FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 8223
November 23, 1977]

REGULATION Q

Extension of Maturity of Time Deposit Agreements

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

The Board of Governors of the Federal Reserve System amended, effective December 1, 1977, section 217.4(d) of its Regulation Q—Interest on Deposits—to permit extensions in the maturity of time deposits without penalty when there is no increase in the rate of interest. The amendment was sent to you with our Circular No. 8215, dated November 10, 1977.

Enclosed is the text of an explanation by the Board of Governors of circumstances in which the amendment will be applicable. You may wish to retain this explanation with your copy of Regulation Q.

Questions regarding this matter may be directed to our Consumer Affairs Division (Tel. No. 212-791-5919).

PAUL A. VOLCKER,
President.

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Board of Governors of the Federal Reserve System

REGULATION Q

Circumstances Under Which the Maturity of Existing Time Deposit Agreements May be Extended Without Penalty

Section 217.4(d) of Regulation Q currently provides that any amendment of a time deposit contract that results in either an increase in the rate of interest paid or a change in the maturity of the deposit constitutes a payment of the time deposit before maturity that is subject to the early withdrawal penalty provision. As a result of the Board's amendment, effective December 1, 1977, § 217.4(d) will provide that any amendment resulting either in an increase in the rate of interest paid or in a reduction in the maturity of the time deposit constitutes a payment of the deposit before maturity requiring imposition of the early withdrawal penalty. Therefore, the amendment enables a member bank, at the request of its depositor, to extend the maturity of an outstanding time deposit without treating such extension of maturity as an early withdrawal so long as the rate of interest paid is not increased.

Consistent with longstanding Board policy, if a member bank extends the maturity of an outstanding time deposit, the new certificate must have a maturity from the date of extension at least equal to the minimum period necessary under § 217.7 of Regulation Q to obtain the rate of interest to be paid under the extended deposit agreement. For example, a time certificate of deposit with an original maturity of four years that has two years remaining until maturity and earns interest at a rate of 7¼ per cent, must be extended for at least an additional two years so that the total maturity of the certificate from the date of extension is at least four years, in order for the certificate to continue to earn interest at 7¼ per cent. The fact that the deposit has already been on deposit for two years is not relevant in determining the minimum maturity from the date of extension. In the same situation, should the depositor desire to increase the maturity for only one additional year, leaving a total of three years remaining to maturity after extension, the maximum permissible rate on such a deposit would be 6.50 per cent.

Without a restriction of the kind described above, the maturity of an outstanding certificate could be extended so as to enable the depositor to obtain interest at a rate higher than that permitted for the additional time the funds will remain on deposit and thus could result in evasions of the limitations on maximum interest rates prescribed by the Board. Thus, if a four-year certificate could be amended to extend its maturity for an additional month and could continue to earn interest at the four-year rate, successive extensions would make it possible for the depositor, after an initial four years, to continue to obtain the maximum rate of 7¼ per cent while in effect being able to withdraw his deposit at the end of each additional month. Therefore, under the Board's amendment, this type of extension is not permitted without imposition of a penalty.

The amendment to the penalty rule also enables a member bank to consolidate a customer's outstanding certificates of deposit into one new certificate so long as the rate of interest paid on the consolidated time deposit is not higher than the lowest rate of interest paid on any of the certificates being consolidated. Of course, as in the case of an extension of maturity of a single time deposit, it is required that from the date of consolidation the new certificate possess a minimum maturity at least equal to the minimum period necessary under § 217.7 of Regulation Q to obtain the rate of interest to be paid on the consolidated deposit. In no event may the maturity of any of the time deposits being consolidated be reduced as the result of the consolidation unless an early withdrawal penalty is imposed. Additional examples of the application of the new rule follow.

Example 1

The depositor holds a time certificate of deposit earning interest at a rate of 7½ per cent with an original maturity of six years. The certificate has three years remaining until maturity. In this situation, the maturity of the certificate must be extended for at least three years so that the maturity of the certificate from the date

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of extension is at least six years, in order for the bank to continue to pay interest on the certificate at a rate of 7½ per cent. If the maturity of the certificate is extended for only one year so that the maturity from the date of extension is four years, the maximum rate of interest that may be paid on the certificate from the date of extension is 7¼ per cent.

Example 2

The depositor holds several certificates obtained on different dates all with original maturities of four years and earning interest at the rate of 7¼ per cent. These certificates may be consolidated into one new certificate with a maturity from the date of consolidation of four years that earns interest at the rate of 7¼ per cent.

Example 3

The depositor holds two certificates with original maturities of four years and six years earning interest at rates of 7¼ and 7½ per cent, respectively. The certificates have remaining maturities of two years and four years, respectively. In this case, the certificates could be consolidated into one new certificate with a maturity of four or more years from the date of consolidation earning interest at the maximum rate of 7¼ per cent. Consolidation into one new certificate earning interest at the rate of 7½ per cent would *not* be possible without imposing an early withdrawal penalty even if the maturity were six years or more from the date of consolidation since such action would result in an increase in the rate of interest paid on one of the original deposits from 7¼ to 7½ per cent. In order to pay interest on the new certificate at the rate of 7½ per cent, the bank would be required to impose the early withdrawal penalty only upon the funds represented by the certificate with the original maturity of four years earning interest at the rate of 7¼ per cent.

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