

FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 8585]
June 13, 1979]

REGULATION Q

- Comment Invited on Proposals to Subject Certain Repurchase Agreements to Interest Rate Ceilings
and Liberalize the Early Withdrawal Penalty in Event of Depositor's Death
—Amendments Providing for Higher Returns for Small Savers
—Interpretation Allowing the Pooling of Deposits Under Certain Conditions

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

In our Circular No. 8583, dated May 31, 1979, we issued a joint statement by the three Federal banking supervisory agencies announcing a series of regulatory changes designed to help small savers obtain a higher return on their deposits. In this connection, enclosed are copies of the amendments to Regulation Q, "Interest on Deposits," of the Board of Governors of the Federal Reserve System, and of the revised Supplement to that Regulation, both effective July 1, 1979. Also enclosed is a copy of a related interpretation of the Board's Regulation Q permitting the pooling of funds by depositors in order to reach a minimum denomination requirement for the payment of higher rates of interest, and a copy of an erratum sheet (unrelated to the Board's current action) correcting an earlier error in the Regulation Q pamphlet.

Printed below is the text of two proposals by the Board of Governors to further amend its Regulation Q in order to (1) subject member bank repurchase agreements of less than \$100,000 to the interest rate ceilings of Regulation Q, and (2) require member banks to redeem a time deposit prior to maturity without penalty upon the death of the depositor, if requested to do by an authorized representative. Comments on these proposals should be submitted by July 2, and may be sent to our Consumer Affairs and Bank Regulations Department.

PAUL A. VOLCKER,
President.

FEDERAL RESERVE SYSTEM

[12 CFR Part 217]

INTERESTS ON DEPOSITS

[Reg. Q; Docket Nos. R-0228; R-0229]

FEDERAL RESERVE SYSTEM

[12 CFR Part 217]

[Docket No. R-0229]

**Interest on Deposits; Deposits as
Including Certain Promissory Notes
and Other Obligations**

AGENCY: Board of Governors of the
Federal Reserve System.

ACTION: Proposed rulemaking.

SUMMARY: The Board has proposed
amending its regulations to subject
member bank repurchase agreements of

less than \$100,000 to the interest rate
ceilings of Regulation Q. Such
repurchase agreements arise from a
transfer of direct obligations of, or
obligations that are fully guaranteed as
to principal and interest by the United
States or any agency thereof that the
bank is obligated to repurchase.

DATE: Comments must be received by
July 2, 1979.

FOR FURTHER INFORMATION CONTACT:
Gilbert T. Schwartz, Assistant General
Counsel (202/452-3623), or Paul S.
Pilecki, Attorney (202/452-3281) Legal
Division, Board of Governors of the

Federal Reserve System, Washington,
D.C. 20551.

SUPPLEMENTARY INFORMATION: Section
217.1(f)(2) of Regulation Q and
§ 204.1(f)(2) of Regulation D presently
exempt from the definition of deposits
any obligations that "evidence an
indebtedness arising from a transfer of
direct obligations of, or obligations that
are fully guaranteed as to principal and
interest by the United States or any
agency thereof that the bank is obligated
to repurchase." Consequently, these
obligations are not subject to the
Regulation Q interest rate ceilings or to
reserve requirements. This general

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exemption was established in 1969 in order to facilitate a strong Government and agency securities market, to provide banks a means of temporarily financing their portfolio positions and to provide a service to customers who desire to invest temporarily idle funds in Government and agency securities in amounts and maturities less than those readily available in the market. The repurchase agreement exemption was not intended to provide member banks with a device for avoiding interest rate ceilings.

The Board is aware of recent actions by banks to offer small denomination repurchase agreements ("RPs") of Government and agency securities at rates in excess of that which would be available for time deposits of comparable terms. The Board views the sale of small denomination repurchase agreements of Government and agency securities not subject to interest rate limitations as potentially harmful to the orderly administration of currently prescribed deposit rate ceilings and to the competitive balance existing between thrifts and commercial banks. In this regard, the issuance of small denomination RPs appears to be primarily a substitute for small denomination time deposits.

Consequently, the Board has proposed to narrow the current exemption from deposit treatment under Regulation Q by including within the definition of deposits member bank obligations arising from a transfer of direct obligations of, or obligations that are fully guaranteed as to principal or interest by the United States or any agency thereof that the bank is obligated to repurchase. Public comment is requested on the extent to which the application of interest rate ceiling to repurchase agreements issued in amounts of less than \$100,000 would affect the practice of providing bank customers a vehicle for investing temporarily idle funds. This proposal would not affect the current exemption for interbank transactions involving repurchase agreements of less than \$100,000.

