

**FEDERAL RESERVE BANK  
OF DALLAS**

Dallas, Texas, January 28, 1938

**RULINGS OF THE BOARD OF GOVERNORS OF THE  
FEDERAL RESERVE SYSTEM REGARDING ITS REGULATION "U"**

**To the Nonmember Bank Addressed:**

Our attention has been called to the fact that although the Board of Governors of the Federal Reserve System forwarded to you a copy of its Regulation "U," amended as of September 1, 1937, pertaining to loans made by banks for the purpose of purchasing or carrying stocks registered on a national securities exchange, you probably have not seen the rulings and interpretations relating to that regulation, which have been issued by the Board from time to time and published in the monthly Federal Reserve Bulletin.

Solely for the purpose of assisting you in keeping currently informed regarding official interpretations of the regulation, we are enclosing herewith copies of all of the Board's currently effective rulings on this subject. We shall furnish you copies of all similar rulings which the Board may hereafter issue from time to time.

As you doubtless know, the provisions of Regulation "U" apply to nonmember State banks, as well as to banks which are members of the Federal Reserve System, and the enclosed rulings are sent to you for your guidance in the event you need them in connection with loans which are subject to the provisions of that regulation.

If at any time you should desire information as to whether or not (or how) the provisions of Regulation "U" apply to specific transactions with your borrowing customers, please address such inquiries to us, instead of to the Board of Governors, and we shall be glad to assist you by furnishing you the desired explanation.

Yours very truly,

B. A. MCKINNEY,  
President

RULINGS OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE  
SYSTEM REGARDING REGULATION U AS PUBLISHED IN THE FED-  
ERAL RESERVE BULLETIN TO FEBRUARY 1, 1938.

Transfers of Loans

In response to an inquiry from certain banks in New York City concerning section 3(e) of Regulation U, the Board of Governors of the Federal Reserve System rules as follows:

A bank may accept the transfer of a loan from another lender, provided the loan is not increased and the collateral for the loan is not changed, even though the "maximum loan value" of the collateral be less than the amount of the loan, but may not thereafter permit at any time withdrawals or substitutions of collateral that would increase the deficiency at such time.

May 1936 Bulletin, p. 525 - Note: In so far as this ruling relates to transfers of loans from lenders other than banks, it was superseded by amendment No. 2 of Regulation U, incorporated in the current reprint of the regulation.

Interpretations of Regulation U

The Board has recently been asked to rule on the following questions under Regulation U, which relates to loans by banks for the purpose of purchasing or carrying stocks registered on a national securities exchange:

1. Whether, in subsection (b) of section 2, which exempts "any loan to any person whose total indebtedness to the bank at the date of and including such loan does not exceed \$1,000," the term "total indebtedness" means the total of all loans regardless of their purposes or the total of all loans for the purpose of purchasing or carrying stocks registered on a national securities exchange?

In response to this inquiry the Board stated that the term "total indebtedness" means total indebtedness for all purposes and is not restricted to total indebtedness for the purpose of purchasing or carrying stocks registered on a national securities exchange.

2. The Board has also been asked, under subsection (a) of section 3 if the statement signed by an officer, upon which a bank may rely in determining whether or not a loan is for the purpose specified in

section 1 or for any of the purposes specified in section 2, must be based only on facts related to the officer by the prospective borrower or if it may be based also on facts within the knowledge of the officer not specifically stated by the borrower.

In response to this inquiry the Board ruled that the officer's statement might be based not only on statements or representations made to him by the prospective borrower but also upon any other information which the officer had obtained from any source.

3. The Board has also been asked whether in subsection (e) of section 3 permitting a bank to accept the transfer of a loan from "another lender," the term "another lender" refers solely to a bank or includes any other lender.

In response to this question the Board ruled that the term quoted includes not only a bank but also any other lender.

June 1936 Bulletin, p. 420 - Note: Part 3 of this ruling was superseded by amendment No. 2 of Regulation U, incorporated in the current reprint of the regulation.

