

**FEDERAL RESERVE BANK
OF NEW YORK**

[Circular No. **9145**]
[September 17, 1981]

ELIGIBILITY CRITERIA FOR NOW ACCOUNTS

Effective September 16, 1981

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

The following statement was issued on September 15 by the Board of Governors of the Federal Reserve System:

The Federal Reserve Board today set September 16 as the effective date of an interpretation of its rules announced August 14 to clarify what depositors are eligible to hold interest-bearing checking accounts at member banks. The effective date of the interpretation — previously September 1 — was suspended August 31 in view of litigation concerning NOW account eligibility rules that has been concluded in the Board's favor.

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

The interpretation of Regulation Q permits the following depositors to establish NOW accounts at member banks:

1. All individuals, including businesses operated as sole proprietorships. (Only these individuals and sole proprietorships will continue to be eligible to hold Automatic Transfer Service (ATS) accounts.)
2. Non-profit organizations described in specified sections of the Internal Revenue Code.
3. Government units, if the funds are in the name of or are used for the purposes of schools, colleges, universities, libraries, hospitals or other medical or educational facilities.

As previously announced, NOW accounts that would no longer qualify under the revised eligibility standards, and that were established before September 1, 1981 are permanently grandfathered.

Enclosed — for depository institutions in this District — is the text of the Board's official notice of its action. It will be published in the *Federal Register*, and copies will be furnished by our Circulars Division upon request.

Questions on this matter may be directed to our Consumer Affairs and Bank Regulations Department (Tel. No. 212-791-5914).

ANTHONY M. SOLOMON,
President.

FEDERAL RESERVE SYSTEM

Regulation Q

[12 CFR PART 217]

[Docket No. R-0356]

INTEREST ON DEPOSITS

Depositors Eligible to Maintain NOW Accounts

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final interpretation.

SUMMARY: The Board of Governors has determined to place into effect immediately its interpretation of Regulation Q--Interest on Deposits (12 CFR Part 217), announced on August 14, 1981, clarifying the rules concerning the class of depositors eligible to maintain NOW accounts at member banks.

DATE: September 16, 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: The Consumer Checking Account Equity Act of 1980 (Title III of Pub. L. 96-221) ("Act") authorized depository institutions nationwide (except credit unions which are authorized to offer share draft accounts) 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 certain qualifying organizations (12 U.S.C. § 1832(a)(2)).

On August 14, 1981, the Board announced an interpretation to clarify the rules concerning the class of depositors eligible to maintain NOW accounts (46 Fed. Reg. 42060). The Federal Home Loan Bank Board issued an interpretation on August 13, 1981, that provides for a broader class of eligibility for NOW accounts (46 Fed. Reg. 42250). On August 18, 1981, the American Bankers Association brought suit in the United States District Court for the District of Columbia challenging the interpretations of both agencies (American Bankers Association v. Federal Home Loan Bank Board, et al. (Civil Action No. 81-1933, U.S. District Court for the District of Columbia)). On August 31, 1981, the Board suspended the effective date of the interpretation in view

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of the pending litigation as a matter of convenience to member banks. The U.S. District Court issued an order on September 15 upholding the Board's interpretation and invalidating the interpretation on NOW account eligibility issued by the Federal Home Loan Bank Board. In view of the court's decision, the Board has determined to implement its interpretation effective immediately.

Under the Board's interpretation, all organizations, partnerships, corporations, and associations that are not operated for profit and are described in section 501(c)(3) through (13) and (19) and section 528 of the Internal Revenue Code (26 U.S.C. (I.R.C. 1954) § 501(c)(3) through (13), (19) and § 528) will 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 the cited Internal Revenue Code provisions can be regarded as being operated primarily for purposes that are similar in nature to religious, philanthropic, charitable, or educational purposes and that such provisions are comprehensive with respect to describing such organizations. The Board believes that this interpretation will facilitate compliance by depository institutions and will reduce greatly the need for individual rulings on NOW account eligibility.