All comments on this proposal should be submitted in writing to the Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551, to be received by July 2, 1979. All material submitted should include the Docket Number R-0229. 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.

Pursuant to its authority under section 19 (a), (i) and (j) of the Federal Reserve Act (12 U.S.C. 461, 371a and 371b) the

Board proposes to amend Regulation Q (12 CFR Part 217) as follows:

§ 217.1 Definitions.

(f) *Deposits as including certain promissory notes and other obligations.* For the purposes of this part, the term "deposits" also includes any member bank's liability on any promissory note, acknowledgment of advance, due bill, or similar obligation (written or oral) that is issued or undertaken by a member bank principally as a means of obtaining funds to be used in its banking business, except any such obligation that:

(2) Is issued in denominations of \$100,000 or more on or after July 1, 1979, and evidences an indebtedness arising from a transfer of direct obligations of, or obligations that are fully guaranteed as to principal and interest by the United States or any agency thereof that the bank is obligated to repurchase;

By order of the Board of Governors of the Federal Reserve System, May 30, 1979.

Theodore E. Allison,

Secretary of the Board.

[FR Doc. 79-17489 Filed 6-5-79; 8:45 am]

BILLING CODE 6210-01-M

[12 CFR Part 217]

[Docket No. R-0228]

Payment of Time Deposits Before Maturity

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Proposed rule.

SUMMARY: The Board of Governors of the Federal Reserve System purposes to amend Regulation Q concerning the payment of time deposits before maturity in the event of the death of any owner of the time deposit funds. Under the Board's current regulation, a member bank, upon the death of any owner of a time deposit, is permitted to pay such time deposit before maturity without imposition of the normally required early withdrawal interest forfeiture penalty. Under the proposed amendment, a member bank would be required to pay a time deposit prior to maturity without penalty upon the death of any owner when requested to do so by the owner's representative or by any other owner.

DATES: Comments must be received by July 2, 1979.

ADDRESS: Theodore E. Allison, Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551. All material submitted should include the Docket Number R-0228.

FOR FURTHER INFORMATION CONTACT: Gilbert T. Schwartz, Assistant General

Counsel (202/452-3623) or Anthony F. Cole, Senior Attorney (202/452-3711), Legal Division, Board of Governors of the Federal Reserve System, Washington, D.C. 20551.

SUPPLEMENTARY INFORMATION:

Regulation Q currently provides that upon the death of any owner of time deposit funds, a member bank, if it so chooses, may pay all or a portion of such time deposit funds before maturity without imposing the normally required early withdrawal interest forfeiture penalty (§ 217.4(d)). The Board proposes to amend this provision to require a member bank to pay a time deposit prior to maturity without penalty upon the death of any owner when requested to do so by the owner's representative or by any other owner. The Board believes that the proposed amendment will more fully effectuate the intent of this exception to the early withdrawal penalty rule, which is to facilitate the administration of estates as well as ease the financial burdens occasioned by the death of a depositor. Public comment is requested on whether the proposed amendment, if adopted, should apply to all time deposits or only to those time deposits issued after the implementation date.

All comments and information on this proposal should be submitted in writing to the Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551, to be received by July 2, 1979. All material submitted should include the Docket Number R-0228. Such material will be made available for inspection and copying upon request except as provided in section 261.6(a) of the Board's Rules Regarding Availability of Information (12 CFR 261.6(a)).

Pursuant to its authority under section 19(j) of the Federal Reserve Act (12 U.S.C. § 371b), the Board proposes to amend Regulation Q (12 CFR 217.4) as follows:

§ 217.4 Payment of time deposits before maturity.

(d) *Penalty for early withdrawals.* A time deposit may be paid before maturity without a forfeiture of interest as prescribed by this paragraph in the following circumstances:

(1) Where a member bank pays all or a portion of a time deposit upon the death of any owner of the time deposit funds. Provided, however, a member bank is required to pay a time deposit prior to maturity without penalty upon the death of any owner of the funds when requested to do so by the owner's representative or other owners.

By order of the Board of Governors, May 30, 1979.

