

ATCIR No 8841
June 5, 1980

To the Addressee:

Enclosed are copies of the new rules of the Depository Institutions Deregulation Committee regarding early withdrawal penalties applicable to time deposits, and relating to rates of interest payable on small saver certificates and money market certificates. Also enclosed is a copy of the DIDC's notice extending, through July 16, 1980, the period for public comment on the DIDC's proposal to prohibit premiums or gifts offered by depository institutions for new and existing deposit accounts. The text of the DIDC's press statement on these matters was contained in this Bank's Circular No. 8841, dated May 30, 1980.

Additional copies of the enclosures will be furnished upon request.

Circulars Division
FEDERAL RESERVE BANK OF NEW YORK

DEPOSITORY INSTITUTIONS DEREGULATION COMMITTEE

[12 CFR Part 1204]

(Docket No. D-0004)

Premiums, Finders Fees, and the Payment of Interest in Merchandise

AGENCY: Depository Institutions Deregulation Committee.

ACTION: Proposed rulemaking: Extension of comment period.

SUMMARY: The Depository Institutions Deregulation Committee ("Committee") has extended the period for receipt of public comment on its proposal to adopt a rule concerning the offering of premiums or gifts by depository institutions (Docket No. D-0004) to July 16, 1980.

DATES: Comments must be received by July 16, 1980.

ADDRESS: Interested parties are invited to submit written data, views or arguments regarding the proposed rules to Normand R. V. Bernard, Executive Secretary, Depository Institutions Deregulation Committee, Federal Reserve Building, 20th Street and Constitution Avenue, N.W., Washington, D.C. 20551. All material submitted should include the Docket Number D-0004.

FOR FURTHER INFORMATION CONTACT: F. Douglas Birdzell, Senior Attorney, Federal Deposit Insurance Corporation (202/389-4324), Daniel L. Rhoads, Attorney, Board of Governors of the Federal Reserve System (202/452-3711), Allan Schott, Attorney-Advisor, Treasury Department (202/566-6798), John Hall, Attorney, Federal Home Loan Bank Board (202/377-6466), or Debra Chong, Attorney, Office of the Comptroller of the Currency (202/447-1632).

SUPPLEMENTARY INFORMATION: On May 6, 1980 (45 Fed. Reg. 32323, May 16, 1980), the Committee requested comment on a proposal to prohibit the offering of premiums by depository institutions and to place limitations on the use of finders fees by depository institutions. Under the proposed rule, the giving to a depositor of a premium or gift (whether in the form of cash or merchandise) by an institution associated directly with the receipt of a deposit would be prohibited. In addition, finders fees paid to third parties would be regarded as the payment of interest to the depositor and would be required to be paid only in cash. The Committee also is considering adoption of a proposed rule that would require that all interest paid on a deposit be paid only in the form of cash or a credit to a deposit account. Comment was requested on the proposal by June 9, 1980. On May 13, 1980, the Committee extended

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the time for receipt of comments to June 16, 1980. In light of the issues involved in this proposal and in order to facilitate public participation in this matter, the Committee is extending the time for receipt of written comments to July 16, 1980.

By order of the Committee, May 28, 1980.

(signed) Normand R. V. Bernard

Normand R. V. Bernard
Executive Secretary of the Committee

[SEAL]

TITLE 12--BANKS AND BANKING

CHAPTER XII--DEPOSITORY INSTITUTIONS DEREGULATION COMMITTEE

[Docket No. D-0007]

PART 1204--INTEREST ON DEPOSITS

AGENCY: Depository Institutions Deregulation Committee.

ACTION: Final rule.

SUMMARY: The Depository Institutions Deregulation Committee ("the Committee") has adopted a final rule concerning the penalty for early withdrawals of time deposit funds. The rule provides for a minimum required penalty of a forfeiture of an amount equal to three months of interest, at the nominal contract rate, on the funds withdrawn where the time deposit has an original maturity of one year or less and six months of interest, at the nominal contract rate, on the funds withdrawn where the time deposit has an original maturity of more than one year, regardless of the length of time the funds have remained on deposit. The rule applies to all commercial banks, mutual savings banks, and savings and loan associations subject to the authorities conferred by section 19(j) of the Federal Reserve Act, section 18(g) of the Federal Deposit Insurance Act and section 5B(a) of the Federal Home Loan Bank Act.

