A meeting of the Board of Governors of the Federal Reserve System was held in Washington on Wednesday, May 20, 1936, at 11:00 a. m.

PRESENT: Mr. Eccles, Chairman
Mr. Broderick
Mr. Szymczak

Mr. Morrill, Secretary
Mr. Bethea, Assistant Secretary
Mr. Carpenter, Assistant Secretary
Mr. Clayton, Assistant to the Chairman

Consideration was given to each of the matters hereinafter referred to and the action stated with respect thereto was taken by the Board:

Telegrams to Mr. Austin, Chairman of the Federal Reserve Bank of Philadelphia, Mr. Stewart, Secretary of the Federal Reserve Bank of St. Louis, and Mr. Thomas, Chairman of the Federal Reserve Bank of Kansas City, stating that the Board approves the establishment without change by the respective banks today of the rates of discount and purchase in their existing schedules.

Approved unanimously.

Letter to Mr. Frank J. Drinnen, Federal Reserve Examiner, reading as follows:

"Receipt is acknowledged of your letter of May 18, in which you tender your resignation as Federal Reserve Examiner, to be effective as of the close of May 31, 1936, in view of your appointment as First Vice President of the Federal Reserve Bank of Philadelphia, effective June 1, 1936.

"The Board accepts your resignation as tendered and wishes you every success in your new work."

Approved unanimously.

Telegram to Mr. Francis G. Fetzer, Secretary-Treasurer, International Longshoremens Association Local 38-82, San Pedro, California, reading as follows:

"Reference your telegram May 18, 1936, requesting decision of Board upon question whether deposit of labor union may be classified by member bank as savings deposit. Section 1(e) of Board's Regulation Q provides that deposit of corporation, association, or other organization may not be classified as savings deposit unless organization is not operated for profit and, in addition, is operated primarily for religious, philanthropic, charitable, educational, fraternal or other similar purposes. Without regard to question whether or not labor unions are operated for profit, it is view of Board that they may not properly be considered as organizations operated primarily for above purposes within meaning of section 1(e) of Regulation Q. Accordingly, deposits of labor unions may not be classified by member banks as savings deposits. Funds of labor unions may, however, be placed in interest-bearing time deposits in member banks, under provisions of Regulation Q."

Approved unanimously.

Letter to Mr. Clark, Assistant Federal Reserve Agent at the Federal Reserve Bank of Atlanta, reading as follows:

"Reference is made to your letter of April 14 to Governor Ransom, enclosing a memorandum on the subject of Regulation U prepared by Mr. Clyde Williams, Vice President, First National Bank of Atlanta, and to the copy of Mr. Parker's letter to Mr. Williams of April 21 which was forwarded to the Board.

"The statements made and the questions asked in the memorandum appear to relate to matters upon which you may receive further inquiries, and for this reason they will be discussed somewhat fully. They will be treated in the order in which they appear in the memorandum.

"A-1. Stocks which are not registered on a national securities exchange have a maximum loan value of 45 percent when serving as collateral for a regulated loan, even in the case of a loan to a broker made in accordance with the second paragraph of the supplement to Regulation U. It is only registered stocks that have, in this case, a loan value of 60 percent.

"A-2. The Board does not feel that it should attempt to approve or disapprove, at the present time at least, the forms which banks may employ in complying with the provisions of Regulation U. To do so in any particular instance might have the result that requests for approval of many forms would be made of the Board by many banks. In this connection it should be pointed out that such certificates are not required by the regulation but the bank is permitted to rely upon them <u>if</u> it obtains them in good faith.

"A-3. It may be noted that neither 'Certificate "A"' nor 'Certificate "B"' attached to the memorandum relates to loans which are excepted by the provisions of section 2 of Regulation U. It is not, therefore, correct to say that a 'loan which is not accompanied by either certificate must not be in excess of 45 percent of the market value of the stocks offered as collateral.'

"A-4. A loan of the following description comes within the provisions of section 2(f) of Regulation U:

> "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.

"If Mr. Williams has in mind a case differing from that described above, it is suggested that he address a new question to you, giving you the facts of his case.

"A-5. It is suggested that in order to assist the Board in answering this question, which relates to the interpretation of section 2(c) of Regulation U, you ask Mr. Williams to give you a specific case, describing in some detail the exact nature of the operation which the bank is being asked to finance.

"B-1. If a given loan is not 'for the purpose of purchasing or carrying a stock registered on a national securities exchange', a bank may make the loan without being required to obtain the margin prescribed by Regulation U. Withdrawals and substitutions of collateral securing any such loan are not subject to the regulation unless the collateral secures also a loan for the purpose specified in section 1 of the regulation.