Applicability of Section 2(c) of Regulation U to Security Dealers "Making a Market" in Registered Stocks or Purchasing an Inventory of Such Stocks for Resale

The Board has recently received a request for a ruling on the question whether section 2(c) of the Board's Regulation U, excepting from the limitations prescribed in section 1 of the regulation "any loan to a dealer, or to two or more dealers, to aid in the financing of the distribution of securities to customers not through the medium of a national securities exchange," applies to the following loans by a bank to a dealer:

(1) The borrower is a dealer, a part of whose business consists of "making a market" in a stock registered on a national securities exchange. In this business he purchases this stock from time to time for his own account on the exchange or "over the counter" from or through members of a national securities exchange or brokers or dealers who transact a business in securities through the medium of such members. In this business he also sells the stock for his own account on the

exchange but more often "over the counter" to his customers or to other persons, his sales in either case being on a cash basis. The bank loan to the dealer is secured by this stock and is for the purpose of enabling him to purchase the stock and to carry it pending its sale.

(2) The borrower is a dealer who is a member of a national securities exchange. A part of his business consists of purchasing on the exchange stocks registered thereon and of selling them on a cash basis to his customers or to other persons "over the counter." The bank loan in question is for the purpose of enabling him to purchase these stocks and to carry them pending their sale. The loan might be expected to be outstanding for several months and to be reduced or increased several times during its life.

On the basis of the facts as stated above, the Board ruled that neither of the foregoing loans comes within the exception contained in section 2(c) of Regulation U because neither loan is a loan to aid in the financing of the distribution of securities within the meaning of the term "distribution" as used in such section.

July 1936 Bulletin, p. 549.

Applicability to Collateral for Loans Made Prior to May 1, 1936, of Provisions in Regulation U Governing Withdrawal or Substitution of Collateral

The Board has recently been presented with the question whether Regulation U restricts the substitution or withdrawal of collateral securing loans made before May 1, 1936. In response, the Board expressed the view that as a general rule the provisions of Regulation U are not applicable to the withdrawal or substitution of collateral for any loan made prior to May 1, 1936.

The Board, however, stated that this general rule is subject to the following qualification: If a bank has made another loan on or after that date (other than a loan excepted by section 2 of the regulation) which is secured directly or indirectly by any stock and is for the purpose of purchasing or carrying a stock registered on a national securities exchange, and if the terms of the bank's agreements with the borrower are such that the collateral securing the first loan also secures the

second loan, the bank must then combine the collateral for both loans in determining whether any of the collateral for either loan may be withdrawn. The bank may not, in this case, permit withdrawal of such an amount of collateral as would cause the maximum loan value of the remainder to be less than the amount of the second loan.

July 1936 Bulletin, p. 549 - Note: This ruling was superseded by amendment No. 3 of Regulation U, incorporated in the current reprint of the regulation.

Applicability of Section 2(f) of Regulation U to a Loan to a Dealer to Purchase Securities to Comply With Orders from Customers

An inquiry has been received by the Board from a member bank as to whether a temporary loan to a dealer for the purpose of completing a transaction, in which he purchases securities to comply with a bona fide order from a customer, is exempted from the provisions of Regulation U by section 2(f) thereof, which excepts from the limitation of the regulation any temporary advance to finance the purchase or sale of securities for prompt delivery which is to be repaid in the ordinary course of business upon completion of the transaction. In reply the Board, without passing upon all possible situations covered by the question, expressed the view that a loan of the following description would be excepted from the regulation under the provisions of section 2(f):

A dealer in securities receives an offer from a customer to purchase a registered stock. It is agreed between the dealer and the customer that the dealer will deliver the stock to the customer promptly, and that the customer will pay for the stock promptly upon delivery of the security. The dealer purchases the security, instructing the seller to deliver it to a designated bank against payment. The bank, knowing the facts of the case and understanding that it will be repaid by the dealer as soon as the dealer can arrange for his customer to take delivery of and pay for the stock, makes a loan to the dealer for the purpose of paying the seller of the stock.

July 1936 Bulletin, p. 549

Determination of Market Value of Stock for Loan Under Regulation U.

The Board recently considered a question regarding the determination of the market value of a stock in connection with a loan on the stock under Regulation U. In the case presented, a bank made an agreement with an out-of-town customer to lend a certain sum of money on a registered stock, the amount being 45 percent of its then market value and the purpose being to purchase registered stocks. The borrower delivered the stock and the note as promptly as possible on the next day, but the market value of the stock had become lower in the interval so that the amount the bank had agreed to lend was in excess of 45 percent. The question arose as to whether Regulation U permits the bank to carry out its commitment.

