

S-227
Reg. Q-41

INTERPRETATION OF LAW OR REGULATION

(Copies to be sent to all Federal Reserve Banks)

August 12, 1940

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

Dear Mr. _____:

This refers to your letter of August 2, 1940 enclosing a copy of a memorandum from your Counsel with regard to the form of certificate of deposit proposed to be used by the _____ National Bank of _____, _____.

The certificate provides that the principal is payable to the registered holder on presentation of the certificate "on the last day of any _____ period after date". The blank in the quoted phrase is to be filled in with a period agreed upon by the parties, such as 90 days, six months, or other period, and the rate of interest payable on the certificate will be fixed in accordance with the supplement to Regulation Q, i.e., if a six months' period--2-1/2 per cent, and if a 90 day period--2 per cent. The certificate is payable at the specified time, however, only if, prior thereto, written notice of a stated number of days has been given by either party to the other; and, if the certificate is not matured for payment or called at the end of any period as provided in the certificate, it is automatically renewed from period to period until it is so matured or called. Checks for accrued interest are mailed to the registered holder on June 30 and December 31 of each year.

Several questions are suggested with reference to the certificate in question. The first is with regard to the provision for successive renewals without requiring the presentation of old certificates and the issuance of new ones. This feature does not prevent the deposit from being considered a time deposit within the meaning of Regulation Q for, if the period named in the certificate is six months when the deposit is made, it is a six months' certificate and, if not called in at the end of the first period, it would after such six months' period automatically become again a six months' certificate. Although a period of notice by one party to the other is required before payment, the certificate is in no event payable except at the end of the specified periods. The case is somewhat similar to the classification as time deposits of postal savings funds payable at the end of successive periods of 30

days, which is covered by the ruling of the Board published in the 1933 Federal Reserve Bulletin, at page 768.

The certificate provides that the principal is payable only on presentation of the certificate but contemplates the payment of interest by semiannual checks to the registered holder. The provisions of Regulation Q are not specific on the question whether the interest on a time certificate of deposit may be paid only on presentation of the certificate; but, in the opinion of the Board of Governors, the fact that interest is payable by check to the registered holder without presentation of the certificate does not prevent the deposit from being classified as a time deposit.

The question has also been suggested whether the provision for the payment of interest on June 30 and December 31, irrespective of the maturity of the certificate, might result in a payment of a rate slightly in excess of the rate mentioned in the supplement to Regulation Q compounded quarterly. For example, if a deposit were made on June 1 and the period of successive renewals were 90 days, interest accrued through June 30 would be paid on that date. If the certificate with accrued interest at the date of payment were paid at the end of the first 90 days, the net yield on the investment, assuming that the depositor redeposited the interest paid him on June 30, would be slightly more than the specified rate compounded quarterly. In order for this to take place, however, it would be necessary for the depositor to make a new deposit in the bank of the interest he received on June 30 and presumably obtain another certificate. This would seem to be an independent transaction requiring a new agreement between the bank and the depositor and, accordingly, it does not appear that the rate of interest paid on a certificate of the kind in question would exceed the maximum permitted by the supplement to Regulation Q.

In the circumstances, it is the Board's opinion that a deposit evidenced by such a certificate may be properly classified as a time deposit within the meaning of Regulation Q.

Very truly yours,

(Signed) Chester Morrill

Chester Morrill,
Secretary.