

**FEDERAL RESERVE BANK  
OF NEW YORK**

Circular No. 8318  
April 11, 1978

**PREPAYMENT OF INTEREST ON DEPOSITS IN THE FORM OF MERCHANDISE**

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

Enclosed for your information is a copy of a letter from the Board of Governors of the Federal Reserve System to a member bank regarding the prepayment of interest on deposits in the form of merchandise. In response to a request from the bank, the Board of Governors has determined that under its Regulation Q, "Interest on Deposits," the amount of interest that a member bank may pay must be discounted to its present value regardless of whether the amount is prepaid in the form of merchandise or cash.

Questions regarding this matter 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

WASHINGTON, D. C. 20551

ADDRESS OFFICIAL CORRESPONDENCE  
TO THE BOARD

March 29, 1978

Dear

The Board of Governors has considered your request concerning the prepayment of interest on deposits. Your letter indicates that your bank has sponsored deposit programs in which the bank prepays interest to the depositor in the form of merchandise. In determining the maximum amount of interest that may be prepaid, the bank wishes to calculate the amount that may be paid without discounting the interest to its present value. You request the Board's permission to compute interest in this manner. This request is based, in part, on the inability of a depositor to readily sell the merchandise received in order to reinvest the proceeds.

After consideration of the views expressed in your letter, the Board remains of the opinion that under Regulation Q (12 CFR 217), a member bank is required to discount the amount of interest it may pay to its present value regardless of whether the amount is prepaid in the form of merchandise or cash. The Board also has determined that reasonable expenses associated with shipping costs and sales tax generally need not be taken into consideration in determining the maximum amount of interest that may be paid under Regulation Q.

Paragraph 3365 of the Board's Published Interpretations (12 CFR 217.149) provides that the maximum amount of interest that may be prepaid by a member bank cannot exceed the aggregate amount of interest that could have been paid on the deposit at maturity computed at the applicable maximum rate. The interpretation indicates that the amount the depositor receives at maturity of the time deposit may not exceed the amount actually placed with the bank (the face amount less the amount of prepaid interest) plus interest at the applicable maximum rate for the life of the deposit.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

-2-

The Board is of the view that this principle should apply regardless of whether interest is prepaid in the form of cash or merchandise. To permit a member bank to pay interest in an amount that exceeds the present value of the future interest would result in the bank paying interest in excess of the maximum permitted by Regulation Q since the depositor would be receiving the same amount of interest at the time the deposit is made as he would have earned if interest had been paid at maturity. The Board sees no valid basis for distinguishing between interest prepaid in the form of merchandise or cash. If such a distinction were authorized, a member bank that prepays interest in the form of merchandise could have a substantial competitive advantage over a financial institution that prepays interest in the form of cash since the member bank could provide merchandise that has a higher cash value than the interest that is actually prepaid in cash. Accordingly, the Board finds no reasonable basis for permitting such a special exception for merchandise programs. As a result, in the future all programs conducted by your bank that involve the prepayment of interest in the form of merchandise should provide for discounting of interest payable to its present value.

In order to promote a uniform position for all commercial banks, we are informing the Federal Deposit Insurance Corporation and the Comptroller of the Currency of this determination.

Very truly yours,

(signed) Griffith L. Garwood

Griffith L. Garwood  
Deputy Secretary of the Board

FEDERAL RESERVE BANK  
OF NEW YORK

Appendix E to  
Operating Circular No. 21

April 12, 1978

AGENCY SECURITIES AVAILABLE  
IN BOOK-ENTRY FORM ONLY

*To All Banking Institutions, and Others Concerned,  
in the Second Federal Reserve District:*

This appendix lists the Federal agencies that have issued regulations providing for the issuance of certain securities in book-entry form only. To date, the Farm Credit Administration, the Federal Home Loan Bank Board, and the Federal National Mortgage Association have issued such regulations. Printed below is a citation of the applicable book-entry regulations, together with the effective date of the availability of each agency's securities in book-entry form only.

*Farm Credit Administration* (12 C.F.R. 615) :

(a) Consolidated systemwide bonds—effective for all new issues as of September 1, 1977;

(b) All consolidated bonds issued by The Twelve *Federal Land Banks*, by The Twelve *Federal Intermediate Credit Banks*, and by The Thirteen *Banks for Cooperatives*—effective for all new issues as of January 1, 1978;

(c) Consolidated systemwide notes, issued under the Discount Note Program, will continue to be issued in definitive form only.

*Federal Home Loan Bank Board* (12 C.F.R. 506)—effective for all new issues as of November 25, 1977; with the exception of consolidated discount notes, which will continue to be issued in definitive form only.

*Federal National Mortgage Association* (24 C.F.R. 81)—effective for all new issues as of March 10, 1978; with the exception of discount notes, which will continue to be issued in definitive form only.

PAUL A. VOLCKER,  
*President.*