

FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 9076]
May 19, 1981

AMENDMENTS TO REGULATION D AND Q

Coverage Extended to Certain Deposits at Foreign Offices

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

The Board of Governors of the Federal Reserve System has amended its Regulation D, "Reserve Requirements of Depository Institutions," and Regulation Q, "Interest on Deposits," to subject deposits of less than \$100,000 maintained at foreign offices to both regulations. The amendments became effective May 14, 1981.

The Board indicated that it acted "to avoid the undermining of interest rate ceilings and the adverse effects on the flow of funds among depository institutions and on monetary policy that would result from recent offerings of foreign deposit accounts."

Enclosed is the text of the amendments. Questions thereon may be directed to our Accounting Department (Tel. No. 212-791-5249 or 5250).

ANTHONY M. SOLOMON,
President.

TITLE 12 -- BANKS AND BANKING

CHAPTER II -- FEDERAL RESERVE SYSTEM

SUBCHAPTER A -- BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

[Regulations D and Q]

[Docket No. R-0358]

PART 204 -- RESERVE REQUIREMENTS OF DEPOSITORY INSTITUTIONS

PART 217 -- INTEREST ON DEPOSITS

Deposits Payable Outside the United States

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rules.

SUMMARY: The Board of Governors of the Federal Reserve System has amended its Regulation D -- Reserve Requirements of Depository Institutions (12 CFR Part 204) and Regulation Q -- Interest on Deposits (12 CFR Part 217) to subject deposits in denominations of less than \$100,000 maintained at foreign branches to interest rate ceilings and reserve requirements. This action is taken in light of recent offerings that have significant potential adverse implications for the viability of the existing interest rate ceiling structure, the flow of funds among depository institutions, and the conduct of monetary policy.

EFFECTIVE DATE: May 14, 1981.

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: In recent days the Board has become aware of a deposit arrangement involving the use of foreign offices of depository institutions that can be used by such institutions to evade the reserve requirements of Regulation D (12 CFR Part 204) and the interest rate ceilings of Regulation Q (12 CFR Part 217). If allowed to proliferate, the arrangement would erode the effectiveness of reserve requirements and interest rate limitations on deposits. In order to preserve the effectiveness of Federal reserve requirements and interest rate ceilings, the Board has determined that it is essential to subject such arrangements to Regulations D and Q, effective immediately if the deposits are in denominations of less than \$100,000. Under the account arrangement, the institution establishes accounts in denominations of less than \$100,000 through its U.S. offices on behalf of its foreign office. Customers may direct the institution to transfer funds to the institution's foreign office for deposit in an account at the foreign office or direct the

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foreign office to transfer funds from the foreign office account to the customer's checking account at a U.S. office of the institution. Transfers may be effectuated by telephone or by other instruction. The account agreement provides that amounts on deposit in the foreign office account are payable only at the foreign office.

The Board has determined that funds deposited in the foreign office account arrangement described above and other arrangements involving the receipt of deposits at foreign offices that would otherwise likely be maintained in the United States should be subjected to deposit interest rate limitations under Regulation Q -- Interest on Deposits (12 CFR Part 217) and to reserve requirements under Regulation D -- Reserve Requirements of Depository Institutions (12 CFR Part 204) if they are in denominations of less than \$100,000. In this connection, the Board has amended Regulations D and Q to provide that deposits will be regarded as payable outside the United States if the depositor has a right to demand payment only outside the United States and only if the deposit is in denominations of \$100,000 or more.

The Board believes that arrangements of the type described above serve no purpose other than as devices to evade Regulations D and Q. The account does not facilitate the conduct of the foreign office's or the customer's foreign business, and the depositor has no interest in maintaining funds in a foreign office other than as a device to obtain a rate of interest in excess of Regulation Q ceilings. The Board regards the foreign office involvement in such transactions as being limited to serving as an accounting convenience.

Under section 19 of the Federal Reserve Act, a deposit that is payable only outside the United States is not subject to basic reserve requirements (12 U.S.C. § 461(b)(6)), interest rate limitations (12 U.S.C. § 371b) or to the prohibition against payment of interest on demand deposits (12 U.S.C. § 371a). The purpose of this exemption is to enable foreign branches of U.S. banks to compete on a more nearly equal basis with foreign banks.^{1/} The Board believes that foreign office accounts in denominations of less than \$100,000 do not serve to further the competitive position of the foreign office vis a vis foreign banks and, thus, such accounts are not entitled to the exemptions in section 19. Moreover, Congress has expressed its will that rate ceilings on deposits of less than \$100,000 should continue in effect until April 1, 1986, unless eliminated sooner by the Depository Institutions Deregulation Committee.^{2/} Proliferation of arrangements such as those described above could abrogate the effectiveness of the interest rate ceiling structure, thereby presenting potential adverse implications for the flow of funds among depository institutions and provide an unfair competitive advantage to U.S. banks with foreign offices relative to depository

^{1/} See 35 FR 2768 (February 10, 1970) and Senate Report No. 1260, 73D Congress, 2d Session, June 6, 1934 (pp. 4, 6).

