A meeting of the Board of Governors of the Federal Reserve System was held in Washington on Wednesday, April 22, 1936, at 10:00 a.m.

PRESENT: Mr. Broderick
Mr. Szymczak
Mr. McKee
Mr. Ransom

Mr. Morrill, Secretary
Mr. Bethea, Assistant Secretary
Mr. Carpenter, Assistant Secretary
Mr. Clayton, Assistant to the Chairman
Mr. Thurston, Special Assistant to the Chairman
Mr. Wyatt, General Counsel
Mr. Smead, Chief of the Division of Bank Operations
Mr. Paulger, Chief of the Division of Examinations
Mr. Parry, Chief of the Division of Security Loans
Mr. Bradley, Assistant Chief of the Division of Security Loans
Mr. Dreibelbis, Assistant General Counsel
Mr. Benedict, Assistant Counsel
Mr. Thomas, Assistant Chief of the Division of Research and Statistics
Mr. Sloan, Federal Reserve Examiner
Mr. Dembitz, Research Assistant, Division of Security Loans

ALSO PRESENT: Mr. L. S. Brady, Vice President, Bankers Trust Company, New York, New York.
Mr. R. E. Broome, Vice President, Guaranty Trust Company of New York, New York, New York.
Mr. J. L. Harrison, Vice President, The National City Bank of New York, New York, New York.
Mr. H. G. Hoskinson, Vice President, Riggs National Bank, Washington, D. C.
Mr. Walter L. Johnson, Member of the brokerage firm of Shearson, Hammill & Company, New York, New York.
Mr. W. W. Lancaster, of the firm of Shearman & Sterling, Counsel for The National City Bank of New York, New York, New York.
Mr. C. H. Willard, of the firm of Davis Polk Wardwell Gardiner & Reed, Counsel for the Guaranty Trust Company of New York, New York, New York.
Mr. Norman Davis, Representative from the Federal Reserve Agent's Department at the Federal Reserve Bank of New York.
Mr. Broome referred to the memorandum prepared by the subcommittee of the American Bankers Association appointed to confer with the Board on Regulation "U" and suggested that the memorandum be read. This procedure was agreed to and Mr. Broderick requested Mr. Parry to direct the discussion.

Mr. Broome read the first part of the memorandum which stated that counsel had advised that the provisions contained in section 1 of Regulation "U" may bring the collateral securing certain types of loans not intended to be covered by the regulation within the scope thereof because of the existence of general loan or liability agreements which are in practically universal use by the banks. The memorandum requested that, in order to meet this situation, the Board amend section 1 of Regulation "U" by adding thereto a new paragraph which would provide that, for the purposes of the regulation, no loan shall be deemed to be secured directly or indirectly by stock merely by reason of any loan or liability agreement creating a general lien, nor shall any lien created by such agreement require any securities to be considered as collateral for any specific loan.

Mr. Parry stated that the suggested amendment was too broad and he pointed out how it would permit evasion of the regulation. Mr. Broome stated that since the submission of the subcommittee's memorandum they had given further consideration to the matter and he read a suggested substitute amendment to subsection 3(f) of the regulation which the subcommittee felt would meet the objection raised by Mr. Parry and
which would provide that, without prejudice to the legal effect of any 
general lien created by any loan agreement or otherwise, for the purpose 
of the regulation a particular loan shall not be treated as collateral-
ized by securities which were held by the bank only in the capacity of 
custodian, depositary or trustee, or held as collateral to loans which 
are not for the purpose described in section 1 of the regulation or 
which are excepted from the provisions of the regulation by section 2 
thereof, or which were made prior to May 1, 1936, if in the making or 
maintenance of the particular loan the bank acting in good faith had 
not specifically allocated such collateral to such loan.

The substitute amendment was discussed 
and it was understood that consideration 
would be given thereto by the Board.

