A meeting of the Board of Governors of the Federal Reserve System was held in Washington on Saturday, October 26, 1940, at 11:30 a.m.

PRESENT: Mr. Eccles, Chairman
Mr. McKee
Mr. Davis
Mr. Draper

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

The action stated with respect to each of the matters hereinafter referred to was taken by the Board:

The minutes of the meeting of the Board of Governors of the Federal Reserve System held on October 25, 1940, were approved unanimously.

Memorandum dated October 24, 1940, from Mr. Parry, Chief of the Division of Security Loans, recommending for the reason stated in the memorandum, that the salary of Catherine A. Hall, economic assistant, be increased from $2,100 to $2,200 per annum, effective November 1, 1940.

Approved unanimously.

Memorandum dated October 24, 1940, from Mr. Parry, Chief of the Division of Security Loans, recommending, for the reasons stated in the memorandum, that the salary of Otto H. Branic, messenger, be increased from $1,260 to $1,320 per annum, effective November 1, 1940.

Approved unanimously.

Memorandum dated October 24, 1940, from Messrs. Goldenweiser, Thurston, and Hammond, the committee appointed by the Board on February 21, 1940, to review and make suggestions with regard to the Banking Studies of 1940, recommending that, for the reason stated in the memorandum, the temporary appointment of Miss Marie Butler (Mrs. Maurice Leven) as an editorial assistant in the Correspondence and Publications Section of the Secretary's Office, be extended for an additional period of not to exceed three months from November 15, 1940, with no change in her present salary at the rate of $400 per month.

Approved unanimously.

Letter to Mr. Fleming, President of the Federal Reserve Bank of Cleveland, reading as follows:

> "In accordance with the request contained in your letter of October 22, the Board approves the appointment of G. D. Lippert as an examiner for the Federal Reserve Bank of Cleveland. Please advise us of the effective date."

Approved unanimously.

Letter to Mr. Upham, Deputy Comptroller of the Currency, reading as follows:

> "This refers to your letter of October 14, 1940, regarding the classification as savings accounts of certain accounts carried by the Condon National Bank, Coffeyville, Kansas.
>
> "It is understood that the accounts in question represent funds set aside by the Columbia Drug Company for depreciation and reserve in connection with fixtures and payments of taxes; and that the drug company is a partnership of C. W. Evans-Lombe and R. G. Evans-Lombe,

"organized for profit, in connection with the operation of two retail drug stores. It is noted that two of the accounts are carried by the bank in the name of the Columbia Drug Store and two in the name of C. W. Evans-Lombe and R. G. Evans-Lombe as joint personal accounts, although deposits and withdrawals in connection with such joint personal accounts are made in the name of the 'Columbia Drug Store'.

"As indicated in footnote 4 of the Board's Regulation Q, deposits in joint accounts of two or more individuals may properly be classified as savings deposits, although deposits of a partnership operated for profit may not be so classified. In the present case, the practices followed by the bank as stated above indicate that the accounts carried in the name of C. W. Evans-Lombe and R. G. Evans-Lombe as joint personal accounts are actually the accounts of a partnership operated for profit. Accordingly, it is the view of the Board that these accounts, as well as the accounts carried in the name of the Columbia Drug Store, may not properly be classified as savings deposits and that, therefore, they are carried by the bank in contravention of the provisions of Regulation Q. There is nothing in the law or regulations, however, which would prevent the accounts in question from being transferred to an interest-bearing time deposit basis."

Approved unanimously.

Letter to the Presidents of all Federal Reserve Banks, reading as follows:

"There is attached a copy of a ruling which will be published in the Federal Reserve Bulletin regarding '"Cash on Delivery" Transactions Under Regulation T'.

"It will be noted that the attached ruling is in the form of a statement for the press which, however, is not to be released until the time specified on the statement."

The statement for the press referred to in the letter read as follows:

"The following ruling will appear in the Federal Reserve Bulletin:

"'Cash on Delivery' Transactions Under Regulation T

"The Board has recently considered certain questions involving the special cash account under section 4(c) of Regulation T, and especially the provisions of section 4(c)(5) relating to so-called 'cash on delivery' or 'C.O.D.' transactions. For convenient reference, the relevant portions of section 4(c), particularly of 4(c)(5) are set out below:

'(c) Special cash account. - (1) In a special cash account, a creditor may effect for or with any customer bona fide cash transactions in securities in which the creditor may--

'(A) purchase any security for, or sell any security to, any customer, provided funds sufficient for the purpose are already held in the account or the purchase or sale is in reliance upon an agreement accepted by the creditor in good faith that the customer will promptly make full cash payment for the security and that the customer does not contemplate selling the security prior to making such payment; . . .

