b) the amount in (1) above.

The Board believes that section 19(e) is intended, in part, to restrict member bank use of nonmember bank institutions for deposit transactions. The Board regards the proposed interpretation as necessary in order to enforce the nonmember bank deposit limit imposed by section 19(e) of the Act on member banks. Under the arrangement described above, a nonmember bank may obtain control over an unlimited amount of deposits of member banks, thereby avoiding the restriction of section 19(e) by merely creating accounting entries on its books.

Accordingly, pursuant to its authority under section 19(a) of the Federal Reserve Act (12 U.S.C. 461) "to define the terms used in this section . . . to determine what types of obligations, whether issued directly by a member bank or indirectly by an affiliate of a member bank or by any other means, and, regardless of the use of the proceeds, shall be deemed a deposit, and to prescribe such regulations as it may deem necessary to effectuate the purposes of this section and to prevent evasions thereof" and section 19(e) (12 U.S.C. 463), the Board proposes to adopt an interpretation to define the term "deposit" for purposes of section 19(e) in order to limit the amount of deposits held by a member at the nonmember bank. The Board's proposed interpretation reads as follows:

§ 250.150 Member bank deposits at nonmember banks.

(a) The Board has been requested to review a relationship between a nonmember bank and a member bank to determine whether the member bank is keeping "deposits" in excess of 10 percent of its paid-in capital and surplus, with the nonmember, a violation of § 19(e) of the Federal Reserve Act (12 U.S.C. 463). That section provides, in part

No member bank shall keep on deposit with any State bank or trust company which is not a member bank a sum in excess of ten percentum of its own paid-up capital and surplus.

(b) The relationship is as follows: A nonmember bank collects checks for one or more member banks (hereafter "respondents"). At the end of each business day, each respondent informs the nonmember of the total of its incoming transit letter. The nonmember does not

deposit the amount of the transit letter to the respondent's account, however. Rather, on a daily basis, the nonmember monitors respondents' cash letters and credits the account of another large member bank (hereafter "correspondent") that is maintained at the nonmember in the amount of the total or some proportion of respondents' transit letters, and informs the correspondent of the credit. In turn, the correspondent immediately credits the respondent accounts maintained at the correspondent and debits the account "due from" the nonmember. This procedure assures that in no case will the nominal balance of any respondent maintained at the nonmember ever exceed the 10 percent statutory limit imposed by section 19(e). This collection arrangement has been established with the stated purpose of avoiding the limits imposed by section 19(e).

(c) Section 19(e) of the Federal Reserve Act was designed, in part, to limit member banks' deposit transactions with nonmember banks not regulated by the Federal Reserve. Because the relationship described above permits a nonmember bank to maintain control of deposits of a member in excess of the 10 percent limits found in § 19(e), the relationship constitutes a violation of the intended purpose of that section of the Act. Therefore, where a member bank enters into a check collection arrangement with a nonmember, as described above, the Board believes that section 19(e) requires such funds represented by checks being collected by a nonmember to be aggregated with deposits of the member directly held at the nonmember. Under the Board's authority (12 U.S.C. 461) to determine what shall be deemed a deposit and to prescribe regulations as it may deem necessary to effectuate the purposes of section 19 of the Federal Reserve Act and prevent evasions thereof, and in order to effectively apply the limitation on member bank deposits with nonmember banks, the Board has determined that a member bank will be regarded as keeping on "deposit" with a nonmember bank (1) those amounts actually maintained in its account at the nonmember bank and (2) those additional amounts that are credited to the account of another bank with that nonmember to the extent that such amounts are determined with respect to (a) the total dollar amount of checks that the member has sent to the nonmember for collection and (b) the amount in (1) above.

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 7, 1977. Reference shall be made to Docket R-0062. 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.

Board of Governors of the Federal Reserve System, November 3, 1976.

THEODORE E. ALLISON,
Secretary of the Board.

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