FEDERAL RESERVE BANK OF NEW YORK

[Circular No. **5068**]
[August 3, 1961]

MARGIN REGULATIONS

— Amendment to Regulation T
— Revision of Regulation U

To All Banks, Members of National Securities Exchanges, and Others Interested, in the Second Federal Reserve District:

Enclosed are copies of an amendment, effective August 7, 1961, to Regulation T of the Board of Governors of the Federal Reserve System, and of a revision of the Board's Regulation U, which incorporates previous amendments to the regulation and includes new amendments, also effective August 7, 1961.

Section 220.4(d) of Regulation T has been amended by substituting "within 90 calendar days following the date of its purchase" for "within a reasonable time" in defining bona fide arbitrage in convertible securities. A conforming change has been made in section 220.3(d)(3). Section 220.6(d) of Regulation T has been amended to eliminate possible ambiguities in the provisions relating to transfers of undermargined general accounts, particularly with respect to transfers from one customer to more than one customer.

The new amendments to Regulation U effect changes in sections 221.2(j) and 221.3(e). Section 221.2(j) incorporates in Regulation U for the first time a specific definition of bona fide arbitrage, which is identical with that in amended section 220.4(d) of Regulation T. Section 221.3(e) of Regulation U, relating to transfers of undermargined loans between borrowers, has been changed to correspond with the amended section 220.6(d) of Regulation T.

Additional copies of the enclosures will be furnished upon request.

ALFRED HAYES,
President.

CREDIT BY BROKERS, DEALERS, AND MEMBERS OF NATIONAL SECURITIES EXCHANGES

AMENDMENT TO REGULATION T

ISSUED BY THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Effective August 7, 1961, sections 220.3(*d*)(3), 220.4(*d*), and 220.6(*d*) are amended to read as follows:

SECTION 220.3--GENERAL ACCOUNTS

(*d*) **Adjusted debit balance.**— * * *

(3) the current market value of any securities (other than unissued securities) sold short in the account plus, for each such security (other than an exempted security), such amount as the Board shall prescribe from time to time in § 220.8 as the margin required for such short sales, except that such amount so prescribed in § 220.8 need not be included when there are held in the account securities exchangeable or convertible within 90 calendar days, without restriction other than the payment of money, into such securities sold short;

SECTION 220.4--SPECIAL ACCOUNTS

(*d*) **Special arbitrage account.**—In a special arbitrage account, a member of a national securities exchange may effect and finance for any customer bona fide arbitrage transactions in securities. For the purposes of this paragraph, the term "arbitrage" means (1) a purchase or sale of a security in one market together with an offsetting sale or purchase of the same security in a different market at as nearly the same time as practicable, for the purpose of taking advantage of a difference in prices in the two markets, or (2) a purchase of a security which is, without restriction other than the payment of money, exchangeable or convertible within 90 calendar days following the date of its purchase into a second security together with an offsetting sale at or about the same time of such second security, for the purpose of taking advantage of a disparity in the prices of the two securities.

(Over)

(d) **Transfer of accounts.**—(1) In the event of the transfer of a general account from one creditor to another, such account may be treated for the purposes of this part as if it had been maintained by the transferee from the date of its origin: *Provided,* That the transferee accepts in good faith a signed statement of the transferor that no cash or securities need be deposited in the account in connection with any transaction that has been effected in the account or, in case he finds that it is not practicable to obtain such a statement from the transferor, accepts in good faith such a signed statement from the customer.

(2) In the event of the transfer of a general account from one customer to another, or to others, as a bona fide incident to a transaction that is not undertaken for the purpose of avoiding the requirements of this part, each transferee account may be treated by the creditor for the purposes of this part as if it had been maintained for the transferee from the date of its origin: *Provided,* That the creditor accepts in good faith and keeps with the transferee account a signed statement of the transferor describing the circumstances giving rise to the transfer.

BOARD OF GOVERNORS

of the

FEDERAL RESERVE SYSTEM

LOANS BY BANKS FOR THE PURPOSE OF PURCHASING OR CARRYING REGISTERED STOCKS

REGULATION U

(12 CFR 221)

As Amended to August 7, 1961

INQUIRIES REGARDING THIS REGULATION

Any inquiry relating to this regulation should be addressed to the Federal Reserve Bank of the district in which the inquiry arises.

EXPLANATORY FOREWORD

(Not a part of the regulation)

This regulation is issued pursuant to the provisions of section 7 of the Securities Exchange Act of 1934.

This regulation does not prevent a bank from taking for any loan collateral in addition to that required by the regulation. Except as provided in § 221.3(*r*) with respect to convertible securities, it does not require a bank to reduce any loan, to obtain collateral for any outstanding loan, or to call any outstanding loan because of insufficient collateral.

NOTE.—The reporting and record-keeping requirements contained herein have been approved by the Bureau of the Budget in accordance with the Federal Reports Act of 1942.

REGULATION U

(12 CFR 221)

As Amended to August 7, 1961

LOANS BY BANKS FOR THE PURPOSE OF PURCHASING OR CARRYING REGISTERED STOCKS*

SECTION 221.1—GENERAL RULE

(*a*) No bank shall make any loan secured directly or indirectly by any stock for the purpose of purchasing or carrying any stock registered on a national securities exchange (and no bank shall make any loan described in § 221.3(*q*) regardless of whether or not such loan is secured by any stock) in an amount exceeding the maximum loan value of the collateral, as prescribed from time to time for stocks in § 221.4 (the Supplement to Regulation U) and as determined by the bank in good faith for any collateral other than stocks.

