

FEDERAL RESERVE BANK
OF NEW YORK

At Circ. No. 8552

April 9, 1979

REGULATION Q

Revised Guidelines for Issuing and Advertising "Money Market Certificates"

To All Member Banks in the Second Federal Reserve District:

In view of the amendment, effective March 15, 1979, to Regulation Q that prohibits the compounding of interest on "money market certificates," the Board of Governors of the Federal Reserve System has revised its guidelines for the offering and advertising of such deposits. The previous guidelines were sent to you on August 16, 1978.

The Board of Governors indicated that the guidelines have been revised—

. . . by eliminating references to compounding formerly contained in the discussions concerning how the ceiling rate on the certificate is determined and in the guidelines concerning how the rate of interest may be advertised. In addition, a new guideline three has been added which requires member banks to indicate clearly and conspicuously in all advertisements, announcements or solicitations that Federal regulations prohibit the compounding of interest during the term of the money market certificate. The new guideline also provides that an annual effective rate of interest on the certificate based upon a reinvestment at maturity of principal and interest earned (which rate member banks are permitted to advertise) shall not include any additional return that a depositor may earn by reinvesting his or her interest during the term of the certificate. The appendix . . . also has been revised to eliminate references to compounding.

Enclosed is a copy of a statement containing the text of the new guidelines. You may wish to keep it with Regulation Q in your Regulation binder. Questions may be directed to our Consumer Affairs and Bank Regulations Department (Tel. No. 212-791-5919).

PAUL A. VOLCKER,
President.

Board of Governors of the Federal Reserve System

INTEREST ON DEPOSITS

STATEMENT REGARDING NEW 26-WEEK TIME DEPOSITS

Effective June 1, 1978, the Board amended section 217.7 of Regulation Q to authorize member banks to pay interest on nonnegotiable time deposits of \$10,000 or more with maturities of exactly 26 weeks at a maximum rate equal to the discount rate on the most recently issued six-month United States Treasury bills (auction average). Effective March 15, 1979, the Board amended that section of Regulation Q to prohibit compounding on these money market certificates. Since the Board's actions, questions have been received concerning the offering of the 26-week instrument by member banks. This letter responds to the most frequently raised questions and provides general guidelines for advertising the new 26-week time deposit.

How is the ceiling rate on the certificate determined?

The ceiling rate for new 26-week time deposits equals the discount rate (auction average) for United States Treasury bills with maturities of six months issued on or immediately prior to the date of deposit. The ceiling rate is *not* established with reference to the coupon-equivalent or effective yield on Treasury bills. Should a member bank desire to round off the *ceiling rate*, such rate may only be rounded down. For example, if the discount rate on Treasury bills is 6.4638 percent, a member bank may round this ceiling rate to 6.463 percent, 6.46 percent or 6.4 percent. Daily interest may be computed on a 360, 365, or, in a leap year, 366-day basis in accordance with the provisions of § 217.3(e) of Regulation Q. However, member banks are prohibited from compounding interest during the term of the deposit on certificates issued or renewed on or after March 15, 1979.

When does the ceiling rate on new deposits change?

United States Treasury bills maturing in six months (26 weeks) are auctioned weekly by the Treasury Department, normally on Monday, and normally are issued the following Thursday. Beginning on the date the Treasury bills are issued, member banks may pay interest on new time deposits with 26-week maturities at a ceiling rate not to exceed the discount rate (auction average) established for Treasury bills and

may continue to pay such rate on new 26-week time deposits until the next issue of six-month Treasury bills. At that time the average discount rate on the new issue of six-month Treasury bills becomes the ceiling rate for new time deposits. For example, the ceiling rate payable on Thursday, August 3, would be fixed at the discount rate (auction average) established on Monday, July 31. That ceiling rate would remain in effect for new time deposits through Wednesday, August 9. On Thursday, August 10, the ceiling rate on new time deposits would change to correspond to the discount rate (average auction) established on Monday, August 7.

Must the maturity of the certificate be 26 weeks exactly or may it be six calendar months?