Theodore E. Allison,
Secretary of the Board.

[FR Doc. 79-17481 Filed 6-5-79; 8:45 am]

BILLING CODE 6210-01-M

Board of Governors of the Federal Reserve System

SUPPLEMENT TO REGULATION Q

Effective July 1, 1979

SECTION 217.7—MAXIMUM RATES OF INTEREST PAYABLE
BY MEMBER BANKS ON TIME AND SAVINGS DEPOSITS

Pursuant to section 19 of the Federal Reserve Act and § 217.3 hereof, the Board of Governors of the Federal Reserve System hereby prescribes the following maximum rates¹ of interest per annum payable by member banks of the Federal Reserve System on time and savings deposits:

(a) **Time deposits of \$100,000 or more.** There is no maximum rate of interest presently prescribed on any time deposit of \$100,000 or more.

(b) **Fixed ceiling time deposits of less than \$100,000.** Except as provided in paragraphs (a), (d), (e), (f), and (g), no member bank shall pay interest on any time deposit at a rate in excess of the applicable rate under the following schedule:

<i>Maturity</i>	<i>Maximum percent</i>
30 days or more but less than 90 days	5
90 days or more but less than 1 year	5½
1 year or more but less than 30 months	6
30 months or more but less than 4 years	6½
4 years or more but less than 6 years	7¼
6 years or more but less than 8 years	7½
8 years or more	7¾

¹ The limitations on rates of interest payable by member banks of the Federal Reserve System on time and savings deposits, as prescribed herein, are not applicable to any deposit which is payable only at an office of a member bank located outside the States of the United States and the District of Columbia.

(c) **Savings deposits.** No member bank shall pay interest at a rate in excess of 5¼ percent on any savings deposit. Provided, however, that no member bank shall pay interest at a rate in excess of 5 percent on any savings deposit that is subject to negotiable orders of withdrawal, the issuance of which is authorized by Federal law.

(d) **Governmental unit time deposits of less than \$100,000.** Except as provided in paragraphs (a), (f), and (g), no member bank shall pay interest on any time deposit which consists of funds deposited to the credit of, or in which the entire beneficial interest is held by, the United States, any State of the United States, or any county, municipality or political subdivision thereof, the District of Columbia, the Commonwealth of Puerto Rico, the Virgin Islands, American Samoa, Guam, or political subdivision thereof, at a rate in excess of 8 percent.²

(e) **Individual Retirement Account and Keogh (H.R. 10) Plan deposits of less than \$100,000.** Except as provided in paragraphs (a) and (g), a member bank may pay interest on any time deposit with a maturity of three years or more that consists of funds deposited to the credit of, or in which the entire beneficial interest is held by, an individual pursuant to an Individual Retirement Account agreement or Keogh (H.R. 10) Plan established pursuant to 26 U.S.C. (I.R.C. 1954) §§ 408, 401, at a rate not in excess of 8 percent.²

² The ceiling rate on this category is the highest fixed ceiling rate that may be paid on time deposits under \$100,000 by any Federally insured commercial bank, mutual savings bank, or savings and loan association.

For this Regulation to be complete, retain:

- 1) Regulation Q pamphlet, effective December 6, 1978.
- 2) Amendments effective March 15, 1979 and July 1, 1979.
- 3) Erratum sheet, dated March 1979.
- 4) This slip sheet.

(f) **26-week money market time deposits of less than \$100,000.** Except as provided in paragraph (a), a member bank may pay interest on any nonnegotiable time deposit of \$10,000 or more, with a maturity of 26 weeks, at a rate not to exceed the rate established (auction average on a discount basis) for United States Treasury bills with maturities of 26 weeks issued on or immediately prior to the date of deposit. Rounding such rate to the next higher rate is not permitted. A member bank may not compound interest during the term of this deposit. A member bank may offer this category of time deposit to all depositors.

(g) **Time deposits of less than \$100,000 with maturities of four years or more.** Except as provided in paragraphs (a) and (b), a member bank may pay interest on any nonnegotiable time deposit with a maturity of four years or more that is issued on or after the first day of every month at a rate not to exceed one and one-quarter percent below the average 4-year yield for United States Treasury securities as determined and announced by the United States Department of the Treasury three business days prior to the first day of such month. The average 4-year yield will be rounded by the United States Department of the Treasury to the nearest 5 basis points. A member bank may offer this category of time deposit to all depositors.

