

FEDERAL RESERVE BANK  
OF NEW YORK

[ Circular No. 9058 ]  
April 21, 1981

ELIGIBILITY CRITERIA FOR NOW ACCOUNTS

Proposed Interpretation of Regulation Q

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

The Board of Governors of the Federal Reserve System has invited comment on a proposed clarification of its rules on the eligibility of depositors to hold interest-bearing checking accounts at member banks. Comments should be submitted by June 15, 1981, and may be sent to our Consumer Affairs and Bank Regulations Department.

The following is quoted from the text of the Board's announcement:

The proposed interpretation would affect eligibility for Negotiable Order of Withdrawal (NOW) accounts authorized nationwide by the Consumer Checking Account Equity Act of 1980.

The Board's proposal is intended to make the eligibility criteria for NOW accounts more understandable, and, by establishing classes of individuals and others eligible to hold such accounts, to serve the public interest by precluding the need for Board review of numerous individual questions of eligibility.

The interpretation proposed by the Board would permit the following to establish NOW accounts at member banks:

1. Individuals, if the funds are not used primarily for business purposes. (These individuals—only—would also be eligible to hold Automatic Transfer Service (ATS) accounts.)
2. Non-profit organizations eligible for tax exemption under specified sections of the Internal Revenue Code (attached).
3. Government units, if the funds are used for the purposes of schools, colleges, universities, libraries or hospitals.

Other governmental units, and all businesses operated for profit—including sole proprietorships, partnerships and corporations—would not be permitted to maintain interest-bearing checking accounts at member banks.

Topics on which the Board would particularly like to receive comment are listed on page 4 of the attached text of the Board's proposal, which also includes background and explanation.

Enclosed—for depository institutions in this District—is the text of the Board's official notice of the proposed interpretation, together with additional material that may assist you in formulating your comments. It will be published in the *Federal Register*, and copies will be furnished by the Circulars Division upon request.

ANTHONY M. SOLOMON,  
*President.*

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

[12 CFR Part 217]

(Docket No. R-0356)

NOTICE OF PROPOSED INTERPRETATION

Depositors Eligible to Maintain NOW Accounts

**AGENCY:** Board of Governors of the Federal Reserve System.

**ACTION:** Proposed interpretation.

**SUMMARY:** The Board of Governors is requesting comment from the public on a proposal to clarify the rules concerning the class of depositors eligible to maintain NOW accounts at member banks. Under Regulation Q at present, NOW accounts are available only to individuals and to organizations operated primarily for religious, philanthropic, charitable, educational, fraternal, or other similar purposes and not operated for profit. The Board proposes to issue an interpretation of the regulation under which the class of depositors eligible to maintain NOW accounts at member banks would include: (1) individuals, if the funds are not used primarily for business purposes, (2) nonprofit organizations that are described in section 501(c)(3) through (13) and (19) of the Internal Revenue Code, and (3) governmental units, if the funds are used for the purposes of schools, colleges, universities, libraries, or hospitals. However, all businesses that are operated for profit, including sole proprietorships, partnerships, corporations, and other organizations, and most governmental units would not be permitted to maintain NOW accounts. The Board believes that, under this approach, the eligibility criteria for NOW accounts would be more understandable, and would preclude the need for Board review of individual questions of eligibility.

**DATE:** Interested parties are invited to submit relevant data, views, and other comments. Comments must be received by June 15, 1981.

**ADDRESS:** Comments, which should refer to Docket No. R-0356, should be addressed to James McAfee, Assistant Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N. W., Washington, D. C. 20551, or should be delivered to room B-2223 between 8:45 a.m. and 5:15 p.m. Comments received may be inspected in room B-1122 between 8:45 a.m. and 5:15 p.m. except as provided in section 261.6(a) of the Board's Rules Regarding Availability of Information (12 CFR 261.6(a)).

FOR FURTHER INFORMATION CONTACT: Gilbert T. Schwartz, Associate General Counsel (202/452-3625), or Paul S. Pilecki, Senior Attorney (202/452-3281), Legal Division, Board of Governors of the Federal Reserve System, Washington, D. C. 20551.