The maturity of the certificate must be exactly 26 weeks (182 days) and not six calendar months. However, where the certificate would mature on a legal holiday, it may be issued with an original maturity in excess of 26 weeks (182 days) so that it would mature on the next succeeding business day. This position is consistent with the similar treatment accorded six-month Treasury bills that would otherwise mature on a holiday and is consistent with ¶ 3349 of the Board's *Published Interpretations* (12 CFR 217.134) which generally provides that a member bank may pay interest on a certificate that matures on a legal holiday until the next succeeding business day. However, upon renewal, such certificate must be issued for exactly 26 weeks.

How is the early withdrawal penalty rule applied to the certificate?

The 26-week certificate is treated like other time deposits for purposes of the Regulation Q early withdrawal penalty. In accordance with § 217.4(d) of Regulation Q (12 CFR 217.4(d)), if the deposit or any portion is paid before maturity, a member bank may pay interest on the amount withdrawn at a rate not to exceed that prescribed for a savings deposit (currently five percent) and, in addition, a forfeiture of three months' interest at such rate is required. However, if the amount withdrawn has been on deposit for three months or less, the minimum penalty consists of the forfeiture of all interest for the period of time the funds were

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on deposit. As is the case with other time deposits, as an alternative to payment before maturity, member banks are permitted to lend on the collateral of such time deposit so long as the rate charged on the loan is at least one percent higher than the rate paid on the deposit pledged.

May the certificate be issued in denominations of \$10,000 only?

The \$10,000 requirement is a *minimum* denomination requirement and a member bank may issue the certificate in any denomination of \$10,000 or more. As with other time deposits, banks may offer this certificate in discount form where the face amount of the certificate is received by the depositor at maturity, so long as the bank initially receives at least \$10,000 from the depositor and the rate paid on the *net* amount deposited does not exceed the applicable six-month Treasury bill discount rate. See ¶ 3365 of the Board's *Published Interpretations* (12 CFR 217.149).

How may the rate of interest be advertised?

A number of questions have been received regarding the appropriate methods of advertising the rate of interest that may be paid on the new 26-week certificate. In particular, these questions concern advertisements that compare a rate or yield on the certificate with a rate or yield on six-month Treasury bills.

A member bank's advertising that the rate of interest paid on its 26-week time deposits "equals" the Treasury bill rate may confuse depositors since Treasury bills are sold at a discount and the effective yield on Treasury bills is higher than the discount rate. Accordingly, any general comparison to Treasury bill rates that conveys the impression that the rate paid by the bank equals the coupon-equivalent or effective yield on Treasury bills would be inappropriate.

The Board has stated that member banks may advertise an annual effective rate of interest for money market time deposits based upon a reinvestment at maturity of principal and interest earned. However, a bank's advertising an annual effective rate based on reinvestment of principal and interest for the entire year may imply an agreement to pay that rate for the entire year. In fact, such rate may not be available since the certificate matures in 26 weeks and can only be renewed at a rate no more than the ceiling rate in effect at the time of renewal.

In view of these considerations, the following advertising guidelines are provided. These

guidelines amplify the specific disclosure and advertising requirements contained in Regulation Q that are applicable generally to all deposits. See § 217.6 of Regulation Q (12 CFR 217.6). These guidelines are applicable to every member bank advertisement, announcement or solicitation relating to the 26-week certificate.

Guidelines

1. Any advertisement, announcement or solicitation that states an annual effective yield based on reinvestment of principal and interest at maturity must contain a clear and conspicuous statement that the rate stated is an annual rate and that this rate is subject to change upon renewal. Such a statement could be expressed in the following manner:

This is an annual rate and is subject to change at renewal.

It is believed appropriate to impose this requirement on advertisements, announcements and solicitations relating to the 26-week certificate, but not on other time deposits with original maturities of less than one year, because the ceiling rates applicable to such other time deposits change infrequently and such deposits are typically renewed by the bank at the same rate.