Board of Governors of the Federal Reserve System

INTEREST ON DEPOSITS

INTERPRETATION OF REGULATION Q

Pooling of Funds to Obtain Higher Interest Rates

FEDERAL RESERVE SYSTEM

12 CFR Part 217

[Reg. Q, Docket No. R-0227]

Interest on Deposits; Pooling of Funds To Obtain Higher Interest Rates

AGENCY: Board of Governors of the
Federal Reserve System.

ACTION: Final interpretation.

SUMMARY: This interpretation provides that under Regulation Q member banks may accept funds pooled by depositors but may not solicit pooled funds through advertisement, announcement or other notice where the purpose of such pooling is to pay higher rates of interest on deposits.

EFFECTIVE DATE: Immediately.

FOR FURTHER INFORMATION CONTACT:
Gilbert T. Schwartz, Assistant General
Counsel (202/452-3623), or Paul S.
Pilecki, Attorney (202/452-3281), Legal
Division, Board of Governors of the
Federal Reserve System, Washington,
D.C. 20551.

SUPPLEMENTARY INFORMATION: 12 CFR
Part 217 is amended by adding a new
§ 217.155 to read as follows:

**§ 217.155 Pooling of funds to obtain
higher interest rates.**

(a) The Board of Governors has reviewed its previous rulings concerning acceptance of pooled funds by member banks. Under these rulings, the Board had expressed the view that a member bank that paid a higher rate on a deposit that it knew or had reason to know resulted from funds aggregated (pooled) principally for the purpose of obtaining a higher rate of interest would be acting

contrary to the spirit of Regulation Q. This interpretation replaces these prior Board rulings that had been issued in the form of letter opinions in 1968 and 1970.

(b) The Board has determined that member banks accepting and paying higher rates of interest on pooled deposits from depositors who themselves have pooled their funds whether or not the bank knows or has reason to know that such funds have been pooled would not be violating Regulation Q. However, member banks are not permitted to solicit, advise or encourage depositors to pool funds for the purpose of paying higher interest rates. In addition, member banks are not permitted to solicit deposits from customers on the basis that the funds will be pooled by the bank for the purpose of paying higher interest rates. The Board believes that participation by member banks in encouraging or establishing pooling arrangements constitutes a device to avoid interest rate limitations. The Board further believes that adopting this new policy will facilitate the administration of Regulation Q interest rate ceilings.

(c) The Board would regard any advertisement, announcement or solicitation by a member bank indicating that it will accept pooled funds or that funds can be pooled to obtain higher rates as a violation of Regulation Q. For example, printed and broadcast advertisements stating that depositors can achieve higher interest rates by pooling their funds with others and depositing them in the bank would be inappropriate. In addition, in responding to inquiries from depositors concerning available deposit instruments and rates, member banks are not permitted to suggest the practice of pooling as a means of meeting

minimum denomination requirements. Similarly, any advertisement, announcement or solicitation, written or oral, by a member bank discussing a policy, practice, program, or procedure for accepting pooled deposits would not be permitted. If, for example, two depositors come into a member bank on their own with checks of \$5,000 each seeking to purchase jointly one \$10,000 minimum denomination money market time deposit, the bank is permitted to accept such funds in the form of a money market time deposit and to pay the ceiling rate on such deposits. However, a member bank could not arrange to introduce, directly or indirectly, separate depositors that are seeking to pool their funds.

(d) This interpretation is not intended to affect other well-established practices which involve pooling of funds such as money market mutual funds, trust department aggregation of temporarily idle balances of *bona fide* fiduciary accounts, or combination of funds held in escrow by a person acting in a fiduciary or custodial capacity. In addition, member banks are expected to report interest earned by depositors on pooled funds in accordance with the regulations of the Internal Revenue Service.

The Board has issued this interpretation based upon its statutory authority under section 19 of the Federal Reserve Act, 12 U.S.C. 461, 371a and 371b.

By order of the Board of Governors of the
Federal Reserve System, May 30, 1979.

Theodore E. Allison,
Secretary of the Board.

[FR Doc. 79-17490 Filed 6-5-79; 8:45 am]

BILLING CODE 6210-01-M

Board of Governors of the Federal Reserve System

INTEREST ON DEPOSITS

AMENDMENTS TO REGULATION Q

(effective July 1, 1979)

Early Withdrawal Penalty and Maximum Rates of Interest

FEDERAL RESERVE SYSTEM

12 CFR Part 217

[Regulation Q; Docket No. R-0215]

Interest on Deposits; Early Withdrawal Penalty and Maximum Rates of Interest

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule.

