February 25, 1970. 423.01

2/25/70

To: Board of Governors

From: Governor Robertson

Subject: Further consideration of (1) rate ceilings on multiple-maturity time deposits, and (2) coverage of subordinated notes.

1. Multiple-maturity time deposits

At the meeting of the Coordinating Committee on February 24, 1970, it was the consensus that the Federal Reserve and the FDIC should amend their regulations to authorize the same interest-rate ceilings on one- and two-year "consumer type" time certificates with provisions for automatic renewal as those now prescribed for "single-maturity" certificates, i.e., 5-1/2 and 5-3/4 per cent, respectively. (At present, the maximum rate payable on any such multiple-maturity certificate is 5 per cent, regardless of maturity; if the deposit is payable at intervals of less than 90 days, the ceiling is 4-1/2 per cent.) The suggested new rates would still be 1/4 per cent below those permitted for savings and loan associations.

It was also agreed that no changes should be made at this time in the provisions of Federal Reserve and FDIC regulations regarding penalties for payment before maturity. (Chairman Randall expressed strong opposition to any such change.) However, it was understood that the Federal Reserve, the Comptroller of the Currency, and the FDIC would institute a survey over the next 60 days to determine the extent, if any, to which the new ceilings may lead to pre-maturity withdrawals, and that the matter of tightening penalties for payment before maturity would be considered again by the Coordinating Committee in the light of such survey.

Attachment A is a proposed amendment to the Supplement to Regulation Q that would make the maximum rates on such certificates the same as those for single-maturity certificates. This would mean that the ceiling on deposits payable at intervals of less than 90 days would continue to be 4-1/2 per cent and the ceiling on deposits payable at intervals of 90 days or more, but less than one year, would continue to be 5 per cent; but the ceilings on one-year or two-year certificates, including those providing for automatic renewal, would be 5-1/2 per cent and 5-3/4 per cent, respectively, instead of the present 5 per cent.

If the Board approves this amendment, our staff will coordinate with the staff of the FDIC as to the time of announcement of such changes in the regulations of the two agencies.

2. Subordinated notes

At the February 24 meeting of the Coordinating Committee, Chairman Martin of the Federal Home Loan Bank Board stated that, if the issuance of notes by banks were to draw substantial funds from savings and loan associations, his Board

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might have to seek legislation. He reported that, according to Frank Wille, New York State Bank Superintendent (and chairman-designate of the FDIC), the New York State Banking Board has just ruled that banks could not issue notes in denominations of less than $20,000 and then only with the prior approval of the Superintendent.

(b) (4) [redacted]

(b) (4) [redacted] He and the Comptroller's Chief Counsel, Mr. Bloom, expressed the belief that the practice could spread rapidly. Mr. Bloom suggested that, if the bank supervisory agencies should take no action, the SEC might well apply the advertising and "anti-fraud" provisions of the 1933 and 1934 Securities Acts to such subordinated notes issued by banks.

Chairman Randall indicated that, so far, the FDIC has not been confronted with this problem in respect to nonmember insured State banks, but that he would not be opposed to action by the Federal Reserve to bring such subordinated notes within the coverage of Regulation Q. (The interest-on-deposit regulations of the FDIC do not cover funds other than conventional deposits; if the Federal Reserve should amend Regulation Q to cover subordinated notes, the FDIC might consider action to apply interest-rate ceilings to such notes as well as to other types of non-deposit instruments.)

I recommend that the Board consider publication for comment of proposed amendments to Regulations D and Q, in the form of Attachment B, that would bring within the coverage of those Regulations all subordinated notes issued by member banks except those that qualify as "legitimate" capital notes or debentures, i.e., subordinated and unsecured notes or debentures that have a maturity of not less than seven years (in lieu of the present two-year minimum maturity) and that are not eligible as security for loans by the issuing bank, but with an "escape clause" permitting exclusion from the Regulations of notes not meeting these requirements if the Comptroller in the case of a national bank or the appropriate State supervisor <u>and</u> the Board of Governors in the case of a State member bank determine that "special circumstances" (an emergency situation) require the issuance of such notes without regard to the limitations of Regulations D and Q.