2. In any advertisement, announcement or solicitation, the following guidelines also apply:

(a) If a member bank's advertisement, announcement or solicitation makes *any* reference to U.S. Treasury bills, it must prominently disclose that the rate of interest paid on Treasury bills is the *discount* rate. Such advertisement, announcement or solicitation must also contain a statement that the effective yield on Treasury bills is higher than the discount rate.

(b) If a member bank's advertisement, announcement or solicitation makes *any* reference to U.S. Treasury bills *and* expresses *any* specific rate (bank's rate or Treasury's rate), it must prominently disclose the coupon-equivalent or effective yield on U.S. Treasury bills and the effective yield on its certificate computed on a comparable basis. If such disclosures are made, the required statement in (a) above that the effective yield on Treasury bills is higher than the discount rate need not appear.

(1) If a member bank advertises an *effective* yield that is equal to (or lower than) the discount rate (the ceiling rate on the certificate) and makes *any* reference to Treasury bills, the bank's yield must be compared with the coupon-equivalent or

effective yield on a six-month Treasury bill.

(2) If a member bank advertises an *effective* yield based on reinvestment at *maturity* of principal and interest earned and makes *any* reference to Treasury bills, the bank's yield must be compared with an effective yield on six-month Treasury bills that is adjusted to reflect reinvestment of proceeds at maturity. (For your convenience, methods of calculation are provided in the attached appendix.)

3. The Board believes it appropriate for all member bank advertisements, announcements, and solicitations, including deposit account brochures and other literature concerning money market time deposits, to indicate clearly and conspicuously that Federal regulations prohibit the compounding of interest during the term of the deposit. In this connection, member banks

may continue to pay interest to depositors in the usual manner (e.g. monthly, quarterly or semi-annually) in accordance with customary banking practice or the bank's current interest payment practice. Such interest may be paid to the depositor or credited to an account maintained by the depositor. The annual effective rate on money market certificates shall not include any additional return that a depositor may earn during the term of the money market deposit by reinvesting his or her interest.

These guidelines also apply in any advertisement, announcement or solicitation in which a bank compares the rate it pays on the certificate with the rates paid on competing instruments of others. Guidelines 2(a) and 2(b) need not apply to advertisements, announcements or solicitations that contain *no* reference to Treasury bills or other competing instruments.

APPENDIX

This appendix provides information for member banks that wish to advertise comparisons between yields offered on the 26-week certificate and yields on six-month Treasury bills.

1. As noted in the accompanying letter, if a member bank advertises an annual effective yield which does not take into account reinvestment of interest after the 26-week maturity of the certificate and refers to Treasury bills, it should compare this rate to the coupon-equivalent yield on Treasury bills. The coupon-equivalent yield on Treasury bills is widely published and is made available by the Treasury and the Federal Reserve Banks.

2. If a member bank advertises an annual effective yield which takes into account reinvestment of interest at maturity and refers to Treasury bills, it should compare its rate to the Treasury bill coupon-equivalent yield adjusted to make the yields comparable. For example, if a member bank advertises such an annual effective yield arrived at by assuming a 365-day year, the appropriate effective yield on Treasury bills would be calculated as follows:

$$\text{Treasury Bill Yield} = (1 + \text{CEY} \left(\frac{182}{365} \right)) \frac{365}{182} - 1$$

where CEY is the coupon-equivalent yield for Treasury bills. For six month Treasury bills issued on June 1, 1978 (coupon-equivalent yield of 7.532 percent), the adjusted yield on Treasury bills would be 7.674 percent:

$$.07674 = (1 + .07532 \left(\frac{182}{365} \right)) \frac{365}{182} - 1$$

If a member bank advertises an annual effective yield assuming reinvestment of interest for a 360-day year, the comparable Treasury bill yield must also be adjusted to a 360-day basis. The adjusted effective yield on Treasury bills would then be calculated as follows:

$$\text{Treasury Bill Yield} = (1 + \text{CEY} \left(\frac{182}{365} \right)) \frac{360}{182} - 1$$

Note that no adjustment should be made to the fraction (182/365), since the coupon-equivalent yield on Treasury bills is expressed on the basis of a 365-day year.