SUMMARY: On April 3, 1979, the Board of Governors of the Federal Reserve System invited public comment of proposals to amend Regulation Q to provide additional returns to savers (44 FR 21023).

The period for receipt of public comment on the proposed amendments expired on May 5, 1979. After consideration of the comments submitted and the views expressed therein, the Board has determined to take the following actions:

(1) Creation of a new time deposit category with a maturity of 4 years or more and no required minimum denomination.

(2) Elimination of the \$1,000 minimum denomination requirements currently imposed on certain time deposits by Regulation Q. (The \$10,000 minimum denomination requirement on the 26-week money market time deposit, however, is retained.)

(3) Modification of the interest forfeiture penalty required to be imposed when funds are withdrawn from time deposits prior to maturity.

(4) Increase the ceiling rate of interest payable on savings deposits by member banks from five percent to five and one-quarter percent.

EFFECTIVE DATE: July 1, 1979.

FOR FURTHER INFORMATION CONTACT:

Gilbert T. Schwartz, Assistant General Counsel (202/452-3623) or Anthony F. Cole, Senior Attorney (202/452-3711), Legal Division, Board of Governors of the Federal Reserve System, Washington, D.C. 20551.

SUPPLEMENTARY INFORMATION:

In response to notice published in the *Federal Register* (44 FR 21023), the Board has received and reviewed over 900 comments on its proposals to provide additional returns to savers. A majority of those responding generally favored action to provide savers with higher rates of return but opposed certain operational aspects of the proposals as unnecessarily complex, costly to administer and difficult for member banks and depositors to understand. With reference to the specific proposals, a majority of respondents commenting favored adoption of the proposed 5-year time deposit. The proposed six-month interest forfeiture penalty for early withdrawals and application of such a penalty to all time deposits also were favored by a majority of respondents. A substantial number of respondents commented that a maturity shorter than five years for the proposed instrument was preferable. A majority of respondents commenting opposed adoption of the proposed 8-year rising rate time deposit and the bonus savings proposal. The respondents generally commented that these two proposals would create costly operational problems and would be confusing to customers. Reduction of the minimum denomination requirements currently imposed on certain time deposits under Regulation Q (12 CFR 217.7) from \$1,000 to \$500 was favored by a majority of respondents commenting. In addition, a

substantial number of respondents favored totally eliminating the minimum denomination requirements for all certificates of deposit, other than the 26-week money market certificate. A detailed summary of comments received is available upon request from the Board's Office of Public Affairs, telephone (202) 452-3215.

After consideration of the comments received, the Board has determined not to adopt the proposals to create an 8-year rising rate time deposit and to authorize the payment of an interest bonus on savings funds. The Board, however, has determined to amend Regulation Q (12 CFR 217) to: (1) create a new time deposit category with a maturity of 4 years or more and with a maximum ceiling rate of interest based on the average 4-year yield on Treasury securities; (2) eliminate the \$1,000 minimum denomination requirements currently imposed on certain time deposits; (3) modify the penalty required to be imposed upon the withdrawal of funds from time deposits prior to maturity; and (4) increase the ceiling rate of interest payable on savings deposits to five and one-quarter percent. The Board believes that these amendments will enable individuals to obtain higher rates of return on their savings without adversely affecting the viability of the nation's financial system. A discussion of the amendments adopted follows.

1. *Four-year fixed rate, variable ceiling time deposit*

Beginning July 1, 1979, member banks will be permitted to offer a nonnegotiable time deposit with a maturity of 4 years or more at a ceiling rate tied to the average 4-year yield on United States Treasury securities. The

For this Regulation to be complete, retain:

- 1) Regulation Q pamphlet, effective December 6, 1978.
- 2) Supplement effective July 1, 1979.
- 3) Amendment effective March 15, 1979.
- 4) Erratum sheet, dated March 1979.
- 5) This slip sheet.

ceiling rate will be the same even if a member bank issues the new time deposit with maturities in excess of four years. Although no minimum denomination will be required, member banks are free to establish a minimum denomination requirement for this new category of deposit. The existing fixed ceiling time deposits with maturities of 4, 6 and 8 years at ceiling rates of 7¼, 7½ and 8 per cent, respectively, are not affected by this action and will remain in effect.