It appeared that the bank had entered into an enforceable commitment, the details of the loan had been perfected in so far as practicable on the first day, and the negotiations for and completion of the loan were to take place as nearly contemporaneously as the circumstances of the case would permit. In the circumstances, the Board expressed the view that the market value of the stock for the purpose of completing the loan might properly be determined as of the time when the bank and the customer agreed upon the amount and terms of the loan. The Board pointed out, however, that any clearly foreseeable change in the stock during the interval, such as a split-up of shares or the stock selling "ex" a dividend of any kind, should be taken into account in such a determination.

April 1937 Bulletin, p. 294.

Application of Regulation U to a Loan to a Securities Dealer for the Purpose of Purchasing Both Registered and Unregistered Stocks.

The Board recently considered a question as to whether a certain loan to be made to a securities dealer and secured by stocks should be considered to be a loan for the purpose of purchasing or carrying stocks registered on a national securities exchange, and thus be considered to be subject to Regulation U.

It appeared that the proceeds of the loan would not be employed immediately but would be kept available for use in acquiring registered or unregistered securities. The securities were only to be acquired when a quick

sale was in prospect and they would be disposed of promptly. The securities purchased were often unregistered securities, but some registered stocks were so purchased and the inquiry was, in effect, whether such purchases of registered stocks caused the loan to be subject to the regulation. No question was presented to the Board as to whether or not, in the event the dealer should treat certain of the transactions separately and obtain loans from time to time for particular purposes, some of these loans to the dealer might be excluded from the operation of the regulation.

It seemed clear from the borrower's business as a dealer that one purpose of the loan in question was to purchase or carry registered stocks. Therefore, the Board expressed the opinion that, while the loan might also have certain other purposes, the loan should be considered to be a loan for the purpose of purchasing or carrying registered stocks.

May 1937 Bulletin, p. 392.

#### Transfers of Loans under Regulation U.

The Board has recently considered a number of questions regarding the transfer of loans pursuant to section 3(e) of Regulation U which provides in part as follows:

"A bank may accept the transfer of a loan from another bank, or permit the transfer of a loan between borrowers, without following the requirements of this regulation as to the making of a loan, provided the loan is not increased and the collateral for the loan is not changed; \* \* \*"

1. ESSENTIALS OF THE TRANSFER OF A LOAN. - The first question presented in connection with this provision was whether a bank should be regarded as accepting the transfer of a loan if it makes a loan to a customer to enable him to reduce or retire existing indebtedness at another bank or to replace funds which the borrower has used to reduce or retire indebtedness at another bank.

A transaction such as that described should not be considered to be the accepting of the transfer of a loan pursuant to section 3(e). The provisions of section 3(e) apply only to a loan which is transferred by the process of payment by the transferee bank to the transferor bank against the receipt of the proper collateral,

and a transaction such as that described above does not come within the provisions of the section.

2. THE INDEBTEDNESS AND COLLATERAL TO BE TRANSFERRED.<sup>1</sup> Questions also were raised as to the indebtedness and the collateral to be transferred. In general, two different types of cases were presented in this connection, one relating to indebtedness incurred on or after May 1, 1936, and the other to indebtedness incurred prior to that date. Since no question was presented as to the requirements that might affect the transferor bank, the two types of cases were considered only with respect to the requirements that affect the transferee bank.

Loans made on or after May 1, 1936. The first type of case involved indebtedness that was for the purpose of purchasing or carrying stocks registered on a national securities exchange, that was not excepted from the regulation, and that was incurred on or after May 1, 1936. Although the transferor bank may have treated certain portions of this indebtedness as separate loans for certain purposes, the agreement between the customer and the bank was such that all the collateral for any of the described indebtedness secured all such indebtedness.

In this connection, it is to be noted that the second paragraph of section 1 of Regulation U provides:

"\* \* \* the entire indebtedness of any borrower to any bank incurred on or after May 1, 1936, for the purpose of purchasing or carrying stocks registered on a national securities exchange shall be considered a single loan; and all the collateral securing such indebtedness shall be considered in determining whether or not the loan complies with this regulation."