^{2/} Section 202 of the Depository Institutions Deregulation Act of 1980 (Pub. L. 96-221).

institutions that do not maintain foreign branches. These arrangements also could have an adverse impact on the conduct of monetary policy. Consequently, the Board believes that if an institution subject to Regulations D and/or Q desires to accept deposits of less than \$100,000 at a foreign office, such deposits must comply with all provisions of Regulations D and/or Q.

In considering this matter, the Board noted that the purpose of foreign branches of U.S. banks is to conduct a foreign and international business and not to function as a substitute for domestic banking facilities. However, the Board is concerned with the ability of U.S. depository institutions to compete with nondepository institutions and recognizes that additional instruments may be needed in order to foster additional competition. The Board notes that the Depository Institutions Deregulation Committee may consider the possibility of creating new deposit instruments that would enhance the competitive position of depository institutions at its next meeting in connection with its consideration of the Committee's proposal to deregulate rate ceilings on deposits.

The Board believes that adoption of these amendments effective immediately is necessary in order to assure the effectiveness of reserve requirements and interest rate ceilings. Consequently, the Board, for good cause, finds that the notice and public procedure provisions of 5 U.S.C. § 553(b) with regard to this action are impracticable and contrary to the public interest, and that deferral of the effective date pursuant to 5 U.S.C. § 553(d) would be inconsistent with the effective enforcement of Regulations D and Q.

In view of the Board's finding that the amendments should be adopted immediately, notice of proposed rulemaking is not required by 5 U.S.C. § 553. Accordingly, sections 603 and 604 of the Regulatory Flexibility Act (5 U.S.C. §§ 603 and 604) are not applicable. However, the Board notes that its action will bolster the ability of small depository institutions, which do not have foreign branches, to compete for deposits with large institutions with foreign branches.

Effective May 14, 1981, pursuant to the Board's authority under § 19(a) of the Federal Reserve Act (12 U.S.C. § 461(a)) to define the terms used in that section and to prescribe such regulations as the Board may deem necessary to effectuate the purposes of § 19 and to prevent evasions thereof, the Board amends Regulations D (12 CFR Part 204) and Q (12 CFR Part 217) as follows:

1. Section 204.2 of Regulation D (12 CFR Part 204) is amended by adding a new paragraph (t) as follows:

SECTION 204.2 -- DEFINITIONS

For purposes of this Part, the following definitions apply unless otherwise specified:

* * * * *

(t) "Any deposit that is payable only at an office located outside the United States" means (1) a deposit of a United States resident^{1/} that is in a denomination of \$100,000 or more, and as to which the depositor is entitled, under the agreement with the institution, to demand payment only outside the United States or (2) a deposit of a person who is not a United States resident^{1/} as to which the depositor is entitled, under the agreement with the institution, to demand payment only outside the United States.

1/ A deposit of a foreign branch, office, subsidiary, affiliate or other foreign establishment ("foreign affiliate") controlled by one or more domestic corporations is not regarded as a deposit of a United States resident if the funds serve a purpose in connection with its foreign or international business or that of other foreign affiliates of the controlling domestic corporation(s).

2. Section 217.1 of Regulation Q (12 CFR Part 217) is amended by adding a new paragraph (k) as follows:

SECTION 217.1 -- DEFINITIONS

For purposes of this Part, the following definitions apply unless otherwise specified:

* * * * *

(k) "Any deposit that is payable only at an office located outside of the States of the United States and the District of Columbia" means (1) a deposit of a U.S. resident^{8a/} (as defined in 12 CFR § 204.2(s)) that is in a denomination of \$100,000 or more, and as to which the depositor is entitled under the agreement with the institution, to demand payment only outside the States of the United States or the District of Columbia or (2) a deposit of a person who is not a United States resident^{8a/} as to which the depositor is entitled under the agreement with the institution to demand payment, only outside the States of the United States or the District of Columbia.

8a/ A deposit of a foreign branch, office, subsidiary, affiliate or other foreign establishment ("foreign affiliate") controlled by one or more domestic corporations is not regarded as a deposit of a United States resident if the funds serve a purpose in connection with its foreign or international business or that of other foreign affiliates of the controlling domestic corporation(s).

By order of the Board of Governors, May 14, 1981.

(Signed) Theodore E. Allison

Theodore E. Allison
Secretary of the Board

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