

Corporate & Financial Weekly Digest

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Federal Reserve Proposes to Repeal Regulation Q Pursuant to Dodd-Frank Act

The Federal Reserve Board on April 6 requested comment on a proposed rule to repeal the Board's Regulation Q, which prohibits the payment of interest on demand deposits by institutions that are member banks of the Federal Reserve System. The proposed rule would implement Section 627 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which repeals Section 19(i) of the Federal Reserve Act in its entirety effective July 21. The repeal of that section of the Federal Reserve Act on that date eliminates the statutory authority under which the Board established Regulation Q. The proposed rule would also repeal the Board's published interpretation of Regulation Q and would remove references to Regulation Q found in the Board's other regulations, interpretations and commentary. The Board is seeking comment on whether the repeal of Regulation Q, currently set forth at 12 CFR 217.101, is expected to have implications for balance sheets and income of depository institutions, short-term funding markets such as the overnight federal funds market, the demand for interest-bearing demand deposits, and competitive burden on smaller depository institutions. Some bankers feel that their banks will be compelled to offer accounts that pay interest or lose corporate business, which would either crimp margins or eliminate a source of deposit liabilities.

Technically, the proposal would affect only member banks of the Federal Reserve System. However, other banking agencies are expected to follow suit with similar actions that would apply to their regulatees, regardless of size, that hold demand deposits. The proposal would permit, but not require, member banks to pay interest on demand deposits maintained at those institutions. As such, the Board expects that the proposal would have a positive impact on such entities because it would eliminate an obsolete regulatory provision and because member banks are not obligated to offer interest-bearing demand deposits following the repeal of Regulation Q. The Board promulgated Regulation Q on August 29, 1933, to implement Section 19(i) of the Act. In the past, Regulation Q also contained provisions implementing then-current statutory provisions regulating the rates of interest payable on various types of interest-bearing deposits. The Depository Institutions Deregulation Act of 1982 phased out these statutory interest rate limitations effective in March 1986. After that time, Regulation Q consisted primarily or exclusively of provisions related to implementing Section 19(i)'s prohibition of the payment of interest on demand deposits by member banks.

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