FEDERAL RESERVE BANK
OF NEW YORK

Fiscal Agent of the United States

[Circular No. 1643]
[February 21, 1936]

Public Notice of Offering of $50,000,000, or thereabouts, of Treasury Bills
Dated February 26, 1936 Maturing November 25, 1936

To all Incorporated Banks and Trust Companies in the Second Federal Reserve District and Others Concerned:

Following is the text of a notice today made public by the Treasury Department with respect to a new offering of Treasury bills payable at maturity without interest to be sold on a discount basis to the highest bidders.

STATEMENT BY SECRETARY MORGENTHAU

The Secretary of the Treasury gives notice that tenders are invited for Treasury bills to the amount of $50,000,000, or thereabouts. They will be 273-day bills; and will be sold on a discount basis to the highest bidders. Tenders will be received at the Federal Reserve Banks, or the branches thereof, up to two o'clock p.m., Eastern Standard time, on Monday, February 24, 1936. Tenders will not be received at the Treasury Department, Washington.

The Treasury bills will be dated February 26, 1936, and will mature on November 25, 1936, and on the maturity date the face amount will be payable without interest. They will be issued in bearer form only, and in amounts or denominations of $1,000, $10,000, $100,000, $500,000, and $1,000,000 (maturity value).

It is urged that tenders be made on the printed forms and forwarded in the special envelopes which will be supplied by the Federal Reserve Banks or branches upon application therefor.

No tender for an amount less than $1,000 will be considered. Each tender must be in multiples of $1,000. The price offered must be expressed on the basis of 100, with not more than three decimal places, e. g., 99.125. Fractions must not be used.

Tenders will be accepted without cash deposit from incorporated banks and trust companies and from responsible and recognized dealers in investment securities. Tenders from others must be accompanied by a deposit of 10 per cent of the face amount of Treasury bills applied for, unless the tenders are accompanied by an express guaranty of payment by an incorporated bank or trust company.

Immediately after the closing hour for receipt of tenders on February 24, 1936, all tenders received at the Federal Reserve Banks or branches thereof up to the closing hour will be opened and public announcement of the acceptable prices will follow as soon as possible thereafter, probably on the following morning. The Secretary of the Treasury expressly reserves the right to reject any or all tenders or parts of tenders, and to allot less than the amount applied for, and his action in any such respect shall be final. Those submitting tenders will be advised of the acceptance or rejection thereof. Payment at the price offered for Treasury bills allotted must be made at the Federal Reserve Banks in cash or other immediately available funds on February 26, 1936.

The Treasury bills will be exempt, as to principal and interest, and any gain from the sale or other disposition thereof will also be exempt, from all taxation, except estate and inheritance taxes. (Attention is invited to Treasury Decision 4550, ruling that Treasury bills are not exempt from the gift tax.) No loss from the sale or other disposition of the Treasury bills shall be allowed as a deduction, or otherwise recognized, for the purposes of any tax now or hereafter imposed by the United States or any of its possessions.

Treasury Department Circular No. 418, as amended, and this notice prescribe the terms of the Treasury bills and govern the conditions of their issue. Copies of the circular may be obtained from any Federal Reserve Bank or branch thereof.

In accordance with the above announcement tenders will be received at the Securities Department of this bank (2nd floor, 33 Liberty Street, New York City) or at the Buffalo Branch of this bank (272 Main Street, Buffalo, New York) until two o'clock p.m., Eastern Standard time, on Monday, February 24, 1936.

It is requested that tenders be submitted on special form and in special envelope enclosed herewith.

Attention is invited to the fact that payment for the Treasury bills cannot be made by credit through the War Loan Deposit Account. Payment must be made in cash or other immediately available funds.

GEORGE L. HARRISON,
Governor.

No.....

TENDER FOR 273-DAY TREASURY BILLS

Dated February 26, 1936. Maturing November 25, 1936.

Dated at.....

.....1936

TO THE FEDERAL RESERVE BANK OF NEW YORK,
Fiscal Agent of the United States,
New York City, N. Y.

Pursuant to the provisions of Treasury Department Circular No. 418, as amended, and to the provisions of the public announcement on February 21, 1936, as issued by the Secretary of the Treasury, the undersigned offers to pay.....* for a total amount
(Rate per 100)
of $..... (maturity value) of the Treasury bills therein described, or for any less amount that may be allotted, payment therefor to be made at your bank in cash or other immediately available funds on the date stated in the public announcement.

