

## FEDERAL RESERVE BOARD

WASHINGTON

X-9292

ADDRESS OFFICIAL CORRESPONDENCE TO  
THE FEDERAL RESERVE BOARD

August 22, 1935.

Subject: Proposed Revision of Regulation Q.

Dear Sir:

There are inclosed herewith six copies of a tentative draft of a revision of Regulation Q. It will be appreciated if you will study this regulation and furnish to the Board your comments and suggestions thereon at the earliest practicable date, not later than thirty days from the date of this letter.

Your special attention is invited to the definition of savings deposits in subsection (e) of section II of the inclosed draft of the regulation. As you know, the Banking Act of 1933 prohibited the payment of interest on demand deposits and the payment of time deposits before maturity but did not make these restrictions applicable to savings deposits. Accordingly, savings deposits are a favored class of deposits which offer the greatest temptation for improper classification because they are the only deposits with respect to which member banks have the privilege of making payment on demand with interest and, at the same time, of carrying reserves of only 3 per cent.

It is believed that the vagueness of the present definition facilitates improper classification to a certain extent. The re-

quirement that savings deposits consist of funds accumulated for "bona fide thrift purposes" has not proved satisfactory from a practical standpoint because of the great difficulty of determining whether this requirement is met by the facts of particular cases.

In addition to the improper classification of demand deposits and time deposits as savings deposits, there has been considerable abuse of savings deposits in certain sections of the country by using them as checking accounts through the method of drawing negotiable or non-negotiable orders on such deposits payable to third parties and sending such orders through the regular banking channels for collection without the presentation of the pass book. This abuse has usually been coupled with the practice of leaving the pass book with the depository bank, despite the Board's ruling that a deposit may not be classified as a savings deposit if the pass book is retained by the bank.

On April 12, 1935, the Board addressed an inquiry (X-9176) to the chairmen of all the Federal Reserve banks requesting their views as to whether some modification should be made in the ruling that savings pass books may not be retained by the depository bank. The replies to this inquiry disclosed a wide divergence of opinion regarding this question but all of the banks stated that they felt that certain exceptions to the rule should be made.

For many years the Board has endeavored unsuccessfully to prevent the evasion of the reserve requirements through the device

of classifying interest bearing personal checking accounts as savings deposits. Since the enactment of the statute prohibiting the payment of interest on demand deposits the temptation to evade the law in this manner is much greater and will become increasingly greater as business revives and competition for bank deposits becomes more active.

For these reasons it would seem especially desirable to have a definition of savings deposits which can be effectively enforced and which will close the door to abuses.

The present would seem to be an especially favorable time to accomplish these objectives because there is less competition for time deposits than normally and because there is every reason why the banks should be glad to be relieved of paying interest on personal checking accounts. Moreover, with the present large amount of excess reserves it would cause no sudden hardship to force deposits which have heretofore been classified for reserve purposes as time deposits to be classified as demand deposits.

The definition contained in the attached draft of the regulation has been prepared in an endeavor to meet the evasions and abuses mentioned above and to provide a workable and effective basis of classification of savings deposits. It will be noted that the requirement that savings deposits shall consist of funds accumulated for "bona fide thrift purposes" has been omitted from the definition and that there has been substituted a requirement that savings deposits

shall consist of funds of one or more individuals or of an organization not operated for profit. It is hoped that this restriction upon the class of depositors whose funds may be classified as savings deposits may eliminate most of the cases in which funds have been improperly classified as savings deposits.

Paragraph (1) of the new definition is essentially the same as paragraph (2) of the existing definition. Paragraphs (2) and (3) of the new definition are designed to liberalize the requirement that the pass book must be presented whenever a withdrawal is made and the Board's ruling that the pass book may not be retained by the bank, so as to care for certain cases of hardship and inconvenience which would be caused by a rigid enforcement of such requirements, and still to place such restrictions on the making of withdrawals as will prevent the use of savings deposits as checking accounts. It should be noted that paragraph (3) prohibits the making of withdrawals from savings deposits by negotiable instruments payable to or indorsed to a third party. The only exception to this prohibition is in cases where a depositor makes a withdrawal through the agency of a bank, in which case, the collecting bank may be the payee of a negotiable instrument drawn upon the depository bank.

In connection with the proposed definition of savings deposits which has been incorporated in the draft of Regulation Q sent you herewith, the Board will be glad to receive your comments as to the desirability of changing the period at the end of paragraph (3) of

the definition to a semicolon and adding, with the appropriate number, either or both of the following two paragraphs:

PARAGRAPH A

If more than one withdrawal be made from such deposit during any one calendar week, no interest shall be paid on any part of such deposit for the calendar month in which Saturday of such week falls.

PARAGRAPH B

The amount in such deposit plus the amount in any other savings deposit belonging to the same depositor in the same bank does not exceed \$10,000.

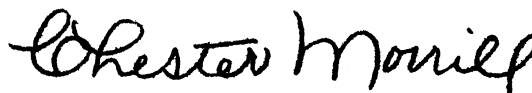
Paragraph A would be inserted for the purpose of preventing the classification as savings deposits of deposits which have a large amount of activity. In some cases several withdrawals a week are made from savings accounts. It would seem that such accounts should be classified as demand checking accounts but if they are classified as savings deposits the proposed paragraph would prevent the payment of interest during the month in which the excessive number of withdrawals is made. It is believed that the proposed limitation of not more than one withdrawal during any one calendar week would be sufficiently liberal to accommodate persons who find it necessary to draw upon their savings accounts and who are accustomed to paying their bills on a weekly basis. However, if you should feel that the principle of limitation upon the number of withdrawals during a given period would be desirable but believe that a different number of withdrawals during a particular period would be more satisfactory, please submit your opinion upon this matter to the Board.

Paragraph B, which limits the amount in a savings deposit to \$10,000, would supplement the limitation upon the class of depositors who may maintain savings deposits by adding an amount limitation on such deposits. Although any such limitation is open to the criticism that the amount is arbitrary, the question arises whether such a limitation might be of some value in preventing the classification as savings deposits of deposits which do not consist of funds of the type which it is believed Congress had in mind in enacting the provisions regarding savings deposits. If you believe that such an amount limitation is desirable but think that a different amount would be more advisable, your suggestions regarding the matter will be appreciated.

As indicated above, however, your comments and suggestions will be appreciated not only with regard to the draft of the definition of savings deposits but also with regard to the other provisions of the inclosed tentative form of the regulation.

The tentative draft of the regulation has been prepared by the Board's staff but not considered by the Board and, in order to expedite the matter and with the permission of the Board, is being sent to you at the same time that it is being submitted to the members of the Board for consideration.

Very truly yours,



Chester Morrill,  
Secretary.

Inclosures. (L - 118)