All sole proprietorships and other businesses operated by individuals will continue to be eligible to maintain NOW accounts at member banks. However, the class of depositors eligible to hold NOW accounts will continue to exclude other entities organized or operated to make a profit regardless of whether they are corporations, partnerships, associations, or any other organization.

Because states and political subdivisions are regarded as primarily serving governmental purposes, the Board believes that governmental units generally should not be permitted to maintain NOW accounts. However, under the Board's interpretation, governmental units will be eligible to maintain NOW accounts if the funds are in the name of or are to be used exclusively by schools, libraries, colleges, universities, and hospitals or other educational or 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 may be placed in a NOW account. (These purposes are regarded as illustrative and not exhaustive.) 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 not to disadvantage any current NOW account customers that qualify under existing eligibility criteria but that would no longer be eligible under the Board's interpretation, the Board determined to grandfather existing NOW accounts that would not qualify under the revised

eligibility criteria. All NOW accounts that meet the current NOW account eligibility criteria may continue in effect if they were established on or before August 31, 1981. NOW accounts opened after that date will be limited solely to the new class of eligible depositors. It should be noted that the Board has not changed the existing policy concerning eligibility for traditional passbook and statement savings accounts.

Effective September 16, 1981, pursuant to its authority under section 19(a) of the Federal Reserve Act (12 U.S.C. § 461(a)), the Board amends Regulation Q (12 CFR Part 217) by adding a new section 217.157 as follows:

§ 217.157 -- Eligibility for NOW Accounts

(a) Background. (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. 146) 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 is to extend the availability of NOW accounts throughout the nation. Previously, as an experiment, NOW accounts were authorized to be offered by depository institutions only 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. As a result, the rules of the Federal Reserve and Federal Deposit Insurance Corporation specified the types of depositors eligible to maintain NOW accounts at member and insured nonmember banks. In enacting the NOW account provision in 1980, 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) In response to many requests for rulings since the new law was enacted, the Board has determined to clarify the types of entities that may maintain NOW accounts at member banks.

(b) Individuals. (1) Any individual may maintain a NOW account regardless of the purposes that the funds will serve. Deposits of an individual used in his or her business may be held in a NOW account, since it is impracticable to distinguish between funds used by an individual in his or her business and funds used for personal purposes. However,

other entities organized or operated to make a profit may not maintain NOW accounts regardless of whether they are corporations, partnerships, associations, business trusts, or other organizations.

(2) Under current provisions, funds held in a fiduciary capacity (either by an individual fiduciary or by a corporate fiduciary such as a bank trust department), including 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 of individuals.

(3) Pension funds, escrow accounts, 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. (1) 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 regards the following kinds of organizations as eligible for NOW accounts under this standard if they are not operated for profit:

(i) organizations 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) and (19)); and

(ii) homeowners and condominium owners associations described in section 528 of the Internal Revenue Code (26 U.S.C. (I.R.C. 1954) § 528), including housing cooperative associations that perform similar functions.

(2) All organizations that are operated for profit are not eligible to maintain NOW accounts at member banks.

(3) The following types of organizations described in the cited provisions of the Internal Revenue Code are among those not eligible to maintain NOW accounts:

(i) credit unions and other mutual depository institutions described in § 501(c)(14);

(ii) mutual insurance companies described in § 501(c)(15);

(iii) crop financing organizations described in § 501(c)(16);

(iv) an organization created to function as part of a qualified group legal services plan described in § 501(c)(20);

(v) farmers' cooperatives described in § 521; or

(vi) political organizations described in § 527.

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

(e) Grandfather Provision. In order to avoid unduly disrupting account relationships, a NOW account established at a member bank on or before August 31, 1981, that represents funds of a nonqualifying entity that previously qualified to maintain a NOW account may continue to be maintained.

By order of the Board of Governors, September 16, 1981.

(signed) William W. Wiles

William W. Wiles
Secretary of the Board

[SEAL]