'(2) In case a customer purchases a security (other than an exempted security) in the special cash account and does not make full cash payment for the security within 7 days after the date on which the security is so purchased, the creditor shall, except as provided in the succeeding subdivisions of this section 4(c), promptly cancel or otherwise liquidate the transaction or the unsettled portion thereof . . . . . .

'(5) If the creditor, acting in good faith in accordance with subdivision (1) of this section 4(c), purchases a security for a customer, or sells a security to a customer, with the understanding that he is to deliver the security promptly to the customer, and the full cash payment to be made promptly by the customer is to be made against such delivery, the creditor may at his option treat the transaction as one to which the period applicable under subdivision (2) of this section 4(c) is not the 7 days therein specified but 35 days after the date of such purchase or sale: Provided, however, That the creditor shall not so treat any purchase by a given customer if any security has been purchased by such customer at any time during the

"'preceding 90 days in a special cash account with the creditor, and then, for any reason whatever, without having been previously paid for in full by the customer, the security has been sold in the account or delivered out to any broker or dealer: Provided, That an appropriate committee of a national securities exchange, on application of the creditor, may authorize the creditor to disregard for the purposes of the preceding proviso any given instance of the type therein described if the committee is satisfied that both creditor and customer are acting in good faith and that circumstances warrant such authorization.

'(6) If an appropriate committee of a national securities exchange is satisfied that the creditor is acting in good faith in making the application, that the application relates to a bona fide cash transaction, and that exceptional circumstances warrant such action, such committee, on application of the creditor, may (A) extend any period specified in subdivision (2), (3), (4) or (5) of this section 4(c) for one or more limited periods commensurate with the circumstances, ... '

"In general. The problems were ones relating, under section 4(c)(5), to the time of delivering a security to a customer and obtaining cash payment against the delivery. The rulings on the particular cases may be understood more readily in the light of certain general principles which apply to section 4(c) and particularly to the C.O.D. transactions under section 4(c)(5).

"It should be noted at the outset that it is not the purpose of section 4(c)(5) to allow additional time to customers for making payment. The 'prompt delivery' described in section 4(c)(5) is delivery which is to be made as soon as the broker or dealer can reasonably make it in view of the mechanics of the securities business and the bona fide usages of the trade. The provision merely recognizes the fact that in certain circumstances it is an established bona fide practice in the trade to obtain payment against delivery of the security to the customer, and the further fact that the mechanics of the trade, unrelated to the customer's readiness to pay, may sometimes delay such delivery to the customer.

"The customer should have the necessary means of payment readily available when he purchases a security in the special cash account. He should expect to pay for it

"immediately or in any event within the period (of not more than a very few days) that is as long as is usually required to carry through the ordinary securities transaction.

"Such an undertaking is a necessary part of the customer's agreement, under section 4(c)(1)(A), that he 'will promptly make full cash payment'. Furthermore, any delay by the customer may cast doubt on the original status of the transaction and should be explainable by exceptional circumstances that justify the delay. Repetition of delays by the customer would be especially hard to justify. Such repetition would almost conclusively label his transactions as unable to qualify as bona fide cash transactions and would almost conclusively disqualify them for inclusion in the special cash account.

"These general principles are illustrated by the specific cases to which the Board has given consideration.

"Broker 'failed to receive' security. A typical example of a case in which the delivery to the customer is delayed because of conditions in the trade is one in which the broker has 'failed to receive' the security which the customer has purchased. Assuming that no evasion of the regulation is involved and that the failure to receive the security is an ordinary incident to the usual operation of the securities business, section 4(c)(5) would cover the time, not exceeding the 35-day maximum specified in the provision, reasonably required for the broker to obtain the security and deliver it to the customer.

"Purchasing for delivery security already sold to customer. It sometimes happens that a dealer will sell a security to a customer although the dealer does not have the security on hand for delivery and expects to purchase it in the market in order to make delivery to the customer. A special case of this type is one in which an institutional investor such as an insurance company, trust fund, or the like, will purchase a block of a particular issue of securities--usually bonds--as a unit, and will request that the entire block of securities be delivered at one time in order to avoid unreasonable duplication of clerical or administrative operations.

"Questions as to the time allowed the dealer to acquire the securities in the market for delivery to the customer under section 4(c)(5) are essentially questions of reasonableness, and must necessarily depend on the circumstances of the particular case.

"As indicated above, the dealer could not delay acquiring the securities he did not have on hand if such

"delay was for the purpose of giving additional time to the customer. Assuming, however, that no such evasion is involved and that there is complete good faith, the dealer would have a reasonable time for acquiring the securities and could take into account the general state of the market, the effect of forcing a sudden purchase of the securities, and similar factors. He would not have to force through a sizeable purchase in a market that is temporarily thin or disorganized. But on the other hand he should proceed to acquire and deliver the securities with all reasonable dispatch.