EFFECTIVE DATE: June 2, 1980.

FOR FURTHER INFORMATION CONTACT: John Hall, Attorney, Federal Home Loan Bank Board (202/377-6466), Debra Chong, Attorney, Office of the Comptroller of the Currency (202/447-1632), F. Douglas Birdzell, Senior Attorney, Federal Deposit Insurance Corporation (202/389-4324), Anthony F. Cole, Senior Attorney, Federal Reserve Board (202/452-3612), or Allan Schott, Attorney-Advisor, Treasury Department (202/566-6798).

SUPPLEMENTARY INFORMATION: Under regulations of the Federal Reserve, the Federal Deposit Insurance Corporation and the Federal Home Loan Bank Board, adopted effective July 1, 1979, a depositor is required to forfeit at least three months of interest on funds withdrawn prior to maturity from a time deposit with an original maturity of one year or less and six months of interest on funds withdrawn prior to maturity from a time deposit with an original maturity of more than one year. Where the funds withdrawn have remained on deposit for less than three months or six months, respectively, the depositor is required to forfeit all interest earned on the funds withdrawn. No reduction of principal is required, however, unless interest has already been paid to the depositor.

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The present penalty rule has not served as an adequate deterrent to premature withdrawals of time deposit funds in the early weeks or months of deposit contracts, particularly when market rates are increasing. In this regard, uncertainty regarding the possible withdrawal of funds before the agreed upon maturity could be disruptive to a depository institution's loan and investment programs. The rule adopted by the Committee modifies the current penalty rules of the agencies to require a forfeiture of an amount equal to three months of interest on the funds withdrawn where the time deposit has an original maturity of one year or less and six months of interest on the funds withdrawn where the time deposit has an original maturity of more than one year, regardless of the length of time the funds have remained on deposit.

The rule also provides that the minimum required penalty is to be calculated on the basis of the nominal (simple interest) rate of interest being paid on the time deposit. Under the current regulatory interpretations of the agencies, where interest is being paid on a compounded basis, the amount of interest forfeited must be calculated on a compounded basis. Calculating the penalty on the basis of the nominal rate of interest is more beneficial to consumers, will simplify the calculation and administration of the early withdrawal penalty, and will facilitate disclosure of penalty amounts to customers. Examples of the application of the modified penalty rule follow.

Example 1

A \$5,000 time deposit with a maturity of one year and earning interest at a rate of 6 per cent compounded continuously (using 365/360) is withdrawn two months (sixty days) after the date of deposit. Regardless of the method of compounding, accruing, or crediting of interest, the penalty is \$75.00, an amount equal to three months of interest at the nominal contract rate on the funds withdrawn ($\$5,000 \times .06/4 = \75.00). Imposition of the penalty in this case requires a reduction of \$24.75 in the principal amount requested to be withdrawn since the funds have earned only \$50.25 (6 per cent compounded continuously on \$5,000 for two months) (the penalty amount under the former penalty rule) at the time of withdrawal. If the deposit were withdrawn six months (182 days) after the date of deposit, the penalty also is \$75.00. However, in this case, no reduction in principal is necessary unless the interest earned has been paid out or withdrawn from the account. The depositor's balance at the time of withdrawal, including accrued interest, would have been a maximum of \$5,153.99 (including 6 per cent interest compounded continuously for six months) and at the time of withdrawal the depositor would receive from the institution \$5,078.99 (\$5,153.99 less \$75.00). If the depositor had already received all of his earned interest from the institution prior to the early withdrawal, the depositor would receive \$4,925.00 at the time of the withdrawal.

