

FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 1398]
July 7, 1934]

*To all Banks and Trust Companies in the
Second Federal Reserve District:*

At the request of the Federal Reserve Board I am transmitting herewith, printed on the following page, a copy of letter dated July 5, 1934, addressed to me by the Federal Reserve Board, containing a statement regarding Section 7 of the Securities Exchange Act of 1934.

J. H. CASE,
Federal Reserve Agent.

FEDERAL RESERVE BOARD

WASHINGTON

July 5, 1934.

Subject: Statement Regarding Section 7 of the Securities Exchange Act of 1934.

Mr. J. H. CASE,
Federal Reserve Agent,
New York, N. Y.

Dear Sir:

At its recent conference with the Chairman and Governors of the Federal reserve banks the Federal Reserve Board considered the new responsibilities placed upon the System by the Securities Exchange Act of 1934. This act gives the Federal Reserve Board authority to determine the margins to be required by brokers and dealers in extending credit to their customers, and also empowers the Board, within certain limitations, to prescribe rules and regulations, including margin requirements, for loans extended by other persons, including banks, for the purpose of purchasing or carrying securities registered on national securities exchanges.

Margin requirements do not become effective before October 1, 1934, and the Board's regulations on the subject will not be issued for several weeks.

In the case of brokers the law lays down a standard of margins, which shall constitute the basis of the Board's regulations, although the Board is given authority to prescribe lower requirements, if it deems it necessary or appropriate for the accommodation of commerce and industry, with due regard to the general credit situation in the country, and to prescribe higher margins if it deems it necessary or appropriate in order to prevent the excessive use of credit to finance transactions in securities. In the case of other lenders on securities, including banks, no standard is specifically laid down in the law, the margins to be prescribed being left to the Board's discretion.

The fundamental principle by which the Board is to be guided in determining margin requirements and in formulating its regulations is stated in the law. The Board is directed to enforce its new powers for the purpose of preventing the excessive use of credit for the purchase or carrying of securities. This principle is in line with the provisions of the Banking Act of 1933, which in several sections places special responsibility on the Federal reserve banks and the Federal Reserve Board in connection with excessive use of bank credit in the security markets. The law imposes upon the Federal Reserve Board no duties in connection with the supervision of the stock exchanges or the prevention of undesirable practices among members of such exchanges. Responsibility for these matters is placed upon the Securities and Exchange Commission. The Federal Reserve Board's duty under this act relates chiefly to the determination of margins to be required on security loans, a power to be exercised as a part of the Federal Reserve System's general credit policy of controlling undue credit expansion in the security markets.

In so far as banks are concerned, the Federal Reserve Board's authority under this act relates to loans made for the purpose of purchasing or carrying securities registered on national securities exchanges. It does not apply, therefore, to loans made solely for industrial, agricultural, or commercial purposes, regardless of the question whether these loans are secured or unsecured, and, if secured, regardless of the character of the collateral. The determining factor is the purpose of the loan and not the nature of the security offered. If a loan is collateralized by stocks or other equity securities and is made for the purpose of purchasing or carrying securities registered on a national securities exchange, it comes under this section of the act; if it is made for any other purpose, then it is exempt. The Board's power under this section, furthermore, does not apply to loans on exempted securities, which are defined by the law as including among other securities obligations of the United States, or of any State or political subdivision, and such other securities as the Securities and Exchange Commission may declare to be exempted securities. The power of the Board is further limited by exempting bank loans on securities other than equity securities, which means in practice that it is not applicable to loans on bonds, except bonds such as those having conversion privileges, and there are certain other exemptions. In general, the law, in so far as it applies to control over banks, is intended to prevent the banks from being used for the purpose of circumventing the margin requirements prescribed for loans extended by brokers to their customers, and to prevent undue expansion of bank credit employed in the securities markets.

General banking practices in relation to loans for industrial, agricultural, or commercial purposes are not affected by this Act.

Please transmit copies of this letter to all the banks in your Federal Reserve District.

Very truly yours,

CHESTER MORRILL,
Secretary.