"Unissued securities. The question was raised whether section 4(c)(5) applies to securities which at the time of the transaction are unissued. The answer is that it does, but that, as in other cases, the broker should deliver the security and complete the transaction as soon as he can in view of the mechanics of the trade. This being the case, it seems that there would be very few instances in which section 4(c)(5) would, in practice, authorize any more time for delivering such a security and obtaining payment therefor than would section 4(c)(3) which, in the following terms, specifically provides for most situations involving unissued securities:

> '(3) If the security when so purchased is an unissued security, the period applicable to the transaction under subdivision (2) of this section 4(c) shall be 7 days after the date on which the security is made available by the issuer for delivery to purchasers.'

"Securities purchased with proceeds of securities called for redemption. Sometimes a customer wishes to purchase a security and to pay for it with the proceeds of another security which the customer holds and which the issuer has called for redemption. Occasionally the proceeds of the called security will not be available for some time, perhaps 30 days, and the customer would like to delay payment for that time.

"Such a circumstance would not justify delay in obtaining payment under section 4(c)(5), since the delay would not arise from the mechanics of the trade as they affect the broker or dealer, but merely from the customer's desire for delay in making payment.

"In the particular case presented to the Board, however, the customer deposited the called security with the dealer with definite instructions to deliver it for redemption and apply the proceeds to payment for the purchased security.

"This made the situation similar to that considered in the ruling at page 1043 of the December 1938 Federal Reserve Bulletin, which was to the effect that in certain circumstances the sale of a security held in the special cash account may serve as payment for a security which has been purchased in the account even though the proceeds of sale have not yet been collected.

"Although the security had not actually been sold in the present case, the Board expressed the view that, if the necessary requirements of good faith were met and there was every reasonable probability that the called security actually would be paid according to the call for redemption, the same principle would apply. In such circumstances, therefore, payment for the purchased security may be considered to have been made for the purposes of section 4(c) at the time when the called security is deposited with the dealer for the indicated purpose."

Approved unanimously, together with the following letter to Mr. Rounds, Vice President of the Federal Reserve Bank of New York, reading as follows:

"Reference is made to your letter of October 1, 1940, regarding an inquiry from Davis, Polk, Wardwell, Gardiner & Reed, Esqs., 15 Broad Street, New York City, with respect to section 4(c) of Regulation T.

"The Board's views with respect to this question have been set forth in the attached statement for the press regarding '"Cash on Delivery" Transactions under Regulation T' which, however, is not to be released until the date indicated on the statement.

"It will be noted that a number of different but related questions have been covered in the ruling, among them certain questions as to which Mr. Norman P. Davis of your Bank some time ago advised the New York Security Dealers Association. The inclusion of these, which has been done with the approval and cooperation of Mr. Davis, reflects the belief that they are of such general interest and importance as to make it desirable for them to be covered by a formal ruling of the Board, to be published in the Federal Reserve Bulletin. Collecting the questions in this way makes it possible not only to indicate the relationship between the various questions but also to clarify

"certain of the underlying principles that are involved."

In connection with the above matter the following letter to Mr. Swanson, Vice President of the Federal Reserve Bank of Minneapolis was also approved unanimously:

"Reference is made to your letter of October 1, 1940 presenting two questions regarding Regulation T.

"The Board's views with respect to the question regarding the application of section 4(c)(5) of the regulation to unissued securities have been set forth in the attached ruling regarding '"Cash on Delivery" Transactions Under Regulation T' which, as you will note, also covers a number of other related questions and is not to be released until the date indicated on the statement.

"Your other question asks how to determine whether a security is exempted by the Securities and Exchange Commission to the extent described in section 2(d)(3) of Regulation T. As suggested by your Counsel, Mr. Ueland, the problem appears to be essentially a matter of obtaining factual information. If the relevant rules of the Securities and Exchange Commission are not readily available, the information could be obtained from the Securities and Exchange Commission, or the Board would be glad to forward it, with respect to any security as to which the question may arise.

"In view of the status of the Minneapolis-St. Paul Stock Exchange as an exempted exchange, you may be particularly interested in paragraph (b) of the Commission's Rule X-7C2-1 (formerly Rule AN1) which exempts certain securities on exempted exchanges to the extent described in section 2(d)(3) of Regulation T. This paragraph reads as follows:

'(b) So long as any security which is not registered on a national securities exchange continues to be admitted to either listed or unlisted trading privileges on any exchange which is exempted from registration as a national securities exchange, such security shall be exempt from the operation of Section 7(c)(2) to the extent necessary to render lawful any direct or indirect extension or maintenance of credit thereon or any direct or indirect arrangement therefor which would not have been unlawful if such security had been a security (other than an exempted security) registered on a national securities exchange.'"

Thereupon the meeting adjourned.

Chester Morrill
Secretary.

Approved:

M. S. Eccles
Chairman.