The Treasury bills for which tender is hereby made are to be dated February 26, 1936, and are to mature on November 25, 1936.

This tender will be inserted in special envelope entitled "Tender for Treasury bills."

IMPORTANT INSTRUCTIONS:

1. No tender for less than $1,000 will be considered, and each tender must be for an amount in multiples of $1,000 (maturity value). Also, if more than one price is offered, a separate form must be executed at each price.

2. If the person making the tender is a corporation, the form should be signed by an officer of the corporation authorized to make the tender, and the signing of the form by an officer of the corporation will be construed as a representation by him that he has been so authorized. If the tender is made by a partnership, it should be signed by a member of the firm, who should sign in the form ".....", a copartnership, by....., a member of the firm."

3. Tenders will be accepted without cash deposit from incorporated banks and trust companies and from responsible and recognized dealers in investment securities. Tenders from others must be accompanied by a deposit of 10 per cent of the face amount of Treasury bills applied for, unless the tenders are accompanied by an express guaranty of payment by an incorporated bank or trust company.

4. If the language of this form is changed in any respect, which, in the opinion of the Secretary of the Treasury, is material, the tender may be disregarded.

Payment by credit through War Loan Deposit Account will not be permitted.

☞ Before signing fill in all required spaces.

Bank or Trust Company.....

Post Office Address.....

State.....

.....
Official signature required.

SPACES BELOW ARE FOR THE USE OF THE FEDERAL RESERVE BANK

Examined	Carded	Classified	Ledger	Acknowledged		Disposition	

Allotment	Figured	Checked	Advised	Method of Payment	Amount	Date Released	By

Received	Checked	Recorded	Window	Custody	Mail	Other Departments

TENTB-254 *a*

* *Price should be expressed on the basis of* 100, *with not more than three decimal places, e. g.,* 99.125. *Fractions must not be used.*

FEDERAL RESERVE BANK

OF NEW YORK

February 26, 1936.

To Each State Member Bank in the
Second Federal Reserve District:

At the request of the Board of Governors of the Federal Reserve System, I transmit to you herewith a copy of the "Regulations Governing The Purchase Of Investment Securities, And Further Defining The Term 'Investment Securities' As Used In Section 5136 Of The Revised Statutes As Amended By The 'Banking Act Of 1935' ", as signed and promulgated by the Comptroller of the Currency on the 15th day of February, 1936.

These regulations have been issued by the Comptroller of the Currency by virtue of the authority vested in him by paragraph "Seventh" of Section 5136 of the Revised Statutes of the United States, as amended; and are applicable, not only to national banks, but also to State member banks of the Federal Reserve System, since Section 9 of the Federal Reserve Act, as amended, provides in part as follows:

> "State member banks shall be subject to the same limitations and conditions with respect to the purchasing, selling, underwriting, and holding of investment securities and stock as are applicable in the case of national banks under paragraph 'Seventh' of Section 5136 of the Revised Statutes, as amended."

J. H. Case,
Federal Reserve Agent.

TREASURY DEPARTMENT

COMPTROLLER OF THE CURRENCY

WASHINGTON

REGULATIONS GOVERNING THE PURCHASE OF INVESTMENT SECURITIES, AND FURTHER DEFINING THE TERM "INVESTMENT SECURITIES" AS USED IN SECTION 5136 OF THE REVISED STATUTES AS AMENDED BY THE "BANKING ACT OF 1935"

The business of buying and selling investment securities by national banks is governed by Paragraph Seventh of Section 5136 of the Revised Statutes of the United States, as amended by Section 308 of the "Banking Act of 1935", approved August 23, 1935, which paragraph now reads as follows:

