FEDERAL RESERVE BANK OF DALLAS
DALLAS, TEXAS

August 12, 1957

To All State Member Banks:

There is enclosed a copy of regulations recently issued by the Comptroller of the Currency pertaining to Investment Securities and to National Bank Loans Secured by Direct Obligations of the United States. A copy of the Comptroller's letter of July 23, 1957, which accompanied these regulations when they were sent to all national banks, is also enclosed.

This information is being forwarded to you since sections 9 and 11(m) of the Federal Reserve Act make these regulations applicable to State banks which are members of the Federal Reserve System.

Yours very truly,

Watrous H. Irons
President

This publication was digitized and made available by the Federal Reserve Bank of Dallas' Historical Library (FedHistory@dal.frb.org)

TREASURY DEPARTMENT
COMPTROLLER OF THE CURRENCY
WASHINGTON 25

ADDRESS REPLY TO
"COMPTROLLER OF THE CURRENCY"

July 23, 1957

TO ALL NATIONAL BANKS:

We are enclosing for your information copies of (1) the Investment Securities Regulation, as amended, and (2) a new regulation covering Loans Made by National Banks Secured by Direct Obligations of the United States. The two regulations were published in the Federal Register on July 17, 1957, and will become effective August 16, 1957.

The Investment Securities Regulation is issued by the Comptroller of the Currency under the authority contained in paragraph Seventh of section 5136 of the Revised Statutes (12 U.S.C. 24) and the purpose of this regulation is to prescribe the limitations and restrictions under which national banks, as well as State member banks of the Federal Reserve System, may purchase investment securities for their own account and to define the term "investment securities."

Under the existing regulation there has been doubt as to the eligibility of certain small issues of special revenue obligations because of the present distribution requirements set forth in paragraphs (a) and (b) of section 1. The new regulation clarifies the position that has been taken by the Comptroller with respect to the eligibility of small issues of special revenue obligations. While the distribution standards as stated in paragraphs (a) and (b) of section 1 of the present regulation and paragraphs (1) and (2) of section 2 of the new regulation may not be met by some small special revenue issues, it is recognized that many of such issues possess a high degree of credit soundness which assures marketability to the point contemplated by section 5136 of the Revised Statutes.

The restrictions in the present regulation governing the purchase or sale of securities by banks under repurchase or resale agreements are no longer considered desirable because of the basic nature of such transactions and are deleted from the new regulation. Experience has shown that repurchase or resale transactions in securities are used for the lending and borrowing of money. They will henceforth be treated as loan or borrowing transactions governed by sections 5200 and 5202 of the Revised Statutes (12 U.S.C. 84, 82) and not by section 5136 of the Revised Statutes (12 U.S.C. 24). This means that a bank selling securities under an agreement to repurchase them at a future date will be borrowing funds from the purchasing bank and section 5202 provides that national banks may not borrow an amount in excess of their capital stock except from a Federal Reserve Bank or as permitted under other exceptions to section 5202. The purchasing bank will be lending funds to the selling bank and, if direct obligations of the United States are involved, national banks, under the provisions of a new regulation discussed below, may lend up to 100% of their capital and surplus accounts on the basis of such security provided the amount of the loan in excess of 25% of capital and surplus is secured by direct obligations of the United States having maturities not exceeding 18 months.

The restrictions in the present regulation governing the amortization of premiums paid on investment securities are being amended in the new regulation to permit amortization to the maturity date rather than the call date of the issue, if Federal Internal Revenue Laws and regulations issued thereunder disallow amortization deductions from gross income when computed to the nearest call date. Also

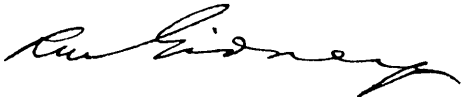
amendments are being provided in the new regulation to clarify the section pertaining to securities convertible into stock. It has also been deemed advisable to incorporate into the new regulation a provision carrying out the present administrative practice which requires that investment securities owned by a bank be supported by adequate information in the files of the bank as to their investment quality.

The new regulation, "Loans Made by National Banks Secured by Direct Obligations of the United States", issued by the Comptroller, with the approval of the Secretary of the Treasury, under the authority contained in paragraph (8) of section 5200 of the Revised Statutes, as amended, prescribes conditions under which national banks may make loans to one borrower in excess of 25% of capital and surplus, and up to 100% of capital and surplus when such loans made in excess of 25% of capital and surplus are secured by direct obligations of the United States which will mature in not exceeding 18 months.