SUPPLEMENTARY INFORMATION: The Consumer Checking Account Equity Act of 1980 (Title III of Pub. L. 96-221) ("Act") authorizes depository institutions (except credit unions which are authorized to offer share draft accounts) nationwide effective December 31, 1980, to permit the owner of a deposit or account on which interest or dividends are paid to make withdrawals by negotiable or transferable instruments for the purpose of making transfers to third parties (12 U.S.C. § 1832(a)(1)). Under the statute, NOW accounts are available only to individuals and to qualifying organizations (12 U.S.C. § 1832(a)(2)). Qualifying organizations must meet two separate tests of eligibility. First, they must be operated primarily for "religious, philanthropic, charitable, educational, or other similar purposes;" second, they must not be operated for profit. The Federal Reserve has advised member banks that the class of depositors eligible to hold NOW accounts is virtually identical to the class of depositors eligible to hold savings deposits without limit (with the exception of governmental units).<sup>1/</sup> Interpretations and opinions issued in the past by the Board with respect to the class of depositors eligible to hold savings accounts without limit are illustrative of the classes of depositors eligible to hold NOW accounts under the Act and the regulation. (See Release of October 20, 1980.)

The Federal Reserve has received a significant number of requests from member banks and their customers for rulings and opinions concerning NOW account eligibility since the enactment of the Act. In many instances these requests have required the consideration of subtle distinctions that are not altogether practical for application on a uniform basis by a large number of depository institutions. In order to alleviate problems that have arisen among member banks concerning the class of depositors eligible to hold NOW accounts, the Board believes it is appropriate at this time to simplify and clarify the rules concerning NOW account eligibility. Accordingly, the Board requests public comment by June 15, 1981, on a proposed interpretation of Regulation Q as described below.

Under the Board's proposal, all organizations, partnerships, corporations, and associations that are not organized for profit and are described in section 501(c)(3) through (13) and (19) of the Internal Revenue Code (26 U.S.C. (I.R.C. 1954) § 501(c)(3) through (13), (19))

---

<sup>1/</sup> Regulation Q explicitly permits fraternal organizations to maintain NOW accounts; however, the statute omits such group from the list of eligible NOW account depositors. Since the statutory provisions were based on Regulation Q, it is believed that the omission of the term "fraternal" was unintentional and without significance.

would be eligible to maintain NOW accounts at a member bank. In this regard, the Act extends NOW account eligibility to organizations not operated for profit if they are operated primarily for religious, philanthropic, charitable, educational or for other similar purposes. The Board believes that virtually all nonprofit organizations described in 501(c) (3) through (13) and (19) can be regarded as being operated primarily for purposes that are similar to religious, philanthropic, charitable, or educational in nature and that such provisions are comprehensive with respect to describing such organizations. The Board believes that this interpretation would facilitate compliance by depository institutions and greatly reduce the need for individual rulings on NOW account eligibility.

The Board also believes that NOW accounts should not be available for funds that represent deposits of an enterprise organized to make a profit. In this regard, the legislative history of the Act indicates that NOWs would be available to nonprofit organizations and to consumers as a means of providing an additional return to household funds.<sup>2/</sup> However, the Board has had a longstanding interpretation (Published Interpretations ¶3085; 1936 Federal Reserve Bulletin 120) which provides that deposits of funds of an individual used in his business, i.e. a sole proprietor, may be classified as savings deposits since it was viewed as impracticable to distinguish between funds of an individual used in a business and other funds of the individual. (However, funds of a corporation owned solely by an individual may not be held as NOW accounts since the corporation exists separate and apart from the individual.) This ruling has been extended to apply also in the case of NOW accounts and eligibility for the automatic transfer service (ATS). Continuation of the policy of permitting deposits of businesses owned by individuals to be held as NOW accounts could be regarded as contrary to Congressional intent in authorizing such accounts. Consequently, the Board proposes to modify the eligibility requirements for NOW accounts (as well as ATS accounts) to exclude entities organized or operated to make a profit regardless of whether they are corporations, partnerships, sole proprietorships, associations, or any other organization. This action also would eliminate the disparate treatment accorded sole proprietorships and closely held corporations. The Board requests comment on the desirability of distinguishing between funds of an individual used primarily for personal purposes and those of a sole proprietorship used primarily for business purposes as well as any operational difficulties presented by such an approach.