"Seventh. To exercise by its board of directors or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes according to the provisions of this title. The business of dealing in securities and stock by the association shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the association shall not underwrite any issue of securities or stock: *Provided, That the association may purchase for its own account investment securities under such limitations and restrictions as the Comptroller of the Currency may by regulation prescribe.* In no event shall the total amount of the investment securities of any one obligor or maker, held by the association for its own account, exceed at any time 10 per centum of its capital stock actually paid in and unimpaired and 10 per centum of its unimpaired surplus fund, except that this limitation shall not require any association to dispose of any securities lawfully held by it on the date of the enactment of the Banking Act of 1935. *As used in this section the term 'investment securities' shall mean marketable obligations evidencing indebtedness of any person, copartnership, association, or corporation in the form of bonds, notes, and/or debentures, commonly known as investment securities, under such further definition of the term 'investment securities' as may by regulation be prescribed by the Comptroller of the Currency.* Except as hereinafter provided or otherwise permitted by law, nothing herein contained shall authorize the purchase by the association for its own account of any shares of stock of any corporation. The limitations and restrictions herein contained as to dealing in, underwriting and purchasing for its own account, investment securities shall not apply to obligations of the United States, or general obligations of any State or of any political subdivision thereof, or obligations issued under authority of the Federal Farm Loan Act, as amended, or issued by the Federal Home Loan Banks or the Home Owners' Loan Corporation, or obligations which are insured by the Federal Housing Administrator, pursuant to section 207 of the National Housing Act, if the debentures to be issued in payment of such insured obligations are guaranteed as to principal and interest by the United States: Provided, That in carrying on the business commonly known as the safe-deposit business the association shall not invest in the capital stock of a corporation organized under the law of any State to conduct a safe-deposit business in an amount in excess of 15 per centum of the capital stock of the association actually paid in and unimpaired and 15 per centum of its unimpaired surplus."

Section 9 of the Federal Reserve Act, as amended, provides in part as follows:

"State member banks shall be subject to the same limitations and conditions with respect to the purchasing, selling, underwriting, and holding of investment securities and stock as are applicable in the case of national banks under paragraph 'Seventh' of Section 5136 of the Revised Statutes, as amended."

SECTION I

By virtue of the authority vested in the Comptroller of the Currency by said Paragraph Seventh of Section 5136 of the Revised Statutes, the following regulation is promulgated, further defining the term "investment securities."

An obligation of indebtedness which may be purchased for its own account by a national bank or a State member bank of the Federal Reserve System, in order to come within the classification of "investment securities" within the meaning of the paragraph of Section 5136 above quoted, must be a marketable security as designated by the express language of said paragraph, and can be purchased for the bank's own account only under the limitations and restrictions provided in said paragraph and the provisions of these regulations.

Under ordinary circumstances the term "marketable" means that the security in question has such a market as to render sales at intrinsic values readily available.

In determining whether a given security is marketable, it must meet the following minimum requirements:

(a) That the issue be of a sufficiently large total to make marketability possible;

(b) (1) That a public distribution of the securities must have been provided for or made in a manner to protect or insure the marketability of the issue, or, in the alternative

(2) other existing securities of the issuer have such a public distribution as to protect or insure the marketability of the issue under consideration, and such issue must be registered under the provisions of the "Securities Act of 1933" as amended, unless it is exempt from registration under Section 3 thereof.

(c) That where the security is issued under a trust agreement, the agreement must provide for a trustee independent of the obligor, and such trustee must be a bank or trust company.

Particular attention is called to the statutory provision that the investment securities which may be purchased, must be "in the *form of bonds, notes, and/or debentures, commonly known as investment securities.*" If an obligation is in the *form of a security,* it must comply with these regulations as to "marketability" as a condition to the bank's right to invest therein.

Any such security which fails to comply with the law and these regulations, will not be deemed legally acquired, even though the bank considers the transaction as being a *loan* rather than a purchase of "investment securities", except where such security evidences real estate loans made pursuant to Section 24 of the Federal Reserve Act, (a) where the obligations actually represent an initial loan by the bank, or (b) where the obligations were purchased pursuant to said section, in which case the bank is required thereby to purchase the entire issue.

SECTION II

By virtue of the authority vested in the Comptroller of the Currency by said Paragraph Seventh of Section 5136 of the Revised Statutes, the following regulation is promulgated as to further limitations and restrictions on the purchase and sale of investment securities for the bank's own account, supplemental to the specific limitations and restrictions of the statute.

(1) Although the bank is permitted to purchase "investment securities" for its own account for purposes of investment under the provisions of R. S. 5136 and this regulation, the bank is not permitted otherwise to participate as a principal in the marketing of securities.

(2) The statutory limitation on the amount of the investment securities of any one obligor or maker which may be held by the bank, is to be determined on the basis of the par or face value of the securities, and not on their market value.