Attachments

ATTACHMENT A

D R A F T

TITLE 12--BANKS AND BANKING

CHAPTER II--FEDERAL RESERVE SYSTEM

SUBCHAPTER A--BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

PART 217--INTEREST ON DEPOSITS

[Reg. Q]

Maximum Rates on Certain Multiple Maturity Time Deposits

1. Effective January 21, 1970, subparagraph (b) of § 217.7 (Supplement to Regulation Q) is amended to read as follows:

§ 217.7 Maximum rates of interest payable by member banks on time and savings deposits.

* * * * *

(b) Multiple maturity time deposits. No member bank shall pay interest on a multiple maturity time deposit at a rate in excess of the applicable rate under the following schedule:

Maturity intervals	Maximum per cent
30 days or more but less than 90 days	4-1/2
90 days or more but less than 1 year	5
1 year or more but less than 2 years	5-1/2
2 years or more	5-3/4

* * * * *

2a. This amendment is designed to permit member banks to pay, effective January 21, 1970, (1) 5-1/2 per cent on multiple maturity time deposits in amounts less than $100,000 payable only one year or more after the date of deposit, or one year or more after the last preceding date on which it might have been paid, and (2) 5-3/4 per cent on such deposits payable only two years or more after the date of deposit, or two years or more after the last preceding date on which it might have been paid. The Board previously authorized member banks to pay, effective January 21, 1970, such rates on single maturity time deposits in like amount and with like maturities (35 F.R. 1156).

b. The amendment was adopted in view of the convenience to bank customers of the automatic renewal feature in connection with deposits of one year or more and to conform to the practice followed by the Federal Home Loan Bank Board in permitting automatic renewal of similar deposits in savings and loan institutions.

c. The requirements of section 553(b) of Title 5, United States Code, with respect to notice, public participation, and deferred effective date were not followed in connection with this amendment. The Board found that, in the circumstances, the public interest compelled it to take action at the earliest practicable time and to make the action retroactive to the date of its action raising the maximum rates payable on single maturity time deposits.

By order of the Board of Governors, February 26, 1970.

Kenneth A. Kenyon,
Deputy Secretary.

ATTACHMENT B

D R A F T

FEDERAL RESERVE SYSTEM

[12 CFR Parts 204, 217]

RESERVES OF MEMBER BANKS; INTEREST ON DEPOSITS

Certain Subordinated Obligations as Deposits

The Board of Governors is considering raising from two to seven years the minimum maturity requirement for an obligation issued by a member bank subordinated to the claims of depositors to be classified by the bank as a nondeposit borrowing for the purposes of member bank reserve requirements (Regulation D) and interest rate controls (Regulation Q).

This would be accomplished by amending the relevant portions of § 204.1(f) and § 217.1(f) to read as follows:

(f) Deposits as including certain promissory notes and other obligations. [The term "deposit" does not include an obligation that]

* * * * *

(3) is designated as a capital note or debenture and possesses the following characteristics:

(i) has an original maturity of more than seven years;

(ii) is subordinated expressly to the claims of depositors and is unsecured; and

(iii) expressly provides that it will not be eligible as collateral for a loan by the issuing bank;

* * * * *

this paragraph shall not, however, affect (i) any instrument issued before [effective date of the amendment] that has an original maturity of more than two years, is unsecured, and states expressly that it is subordinated to the claims of depositors or (ii) capital notes or debentures issued by a national bank with the specific approval of the Comptroller of the Currency or by a State member bank with the specific approval of its State supervisor and the Board of Governors, upon a determination in each case that special circumstances require the issuance of such capital notes or debentures without regard to the provisions of this Part.

* * * * *

Recent evidence indicates that member banks are able to market subordinated obligations having a maturity in excess of two years to depositors with small as well as large amounts of funds to invest, with results that the Board considers are inconsistent with the purposes and policies of deposit interest rate controls and reserve requirements.

To aid in the consideration of this matter by the Board, interested persons are invited to submit relevant data, views, or arguments. Any such material should be submitted in writing to the Secretary, Board of Governors of the Federal Reserve System, Washington, D. C. 20551, to be received not later than April 22, 1970. Under the Board's rules regarding availability of information

(12 CFR Part 261), such materials will be made available for inspection and copying upon request unless the person submitting the material asks that it be considered confidential.

By order of the Board of Governors, February 26, 1970.

Kenneth A. Kenyon,
Deputy Secretary.