Under the terms of paragraph (8) of section 5200 of the Revised Statutes, national banks may lend to a single borrower an additional 15% of capital and surplus (in addition to the customary 10% limitation) on obligations secured by not less than a like amount of bonds or notes of the United States, certificates of indebtedness of the United States, Treasury Bills of the United States, or obligations fully guaranteed both as to principal and interest by the United States. Because of the amendments being made in the Investment Securities Regulation which will place resale and repurchase transactions in bonds under sections 5200 and 5202 of the Revised Statutes (12 U.S.C. 84, 82) rather than section 5136 of the Revised Statutes (12 U.S.C. 24), the present 25% limitation embodied in section 5200 is believed to be too restrictive with respect to loans to one borrower which are secured by not less than a like amount of direct obligations of the United States. Under the provisions of section 5136, repurchase and resale transactions involving United States Bonds have not been subject to any limitation measured by capital and surplus. The issuance of this regulation is necessary to implement the making of such loans above 25% and up to 100% of the bank's capital and surplus, provided they are secured by direct obligations of the United States which will mature within 18 months.

As stated above, the two regulations become effective August 16, 1957. It was not possible to include the regulations in the 1957 Supplement to the Digest of Opinions which has now been distributed to national banks. We will issue an investment securities Supplement to the Digest in approximately 30 days, which will include the new regulations and appropriate comments relating thereto in the paragraphs of the Digest dealing with the subject matter of the regulations.

Very truly yours,



Comptroller of the Currency.

Enclosures

TREASURY DEPARTMENT

COMPTROLLER OF THE CURRENCY

WASHINGTON

INVESTMENT SECURITIES REGULATION

SECTION 1 — SCOPE AND APPLICATION.

(a) This regulation is issued by the Comptroller of the Currency under authority of paragraph Seventh of Section 5136 of the Revised Statutes, as amended (12 U.S.C. 24);

(b) This regulation applies to the purchase for its own account of investment securities by a national bank or a State member bank of the Federal Reserve System.

SECTION 2 — DEFINITION OF THE TERM "INVESTMENT SECURITIES".

(a) An obligation of indebtedness which may be purchased for its own account by a national bank or State member bank of the Federal Reserve System in order to constitute an "investment security" within the meaning of paragraph Seventh of Section 5136 of the Revised Statutes, must be a marketable obligation, i.e., it must be salable under ordinary circumstances with reasonable promptness at a fair value; and except as provided in (b) and (c) below, there must be present one or both of the following characteristics:

(1) A public distribution of the securities must have been provided for or made in a manner to protect or insure the marketability of the issue; or,

(2) Other existing securities of the obligor must have such a public distribution as to protect or insure the marketability of the issue under consideration.

(b) In the case of investment securities for which a public distribution as set forth in (1) or (2) above cannot be so provided, or so made, and which are issued by established commercial or industrial businesses or enterprises, that can demonstrate the ability to service such securities, the debt evidenced thereby must mature not later than ten years after the date of issuance of the security and must be of such sound value or so secured as reasonably to assure its payment; and such securities must, by their terms, provide for the amortization of the debt evidenced thereby so that at least 75% of the principal will be extinguished by the maturity date by substantial periodic payments: Provided, that no amortization need be required for the period of the first year after the date of issuance of such securities.

(c) Special revenue obligations of States or local governments or of duly constituted public Authorities thereof which possess a high degree of credit soundness, so as to assure sale under ordinary circumstances with reasonable promptness at a fair value, but which do not meet the distribution standards of (a) (1) or (a) (2) above, may be considered to constitute "investment securities."

(d) Where the security is issued under a trust agreement, the agreement must provide for a trustee independent of the obligor, and such trustee must be a bank or trust company.

(e) All purchases of investment securities by national and State member banks for their own account must be securities "in the form of bonds, notes, and/or debentures, commonly known as investment securities"; and every transaction which is in fact such a purchase must, regardless of its form, comply with this regulation.

SECTION 3 — LIMITATIONS AND RESTRICTIONS ON PURCHASE OF INVESTMENT SECURITIES FOR BANK'S OWN ACCOUNT.

(a) Although the bank is permitted to purchase "investment securities" for its own account for purposes of investment under the provisions of R. S. 5136 and this regulation, the bank is not permitted otherwise to participate as a principal in the marketing of securities.

(b) The statutory limitation on the amount of the "investment securities" of any one obligor or maker which may be held by the bank is to be determined on the basis of the par or face value of the securities, and not on their market value.

(c) The purchase of "investment securities" in which the investment characteristics are distinctly or predominantly speculative, or the purchase of securities which are in default, whether as to principal or interest, is prohibited.