At present, certain governmental units are eligible for NOW accounts at member banks. These entities include independent school districts and state universities, redevelopment authorities, and public housing authorities. Because states and political subdivisions are

---

<sup>2/</sup> See 126 Cong. Rec. H2276, H2288, H2291 (daily ed. March 27, 1980).

regarded as serving governmental purposes, the Board believes that governmental units generally should not be permitted to maintain NOW accounts. However, under the Board's proposal, governmental units would be eligible to maintain NOW accounts if the funds are to be used exclusively by schools, libraries, colleges, universities, and hospitals or other medical facilities. The Board believes that funds used for such purposes should be permitted to be placed in NOW accounts in order to accord equal treatment to public entities that perform functions similar to nonprofit entities in the private sector. Thus, if a governmental unit is organized for any one of the listed purposes or maintains an account exclusively for one of those purposes, such funds could be placed in a NOW account. All other governmental accounts would not be eligible for NOW accounts, including redevelopment authorities and public housing authorities. This approach will also eliminate the need for a determination of whether a particular governmental entity is independent or separately constituted as is required under current interpretations.

In order to provide for an orderly transition for NOW account and ATS customers, the Board proposes to provide for a phase-out period for existing NOW accounts that would not qualify under the revised eligibility criteria. Under the proposal, all NOW and ATS accounts that met the current NOW account eligibility criteria could continue in effect until December 31, 1981. After that date, NOW and ATS accounts would be limited to the new list of eligible depositors.

It should be noted that the Board does not propose to change the existing policy concerning eligibility for traditional passbook and statement savings accounts. In addition, the Board will coordinate its NOW account eligibility policy with the other Federal financial institution regulatory agencies.

Comment is invited from all parties on the issues raised by the proposal. The Board is particularly interested in views (1) on using section 501(c) (3) through (13) and (19) of the Internal Revenue Code as the criteria for determining which nonprofit organizations would be eligible for NOW accounts, (2) on excluding sole proprietorships from NOW and ATS account eligibility, (3) on prohibiting NOW accounts for governmental units except where the funds are used for the purposes of schools, colleges, universities, hospitals and libraries, (4) on the phase-out of existing NOW and ATS accounts that would no longer qualify under the proposed rules, (5) on the potential problems that could arise in attempting to distinguish whether funds of an individual are used primarily for personal rather than business purposes, and (6) on whether the proposed revised rules concerning NOW and ATS eligibility would be more understandable and easier to administer for member banks. Comment should be sent by June 15, 1981, to James McAfee, Assistant Secretary, Board of Governors of the Federal Reserve System, Washington, D. C. 20551.

Pursuant to its authority under section 19(a) of the Federal Reserve Act (12 U.S.C. § 461(a)), the Board proposes to amend Regulation Q (12 CFR Part 217) by adding a new section 217.157 as follows:

§ 217.157 -- Eligibility for NOW and ATS Accounts

(a) (1) Effective December 31, 1980, the Consumer Checking Account Equity Act of 1980 (Title III of the Depository Institutions Deregulation and Monetary Control Act of 1980, P.L. 96-221; 94 Stat. 147) authorizes depository institutions nationwide to offer interest-bearing checking (NOW) accounts to depositors where the "entire beneficial interest is held by one or more individuals or by an organization which is operated primarily for religious, philanthropic, charitable, educational, or other similar purposes and which is not operated for profit." (12 U.S.C. 1832(a)(2)). The purpose of the Act was to extend the availability of NOW accounts throughout the nation. Previously, as an experiment, NOW accounts were only authorized to be offered by depository institutions in New England, New York, and New Jersey.

(2) The NOW account experiment established by Congress in 1973 did not specify the types of customers that could maintain NOW accounts. In enacting the NOW account provision, Congress adopted virtually the same language concerning NOW account eligibility that previously had been adopted by the Board and the Federal Deposit Insurance Corporation with regard to the types of customers permitted to maintain NOW accounts in institutions located in the NOW account experiment region. (12 CFR 217.1(e)(3) and 12 CFR 329.1(e)(2)). This definition was based upon longstanding regulatory provisions concerning eligibility criteria for savings deposits.