Mr. Broome then read the second part of the memorandum prepared 
by the subcommittee which discussed two problems presented by the pro-
vision of the supplement to Regulation "U" that a stock registered on 
a national securities exchange shall have a special maximum loan value 
of 60% 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 
accepts in good faith a signed statement to the effect that the securi-
ties hypothecated to secure the loan are securities carried for the 
account of his customers other than his partners. The memorandum stated 
that counsel, after a study of the authorities, had advised that such 
a statement might very materially impair the rights of a bank as pledgee 
of the securities and might expose the bank to liability for damages
in cases where the broker or dealer did not have authority to pledge the securities in question. In this connection it was stated that heretofore the banks had not been on legal notice that the securities pledged might be customers' securities and that, therefore, they could not be charged with notice that the broker might not have authority to pledge the securities.

This problem was discussed on the basis of questions put by Mr. Parry which brought out the facts that it is the usual practice of members of securities exchanges to obtain agreements from their customers authorizing the rehypothecation of customers' securities and that the possibility of impairment of the rights of a lending bank could arise only in the event the broker became insolvent or was otherwise in straitened financial circumstances.

The second point raised by the memorandum with regard to the limitation of 60% on the loan value of rehypothecated securities was that the limitation would result in brokers being placed under the necessity of having to establish maintenance margins; that this would seriously interfere with the brokerage business; and that it was contrary to the Policy of Regulations "T" and "U" of not requiring maintenance margins. The memorandum suggested that, inasmuch as loans by brokers to finance their customers are amply controlled by Regulation "T", loans to brokers and dealers be exempted from Regulation "U". In accordance with this suggestion the memorandum requested that the supplement to the regulation be amended by eliminating the second paragraph thereof and that
section 2 of the regulation be amended by adding a new subsection which would exempt from the regulation any loan to a broker or dealer who is subject to the provisions of Regulation "T" or who does not extend or maintain credit to or for customers except in accordance therewith as if he were subject thereto.

Mr. Parry pointed out that the suggested amendment would remove from the regulation any restriction on loans by banks to brokers or dealers for the purpose of purchasing or carrying securities for their own account and he inquired if the subcommittee had any suggestion to offer which would meet that point. Mr. Broome answered this question in the negative.

Mr. Robert V. Fleming, President of the American Bankers Association joined the meeting for a short period during the discussion of this point.

Mr. Wyatt stated that his office had looked into the question of the possible impairment of the rights of a lending bank by the bank being placed on legal notice that the securities pledged by a broker or dealer were securities carried for the account of customers and stated that he was not impressed that the bank's position would be substantially impaired by such notice. In this connection, he suggested that the Board be furnished with copies of any opinions submitted to the subcommittee by counsel in order that they may be studied in connection with the further consideration of the matter. Mr. Broome stated that no written opinions had been submitted by counsel on this matter.
Mr. Harrison inquired whether the Board would consider the possibility of postponing the effective date of Regulation "U" in order to afford the banks additional time to work out an operating procedure and to institute the necessary methods and new forms to enable them to comply with the regulation. He stated that the banks would not be able to accomplish much in this direction until the questions discussed at this meeting had been definitely settled.

Mr. Davis asked whether the banks anticipated that after the new procedure was in effect at the banks, the regulation would result in increased clerical work because of increased amounts of collateral held, an increase in the number of substitutions of collateral, or for other reasons. The members of the subcommittee expressed the opinion that the regulation would increase considerably the amount of collateral held and that, if the volume of loans on securities by banks increased, compliance with the provisions of the regulation would result in considerable additional clerical work.

Upon inquiry, Mr. Broome stated that it was believed that the banks would be in a position to comply with the provisions of the regulation by May 1 if the Board would reach a decision promptly on the points raised in the memorandum submitted by the subcommittee.

Mr. Parry stated that the questions presented would be considered by the staff and, if possible, submitted to the Board tomorrow for action.

Mr. L. H. Johnston inquired whether a loan which had been made
Prior to May 1, 1936, for the purpose of purchasing or carrying registered stocks would maintain its exempt status if transferred from one bank to another after that date. Upon inquiry from Mr. Parry, Mr. Davis stated that this question had been raised with the Federal Reserve Bank of New York and that the bank had addressed a communication to the Board requesting a ruling thereon.

The question was discussed briefly and it was understood that the Board would consider it in due course and issue a ruling thereon.

Thereupon the meeting adjourned.

Approved:

Member.

Secretary.