The ceiling rate on the new deposit category will be established each month for new deposits received during that month at one and one-quarter per cent below the average 4-year yield for United States Treasury securities as determined by the U.S. Treasury Department. Beginning the first day of every month, a member bank will be permitted to pay interest at a ceiling rate of one and one-quarter per cent below the average 4-year yield as announced by the Treasury. This ceiling rate will remain in effect for all instruments issued during the month until the first day of the next month when a new ceiling rate will go into effect for instruments issued on or after that date. The ceiling rate of interest established at the time of issue of any time deposit in this category will not change during the period the deposit is outstanding. Member banks are permitted to compound and compute interest on this deposit in accordance with any of the methods authorized by section 217.3 of Regulation Q. The average 4-year yield will be announced three business days prior to the effective date (the first day of the month) and will represent an average of the 4-year yields for the previous five business days. As explained more fully hereinafter, the minimum penalty required to be imposed upon the withdrawal of funds from this category of time deposit is a forfeiture of six months interest at the rate being paid on the deposit.

With respect to this new deposit category, member banks should maintain data such as rates paid and amounts issued in a manner that facilitates reporting to the Board.

II. Elimination of minimum denomination requirements

Effective July 1, 1979, the Board has amended Regulation Q to eliminate the \$1,000 minimum denomination requirements currently imposed on time deposits with maturities of 4 years or more in order to earn interest at a ceiling rate of 7¼ per cent or more (12 CFR 217.7(b)(2), (3), and (4)). Although no minimum denomination will be required on such deposits, member

banks will be free to impose such requirements. However, the \$10,000 minimum denomination required on 26-week money market time deposits by section 217.7(f) of Regulation Q (12 CFR 217.7(f)) will remain in effect. The Board believes that this action will broaden the availability of time deposit categories to all depositors and enable small savers to obtain higher yields on their funds.

III. Penalty for early withdrawals

Regulation Q currently provides that where a member bank agrees to pay a time deposit prior to maturity, the bank must impose an early withdrawal penalty on the funds withdrawn (12 CFR 217.4(d)). The current minimum required penalty is a reduction in the rate of interest paid on the funds withdrawn to a rate not to exceed the rate currently prescribed for a savings deposit (5 per cent) plus a forfeiture of three months interest at such rate. Under the current structure, the amount of the early withdrawal penalty increases significantly the longer the deposit is maintained. In order to reduce the severity of this penalty, the Board has amended section 217.4(d) of Regulation Q (12 CFR 217.4(d)) to create a new early withdrawal penalty.

Effective July 1, 1979, the minimum required early withdrawal penalty on time deposits with original maturities of one year or less is a forfeiture of three months interest on the amount withdrawn at the rate being paid on the deposit. If the amount withdrawn has been on deposit for less than three months, however, all interest is forfeited. The minimum required early withdrawal penalty on time deposits with original maturities of more than one year is a forfeiture of six months interest on the amount withdrawn at the rate being paid on the deposit. If the amount withdrawn has been on deposit for less than six months, however, all interest is forfeited. No reduction of interest to the savings rate will be required. This penalty will apply to all time deposit contracts entered into on or after July 1, 1979, and to all existing time deposit contracts that are extended or reviewed on or after July 1, 1979. The new penalty is a minimum required penalty only and a member bank is free to specify in its deposit contract a more severe premature withdrawal penalty as long as such penalty is disclosed to the depositor. Time deposits entered into before July 1, 1979, and not extended or renewed on or after such date, will continue to be subject to the Board's current penalty rule which requires a reduction of the rate of interest paid on the funds withdrawn before maturity to

the savings rate, less three months interest at that rate.

IV. Ceiling Rate on Savings Deposits

Regulation Q currently provides that no member bank shall pay interest on any savings deposit at a rate in excess of 5 per cent (12 CFR 217.7(c)). Effective July 1, 1979, the Board has amended Regulation Q to increase the ceiling rate of interest payable on savings deposits by member banks, except savings deposits that are subject to negotiable orders of withdrawal, from 5 per cent to 5¼ per cent. This action is being taken in lieu of the proposal to authorize member banks to pay an interest bonus on savings funds held by individuals or certain nonprofit organizations and will provide higher returns to savers. The ceiling rate of interest payable by member banks on savings deposits subject to negotiable orders of withdrawal will remain at 5 per cent.

