FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 6465
January 8, 1970]

AMENDMENTS TO REGULATIONS D AND Q

Federal Funds Transactions

To the Member Banks of the Second Federal Reserve District:

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

> The Board of Governors of the Federal Reserve System today issued amendments to its regulations to narrow the category of "Federal funds" transactions that are exempt from its rules covering reserves of member banks (Regulation D) and payment of interest on deposits (Regulation Q). The action is effective February 12.
>
> A "Federal funds" transaction is one involving the transfer of member bank deposits at Federal Reserve Banks (or other immediately available funds) for a brief period, usually one business day. The main effect of the amendments will be to bring within the coverage of the regulations such transactions with any person other than a bank and its subsidiaries, various governmental institutions, or a securities dealer in certain cases.
>
> For purposes of the exemption, a "bank" includes a member bank, a nonmember commercial bank, a savings bank (mutual or stock), a building or savings and loan association or cooperative bank, the Export-Import Bank of the United States, or a foreign bank.

Copies of the amendments are enclosed. The Board of Governors also revised an existing interpretation of Regulation Q, the text of which is printed below.

ALFRED HAYES,
President.

(Reg. Q)

PART 217—INTEREST ON DEPOSITS

Federal Funds Transactions

Effective February 12, 1970, section 217.137 is amended to read as follows:

SECTION 217.137—MEMBER BANK PARTICIPATION IN "FEDERAL FUNDS" MARKET

(*a*) Effective February 12, 1970, the Board of Governors has amended § 217.1(*f*) to narrow the category of "Federal funds" transactions entered into by member banks that may be classified as nondeposit borrowings rather than as deposits. One question that arose in connection with such amendments is the meaning of "bank" as such term is used in the exemption from Regulation Q for obligations in nondeposit form to another bank. Such an exemption has been included in § 217.1(*f*) since its adoption in 1966. As used in such exemption, "bank" includes a member bank, a nonmember commercial bank, a savings bank (mutual or stock), a building or savings and loan association or cooperative bank, the Export-Import Bank of the United States, or a foreign bank. It also includes bank subsidiaries that engage in business in which their parents are authorized to engage and subsidiaries the stock of which is by statute explicitly eligible for purchase by national banks.

(*b*) To assure that the exemption for liabilities to banks is not used as a means by which nonbanks may arrange through a bank to "sell" Federal funds to

(OVER)

a member bank that are not subject to Regulations D and Q, obligations within the exemption must be issued to another bank for its own account. In view of this requirement, a member bank that "purchases" Federal funds should take such action as may be necessary to ascertain the character (not necessarily the identity) of the actual "seller" in order to justify classification of its liability on the transaction as "Federal funds purchased" rather than as a deposit. Any bank that has given general assurance to a member bank that sales by it of Federal funds ordinarily will be for its own account and thereafter executes such transactions for the account of others, should disclose the nature of the actual lender with respect to each such transaction. If it fails to do so, the selling bank would be deemed by the Board as indirectly violating section 19 of the Federal Reserve Act and Regulation Q.

(*c*) Also to assure the effectiveness of the limitations on persons who sell Federal funds to member banks, the amended § 217.1(*f*) applies to nondocumentary obligations undertaken by a member bank to obtain funds for use in its banking business, as well as to documentary obligations. In recent months a number of banks have made the Federal funds market available to business corporations. In some cases this has been on the basis of book entries, in which no instrument is involved. Under the amendment, a bank's liability under informal arrangements as well as those formally embodied in a document are within the coverage of § 217.1(*f*).

(*d*) The expansion of § 217.1(*f*) to nondocumentary obligations does not mean that every bank liability on a transaction that results in the bank obtaining funds is a deposit. An indorser's or conditional liability such as arises when a bank sells a loan with recourse need not be classified as a deposit liability. Also, a bank's liability on an acceptance that it sells in the market is not a deposit liability under the amendment.