(3) The purchase of "investment securities" in which the investment characteristics are distinctly or predominantly speculative, or "investment securities" of a lower designated standard than those which are distinctly or predominantly speculative, is prohibited.* The purchase of securities which are in default, either as to principal or interest, is also prohibited.

(4) Purchase of an "investment security" at a price exceeding par is prohibited, unless the bank shall:

(a) Provide for the regular amortization of the premium paid, so that the premium shall be entirely extinguished at or before the maturity of the security and the security

* The terms employed herein may be found in recognized rating manuals, and where there is doubt as to the eligibility of a security for purchase, such eligibility must be supported by not less than two rating manuals.

(including premium) shall at no intervening date be carried at an amount in excess of that at which the obligor may legally redeem such security; or

(b) Set up a reserve account in order to amortize the premium, said account to be credited periodically with an amount not less than the amount required for amortization under (a) above.

(5) Purchase of securities convertible into stock at the option of the issuer is prohibited.

(6) As to purchases of securities under repurchase agreement, subject to the limitations and restrictions set forth in the law and these regulations:

(a) It is permissible for the bank to purchase "investment securities" from another under an agreement whereby the bank has an option or an absolute right to require the seller of the securities to repurchase them from the bank at a price stated or at a price subject to determination under the terms of the agreement, but in no case less than the market value at the time of repurchase.

(b) It is permissible for the bank to purchase "investment securities" from another under an agreement whereby the seller or a third party guarantees the bank against loss on resale of the securities.

(c) It is not permissible for the bank to purchase "investment securities" from another under an agreement whereby the seller reserves the absolute right or the option to repurchase said securities itself or through its nominee at a price stated or at a price subject to determination under the terms of the agreement, notwithstanding the fact that the bank may also, under such agreement, have the absolute right or option to compel the seller to repurchase the securities at a price stated or at a price subject to determination under the terms of the agreement.

(7) As to sales of securities under repurchase agreement,

(a) It is permissible for the bank to sell securities to another under an agreement whereby the bank has an option or an absolute right to repurchase the securities from the buyer at a price stated or at a price subject to determination under the terms of the agreement, but in no case in excess of the market value at the time of repurchase.

(b) It is not permissible for the bank to sell securities to another under an agreement whereby the purchaser reserves the absolute right or the option to require the bank to repurchase said securities at a price stated or at a price subject to determination under the terms of the agreement, notwithstanding the fact that the bank may also, under such agreement, have the option or absolute right to repurchase the securities from the buyer at a price stated or at a price subject to determination under the terms of the agreement.

In view of the fact that some banks may have bought or sold securities under a form of agreement above indicated as prohibited, the bank should either terminate or modify same so as to conform to these regulations, where such action may lawfully be taken. Existing agreements of the prohibited type must not be renewed.

EXCEPTION

(1) The restrictions and limitations of these regulations do not apply to securities acquired through foreclosure on collateral, or acquired in good faith by way of compromise of a doubtful claim or to avert an apprehended loss in connection with a debt previously contracted.

Signed and promulgated this 15th day of February, 1936.

J. F. T. O'CONNOR,
Comptroller.

These "interpretative rulings" have been sent by the Comptroller of the Currency to all National Banks - Board of Governors states it is not necessary for us to make any distribution of this pamphlet.

TREASURY DEPARTMENT

COMPTROLLER OF THE CURRENCY

WASHINGTON

February 15, 1936

To All National Banks:

INTERPRETATIVE RULINGS WITH RESPECT TO SECTION 5136, U.S.R.S.

SECTION I

PURCHASE AND SALE OF "EXEMPTED" SECURITIES BY NATIONAL BANKS UNDER REPURCHASE AGREEMENT

Notwithstanding the fact that said statute exempts certain classes of securities specified therein, from the "limitations and restrictions" of the statute as to a national bank dealing in, underwriting and purchasing such securities for its own account, it is the opinion of the Comptroller of the Currency that national banks may purchase or sell such exempted securities under repurchase agreement, only under the following conditions and circumstances:

(a) It is permissible for the bank to purchase such securities from another under an agreement whereby the bank has an option or an absolute right to require the seller of the securities to repurchase them from the bank at a price stated or at a price subject to determination under the terms of the agreement, but in no case less than the market value at the time of repurchase.