Pursuant to its authority under section 19(j) of the Federal Reserve Act (12 U.S.C. § 371b) to prescribe rules governing the payment of interest on deposits, effective July 1, 1979, the Board amends Regulation Q (12 CFR §§ 217.4, 217.6, and 217.7) as follows:

(1) Amend § 217.4 (d) and (e) to read as follows:

§ 217.4 Payment of the time deposits before maturity.

(d) *Penalty for early withdrawals.* Where a time deposit with an original maturity of one year or less, or any portion thereof, is paid before maturity, a depositor shall forfeit at least three months of interest on the amount withdrawn at the rate being paid on the deposit. If the amount withdrawn has remained on deposit for less than three months, all interest shall be forfeited. Where a time deposit with an original maturity of more than one year, or any portion thereof, is paid before maturity, a depositor shall forfeit at least six months interest on the amount withdrawn at the rate being paid on the deposit. If the amount has remained on deposit for less than six months, all interest shall be forfeited.¹¹ Where

¹¹ The provisions of this paragraph apply to all time deposit contracts entered into on or after July 1, 1979, and to all existing time deposit contracts that are extended or renewed (whether by automatic renewal or otherwise) on or after such date. All contracts not subject to the provisions of this paragraph shall be subject to the restrictions of § 217.4(d) in effect prior to July 1, 1979, which provided that where a time deposit, or any portion thereof, is paid before maturity, a member bank may pay interest on the amount withdrawn at a rate not to exceed that prescribed in § 217.7 for a savings deposit and the depositor shall forfeit three months of interest payable at such rate. If, however, the amount withdrawn has remained on deposit for three months or less, all interest shall be forfeited.

necessary to comply with the requirements of this paragraph, any interest already paid to or for the account of the depositor shall be deducted from the amount requested to be withdrawn. Any amendment of a time deposit contract that results in an increase in the rate of interest paid or in a reduction in the maturity of the deposit constitutes a payment of the time deposit before maturity. A time deposit may be paid before maturity without a forfeiture of interest as prescribed by this paragraph in the following circumstances: * * *

(e) *Disclosure of early withdrawal penalty.* At the time a depositor enters into a time deposit contract with a

member bank, the bank shall provide a written statement of the effect of the penalty prescribed in paragraph (d) of this section, which shall (1) state clearly that the customer has contracted to keep his funds on deposit for the stated maturity and (2) describe fully and clearly how such penalty provisions apply to time deposits in such bank, in the event the bank, notwithstanding the contract provisions, permits payment before maturity. Such statements shall be expressly called to the attention of the customer.

* * * * *

(2) Amend § 217.6(e) to read as follows:

§ 217.6 Advertising of interest on deposits.

* * * * *

(e) *Penalty for early withdrawals.* Any advertisement, announcement, or solicitation relating to interest paid by a member bank on time deposits shall include clear and conspicuous notice that the bank is prohibited from allowing payment of a time deposit before maturity unless substantial interest is forfeited. Such notice may state that,

"Substantial interest penalty is required for early withdrawal."

* * * * *

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

INTEREST ON DEPOSITS

ERRATUM: REGULATION Q

Correction to pamphlet amended effective December 6, 1978

The Regulation Q pamphlet amended effective December 6, 1978 contains an error. The following passage appeared incorrectly in the text of § 217.4(d):

A member bank may not be paid before maturity. This provision does not prevent a member bank from arranging the sale or purchase of such a certificate on behalf of the holder or prospective purchaser of a certificate issued under that subpart.

The first sentence should not have appeared and the second had appeared previously. This passage has been deleted so that § 217.4(d) reads correctly as set forth below:

SECTION 217.4 – PAYMENT OF TIME DEPOSITS BEFORE MATURITY

(a) **Time deposits payable on a specified date.**

No member bank shall pay any time deposit, which is payable on a specified date, before such specified date, except as provided in paragraph (d) of this section.

(b) **Time deposits payable after a specified period.** No member bank shall pay any time deposit, which is payable at the expiration of a certain specified period, before such specified period has expired, except as provided in paragraph (d) of this section.

(c) **Time deposits payable after a specified notice.** No member bank shall pay any time deposit, with respect to which notice is required to be given a certain specified period before any withdrawal is made, until such required notice has been given and the specified period thereafter has expired, except as provided in paragraph (d) of this section.