"B-2. The question which the memorandum seeks to answer is not altogether clear. If this question is how a loan which is made after May 1 for the purpose of purchasing or carrying registered stocks, but which is unsecured, shall be treated in the event that the bank makes, or has made, another loan to the same borrower after May 1 for the same purpose secured by a stock, the answer is as follows:

> "If a bank has outstanding to a borrower no loan whatever which is secured directly or indirectly by any stock, any loan by the bank to such borrower, even if the purpose of the loan be to purchase or carry registered stocks, is not subject

"to the regulation, if it is itself not secured by any stock. If, however, a bank has outstanding a loan to a borrower which, by reason of its purpose and its collateral, is subject to Regulation U, the bank may not make to the borrower any additional loan secured, under a general loan agreement, by stock securing the first loan or by other stock and for the purpose of purchasing or carrying registered stock unless the bank obtains the margin on the additional loan required by the regulation.

"If a bank has outstanding a loan to a borrower which is unsecured or which is not secured by any stock, and is, therefore, not subject to Regulation U, it may make a second loan which is subject to the regulation, without regard to the status of the first loan, i.e., if the bank obtains additional collateral with a maximum loan value at least equal to the amount of the second loan. Thereafter, however, if the bank permits withdrawals or substitutions of collateral for either loan, it is obliged to ascertain the purpose of the first loan. If the first loan was for the purpose of purchasing or carrying registered stocks, the two loans must be treated as a single loan, and all the collateral securing both loans must be considered in determining whether or not the contemplated withdrawals or substitutions may be made.

"B-3. 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. This general rule is subject, however, to one 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.

"B-4. The term 'stock' as used in section 3(1) of Regulation U does not include any bond, even a bond convertible into stock, or a bond carrying stock purchase warrants."

Approved unanimously.

Letter to Mr. Wheeler, Assistant Federal Reserve Agent at the Federal Reserve Bank of San Francisco, reading as follows:

"This refers to your letter of May 11, 1936, containing questions submitted to you by the Seattle-First National Bank regarding the effect on the bank's operations under Regulation U of its 'general pledge agreement' enclosed with your letter.

"Before answering the specific questions relating to this general loan agreement it may be pointed out that in the preparation of Regulation U consideration was given to the fact that most banks use a general loan agreement of this type. Although no attempt will be made in this letter to construe the legal effect of the enclosed agreement in the State of Washington, it will be assumed that it will have an effect similar to general loan agreements which have been considered and which subject to the lien of each existing or future loan of the bank to a given borrower all collateral or property of that borrower in the possession of the bank.

"You first ask whether the pledge resulting from such a general loan agreement of all property in the possession of the bank as security for all the borrower's indebtedness prevents the separate allocation under Regulation U of certain collateral to loans subject to the regulation and of other collateral to loans not subject to the regulation. Regulation U is not intended to prevent a borrower from pledging specifically securities or other collateral for a particular loan or to prevent a bank from allocating definite collateral to such a loan. However, if a general loan agreement be in effect by which collateral securing each loan also secures all other loans, the loan value of collateral specifically pledged for or allocated to loans not subject to the regulation may be considered as a basis for making or increasing loans subject to the regulation. Further, in determining whether collateral specifically pledged or allocated to loans not subject to the regulation may be withdrawn, the bank must combine the collateral for all loans. The bank may not in this case permit withdrawal of such an amount of collateral as will cause the maximum loan value of the remainder to be less than the amount of the loans subject to the regulation.

"In answer to your second question, it follows from the foregoing that such a general loan agreement permits the use of collateral previously allocated to loans not subject to the regulation in computing the maximum loan value for the purpose of making a loan subject to the regulation. In this connection, it is recognized that resort to this practice would tend to nullify the regulation and that evidence of extensive use of the practice would give the Board reason to consider tightening the regulation.

"Your last question is whether specific inclusion under the lien of a general loan agreement of all property deposited for safekeeping by the borrower conclusively indicates that securities in safekeeping are relied upon, so that under section 3(f)

"of Regulation U a bank must treat a loan as collateralled by such securities. Although subjection to the lien in such a case may not conclusively establish the reliance referred to in section 3(f), it will raise a presumption that the bank must have relied upon the securities in safekeeping. This might be overcome, however, by clear evidence to the contrary in the records of the bank or elsewhere.

"The Bulletin of the Irving Trust Company referred to by you represents, it is understood, the construction by that bank of Regulation U. The statements therein will be treated, it is believed, as a reasonable interpretation made in good faith by a member bank. This letter, however, will not attempt to approve or disapprove the construction quoted by you from that Bulletin, as the Board does not feel that it should, at least for the present, pass upon any documents published or used by member banks in connection with Regulation U. To do so in a particular case might result in requests from many banks for approval of their forms."

Approved unanimously.

Thereupon the meeting adjourned.

Chester Morrill
Secretary.

Approved:

M S Eccles
Chairman.