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<sup>1</sup>In view of Amendment No. 3 of Regulation U which eliminates the distinction between loans made on or after May 1, 1936, and loans made before that date, that portion of part 2 of this ruling which relates to loans made before May 1, 1936, will no longer be applicable after September 1, 1937, the effective date of Amendment No. 3. On and after this effective date, transfers of all loans should be treated as if the loan had been made after May 1, 1936.



In view of this provision, it is evident that the regulation contemplates that, in certain connections, the aggregate of the described indebtedness and all the collateral that secures the indebtedness should be considered a unit, regardless of whether or not the transferor bank may have treated a portion of such indebtedness as a separate loan and assigned particular collateral to that portion. It is clear that it would be permissible under section 3(e) for a transferee bank to accept the transfer of the aggregate of such indebtedness accompanied by the aggregate collateral, but there was presented the additional question of whether it is permissible under section 3(e) to accept the transfer of a portion of this aggregate indebtedness accompanied by a proportionate part of the aggregate collateral.

If a portion of the aggregate indebtedness is transferred to a bank and the transferred portion is accompanied by a corresponding portion of the collateral so that the ratio of the part of the indebtedness transferred to the part of the collateral transferred is the same as that of the aggregate indebtedness to the aggregate collateral, it may properly be considered that "the collateral for the loan is not changed" and the transferee bank may in accordance with section 3(e) of the regulation accept such a transfer "without following the requirements of this regulation as to the making of a loan".

Loans made before May 1, 1936. The other type of case involved indebtedness that was for the purposes of purchasing or carrying registered stocks, that was not excepted from the regulation, but that was incurred prior to May 1, 1936.

It will be noted that the provision of section 1 of the regulation quoted above with respect to the treatment of aggregate indebtedness and aggregate collateral as a unit does not apply to indebtedness incurred prior to May 1, 1936. In the case of such an old loan, therefore, identification of the loan and the collateral therefor, all or part of which are to be transferred, should be made on the basis of the practice which the transferor bank and the borrower have consistently followed in good faith in dealing with the loan. Any indebtedness which has been treated as constituting a single loan, and collateral which has been

treated as having loan value for the purposes of the loan and as not having loan value for other purposes, should be considered as a unit, and they should be so considered without regard to a customers' agreement under which collateral for one loan secures another.

Accordingly, if the entire amount of such an old loan thus identified is to be accepted by the transferee bank pursuant to section 3(e), it should be accompanied by all the collateral which, as indicated above, has been treated as having loan value for the purposes of the loan and as not having loan value for other purposes. Similarly, if a portion of such a loan is to be accepted by the transferee bank pursuant to section 3(e), it should be accompanied by a corresponding portion of the collateral so that the collateral will not be changed, i.e., the ratio of the part of the indebtedness transferred to the part of the collateral transferred is the same as that of the indebtedness originally treated as a single loan to the collateral treated as having loan value only for the purposes of such loan.

**3. DETERMINATION OF FACTS REGARDING TRANSFER OF LOAN.** A question was also presented as to the method which a transferee bank may use to determine whether or not the conditions necessary for the transfer of a loan pursuant to section 3(e) are being followed. Specifically, the question was raised whether the transferee bank may rely upon a signed statement of the borrower or the transferor bank which it accepts in good faith to determine these facts.

The Board pointed out that, as in the case of a number of other facts that are relevant to operations under the regulation, no specific method of determining these facts is required. The requirement is that the bank act diligently and in entire good faith, and in doing this it may utilize various methods for ascertaining the facts in particular cases. As one method of determining the facts in connection with the transfer of a loan, a transferee bank acting in good faith would be justified in relying upon a signed statement of the borrower or the transferor bank.

August 1937 Bulletin, p. 715. - Note: As indicated in the footnote to the ruling, a portion of the ruling was superseded by amendment No. 3, incorporated in the current reprint of the regulation.

Application of Regulation U to the Purchase of Debentures.

The Board recently considered the question whether the purchase of certain debentures by a national bank is subject to the Board's Regulation U, which relates to loans by banks for the purpose of purchasing or carrying stocks registered on a national securities exchange.

It appeared that the debentures in question were issued for the purpose of obtaining funds to acquire certain stocks which were registered on a national securities exchange. These stocks were pledged with a trustee that was to maintain the collateral for the debentures at a certain level, calling debentures for redemption and liquidating collateral as might be necessary for this purpose.