Example 2

A \$5,000 time deposit with a maturity of four years earning interest at a rate of 7-1/4 per cent compounded continuously (using 365/360) is withdrawn three months (90 days) after the date of deposit. Regardless of the method of compounding, accruing, or crediting of interest, the penalty is \$181.25, an amount equal to six months interest at the nominal contract rate on the funds withdrawn ($\$5,000 \times .0725/2 = \181.25). Imposition of the penalty in this case requires a reduction of \$89.80 in the principal amount requested to be withdrawn since the funds have earned only \$91.45 (7-1/4 per cent compounded continuously on \$5,000 for three months) (the penalty amount under the former penalty rule) at the time of withdrawal. If the deposit were withdrawn three years after the date of deposit, the penalty also is \$181.25. However, in this case, no reduction in principal is necessary unless the interest earned has been paid out or withdrawn from the account. The depositor's balance at the time of withdrawal, including accrued interest, would have been a maximum of \$6,233.63 (including 7-1/4 per cent interest compounded continuously for three years) and at the time of withdrawal the depositor would receive from the institution \$6,052.38 (6,233.63 less \$181.25). If the depositor had already received all of his earned interest from the institution prior to the early withdrawal, the depositor would receive \$4,818.75 at the time of the withdrawal.

The new rule will apply to all time deposits entered into, or renewed or extended, on or after June 2, 1980. Time deposits entered into before June 2, 1980, will continue to be subject to the rules of the agencies adopted effective July 1, 1979. Depository institutions, however, with the depositor's consent, may calculate the minimum penalty required to be imposed on withdrawals from pre-existing time deposits on the basis of the nominal simple rate of interest paid on such deposits. The new rule does not affect other provisions of the agencies' early withdrawal penalty rules, such as the exceptions to application of the penalty in the event of the death or incompetence of a depositor.

This action was taken by the Committee in view of the increased number of early withdrawals of time deposits that have occurred and the adverse effects of such withdrawals on the costs of depository institutions and on their ability effectively to manage their liabilities. In view of these considerations and to facilitate the orderly administration of currently prescribed deposit interest rate regulations, the Committee finds that application of the notice and public participation provisions of 5 U.S.C. § 553 to this action would be contrary to the public interest and that good cause exists for making this action effective in less than 30 days.

Pursuant to its authority under Title II of Public Law 96-221, 94 Stat. 142 (12 U.S.C. 3501 et seq.), to prescribe rules governing the payment of interest and dividends on deposits of federally insured commercial banks, savings and loan associations and mutual savings banks, effective June 2, 1980, the Committee adopts a final rule as follows:

PART 1204--INTEREST ON DEPOSITS

§ 1204.103--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 an amount at least equal to three months of interest earned, or that could have been earned, on the amount withdrawn at the nominal (simple interest) rate being paid on the deposit, regardless of the length of time the funds withdrawn have remained on deposit. 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 an amount at least equal to six months of interest earned, or that could have been earned, on the amount withdrawn at the nominal (simple interest) rate being paid on the deposit, regardless of the length of time the funds withdrawn have remained on deposit.

By order of the Committee, May 28, 1980.

(Signed) Normand R. V. Bernard

Normand R. V. Bernard

Executive Secretary of the Committee

TITLE 12--BANKS AND BANKING

CHAPTER XII--DEPOSITORY INSTITUTIONS DEREGULATION COMMITTEE

[Docket No. D-0008]

PART 1204--INTEREST ON DEPOSITS

AGENCY: Depository Institutions Deregulation Committee.

ACTION: Final rules.

