

FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 8227]
[November 30, 1977]

AMENDMENTS TO REGULATION Q

Reduction of Minimum Rate of Interest on Loans Secured by Time and Savings Deposits

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

The following statement was issued by the Board of Governors of the Federal Reserve System in connection with amending its Regulation Q, "Interest on Deposits":

The Board of Governors of the Federal Reserve System today announced that it has lowered the minimum rate of interest that must be paid on a loan secured by a depositor's time or savings deposit at a member bank.

The Regulation Q rule for such loans has required that the interest rate on loans using as collateral a time deposit, or a savings deposit for which prior notice of withdrawal is required, may not be less than 2 per cent above the rate being paid on the deposit.

Effective immediately [November 23, 1977], Regulation Q has been amended to provide that the minimum rate such borrowers must pay is 1 per cent above the rate being paid on the deposit.

A minimum borrowing rate is set on such loans to avoid the use of loans to in effect withdraw time deposits before maturity without incurring the penalty for early withdrawal (loss of 90 days' interest and reduction of interest on the amount withdrawn to the passbook rate—5 per cent at commercial banks—for the period the amount was held in the time deposit).

The reduced minimum applies to future interest payments on outstanding loans, as well as to new loans.

It is anticipated that the Federal Deposit Insurance Corporation will take similar action in the near future with respect to financial institutions the Corporation supervises.

Enclosed is a copy of the amendments. Questions thereon may be directed to our Consumer Affairs Division (Tel. No. 212-791-5919).

PAUL A. VOLCKER,
President.

Board of Governors of the Federal Reserve System

INTEREST ON DEPOSITS

AMENDMENTS TO REGULATION Q

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule.

SUMMARY: This rule amends the provisions contained in sections 217.4(f) and 217.5(b) of Regulation Q (12 CFR 217) concerning loans upon the security of a depositor's time and savings deposits. Sections 217.4(f) and 217.5(b) of the Board's Regulation Q currently provide that a member bank may make a loan to a depositor upon the security of the depositor's time or savings deposit maintained in that member bank provided that the rate of interest on such loan is not less than 2 percent per annum in excess of the rate of interest on the deposit. In the case of loans secured by savings deposits, the 2 percent differential requirement applies only if it is the practice of the member bank to require prior notice of withdrawal of savings deposits. Under the regulation as amended, member banks will be permitted to make loans to depositors secured by depositors' time or savings deposits maintained in that member bank at a rate of interest *not less than 1 percent* per annum in excess of the rate of interest on the time or savings deposits.

EFFECTIVE DATE: November 23, 1977.

FOR FURTHER INFORMATION, CONTACT: Anthony F. Cole, Attorney, Legal Division, Board of Governors of the Federal Reserve System, Room M-3421, Washington, D.C. 20551 (202-452-3711).

SUPPLEMENTARY INFORMATION: Section 217.4(f) of Regulation Q (12 CFR 217) currently permits a member bank to make a loan to a depositor on the security of the depositor's time deposit only when the interest rate charged for the loan is at least 2 percent

higher than the rate of interest paid on the depositor's time deposit. Section 217.5(b) of Regulation Q contains a similar provision applicable to loans secured by savings deposits with respect to which it is the practice of the member bank to require prior notice of withdrawal. (It should be noted that this requirement does not apply when a member bank extends a loan to a person secured by the person's time or savings deposit in another institution.) For depositors faced with a need for time deposit funds, a loan secured by the depositor's time deposit is generally a less expensive alternative than a premature withdrawal subject to the interest forfeiture penalty contained in section 217.4(d) of Regulation Q.

The purpose of the current 2 percent differential requirement is to ensure compliance with statutory prohibitions contained in section 19 of the Federal Reserve Act (12 U.S.C. §§ 371a and 371b) against the payment of interest on demand deposits and the payment of time deposits before maturity except upon such conditions and in accordance with such rules and regulations as the Board may prescribe. The 2 percent differential requirement assists in preventing evasions of the above statutory provisions since a loan extended at the same rate being paid on the time or savings deposit would be tantamount to payment of the time or savings deposit before maturity or prior to the expiration of a required notice period. In this connection, the Board believes that a 1 percent loan differential requirement is sufficient to ensure compliance with the underlying statutory provisions and, accordingly, has amended sections 217.4(f) and 217.5(b) to reduce the current 2 percent loan differential requirement to 1 percent. These amendments apply to outstanding loans made by member banks that are secured by a depositor's time or savings deposits.

(OVER)

For this Regulation to be complete, retain:

- 1) Regulation Q pamphlet, effective December 4, 1975.
- 2) Amendments effective March 1, 1976, July 26, 1976, November 8, 1976, March 24, 1977, July 6, 1977, and December 1, 1977.
- 3) Supplement effective December 4, 1975.
- 4) This slip sheet.

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The Board notes that these amendments generally conform the Board's rules to the rules applicable to Federally insured savings and loan associations promulgated by the Federal Home Loan Bank Board.

In view of the substantial public benefits that will immediately result from adoption of these amendments which reduce the minimum rate of interest that a member bank must charge on loans to depositors secured by time and savings deposits, and, in view of the fact that these amendments relieve existing regulatory restrictions, the Board has determined that the notice and public participation requirements of 5 U.S.C. § 553 are unnecessary and contrary to the public interest and that the deferred effectiveness provisions of that section are inapplicable. Therefore, pursuant to sections 19(i) and 19(j) of the Federal Reserve Act (12 U.S.C. §§ 371a and 371b), section 217.4(f) and the second sentence of section 217.5(b) of Regulation Q, effective November 23, 1977, are amended to read as follows:

SECTION 217.4—PAYMENT OF TIME DEPOSITS BEFORE MATURITY

* * *

(f) *Loans upon security of time deposits.* A member bank may make a loan to the depositor upon the security of his time deposit provided that the rate of interest on such loan shall be not less than 1 percent per annum in excess of the rate of interest on the time deposit.

SECTION 217.5—WITHDRAWAL OF SAVINGS DEPOSITS

* * *

(b) *Loans on security of savings deposits.* *** If it is the practice of a member bank to require notice of withdrawal of a savings deposit, such bank may make loans to a depositor upon the security of such deposit, but the rate of interest on such loans shall be not less than 1 percent per annum in excess of the rate of interest paid on such deposit.