(b) It is permissible for the bank to purchase such securities from another under an agreement whereby the seller or a third party guarantees the bank against loss on resale of the securities.

(c) It is not permissible for the bank to purchase such securities from another under an agreement whereby the seller reserves the absolute right or the option to repurchase said securities itself or through its nominee at a price stated or at a price subject to determination under the terms of the agreement, notwithstanding the fact that the bank may also, under such agreement, have the absolute right or option to compel the seller to repurchase the securities at a price stated or at a price subject to determination under the terms of the agreement.

(d) It is permissible for the bank to sell such securities to another under an agreement whereby the bank has an option or an absolute right to repurchase the securities from the buyer at a price stated or at a price subject to determination under the terms of the agreement, but in no case in excess of the market value at the time of repurchase.

(e) It is not permissible for the bank to sell such securities to another under an agreement whereby the purchaser reserves the absolute right or the option to require the bank to repurchase said securities at a price stated or at a price subject to determination under the terms of the agreement, notwithstanding the fact that the bank may also, under such agreement, have the option or absolute right to repurchase the securities from the buyer at a price stated or at a price subject to determination under the terms of the agreement.

In view of the fact that some banks may have bought or sold such securities under a form of agreement above indicated as prohibited, the bank should either terminate or modify same so as to conform to these rulings, where such action may lawfully be taken. Existing agreements of the prohibited type must not be renewed.

SECTION II

WHEN PURCHASE TRANSACTIONS BY A NATIONAL BANK WILL BE CONSIDERED AS LOANS BY THE BANK

Purchase transactions under repurchase agreement, whether involving "investment securities" or securities in the "exempted" classification of Section 5136 of the Revised Statutes, may under certain circumstances have to be considered as loans subject to the limitations of R. S. 5200. It is not possible to define a set standard for determining this question, because its determination depends upon the true nature of the transaction as respects the intention of the parties thereto. There have been occasions where for various reasons either the borrower or the bank desires to disguise a loan transaction by clothing it with the outward aspect of a sale and purchase of securities. Among the circumstances that will be considered indicative or possibly conclusive that the transaction represents a loan subject to the limitations of R. S. 5200 are the following:

(1) Where the seller is already indebted to the bank to such an extent that the seller's repurchase obligation on the securities sold to the bank will, when added to its other indebtedness, exceed the amount which the bank is permitted to loan the seller under R. S. 5200.

(2) Where, under the terms of the repurchase agreement, the price at which the seller may be required to repurchase the securities from the bank includes a specified rate of interest on the purchase price paid by the bank over the period of time the securities were held by the bank, or any other form of agreement whereby the repurchase price exceeds the sale price by an amount approximately equivalent to usual loan rate of interest on the sale price for the period the securities were held by the bank.

(3) Where the seller has the right or option to make substitution in the securities sold to the bank.

Particular note is called to the fact that even though a transaction in the form of a sale or purchase of securities under a repurchase agreement, is considered and required to be treated, as a loan transaction subject to the limits of R. S. 5200, such transaction shall nevertheless be considered unlawful, notwithstanding its loan features, if the securities in question are not in the form of investment securities, and are ineligible for investment by national banks under the provisions of R. S. 5136 and the regulations issued thereunder by this office.

SECTION III

BUSINESS OF DEALING IN STOCK AND SECURITIES BY NATIONAL BANKS UPON THE ORDER AND FOR THE ACCOUNT OF CUSTOMERS

The statute authorizing national banks to purchase and sell securities and stock upon the order and for the account of customers and not for the bank's own account, is not considered to be authority for national banks to engage in the following activities:

(a) Charging any commission or fee in excess of the fair cost of handling the transaction.

(b) Retaining any commission, rebate, or discount, obtained from others in purchasing for a customer, but the benefit of such reduction in price must be passed on to the purchaser, unless it does not exceed the cost of handling the transaction.

(c) Acting as agent for a customer of the bank, to sell or distribute securities which are the obligation of said customer.

(d) Using solicitors to obtain orders to purchase or sell securities for customers.

(e) Acting as a middleman to bring borrower or issuer, and lender or purchaser together for a fee or commission.