SUMMARY: The Depository Institutions Deregulation Committee ("Committee") has adopted final rules concerning the ceiling rates of interest payable on the 26-week money market certificate (MMC) and on the 2-1/2 year and longer small saver certificate (SSC). Under the rules adopted, the ceiling rate of interest payable on the MMC by all institutions (commercial banks, mutual savings banks, and savings and loan associations) will be at least one quarter of one per cent above the rate established for six-month United States Treasury bills and in no event will the ceiling rate drop below 7-3/4 per cent. In addition, during the period May 29 through November 30, 1980, commercial banks may renew maturing MMCs with the same depositor at a rate of interest equal to the ceiling rate of interest payable on MMCs by mutual savings banks and savings and loan associations. The ceiling rate of interest payable by all institutions on the SSC has been increased by one-half of one per cent and in no event will the ceiling rate drop below 9.25 per cent for commercial banks and 9.50 per cent for mutual savings banks and savings and loan associations. These actions will provide consumers with a higher rate of return on their savings and will improve the competitive position of depository institutions. The actions also will enhance the ability of small banks to serve the agricultural and small business needs of their communities, help thrift institutions to increase liquidity, and permit banks and savings institutions to better serve the nation's needs for financing home building and home ownership. The rules apply to all commercial banks, mutual savings banks, and savings and loan associations subject to the authorities conferred by section 19(j) of the Federal Reserve Act, section 18(g) of the Federal Deposit Insurance Act, and section 5B(a) of the Federal Home Loan Bank Act.

EFFECTIVE DATE: The new ceiling rules for MMCs are effective for MMCs issued beginning on June 5, 1980. The provision permitting commercial banks to renew maturing MMCs at the thrift ceiling rate is effective May 29, 1980. The new ceiling rules for SSCs are effective for SSCs issued beginning on June 2, 1980.

FOR FURTHER INFORMATION CONTACT: John Hall, Attorney, Federal Home Loan Bank Board (202/377-6466), Debra Chong, Attorney, Office of the Comptroller of the Currency (202/447-1632), F. Douglas Birdzell, Senior Attorney, Federal Deposit Insurance Corporation (202/389-4324), Anthony F. Cole, Senior Attorney, Federal Reserve Board (202/452-3612), or Allan Schott, Attorney-Advisor, Treasury Department (202/566-6798).

SUPPLEMENTARY INFORMATION: Effective June 1, 1978, the Federal Reserve, the Federal Deposit Insurance Corporation ("FDIC") and the Federal Home Loan Bank Board ("FHLBB") promulgated regulations authorizing Federally insured commercial banks, mutual savings banks, and savings and loan associations to offer MMCs (nonnegotiable time deposits of \$10,000 or more with maturities of 26 weeks) at a maximum rate of interest tied to the discount yield (auction average) on the most recently issued six-month United States Treasury bills. Under regulations of the agencies, the maximum rate of interest payable by commercial banks on MMCs is the Treasury bill discount rate. The maximum rate of interest payable by mutual savings banks and savings and loan associations on MMCs is one-quarter of one per cent above the Treasury bill discount rate when that rate is less than 8-3/4 per cent, 9 per cent when the Treasury bill discount rate is between 8-3/4 per cent and 9 per cent, and the Treasury bill discount rate when that rate is above 9 per cent. Thus, when the Treasury bill discount rate is 9 per cent or higher, all institutions may pay interest on the MMC at the same ceiling rate. However, when the Treasury bill discount rate is between 8-3/4 per cent and 9 per cent, mutual savings banks and savings and loan associations may pay interest on MMCs at a ceiling rate of up to 25 basis points more than the rate payable by commercial banks, and when the discount rate is less than 8-3/4 per cent, thrift institutions may pay 25 basis points more than the rate payable by commercial banks.

The rule adopted by the Committee establishes a new MMC ceiling rate for all institutions that is at least 25 basis points above the rate established (auction average on a discount basis) for six-month Treasury bills issued on or immediately prior to the date of deposit. The rule also establishes a minimum ceiling rate of 7-3/4 per cent which all institutions will be authorized to pay regardless of the Treasury bill rate. Of course, an institution may pay less than the ceiling rate if it wishes to do so. When the Treasury bill rate is 8-3/4 per cent or higher, both commercial banks and thrift institutions may pay interest at a ceiling rate of 25 basis points above the bill rate. A differential of up to 25 basis points on the ceiling rate payable by commercial banks and thrift institutions has been retained where the Treasury bill rate is more than 7-1/4 per cent, but less than 8-3/4 per cent. The new ceiling rates of interest payable are described in the table below. The new rule affects only the establishment of the

ceiling rate payable on the MMC and the other provisions of the agencies' regulations, including the prohibition against compounding of interest on MMCs, are not affected by this rule. As in the past, the ceiling rates will continue to be established by the result of the weekly Treasury auction of six-month bills and will continue to be effective on the Thursday following the auction. The new ceiling rules will be effective for MMCs issued beginning on Thursday, June 5.