(3) The Board has determined to clarify the types of entities that may maintain NOW accounts at member banks.

(b) Individuals. (1) Under current provisions, an individual may maintain a NOW account if the funds are used primarily for personal or business purposes. Since NOW accounts are generally not available to business organizations, the Board believes that it would be consistent with Congressional intent to permit individuals to maintain NOW accounts only if the funds in the account are to be used primarily for personal, not business, purposes. Consequently, entities organized or operated to make a profit may not maintain NOW accounts regardless of whether they are corporations, partnerships, sole proprietorships, associations, or other form of organization.

(2) Under current provisions, funds held in a fiduciary capacity (either an individual fiduciary or a corporate fiduciary such as a bank trust department), particularly those awaiting distribution or investment, may be held in the form of NOW accounts if the beneficiaries are individuals.

The Board believes that such a classification should continue since fiduciaries are required to invest even temporarily idle balances to the greatest extent feasible in order to responsibly carry out their fiduciary duties. The availability of NOW accounts provides a convenient vehicle for providing a short-term return on temporarily idle trust funds.

(3) Pension funds, escrow accounts, and security deposits, and other funds held under various agency agreements may also be classified as NOW accounts if the entire beneficial interest is held by individuals. The Board believes that these accounts are similar in nature to trust accounts and should be accorded identical treatment. Therefore such funds may be regarded as eligible for classification as NOW accounts.

(c) Nonprofit Organizations. Under the Act, a nonprofit organization that is operated primarily for religious, philanthropic, charitable, educational, or other similar purposes may maintain a NOW account. The Board has determined that it is appropriate to regard all organizations that are not organized for profit and that are described in section 501(c)(3) through (13) and (19) and 528 of the Internal Revenue Code (26 U.S.C. (I.R.C. 1954) §§ 501(c)(3) through (13), (19), 528) as being operated for religious, philanthropic, charitable, educational, or other similar purposes. Accordingly, all such organizations that are not organized for profit may maintain NOW accounts.

(d) Governmental Units. Under the Act, governmental units generally may not maintain NOW accounts. The Board believes that some governmental units are operated for philanthropic, educational, or charitable purposes, and that with regard to their eligibility for NOW accounts, such entities should be regarded as being operated primarily for such purposes. Consequently, a governmental unit, regardless of form of organization, may maintain a NOW account if the funds are in the name of and used solely for schools, universities or colleges, libraries, or hospitals and other medical facilities.

(e) Phase-out. In order to avoid unduly disrupting existing account relationships, a NOW account established at a member bank prior to April 8, 1981, that represents funds of a nonqualifying entity that previously qualified to maintain a NOW or ATS account may be maintained until December 31, 1981.

TITLE 26—INTERNAL REVENUE CODE

§ 501. Exemption from tax on corporations, certain trusts, etc.

(3) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

(4) Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes.

(5) Labor, agricultural, or horticultural organizations.

(6) Business leagues, chambers of commerce, real-estate boards, boards of trade, or professional football leagues (whether or not administering a pension fund for football players) not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

(7) Clubs organized for pleasure, recreation, and other nonprofitable purposes, substantially all of the activities of which are for such purposes and no part of the net earnings of which inures to the benefit of any private shareholder.

(8) Fraternal beneficiary societies, orders, or associations—

(A) operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, and

(B) providing for the payment of life, sick, accident, or other benefits to the members of such society, order, or association or their dependents.

(9) Voluntary employees' beneficiary associations providing for the payment of life, sick, accident, or other benefits to the members of such association or their dependents or designated beneficiaries, if no part of the net earnings of such association inures (other than through such payments) to the benefit of any private shareholder or individual.

(10) Domestic fraternal societies, orders, or associations, operating under the lodge system—

(A) the net earnings of which are devoted exclusively to religious, charitable, scientific, literary, educational, and fraternal purposes, and

(B) which do not provide for the payment of life, sick, accident, or other benefits.

(11) Teachers' retirement fund associations of a purely local character, if—

(A) no part of their net earnings inures (other than through payment of retirement benefits) to the benefit of any private shareholder or individual, and

(B) the income consists solely of amounts received from public taxation, amounts received from assessments on the teaching salaries of members, and income in respect of investments.

