FEDERAL RESERVE BANK
OF DALLAS

Dallas, Texas, January 17, 1941

AMENDMENT TO REGULATION U

To All Banks in the
Eleventh Federal Reserve District:

The Board of Governors of the Federal Reserve System has adopted the attached amendment to its Regulation U.

There is appended hereto a statement which was issued by the Board in explanation of the purposes of this amendment.

Regulation U is being reprinted for the purpose of incorporating therein the new amendment. A copy of such reprint will be sent to all banks in this district as soon as practicable.

Member banks of the Federal Reserve System are requested to insert the attached amendment in their ring binders containing the regulations of the Board of Governors.

Additional copies of the amendment and explanatory statement will be furnished upon request.

Yours very truly,

R. R. GILBERT
President

BOARD OF GOVERNORS

OF THE FEDERAL RESERVE SYSTEM

AMENDMENT TO REGULATION U

Effective February 17, 1941

AMENDMENT NO. 4 TO REGULATION U

Effective February 17, 1941

Regulation U and the Supplement thereto are hereby amended in the following respects, and such amendment shall become effective February 17, 1941, but any bank may, at its option, conduct its operations in accordance with such amendment at any time prior to that date:

1. Section 3 of Regulation U is amended by adding the following subsections at the end thereof:

(m) Indebtedness "subject to section 1" is indebtedness which is secured directly or indirectly by any stock, is for the purpose of purchasing or carrying any stock registered on a national securities exchange, and is not excepted by section 2.

(n) In the case of any loan subject to section 1 to a broker or dealer in securities, and in the case of any such loan to any other borrower whose indebtedness the bank elects to treat for the purposes of this subsection as if it were that of a broker or dealer, the bank shall identify all the collateral used to meet the collateral requirements of section 1 and shall not cancel the identification of any part thereof except in circumstances that would permit the withdrawal of that part. Such identification may be made by any reasonable method.

In any such case—

(1) Only the collateral so identified shall have loan value for purposes of section 1 or be subject to the restrictions therein specified with respect to withdrawals and substitutions; and

(2) For any indebtedness of the same borrower that is not subject to section 1, other than a loan described in section 2 (d), (f), (g), or (h), the bank shall in good faith require as much collateral not so identified as the bank would require, if any, if it held neither the indebtedness subject to section 1 nor the identified collateral. This rule shall not be construed, however, to require the bank, after it has made any loan, to obtain any collateral therefor because of any decline in the value or quality of the collateral or in the credit rating of the borrower.

(o) This subsection applies to any case in which indebtedness of a broker or dealer that is subject to section 1 is secured by any securities which, according to written notice received by the bank from the broker or dealer pursuant to a rule of the Securities and Exchange Commission concerning the hypothecation of customers' securities (Rule X-8C-1 or Rule X-15C2-1), are securities carried for the account of one or more customers. For the purposes of this regulation—

(1) All such securities and all such indebtedness shall be considered separately from other collateral and indebtedness of the borrower;

(2) Only such securities shall have loan value for any such indebtedness; and

(3) All such indebtedness shall be considered a single loan and all such securities shall be considered in connection therewith, except that specified indebtedness, together with the securities treated by the bank as having loan value therefor, may be treated separately if such securities secure only such specified indebtedness and the borrower states in writing that they are carried for the account of a single customer.

2. The second paragraph of the Supplement to Regulation U is amended to read as follows:

Loans to brokers and dealers.—Notwithstanding the foregoing, a stock, if registered on a national securities exchange, shall have a special maximum loan value of 75 per cent of its current market value, as determined by any reasonable method, in the case of a loan to a broker or dealer from whom the bank (1) accepts in good faith a signed statement to the effect that he is subject to the provisions of Regulation T, or that he does not extend or maintain credit to or for customers except in accordance therewith as if he were subject thereto, and (2) receives written notice, pursuant to a rule of the Securities and Exchange Commission concerning the hypothecation of customers' securities by brokers or dealers (Rule X-8C-1 or Rule X-15C2-1), to the effect that the stock is a security carried for the account of a customer.

STATEMENT ISSUED BY THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

"Washington, D. C.

January 16, 1941

"The Board of Governors of the Federal Reserve System has adopted the attached amendment to Regulation U, 'Loans by Banks for the Purpose of Purchasing or Carrying Stocks Registered on a National Securities Exchange.'

"The amendment, which becomes effective February 17, 1941, is essentially technical. Its principal purpose is to reconcile provisions of Regulation U with rules recently issued by the Securities and Exchange Commission with respect to the hypothecation by brokers or dealers of securities carried by them for the account of customers (Rule X-8C-1 and Rule X-15C2-1), which become effective on February 17, 1941.

"These SEC rules, in order to safeguard the rights of customers in their securities, provide among other things that when a broker or dealer borrows on any customers' securities he must not commingle them with his own under the same pledge. The amendment to Regulation U takes account of this requirement by providing, in effect, that any indebtedness of a broker or dealer that is secured by customers' securities shall be treated separately from any of his other indebtedness. There are provisions, however, both in the SEC rules and in Regulation U, which permit an agreement between the borrower and the lender by which securities belonging to the broker or dealer himself may be used as supplementary collateral for a loan secured by securities of his customers.

"In addition to making changes necessitated by the SEC rules, the amendment to Regulation U provides for a simple mechanism by which collateral that is used to meet the requirements of Regulation U may be earmarked and distinguished from other collateral which, even though it secures a loan subject to the regulation, is not used for the purpose of meeting those requirements. This will simplify operations under the regulation, especially in cases involving loans to a broker and dealer in securities who has at the bank both a loan that is subject to the Board's margin requirements and a loan that is not subject to these requirements. In connection with this mechanism, collateral which must be used to meet the Board's margin requirements for certain loans to brokers and dealers may be used for other purposes only to a limited extent. In particular, it may not be used to enable the borrower to obtain on the basis of the same collateral both a loan subject to the Board's margin requirements and a loan not subject thereto. This restriction, however, does not apply to the use of collateral for purposes of maintaining both loans, provided both loans have been properly made in the first place. One effect of the amendment will be to enable banks which must revise any of their loan agreements with brokers or dealers as a consequence of the SEC rules to do so with a minimum of inconvenience. The amendment does not require any bank to reduce any loan, to obtain additional collateral for any loan, or to call any outstanding loan because of insufficient collateral."