(d) Purchase of an investment security at a price exceeding par or face value is prohibited, unless the bank shall:

(1) Provide for the regular amortization of the premium paid so that the premium shall be entirely extinguished at or before the maturity of the security, and the security (including premium) shall at no intervening date be carried at an amount in excess of that at which the obligor may legally redeem such security, unless the amortization which would be necessary to meet the latter requirement would not be allowable as a deduction from gross income under applicable Federal Internal Revenue laws and regulations issued thereunder, in which case the rate of amortization shall be sufficient to extinguish the premium by maturity; or

(2) Set up a reserve account to amortize the premium, said account to be credited periodically with an amount not less than the amount required for amortization under (1) above.

(e) Purchase of securities convertible into stock at the option of the issuer is prohibited.

(f) Purchase of securities convertible into stock at the option of the holder or with stock purchase warrants attached is prohibited if the price paid for such security is in excess of the investment value of the security itself, considered independently of the stock purchase warrants or conversion feature. If it is apparent that the price paid for an otherwise eligible security reflects the investment value of the security and does not include any speculative value based upon the presence of a stock purchase warrant or conversion option, the purchase of such security is not prohibited. If the price paid for a convertible security provides a yield reasonably similar to that of non-convertible securities of similar quality and maturity, a speculative value will not be deemed to exist.

(g) All investment securities shall be supported by adequate information in the files of the bank as to their investment quality.

SECTION 4 — EXCEPTION TO LIMITATIONS AND RESTRICTIONS.

The restrictions and limitations of this regulation do not apply to securities acquired through foreclosure on collateral, or acquired in good faith by way of compromise of a doubtful claim or to avert an apprehended loss in connection with a debt previously contracted, or to real estate securities acquired pursuant to Section 24 of the Federal Reserve Act, as amended.

SECTION 5 — EFFECTIVE DATE.

This regulation is effective August 16, 1957.

RAY M. GIDNEY
Comptroller of the Currency

TREASURY DEPARTMENT

COMPTROLLER OF THE CURRENCY

WASHINGTON

REGULATION REGARDING NATIONAL BANK LOANS SECURED BY DIRECT OBLIGATIONS OF THE UNITED STATES

Section 5200 U.S.R.S. (12 U.S.C. 84) provides as follows:

"Sec. 5200. The total obligations to any national banking association of any person, copartnership, association, or corporation shall at no time exceed 10 per centum of the amount of the capital stock of such association actually paid in and unimpaired and 10 per centum of its unimpaired surplus fund. The term 'obligations' shall mean the direct liability of the maker or acceptor of paper discounted with or sold to such association and the liability of the indorser, drawer, or guarantor who obtains a loan from or discounts paper with or sells paper under his guaranty to such association and shall include in the case of obligations of a copartnership or association the obligations of the several members thereof and shall include in the case of obligations of a corporation all obligations of all subsidiaries thereof in which such corporation owns or controls a majority interest. Such limitation of 10 per centum shall be subject to the following exceptions:

* * * * *

"(8) Obligations of any person, copartnership, association, or corporation in the form of notes secured by not less than a like amount of bonds or notes of the United States issued since April 24, 1917, or certificates of indebtedness of the United States, Treasury bills of the United States, or obligations fully guaranteed both as to principal and interest by the United States, shall (except to the extent permitted by rules and regulations prescribed by the Comptroller of the Currency, with the approval of the Secretary of the Treasury) be subject under this section to a limitation of 15 per centum of such capital and surplus in addition to such 10 per centum of such capital and surplus."

SECTION 1 — SCOPE AND APPLICATION.

(a) This regulation is issued by the Comptroller of the Currency with the approval of the Secretary of the Treasury under authority of paragraph (8) of section 5200 of the Revised Statutes, as amended (12 U.S.C. 84), and section 321 (b) of the Act of August 23, 1935 (49 Stat. 713);

(b) This regulation applies to loans made by national banks secured by direct obligations of the United States which will mature in not exceeding 18 months.

SECTION 2 — GENERAL AUTHORIZATION.

The obligations to any national banking association in the form of notes of any person, copartnership, association, or corporation, secured by not less than a like amount of direct obligations of the United States which will mature in not exceeding eighteen months from the date such obligations to such national banking association are entered into shall be limited to 75 per centum of the capital and surplus of such association in addition to the 10 per centum of such capital and surplus prescribed in the opening paragraph of said section 5200 and the 15 per centum limitation referred to in paragraph (8) of section 5200.

SECTION 3 — EFFECTIVE DATE.

This regulation is effective August 16, 1957.

RAY M. GIDNEY
Comptroller of the Currency

Approved:

GEORGE M. HUMPHREY
Secretary of the Treasury