(12) Benevolent life insurance associations of a purely local character, mutual ditch or irrigation companies, mutual or cooperative telephone companies, or like organizations; but only if 85 percent or more of the income consists of amounts collected from members for the sole purpose of meeting losses and expenses.

(13) Cemetery companies owned and operated exclusively for the benefit of their members or which are not operated for profit; and any corporation chartered solely for the purpose of the disposal of bodies by burial or cremation which is not permitted by its charter to engage in any business not necessarily incident to that purpose and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

(19) A post or organization of war veterans, or an auxiliary unit or society of, or a trust or foundation for, any such post or organization—

(A) organized in the United States or any of its possessions,

(B) at least 75 percent of the members of which are war veterans and substantially all of the other members of which are individuals who are veterans (but not war veterans), or are cadets, or are spouses, widows, or widowers of war veterans or such individuals, and

(C) no part of the net earnings of which inures to the benefit of any private shareholder or individual.

§ 528. Certain homeowners associations

(a) General rule

A homeowners association (as defined in subsection (c)) shall be subject to taxation under this subtitle only to the extent provided in this section. A homeowners association shall be considered an organization exempt from income taxes for the purpose of any law which refers to organizations exempt from income taxes.



## Appendix

### Initial Regulatory Flexibility Analysis

The Board of Governors of the Federal Reserve System is requesting comment from the public on a proposal to clarify the class of depositors eligible to maintain NOW and ATS accounts at member banks. Public comment is requested by June 15, 1981. This statement describes the impact of the proposed rule on small entities in accordance with section 603 of the Regulatory Flexibility Act (5 U.S.C. § 603; Pub. L. 96-354).

The Federal Reserve has received a significant number of requests from member banks and their customers for rulings and opinions concerning NOW account eligibility since the enactment of the Consumer Checking Account Equity Act of 1980 (Title III of Pub. L. 96-221). In many instances, these requests have required the consideration of subtle distinctions implied by the existing interpretations that have proved to be impractical for application on a uniform basis by a large number of depository institutions. The Board's objective in issuing this proposal is to simplify and clarify the rules concerning NOW and ATS accounts. The Board's proposal is issued under its authority in section 19(a) of the Federal Reserve Act (12 U.S.C. § 461(a)).

The proposed interpretation concerning NOW account eligibility will apply directly to all banks that are members of the Federal Reserve System. However, other regulatory agencies are expected to adopt similar interpretations; and, thus, nonmember insured commercial banks and thrift institutions likely would be affected. The interpretation would affect all small entities that desire to maintain NOW accounts at member banks; however, the number of affected entities cannot be estimated. The proposal is of particular interest to sole proprietorships, which would no longer be eligible to maintain NOW and ATS accounts at member banks under the new interpretation. As under existing interpretations, all other entities organized to make a profit also would not be eligible for NOW accounts. The proposed interpretation would generally expand the class of eligible nonprofit organizations and would permit governmental units to maintain NOW accounts for purposes of education, libraries, and hospitals.

The proposal will not require any additional reporting or recordkeeping requirements and the burden of compliance will rest only with member banks. It is expected that a member bank would be able to demonstrate compliance with the information that it normally obtains upon the opening of a deposit account. The Board believes that the clarifications embodied in the proposal would facilitate compliance with the NOW account eligibility rules.

A second alternative to the approach chosen by the Board would be for the Federal Reserve to issue detailed lists of the types of organizations or other depositors eligible to maintain NOW accounts. This approach would be administratively burdensome in that the Board would continue to be required to consider a large volume of inquiries. Moreover, member banks would be required to maintain updated lists of the types of eligible depositors which could prove burdensome for smaller entities. As a third alternative, the Board could withdraw all existing interpretations and allow member banks to interpret the statutory language on their own. This approach would not seem feasible since 12 U.S.C. § 1832(c) provides a \$1,000 per violation fine for violations of the NOW account provisions.

Comments on this regulatory flexibility analysis may be submitted to Barbara Lowrey, Assistant Secretary of the Board, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N. W., Washington, D. C. 20551.