

X-7503

(INTERPRETATION OF BANKING ACT OF 1933)

Copies to be sent to all Federal Reserve Banks.

July 17, 1933.

Mr. W. S. Johns, Acting Governor,
Federal Reserve Bank of Atlanta,
Atlanta, Georgia.

Dear Mr. Johns:

Receipt is acknowledged of your letter of June 22, 1933, inclosing a letter dated June 21, 1933, from Mr. _____, President of (a national bank). Mr. _____ requests a definite ruling on the question whether a bona fide oral agreement (or arrangement by correspondence) made prior to June 16, 1933, to pay interest on demand deposits in accordance with clearing house regulations constitutes "a contract heretofore entered into" within the meaning of Section 19 of the Federal Reserve Act, as amended by Section 11(b) of the Banking Act of 1933. If the answer is in the affirmative, Mr. _____ desires to know whether member banks may continue to pay interest on any such account and for what period of time in the future.

The proviso regarding payment of interest "in accordance with the terms of any * * * contract heretofore entered into in good faith" which was in force on June 16, 1933, does not authorize payment of interest until the end of a customary interest period unless there was a definite contract to that effect. In deciding such question, the determinative factor is not whether the alleged agreement to pay interest was oral or written, but whether the bank in question is under a legal obligation to pay interest on any deposit payable on demand in

accordance with a bona fide agreement, whether oral or written, which was in force on June 16, 1933.

Accordingly, if an oral agreement (or arrangement by correspondence) to pay interest on a deposit payable on demand, which was entered into in good faith and was in force on June 16, 1933, is the valid and binding obligation of the bank, interest may be paid in accordance with the terms thereof and for such period as may be provided for therein. Conversely, if a contract in respect to payment of interest on such deposits, whether oral or written, is subject to cancellation at the option of bank and without liability on the part of the bank, it must be canceled as soon as possible, unless the deposit which is the subject of the contract is one payable only at an office of the bank located in a foreign country, or a deposit made by a mutual savings bank, or a deposit of public funds made by or on behalf of any State, county, school district, or other subdivision or municipality, with respect to which payment of interest is required by State law.

It seems probable that, in most instances of an alleged oral contract, the agreement or understanding to allow interest would not be sufficiently definite in respect to the interest period, the amount of interest, and other essentials to constitute it a valid and binding contract. Therefore, in any case in which interest on deposits payable on demand is allowed under an alleged oral contract, the bank so allowing interest, if requested to do so, must be able to show clearly to the satisfaction of the examiner duly authorized to

Johns - Atlanta

-3-

X-7503

examine such bank, or to the Federal Reserve Board, or to any other duly constituted authority that such agreement could not have been terminated legally by such bank at its option and without liability.

As you were advised by telegram under date of June 20, 1933, member banks are forbidden to renew or extend any contract for payment of interest on deposits payable on demand which are not within a class excepted by statute, unless they eliminate the provision for payment of interest; and they are required to take such action as may be necessary to eliminate payment of interest on such deposits as soon as possible consistently with their contractual obligations.

Very truly yours,

Chester Morrill,
Secretary.