In view of the fact that commercial banks that are relatively large lenders in the mortgage and agricultural credit markets and which, especially in the agricultural credit market, tend to be quite small, have relied particularly heavily on MMCs, the Committee also has decided to permit commercial banks, during the next six months (May 29 through November 30, 1980) to renew maturing MMCs with the same depositor at a rate of interest equal to the ceiling rate of interest payable on MMCs by thrift institutions.

The following table illustrates the new ceiling rate schedule for MMCs:

<u>Bill Rate</u>	<u>Commercial Bank Ceiling</u>	<u>Thrift Ceiling</u>	<u>Differential</u>
8.75 and above	Bill rate + 25 basis points	Bill rate + 25 basis points	0
8.50 but less than 8.75	Bill rate + 25 basis points	9.00	0 to 25 basis points
7.50 but less than 8.50	Bill rate + 25 basis points	Bill rate + 50 basis points	25 basis points
7.25 but less than 7.50	7.75	Bill rate + 50 basis points	25 basis points to 0
Below 7.25	7.75	7.75	0

SSCs

Effective January 1, 1980, the Federal Reserve, FDIC and FHLBB promulgated regulations authorizing Federally insured commercial banks, mutual savings banks and savings and loan associations to offer SSCs (nonnegotiable time deposits with maturities of 2-1/2 years or more)

at a maximum rate of interest tied to the average 2-1/2 year yield for United States Treasury securities as determined monthly by the United States Treasury. For thrift institutions (mutual savings banks and savings and loan associations), the ceiling rate of interest on SSCs is currently 50 basis points below the 2-1/2 year Treasury rate or 12 per cent, whichever is lower. The ceiling rate for commercial banks is the lower of 75 basis points below the 2-1/2 year Treasury rate or 11-3/4 per cent.

The rule adopted by the Committee establishes new SSC ceiling rates for all institutions that generally are 50 basis points higher than the current ceiling rates. The rule also establishes minimum ceiling rates of 9-1/4 per cent for commercial banks and 9-1/2 per cent for thrift institutions, regardless of the average 2-1/2 year Treasury rate. Under the new rule, the ceiling rate for thrift institutions will be the higher of the average 2-1/2 year yield for Treasury securities, or 9-1/2 per cent. The ceiling rate for commercial banks will be the higher of the average 2-1/2 year yield for Treasury securities less 25 basis points, or 9-1/4 per cent. Of course, an institution may pay less than the ceiling rate if it chooses to do so. The cap of 12 per cent (for thrift institutions) and 11-3/4 per cent (for commercial banks) imposed on the SSC ceiling rate by the agencies effective February 27, 1980, will be retained. In no event, may a thrift institution or a commercial bank pay interest on an SCC at a rate in excess of 12 per cent and 11-3/4 per cent, respectively. As in the past, institutions will be permitted to compound interest on SSCs.

Under the current regulations of the agencies, the ceiling rate on the SSC is established monthly for new deposits based on the rate announced by the Treasury three business days before the beginning of each month. This rate is the average 2-1/2 year yield for United States Treasury securities for the five business days preceding the last three business days of the month. Under the new rule, the ceiling rate will be established bi-weekly. The average 2-1/2 year yield on United States Treasury securities will be announced by Treasury on Monday (based on the average 2-1/2 year yield for the five business days ending on Monday) and the ceiling rates based on that rate will be effective for a two week period beginning on the following Thursday. If Monday is a holiday, the yield will be based on the five business days ending the preceding Friday and the ceiling rate will still be effective on the next Thursday. Although the ceiling rate will be determined bi-weekly, as in the past, the ceiling rate applicable to outstanding deposits will not change during the life of the deposit.