It seemed clear that the purpose of the issue of debentures was to purchase or carry stocks registered on a national securities exchange, but it was noted that Regulation U is expressed almost entirely in terms of "loans" instead of using the somewhat broader term of "extend credit" which appears in the provisions of section 7 of the Securities Exchange Act of 1934 under which the regulation is issued. This, of course, would not prevent the scope of the regulation from being broadened in this respect if such a change should appear to be advisable.

The information in the inquiry was not entirely clear as to the status of the debentures; but it was the view of the Board that, if the debentures complied with the requirements of section 5136 of the Revised Statutes and the regulations of the Comptroller of the Currency issued thereunder with respect to the purchase of investment securities, the purchase of the debentures, whether directly from the issuer or from some other source, would not be subject to the present provisions of Regulation U since the regulation is at present expressed in terms of loans. If the debentures were securities that failed to meet these requirements, the inability of the national bank to purchase the debentures would have prevented any question from arising in the present case as to the application of Regulation U.

The Board further stated that, if the facts are such that the debentures should not be considered to be

securities and thus would not be subject to section 5136, they should, of course, be treated as loans. The facts stated in the inquiry seemed to indicate that, if the debentures should be treated as loans, they would be loans subject to Regulation U.

August 1937 Bulletin, p. 716.

Application of Regulation U to a Loan to an Investment Trust to Retire Debentures.

The Board has considered a question as to whether Regulation U applies to a loan to a corporate investment trust on stocks to enable the investment trust to retire certain debenture bonds issued by it prior to the enactment of the Securities Exchange Act of 1934. It was understood that the debentures were originally issued to obtain funds for the usual operations of the investment trust which consist very largely of purchasing and carrying listed stocks.

Since the loan was to retire the debentures of the investment trust, it appeared not to be for the purpose of purchasing stocks registered on a national securities exchange and, therefore, the question was whether the loan was for the purpose of carrying such stocks.

It appeared from the nature of the loan that it was one for the purpose of carrying registered stocks unless some provision of the regulation removed it from that category. In this connection section 3(b) of the regulation provides:

"No loan, however it may be secured, need be treated as a loan for the purpose of 'carrying' a stock registered on a national securities exchange unless the purpose of the loan is to enable the borrower to reduce or retire indebtedness which was originally incurred to purchase such a stock, or, if he be a broker or dealer, to carry such stocks for customers."

It will be seen that section 3(b) was intended to exempt from the regulation loans which might otherwise be considered to be for the purpose of "carrying" registered stocks merely because they happen to be secured by such stocks. This was to afford banks more certainty in their operations under the regulation.

It was the view of the Board that the debentures in question constituted indebtedness within the meaning of section 3(b) and that the purpose of the loan must

be considered to be the retirement of these debentures rather than merely their purchase. It also was felt that in connection with matters of this kind the present status of the stocks should be considered and that, therefore, since the stocks in question had become registered after the passage of the Act, the debentures should be considered to be indebtedness originally incurred for the purchase of registered stocks within the meaning of section 3(b). Furthermore, the reference in the section to brokers and dealers indicates that the section was not intended to exempt loans which are closely connected with trading in registered stocks and emphasizes the fact that loans of the type under consideration do not come within the general purposes of the exemption contained in the section.

In view of these facts, the Board expressed the opinion that the loan in question was subject to the provisions of Regulation U.

August 1937 Bulletin, p. 717.

Applicability of Regulation U to Stock Registered After Loan is Made.

The Board recently considered an inquiry regarding the applicability of Regulation U, as amended to September 1, 1937, to a loan originally made for the purpose of purchasing or carrying a stock which was not then registered on a national securities exchange but which became registered subsequently.

The Board pointed out that the regulation is applicable, with certain exceptions, to any loan initially made for the purpose of purchasing or carrying a stock "registered on a national securities exchange," and stated that the phrase quoted has reference to the present status of the stock. Accordingly, a loan for the purpose of purchasing or carrying a particular stock is for the purpose of purchasing or carrying a registered stock if that particular stock is now registered, and this would be true even if the stock were not registered at the time the loan was originally made, as would be the case, for example, if the loan had been made prior to the enactment of the Securities Exchange Act of 1934.

October 1937 Bulletin, p. 995.