(*e*) It should also be noted that when a member bank issues an obligation principally for a purpose other than as a means of obtaining funds to be used in its banking business—such as usually would be the case with respect to a due bill issued to evidence the bank's liability to deliver securities or foreign exchange sold—it need not classify its liability thereon as a deposit. However, the circumstances surrounding an obligation issued ostensibly for a purpose other than obtaining funds for use in the ordinary course of business may cause an obligation to become subject to Regulation Q—for example, if the bank's liability on a due bill extended beyond a period exceeding that necessary to complete the securities sale, or if the bank paid interest to the customer in excess of the amount that accrued on the securities sold during the delay in delivery. (12 U.S.C. 248(*i*). Interprets and applies 12 U.S.C. 371b and 461.)

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

RESERVES OF MEMBER BANKS

AMENDMENTS TO REGULATION D

1. Effective February 12, 1970, section 204.1(*f*) is amended to read as follows:

SECTION 204.1—DEFINITIONS

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(*f*) **Deposits as including certain promissory notes and other obligations.**—For the purposes of this Part, the term "deposits" also includes a member bank's liability on any promissory note, acknowledgement of advance, due bill, or similar obligation (written or oral) that is issued or undertaken by a member bank principally as a means of obtaining funds to be used in its banking business, except any such obligation that:

(1) Is issued to (or undertaken with respect to) and held for the account of (i) a domestic banking office[5a] of another bank or (ii) an agency of the United States or the Government Development Bank for Puerto Rico;

(2) Evidences an indebtedness arising from a transfer of direct obligations of, or obligations that are fully guaranteed as to principal and interest by, the United States or any agency thereof that the bank is obligated to repurchase;

(3) Has an original maturity of more than two years, is unsecured, and states expressly that it is subordinated to the claims of depositors; or

(4) Arises from a borrowing by a member bank from a dealer in securities, for one business day, of proceeds of a transfer of deposit credit in a Federal Reserve Bank (or other immediately available funds), commonly referred to as "Federal funds," received by such dealer on the date of the loan in connection with clearance of securities transactions.

This paragraph shall not, however, affect (i) any instrument issued before June 27, 1966, (ii) any instrument that evidences an indebtedness arising from a transfer of assets under repurchase agreement issued before July 25, 1969, or (iii) any instrument issued to a foreign office of another bank before June 27, 1969.

2. Effective February 12, 1970, section 204.5(*c*) (Supplement to Regulation D) is amended by inserting after "to foreign offices of other banks[8]" the following: ",or institutions the time deposits of which are exempt from the rate limitations of Regulation Q in § 217.3(*g*) thereof,".

5a Any banking office in any State of the United States or the District of Columbia of a bank organized under domestic or foreign law.

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BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

INTEREST ON DEPOSITS

AMENDMENT TO REGULATION Q

Effective February 12, 1970, Section 217.1(*f*) is amended to read as follows:

SECTION 217.1—DEFINITIONS

* * *

(*f*) **Deposits as including certain promissory notes and other obligations.**—For the purposes of this Part, the term "deposits" also includes a member bank's liability on any promissory note, acknowledgement of advance, due bill, or similar obligation (written or oral) that is issued or undertaken by a member bank principally as a means of obtaining funds to be used in its banking business, except any such obligation that:

(1) Is issued to (or undertaken with respect to) and held for the account of (i) a bank or an institution the time deposits of which are exempt from § 217.7 pursuant to § 217.3(*g*), or (ii) an agency of the United States or the Government Development Bank for Puerto Rico;

(2) Evidences an indebtedness arising from a transfer of direct obligations of, or obligations that are fully guaranteed as to principal and interest by, the United States or any agency thereof that the bank is obligated to repurchase;

(3) Has an original maturity of more than two years, is unsecured, and states expressly that it is subordinated to the claims of depositors; or

(4) Arises from a borrowing by a member bank from a dealer in securities, for one business day, of proceeds of a transfer of deposit credit in a Federal Reserve Bank (or other immediately available funds), commonly referred to as "Federal funds," received by such dealer on the date of the loan in connection with clearance of securities transactions.

This paragraph shall not, however, affect (i) any instrument issued before June 27, 1966, or (ii) any instrument that evidences an indebtedness arising from a transfer of assets under repurchase agreement issued before July 25, 1969.

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