The new ceiling rules will be effective for SSCs issued beginning on Monday June 2, 1980. Since the average 2-1/2 yield on Treasury securities, as announced by Treasury on Wednesday, May 28, is 9.05 per cent, the ceiling rate effective June 2 will be 9-1/2 per cent for thrift institutions and 9-1/4 per cent for commercial banks. This ceiling rate will remain in effect for SSCs issued through Wednesday June 11. Thereafter, the new ceiling rate will be established bi-weekly each Monday (June 9, June 23, July 7, etc.) and will be effective the following Thursday (June 12, June 26, July 10, etc.). The new rule affects only the establishment of the ceiling rates payable on the SSC and other provisions of the agencies' regulations are not affected by this rule.

These actions were taken by the Committee in order to enable depository institutions to provide depositors with a higher rate of return and to improve the competitive position of depository institutions. In order to facilitate the accomplishment of these objectives as soon as possible, the Committee finds that application of the notice and public participation provisions of 5 U.S.C. § 553 to these actions would be contrary to the public interest and that good cause exists for making these actions effective in less than 30 days.

Pursuant to its authority under Title II of Public Law 96-221, 94 Stat. 142 (12 U.S.C. 3501 et seq.), to prescribe rules governing the payment of interest and dividends on deposits of federally insured commercial banks, savings and loan associations, and mutual savings banks, the Committee amends Part 1204 (Interest on Deposits) by adding sections 104, 105 and 106 as follow:

1. Effective June 5, 1980:

§ 1204.104--26-Week Money Market Time Deposits of Less than \$100,000.

Commercial banks, mutual savings banks, and savings and loan associations 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 rates set forth below. Rounding any rate to the next higher rate is not permitted and interest may not be compounded during the term of this deposit.

Rate established (auction average on a discount basis) for U.S. Treasury bills with maturities of 26 weeks issued on or immediately prior to the date of deposit ("Bill Rate")

Maximum per cent

Commercial Banks

7.50 per cent or below

7.75

Above 7.50 per cent

Bill Rate plus one-quarter of one per cent

Mutual Savings Banks and Savings and Loan Associations

7.25 per cent or below

7.75

Above 7.25 per cent, but below 8.50 per cent

Bill Rate plus one-half of one per cent

8.50 per cent, but below 8.75 per cent

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8.75 per cent or above

Bill Rate plus one-quarter of one per cent

2. Effective May 29, 1980:

§ 1204.105--26-Week Money Market Time Deposits of Less Than \$100,000.

Notwithstanding any other limitations, during the period May 29, 1980 through November 30, 1980, a commercial bank may renew maturing 26-week money market certificates with the same depositor at a rate of interest equal to the ceiling rate of interest payable on such certificates by mutual savings banks and savings and loan associations.

3. Effective June 2, 1980:

§ 1204.106--Time Deposits of Less Than \$100,000 With Maturities of 2-1/2 Years or More.

(a) Beginning on Thursday of every other week, a commercial bank may pay interest on any nonnegotiable time deposit with a maturity of 2-1/2 years or more at a rate not to exceed the higher of one-quarter of one per cent below the average 2-1/2 year yield for United States Treasury securities as determined and announced by the United States Department of the Treasury immediately prior to such Thursday, or 9.25 per cent. The average 2-1/2 year yield will be rounded by the United States Department of the Treasury to the nearest 5 basis points. In no event shall the rate of interest paid exceed 11.75 per cent.

(b) Beginning on Thursday of every other week, a mutual savings bank or savings and loan association may pay interest on any nonnegotiable time deposit with a maturity of 2-1/2 years or more at a rate not to exceed the higher of the average 2-1/2 year yield for United States Treasury securities as determined and announced by the United States Department of the Treasury immediately prior to such Thursday, or 9.50 per cent. The average 2-1/2 year yield will be rounded by the United States Department of the Treasury to the nearest 5 basis points. In no event shall the rate of interest paid exceed 12.00 per cent.

By order of the Committee, May 28, 1980.

(Signed) Normand R. V. Bernard

Normand R. V. Bernard
Executive Secretary of the Committee