

INTERPRETATION OF BANKING ACT OF 1933

(Copies to be sent to all Federal reserve banks)

January 9, 1934.

Mr. _____, President,
The _____ National Bank,

_____.

Dear Sir:

Your letter of September 7, 1933, addressed to the Comptroller of the Currency, regarding certain provisions of the Federal Reserve Board's Regulation Q, has been referred to the Federal Reserve Board for reply.

Your first question relates to a time certificate of deposit payable one year from date, but having the following clause printed on its face:

"In order to comply with the provisions of the Federal Reserve Act relative to time deposits, this bank reserves the right to require thirty days' written notice of withdrawal."

You request to be advised whether such a certificate may be considered a time certificate of deposit for reserve purposes until actually paid, and whether interest may be paid on such certificate up to the date of its maturity. Without an opportunity to examine a copy of the certificate of deposit in question the Board is unable to advise you definitely whether the certificate conforms to the definition of a time certificate of deposit contained in Regulation D or Regulation Q. Assuming, however, that the certificate complies in other respects with the requirements of the regulations on this subject and that a definite maturity is provided in the certificates

one year after the date of the deposit, it constitutes a time certificate of deposit as defined in Regulation Q and interest may be paid thereon in accordance with that regulation until the date of maturity; and, in view of the reservation by the bank of the right to require thirty days' written notice of withdrawal, a deposit represented by such a certificate may properly be classified as a time deposit within the meaning of Regulation D relating to reserve requirements until such deposit is actually paid. After maturity, however, the certificate is one with respect to which the bank merely reserves the right to require thirty days' written notice before payment and, as stated in footnote 4 of Regulation Q, while such a certificate may be classified as a time deposit for computing reserves, interest may not be paid thereon for the reasons there stated. Accordingly, if a deposit represented by such a certificate is not paid at the maturity specified therein, no interest accruing thereafter may lawfully be paid on such deposit but it may be classified as a time deposit for computing reserves until actually paid.

Attention is invited to the fact, however, that the phrase "in order to comply with the provisions of the Federal Reserve Act relative to time deposits" contained in the above-quoted provision of your certificate is not entirely accurate; for even without the provision in question a deposit represented by a time certificate payable one year after date would constitute a time deposit within the meaning of Regulation Q until maturity and within the meaning of Regulation D until thirty days prior to maturity.

You also inquire whether your bank may lawfully pay interest at the rate of 4 per cent per annum on time certificate of deposit issued by you subsequent to June 16, 1933. Section 19 of the Federal Reserve Act was amended by the Banking Act of 1933 so as specifically to require the Federal Reserve Board to limit by regulation the rate of interest which may be paid by member banks on time deposits. The Banking Act of 1933 was enacted June 16, 1933 and it follows as a matter of law that the rate of interest which may be paid by a member bank on a time deposit under the terms of any certificate or contract issued or entered into after that date may not exceed the rate as limited by the Federal Reserve Board from time to time pursuant to the statute. The Board in its Regulation Q has limited the rate which may be paid by a member bank on a time deposit for any period subsequent to October 31, 1933 to 3 per cent per annum compounded semiannually and, accordingly, no member bank may pay interest accruing after the latter date on a time deposit, at a rate in excess of that prescribed in Regulation Q, under the terms of any certificate or contract entered into after June 16, 1933, even though such certificate or contract may provide for the payment of interest at a rate in excess of that stated.

In this connection, it is suggested, in order that depositors may have actual knowledge that the rate of interest stated in your time certificates of deposit is subject to such modification as may be necessary to conform to the rate on time deposits as limited or prescribed by the Federal Reserve Board from time to time under the

law, that you include in certificates hereafter issued a provision substantially in the following form:

"The rate of interest payable hereunder is subject to change by the bank to such extent as may be necessary to comply with requirements of the Federal Reserve Board made from time to time pursuant to the Federal Reserve Act."

With reference to your third question, the Federal Reserve Board is of the opinion that since a member bank is forbidden by law to pay interest on a deposit which is payable on demand, it may not lawfully pay interest for the period intervening between the maturity date of a certificate of deposit and the date on which a renewal certificate of deposit is actually issued, even though such renewal certificate is dated back to the date of maturity of the original certificate.

You further request to be advised under what conditions a loan to the owner of a time deposit will be deemed to be made "in good faith." As you know, footnote 7 under Section IV of Regulation Q provides that the making of a loan to the owner of a time deposit by a member bank for the purpose of evading the prohibition upon the payment of a time deposit by a member bank before its maturity will, to the extent of such loan, be deemed to be a payment of such deposit in violation of the prohibition. It is not believed that any general rule can be prescribed as to whether a loan is made in good faith or for the purpose of evading the prohibition in question; and each case should be determined on the basis of its own particular facts. It would not be practicable for the Federal Reserve Board to undertake

to determine in individual cases questions submitted to it by member banks as to whether loans made in particular circumstances are loans for the purpose of evading the prohibition upon the payment of a time deposit by a member bank before its maturity; and the Board feels that these are questions upon which each member bank should exercise its best judgment in the light of the provisions of the law and the regulation. As indicated in the regulation, in any case in which a loan is made to the owner of a time deposit by a member bank, the bank must be prepared to show clearly that it was made in good faith and not for the purpose of evading such prohibition.

Very truly yours,

(Signed) Chester Morrill

Chester Morrill,
Secretary.