Minutes of actions taken by the Board of Governors of the Federal Reserve System on Monday, August 6, 1951.

PRESENT: Mr. Martin, Chairman
Mr. Szymczak
Mr. Evans

Mr. Carpenter, Secretary
Mr. Kenyon, Assistant Secretary

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

"The Board of Governors has been asked to rule upon the question whether so-called 'cash collateral accounts' held by member banks against outstanding commercial letters of credit providing for the drawing of sight drafts should be considered deposits for purposes of reserve requirements under section 19 of the Federal Reserve Act. The Board is authorized to define demand and time deposits for the purposes of this section.

"In a typical case, it is understood that, in connection with the issuance of a commercial letter of credit by a member bank and its customer's obligation to place the bank in funds to meet drafts drawn under the letter, a separate account in the name of the customer, known as a 'cash collateral account', is set up on the books of the member bank, either through transfer of funds from another account or a deposit of cash, in an amount equal to all or some portion of the maximum authorized amount of the letter of credit; that, as drafts are drawn under the letter of credit and presented to the bank for payment, the amounts of such drafts are charged to such account; and that, after termination of the letter of credit, any balance remaining in the account is paid or credited to the customer.

"After careful consideration of all aspects of this matter, it is the Board's view that, for purposes of reserve requirements under section 19 of the Federal Reserve Act, such a cash collateral account should be considered a deposit against which a member bank is required to maintain reserves.

"Since 1922, the Board has applied the general principle that 'all funds received by a bank in the course of its commercial or fiduciary business must be treated either as deposits

"against which reserves must be carried, or as trust funds subject to the ordinary restrictions and safeguards imposed upon the custody and use of trust funds.' (1922 Bulletin 572) This general principle, of course, was not intended, nor has it been construed, to mean that funds received by a bank in payment of a liability to the bank are to be treated as deposits. In the present case, funds held in the cash collateral accounts in question are not segregated but are mingled with the bank's other cash assets and used in the course of its business. It has been contended, however, that such funds should not be treated as deposits for reserve purposes because they constitute a prepayment of the customer's liability to place the bank in funds with which to pay drafts subsequently drawn and presented for payment under the letter of credit.

"Funds received by a bank in payment or prepayment of a customer's liability do not, of course, give rise to a deposit where the customer's liability to the bank is in fact simultaneously reduced at the time of the receipt of such funds. For example, no deposit arises when funds are received by a bank from its customer and are used at the time of receipt to reduce the customer's obligation on an instalment loan or to reduce the customer's obligation to place the bank in funds with which to meet executed and outstanding acceptances at their maturity.

"In such cases, however, the amount of the customer's liability is definitely known. This is not the case where a cash collateral account is set up to meet drafts drawn under an outstanding letter of credit. It is true, of course, that the maximum potential amount of the drafts which may be drawn under the letter is known; but the amount, if any, of drafts that will be drawn and presented to the bank under the letter cannot be determined. In such circumstances, funds in the cash collateral account cannot properly be considered a prepayment of the customer's liability.

"Until such time as the customer's cash collateral account has been completely used in reimbursing the bank for drafts paid by it, the bank remains liable to return the unused cash collateral to the customer in the event that the unused portion of the letter of credit is canceled. In other words, the bank becomes and remains liable to

"return to the customer the whole or part of the cash collateral deposited by him and mingled by the bank with its other cash assets. This is also true, of course, of cash received from customers for letters of credit sold for cash, which are specifically included in the definition of demand deposits set forth in Regulation D."

Approved unanimously, together with a letter to Mr. Sproul, President of the Federal Reserve Bank of New York, stating in more detail the reasons for the Board's ruling.

Letter to Mr. Sproul, President of the Federal Reserve Bank of New York, reading as follows:

"Careful consideration has been given to your letter of July 9, 1951, with regard to mergers and absorptions between banks requiring prior written consent of the Board of Governors pursuant to Section 18(c) of the Federal Deposit Insurance Act.

"It is felt that the procedure which you suggest is in line with the general tenor of the Board's letter of May 14, 1951, and, of course, the confidential character of any preliminary information that might be submitted is recognized. The Board's letter also contemplated that the Reserve Banks would communicate with any member banks believed to be interested with a view to having them follow the suggested procedure.

"In the case of a bank that currently increases its capital funds in anticipation of possible later absorption of, or merger with, other banking institutions, such action would certainly be taken into account in consideration of subsequent applications for written consent pursuant to Section 18(c). However, the passage of time may make the relation of a subsequent absorption to a prior capital increase difficult and developments in the interim with respect to the condition of the institution and the expansion of its liabilities in relation to capital would also be brought into consideration. It should be noted, also, that questions of public interest with respect to any subsequent transaction such as competitive situations, tendency toward monopoly, etc., would not be answered by a present increase in capital."

Approved unanimously.

Letter to Mr. H. H. Geddes, Motor Statistical Division, R. L. Polk and Company, Detroit, Michigan, reading as follows:

"We would like to continue to subscribe to your semimonthly reporting service for sales of new passenger cars in 12 cities during the last six months of 1951 on the same basis as set forth in our letter of March 7, 1951, for the data pertaining to the first six months of 1951.

"Specifically, we would expect to receive data covering the period July 1951 through December 1951 for sales of new passenger cars in 12 cities in 1951 and for approximately similar time periods in 1950, and we would expect the cost to be $125.00 per month for this service. As before, we would expect to continue the current subscription for a six-month period, although we understand that this subscription to the service may be canceled upon a month's notice. As usual, we assume we are free to use the figures for which we are currently subscribing in testimony before Congressional committees, in discussion with governmental agencies and private groups and for other purposes, except regular release of them to the press."

Approved unanimously.

Letter to Albert A. Jones, Esquire, National Press Building, Washington, D. C., reading as follows:

"This is in further reference to your letter concerning the application of Regulation W to outside barbecues. This matter was the subject of our letter to you of July 11, 1951. We have now had reply from the Federal Reserve Bank of San Francisco concerning this matter.

"On the basis of the facts presented, the Board is of the view that an outside barbecue should be regarded as an article of the kind listed in Group D of the Supplement to the regulation. Accordingly, instalment credit for the purpose of purchasing an outside barbecue would be subject to the requirements of the regulation. However, effective

"July 31, 1951, the maximum maturity for instalment credit to purchase an article in Group D was extended from 30 months to 36 months, in accordance with the 'Defense Production Act Amendments of 1951.'"

Approved unanimously, with a copy to Mr. Millard, Vice President of the Federal Reserve Bank of San Francisco.

Telegram to Mr. Olson, Vice President of the Federal Reserve Bank of Chicago, reading as follows:

"Reurtel July 31 re section 5(e) of Regulation X. In view of Board's telegram of August 1, 1951 (X-61) that the exemption extends to tenants of structures destroyed by fire, our view is that exemption extends to person building structure for lease to tenant who will use structure as replacement for structure destroyed by fire."

Approved unanimously.

Secretary.