(f) Purchasing stocks or securities for a customer unless payment therefor has been received by the bank, or the customer has credits or collateral with the bank sufficient to cover, and the bank is authorized to charge the cost of the transaction against such credits or collateral. The bank must not use its own funds in such transactions.

(g) Making any purchase or sale without disclosing that the bank is acting as agent and not as principal.

J. F. T. O'CONNOR,
Comptroller.

TREASURY DEPARTMENT
COMPTROLLER OF THE CURRENCY
WASHINGTON

EXCERPT FROM ADDRESS OF HONORABLE J. F. T. O'CONNOR, COMPTROLLER OF THE CURRENCY, BEFORE THE CALIFORNIA BANKERS ASSOCIATION, AT SACRAMENTO, CALIFORNIA, ON MAY 22, 1936

Effective as of February 15, 1936, certain regulations governing the purchase of investment securities by banks, subject to the provisions of Section 5136 of the Revised Statutes, were promulgated by the Comptroller's office. These regulations were issued in compliance with a duty imposed by Congress in Section 5136 which reads:

"The association may purchase for its own account investment securities *under such limitations and restrictions as the Comptroller of the Currency may by regulation prescribe* . . . As used in this Section the term 'investment securities' shall mean marketable obligations evidencing indebtedness of any person, co-partnership, association or corporation, in the form of bonds, notes and/or debentures, commonly known as investment securities under such further definition of the term 'investment securities' *as may by regulation be prescribed by the Comptroller of the Currency.*"

It will also be noted that it was by virtue of the Act of Congress and not by regulation of the Comptroller's office that the limitation on investment is imposed in Section 5136, which provides that:

"In no event shall the total amount of the investment securities of any one obligor or maker, held by the association for its own account, exceed at any time 10 per centum of its capital stock actually paid in and unimpaired and 10 per centum of its unimpaired surplus fund."

A few State Federal Reserve member banks have not understood that the reason that both the 10 per cent limitation and the provisions of the regulations of the Comptroller's office apply to them is due to the fact that Congress enacted as part of the Banking Act of 1933, an amendment to Section 9 of the Federal Reserve Act, providing that:

"State member banks shall be subject to the same limitations and conditions with respect to the purchasing, selling, underwriting and holding of investment securities and stock as are applicable in the case of national banks under paragraph 'Seventh' of Section 5136 of the Revised Statutes, as amended."

Having in mind the great extent to which the healthy condition of our banks is dependent upon the exercise of sound investment policies, and being acutely conscious of the disasters precipitated in the past because a portion of the banks failed to exercise such sound policies, my office made a protracted and comprehensive study of the situation with a view to prescribing, *with the effect of law,* the investment policies which must hereafter be followed—policies which were in the main already in force in the better managed institutions. Manifestly, the problems of the bil-

lion-dollar bank are not the same as those of a two-hundred-thousand dollar bank, and to frame a regulation that will in every case operate equally and equitably on both the large and small institution is a difficult task.

As you may have observed, the motif running through the regulations is one of anti-speculation. The reason therefor is based on causes which have been admirably expressed by the commission on Banking Law and Practice of the Association of Reserve City Bankers in its "Summary of Arguments on Title II of the Banking Bill of 1935" issued in May, 1935.

Permit me to quote from that pamphlet:

"The disastrous period of bank liquidations is getting further and further behind us and it is probable that even bankers are becoming somewhat forgetful of the true causes of the trouble, although at one time there would have been little disagreement as to the factors involved. Most of the public, unfortunately, never knew fully the causes of our banking troubles because the facts were not available to them, and they might be easily convinced that the whole trouble can be charged to so simple a thing as strict eligibility requirements.

"It is contended that a study of the assets of failed banks would completely dispel the view that the troubles of these banks were due chiefly to a lack of borrowing power. No one can peruse the facts without arriving at the absolute conviction that the troubles of the banks were due in considerable part to assets which should never have been in the banks at any time, under any conditions. In the years prior to the depressions of both 1921 and 1929 the banks became involved in the speculative fever of the age, and many of them filled their portfolios with assets which were bound to show losses with the turn of the economic tide. No artificial methods of liquidity and no attempt to have the Federal Reserve System hold up the inflated balloon could possibly have avoided the ultimate consequences.