(d) **Penalty for early withdrawals.** Where a time deposit, or any portion thereof, is paid before maturity, a member bank may pay interest on the amount withdrawn at a rate not to exceed

that currently prescribed in § 217.7 for a savings deposit: *Provided*, That the depositor shall forfeit three months of interest payable at such rate. If, however, the amount withdrawn has remained on deposit for three months or less, all interest shall be forfeited. Where necessary to comply with the requirements of this paragraph, any interest already paid to or for the account of the depositor shall be deducted from the amount requested to be withdrawn.¹¹ Any amendment of a time deposit contract that results in an increase in the rate of interest paid or in a reduction in the maturity of the deposit constitutes a payment of the time deposit before maturity. *Provided further*, That Investment Certificates issued in negotiable form by a member bank pursuant to subpart 3 of § 217.7(b) may not be paid before maturity. This provision does not prevent a member bank from arranging the sale or purchase of such a certificate on behalf of the holder or prospective purchaser of a certificate issued under that subpart. A member bank may not, however, repurchase such certificates for its own account. *Provided further*, That a time deposit may be paid before maturity without a reduction or forfeiture of interest as prescribed by this paragraph in the following circumstances:

¹¹ The provisions of this paragraph apply to all time deposit contracts entered into after July 5, 1973, and to all existing time deposit contracts that are extended or renewed (whether by automatic renewal or otherwise) after such date, and to all time deposit contracts that are amended after such date so as to increase the rate of interest paid. All contracts not subject to the provisions of this paragraph shall be subject to the restrictions of § 217.4(d) in effect prior to July 5, 1973, which permitted payment of a time deposit before maturity only in an emergency where necessary to prevent great hardship to the depositor, and which required the forfeiture of accrued and unpaid interest for a period of not less than 3 months on the amount withdrawn if an amount equal to the amount withdrawn had been on deposit for 3 months or longer, and the forfeiture of all accrued and unpaid interest on the amount withdrawn if an amount equal to the amount withdrawn had been on deposit less than 3 months.

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(1) Where a member bank pays all or a portion of a time deposit upon the death of any owner of the time deposit funds;¹¹

(2) Where a member bank pays all or a portion of a time deposit representing funds contributed to an Individual Retirement Account or a Keogh (H.R. 10) plan established pursuant to 26 U.S.C. (I.R.C. 1954) § § 408, 401 when the individual for whose benefit the account is maintained attains the age 59½ or is disabled (as defined in 26 U.S.C. (I.R.C. 1954) § 72 (m)(7) or thereafter; or

(3) Where a member bank pays that portion of a time deposit on which Federal deposit insurance has been lost as the result of the merger of two or more Federally insured banks in which the depositor previously maintained separate time deposits for a period of one year from the date of the merger.

Under a time deposit agreement where subsequent deposits reset the maturity of the entire account, each deposit maintained in the account for at least a period equal to the original maturity of the deposit may be regarded as having matured individually and been redeposited at intervals equal to

¹¹For the purposes of this provision, an "owner" of time deposit funds is any individual who at the time of his or her death has full legal and beneficial title to all or a portion of such funds, or, at the time of his or her death, has beneficial title to all or a portion of such funds and full power of disposition and alienation with respect thereto.

such period. When a time deposit is payable only after notice, for funds on deposit for at least the notice period, the penalty for early withdrawal shall be imposed for at least the notice period.

(e) **Disclosure of early withdrawal penalty.** At the time a depositor enters into a time deposit contract with a member bank, the bank shall provide a written statement of the effect of the penalty prescribed in paragraph (d) of this section, which shall (1) state clearly that the customer has contracted to keep his funds on deposit for the stated maturity, and (2) describe fully and clearly how such penalty provisions apply to time deposits in such bank, in the event the bank, notwithstanding the contract provisions, permits payment before maturity. Such statements shall be expressly called to the attention of the customer. Written statements made with respect to negotiable Investment Certificates issued by a member bank pursuant to subpart 3 of § 217.7(b) shall state clearly that no payment before maturity will be permitted under any circumstances. Such statements shall be expressly called to the attention of the customer. In addition, every negotiable Investment Certificate shall state conspicuously on its face that, "This time deposit cannot be paid prior to 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 per cent per annum in excess of the rate of interest on the time deposit.