

FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 9389]
[October 26, 1982]

INTERPRETATION OF REGULATION Q

Minimum Rates on Loans Secured by Time Deposits

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

Following is the text of a statement issued by the Board of Governors of the Federal Reserve System:

The Federal Reserve Board has announced an interpretation of its Regulation Q — Interest on Deposits — stating that loans made upon the security of a time deposit must be made at an interest rate at least one percentage point higher than the *effective* interest rate being paid upon the time deposit.

This means that the effect of compounding on the rate of interest paid on the time deposit must be taken into account in determining the minimum rate that must be charged for a loan for which the time deposit is security.

The interpretation is applicable to loans secured by a time deposit that are made, extended or renewed on or after October 18, 1982, or agreements for such loans entered into on or after October 18, 1982.

Enclosed is the text of the interpretation. Questions thereon may be directed to our Consumer Affairs and Bank Regulations Department (Tel. No. 212-791-5914).

ANTHONY M. SOLOMON,
President.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

INTEREST ON DEPOSITS

Loans Upon the Security of a Time Deposit

INTERPRETATION OF REGULATION Q

(October 18, 1982)

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final interpretation.

SUMMARY: The Board of Governors has adopted an interpretation of Regulation Q--Interest on Deposits (12 CFR Part 217) concerning the terms under which a member bank may make a loan upon the security of a time deposit. Under the interpretation, a member bank, in making a loan to a depositor upon the security of his or her time deposit, must charge an interest rate on the loan of at least 1 percentage point above the annual effective rate being paid on the time deposit.

EFFECTIVE DATE: October 18, 1982.

FOR FURTHER INFORMATION CONTACT: Gilbert T. Schwartz, Associate General Counsel (202/452-3625), Paul S. Pilecki, Senior Attorney (202/452-3281), or Beverly A. Belcamino, Legal Assistant (202/452-3623), Legal Division, Board of Governors of the Federal Reserve System, Washington, D. C.

List of Subjects in 12 CFR Part 217

Advertising; Bank, banking; Federal Reserve System; Foreign banking.

SUPPLEMENTARY INFORMATION: Effective October 18, 1982, pursuant to its authority under section 19 of the Federal Reserve Act (12 U.S.C. §§ 371a, 371b, 461(a)), the Board amends Regulation Q (12 CFR Part 217) by adding a new section 217.160 as follows:

§ 217.160--Loan Upon the Security of a Time Deposit

(a) Section 217.4(f) of Regulation Q (12 CFR § 217.4(f)) provides that a member bank may make a loan to a depositor upon the security of his or her time deposit as long as the rate of interest on the loan is at least 1 percentage point above the rate being paid on the deposit. The purpose of this provision is to ensure that the rules regarding the maintenance of interest rate ceilings are not violated, including rules that require penalties for early withdrawals of time deposits.

(b) Effective October 5, 1982, the Board amended Regulation D--Reserve Requirements of Depository Institutions (12 CFR Part 204) to define as transaction accounts, time deposits issued in connection with an arrangement that permits the depositor to obtain credit, directly or indirectly, through the drawing of a check, draft or similar device that can be used for the purpose of making payments or transfers to third persons or others. (47 Federal Register 44992) In considering this amendment, the Board concluded that some of these arrangements are structured using a loan secured by a time deposit with terms providing for interest on the loan to be charged at 1 percentage point over the annual simple rate being paid on the deposit when the effective rate on the deposit is higher due to the effects of compounding. For example, after daily compounding on a 365/360 basis, a 12 per cent annual simple rate being paid on a deposit results in an annual effective rate of 12.935 per cent. This result has the effect of minimizing the impact of the required 1 percentage point differential. In order to preserve the effectiveness of § 217.4(f) of Regulation Q, the Board believes the interest rate charged (on an annual basis) on a loan secured by a time deposit must be at least 1 percentage point above the annual effective rate paid on the time deposit, taking into account the effects of compounding of the interest on the deposit. Thus, in the example, provided above, the minimum annual rate that may be charged on a loan secured by the time deposit would be 13.935 per cent, which is 1 percentage point above the 12.935 annual effective rate being paid on the deposit. The Board has been advised that a similar position has been adopted by the Federal Deposit Insurance Corporation and the Federal Home Loan Bank Board.

(c) In order not to disadvantage depositors who currently have such loans outstanding or agreements for such loans, this interpretation is applicable to loans secured by a time deposit that are made, extended or renewed on or after October 18, 1982, or agreements for such loans entered into on or after October 18, 1982.

By order of the Board of Governors, October 18, 1982.

(signed) William W. Wiles

William W. Wiles
Secretary of the Board

[SEAL]