"It may be of interest at this point to present a few simple facts which were revealed by a detailed analysis of the assets of failed banks. Of the banks failing in 1931, 105 were picked at random from all sections of the country, and the 50 bonds contributing the greatest depreciation to the portfolios of the 105 banks were listed and tabulated. The two bonds which contributed the greatest depreciation to the portfolios of this group were convertible bonds which had been bought at prices substantially above par. In other words, they were speculations. There were several other convertible bonds in the list which also caused heavy losses. Of the first 50 bonds in point of depreciation, only five had ratings of the first three grades in 1929; four of these five were convertible issues in which the banks' losses were due to having bought them at too high a price. The remainder of the issues were of the fourth grade or lower. These banks were sacrificing security for high yield. Only four of the 50 issues were brought out before 1923 and 42 per cent of them were brought out in 1928 or later. In other words, the bonds causing the greatest amount of depreciation were unseasoned issues, largely the product of boom conditions in the bond market."

As is inevitable in the matter of regulations, questions of interpretation arise from time to time. While there has been unanimous approval of the objective toward which these regulations are directed, a Committee of the American Bankers Association has suggested that some of their members desire to have clarified certain aspects of the regulations. The provision which

has probably been of most interest in this connection is Paragraph (3) of Section II of the regulations, and the footnote thereto. This paragraph prohibits the purchase of investment securities in which the investment characteristics are distinctly or predominately speculative and the footnote states that the terms used in the paragraph may be found in recognized rating manuals, and that where there is doubt as to eligibility, then such eligibility must be supported by not less than two rating manuals.

Inquiry has been made as to whether this means that member banks are thus confined to the purchase of securities which have a rating classification in one of the four groups according to rating services. The responsibility for proper investment of bank funds, now, as in the past, rests with the Directors of the institution, and there has been and is no intention on the part of this office to delegate this responsibility to the rating services, or in any way to intimate that this responsibility may be considered as having been fully performed by the mere ascertaining that a particular security falls within a particular rating classification.

Reference to the rating manuals was made in the regulation in recognition of the fact that many banking institutions, by reason of lack of experienced personnel and access to original sources, are unable personally to investigate the background, history and prospects of a particular issuer of securities, and consequently must rely to some extent upon such information as has been compiled by various rating services in their large rating manuals. It may also be expected that banking institutions will desire to supplement their own judgment by checking it against the opinion of others, including ratings that have been given by rating services. Such ratings, however, regardless of whether or not they are in the first four groups, are not conclusive on the question of eligibility. It is recognized that some securities, which are entirely eligible from a non-speculative standpoint at the time they are available for purchase, may have as yet received no rating by the rating services. It is also recognized that a security with a high rating according to the services may, in the circumstances of a particular case, be an undesirable investment, whereas on the other hand, conditions existing at the time of investment may make a security entirely eligible, notwithstanding the fact that it has a comparatively low rating according to the standard rating services. In the latter type of case, of course, there will be a correspondingly greater burden upon the bank to satisfy the examiners that a particular security is in fact eligible from a non-speculative standpoint.

Paragraph (5) in Section II of the regulations prohibits the purchase of securities convertible into stock at the option of the issuer. In this connection question has been raised as to purchase of securities accompanied by stock purchase warrants or rights. It is unnecessary to remind you gentlemen of the prohibition against banks investing in stocks. The statement quoted a few moments ago relative to the danger of investment in convertible bonds equally applies to securities carrying stock purchase rights. They are speculations—and in addition to being objectionable as such, they in effect constitute a prohibited investment in stocks because the price paid by the bank involves a premium which in part reflects the conjectural value of the stock right, and such purchase is to that extent not a purchase of an investment security. Inasmuch as the bank is prohibited by law from exercising the purchase warrant after it has been acquired, such portion of the bank funds as are allocable to the original purchase of the warrant, would have been expended on no justifiable basis under the law.

Some banks have misunderstood the amortization requirements of the regulations as respects securities purchased at a price exceeding par. It should be made clear that the premium need only be gradually amortized at regular intervals over the life of a security to the end that at its maturity the security will not be carried at an amount in excess of par. If the security is callable at a given price above par, the rate of amortization will have to be such as to have gradually extinguished the premium down to call price by the call date, regardless of whether the security is in fact called on that date. Thereafter, if not called, amortization shall continue from that point to maturity on the same basis as though the security had been purchased on the call date at the call price.