

INTERPRETATION OF LAW OR REGULATION

(Copies to be sent to all Federal reserve banks)

March 22, 1938.

Mr. _____, Vice President,
Federal Reserve Bank of _____,
_____, _____.

Dear Mr. _____:

This refers to your letter of March 7, 1938, and inclosure, presenting the question whether amounts carried by The _____ National Bank of _____ in an account called "Special Reserve, Contracts Department" constitute deposits against which reserves are required to be carried with the Federal Reserve Bank of _____.

You state that the national bank examiners have raised the question as to whether the amounts should not be treated as demand deposits subject to reserves rather than as "other liabilities." You further state that, since the release of the funds appears conditional, they being held to indemnify the bank in case of loss in its dealings with certain borrowers, and since a substantial portion of such funds reverts to the bank, you are inclined to the opinion that the items may properly be classified as "other liabilities."

It is understood that the account arises from the bank's installment financing activities wherein it makes an arrangement with an automobile dealer or other similar dealer to discount his contracts with the understanding that out of the proceeds of each contract a certain amount will be set aside in a reserve fund and will not be paid to the dealer until the contract from which it arose is paid in full; that all such amounts are available to the bank to cover losses sustained in the collection of any or all such contracts discounted for the dealer and may be applied by the bank against any other indebtedness incurred by the dealer; and that in actual practice half or less of such amounts is paid to the dealer, as losses generally consume some portion of the amounts and other portions are applied against other indebtedness of the dealer. Although it does not appear from your letter, it is assumed that the amounts held in the special reserve account are not segregated but are commingled with the other assets of the bank.

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As you know, in a ruling published at page 572 of the Federal Reserve Bulletin for May, 1922, the Board laid down the "broad rule that all funds received by a bank in the course of its commercial or fiduciary business must be treated either as deposits against which reserves must be carried, or as trust funds subject to the ordinary restrictions and safeguards imposed upon the custody and use of trust funds". In that ruling it was made clear that even in the case of trust funds, if they were not segregated from the bank's other assets but were mingled with the bank's general funds, a deposit liability would be created against which reserves must be carried. This position was recently affirmed in the ruling published at page 113 of the February, 1937, Bulletin and in the ruling published at page 391 of the May, 1937, Bulletin. In the light of the principles stated in these rulings and on the basis of our understanding of the facts as stated above, it is the view of the Board of Governors that amounts carried in the special reserve account under consideration are deposits against which reserves are required to be carried with the Federal Reserve bank.

The fact that amounts carried in the special reserve account may not be withdrawn by the dealer and probably will be used by the bank at least in part to cover losses on the discounted paper or other indebtedness of the dealer is believed not to be a controlling consideration. In this connection, your attention is invited to the Board's letter of February 5, 1938 (S-72), which reaffirmed the position taken in a ruling published at page 538 of the Bulletin for September, 1931, to the effect that amounts carried in accounts opened to secure the payment of personal loans were deposits for reserve purposes, even though they could not be withdrawn by the depositor but were to be used solely for the purpose of paying the amount of the personal loan.

The question whether amounts carried in a special reserve account are demand deposits or time deposits will, of course, depend upon whether or not the agreement or arrangement under which the funds are held complies with the definitions in section 1 of Regulation D. In this connection, your attention is invited to the fact that all deposits which do not comply with the definitions of time deposits constitute demand deposits.

As heretofore stated, the Board's ruling in this case is based upon our understanding of the facts as set forth above, but if there should be any material variation between the actual facts and our understanding of them, the matter may require further consideration.

Very truly yours,
(Signed) L. P. Bethea

L. P. Bethea,
Assistant Secretary.