(*b*) For the purpose of this part, the entire indebtedness of any borrower to any bank incurred at any time for the purpose of purchasing or carrying stocks registered on a national securities exchange shall be considered a single loan; and all the collateral securing such indebtedness shall be considered in determining whether or not the loan complies with this part.

(*c*) While a bank maintains any such loan, whenever made, the bank shall not at any time permit any withdrawal or substitution of collateral unless either (1) the loan would not exceed the maximum loan value of the collateral after such withdrawal or substitution, or (2) the loan is reduced by at least the amount by which the maximum loan value of any collateral deposited is less than the "retention requirement" of any collateral withdrawn. The "retention requirement" of nonstock collateral is the same as its maximum loan value, and the "retention requirement" of stock collateral is prescribed from time to time in § 221.4 (the Supplement to Regulation U). If the maximum loan value of the collateral securing the loan has become less than the amount of the loan, the amount of the loan may nevertheless be increased if there is provided additional collateral having maximum loan value at least equal to the amount of the increase.

SECTION 221.2—EXCEPTIONS TO GENERAL RULE

Notwithstanding the provisions of § 221.1, a bank may make and may maintain any loan for the purpose specified in § 221.1, without

* This text corresponds to the Code of Federal Regulations, Title 12, Chapter II, Part 221; cited as 12 CFR 221.

regard to the limitations prescribed therein, if the loan comes within any of the following descriptions:

(*a*) Any loan to a bank or to a foreign banking institution;

(*b*) Any loan made prior to July 16, 1945, to any person whose total indebtedness to the bank at the date of and including such loan does not exceed $1,000;

(*c*) Any loan to a dealer, or to two or more dealers, to aid in the financing of the distribution of securities to customers not through the medium of a national securities exchange;

(*d*) Any loan to a broker or dealer that is made in exceptional circumstances in good faith to meet his emergency needs;

(*e*) Any loan to a broker or dealer secured by any securities which, according to written notice received by the bank from the broker or dealer pursuant to a rule of the Securities and Exchange Commission concerning the hypothecation of customers' securities (Rule X-8C-1 or Rule X-15C2-1), are *securities carried for the account of one or more customers,* provided the bank accepts in good faith from the broker or dealer a signed statement to the effect that he is subject to the provisions of Part 220 of this chapter (Regulation T) (or that he does not extend or maintain credit to or for customers except in accordance therewith as if he were subject thereto);

(*f*) Any temporary advance to finance the purchase or sale of securities for prompt delivery which is to be repaid in the ordinary course of business upon completion of the transaction;

(*g*) Any loan against securities in transit, or surrendered for transfer, which is payable in the ordinary course of business upon arrival of the securities or upon completion of the transfer;

(*h*) Any loan which is to be repaid on the calendar day on which it is made;

(*i*) Any loan made outside the States of the United States and the District of Columbia;

(*j*) Any loan to a member of a national securities exchange for the purpose of financing his or his customers' bona fide arbitrage transactions in securities. For the purposes of this paragraph, the term "arbitrage" means (1) a purchase or sale of a security in one market together with an offsetting sale or purchase of the same security in a different market at as nearly the same time as practicable, for the purpose of taking advantage of a difference in prices in the two markets, or (2) a purchase of a security which is, without restriction other than the payment of money, exchangeable or convertible within 90 calendar days following the date of its purchase into a second security together with an offsetting sale at or about the same time of such second security, for the purpose of taking advantage of a disparity in the prices of the two securities;

(*k*) Any loan to a member of a national securities exchange for the purpose of financing such member's transactions as an odd-lot dealer in securities with respect to which he is registered on such national securities exchange as an odd-lot dealer.

SECTION 221.3—MISCELLANEOUS PROVISIONS

(*a*) In determining whether or not a loan is for the purpose specified in § 221.1 or for any of the purposes specified in § 221.2, a bank may rely upon a statement with respect thereto only if such statement (1) is signed by the borrower; (2) is accepted in good faith and signed by an officer of the bank as having been so accepted; and (3) if it merely states what is not the purpose of the loan, is supported by a memorandum or notation of the lending officer describing the purpose of the loan. To accept the statement in good faith, the officer must be alert to the circumstances surrounding the loan and the borrower and must have no information which would put a prudent man upon inquiry and if investigated with reasonable diligence would lead to the discovery of the falsity of the statement.

(*b*) (1) No loan, however it may be secured, need be treated as a loan for the purpose of "carrying" a stock registered on a national securities exchange unless the loan is as described in subparagraph (2) of this paragraph or the purpose of the loan is to enable the borrower to reduce or retire indebtedness which was originally incurred to purchase such a stock, or, if he be a broker or a dealer, to carry such stocks for customers.

(2) A loan for the purpose of purchasing or carrying a "redeemable security" (i.e. a redeemable proportionate interest in the issuer's assets) issued by an "open-end company," as defined in the Investment Company Act of 1940, whose assets customarily include stock registered on a national securities exchange, shall be deemed to be for the purpose of purchasing or carrying a stock so registered.

(*c*) In determining whether or not a security is a "stock registered on a national securities exchange" or a "redeemable security" described in paragraph (*b*) (2) of this section, a bank may rely upon any reasonably current record of such securities that is published or specified in a publication of the Board of Governors of the Federal Reserve System.

(d) Except as provided in paragraph (*r*) of this section, the renewal or extension of maturity of a loan need not be treated as the making of a loan if the amount of the loan is not increased except by the addition of interest or service charges on the loan or of taxes on transactions in connection with the loan.

(*e*) A bank, without following the requirements of this part as to the making of a loan, may

(1) accept the transfer of a loan from another bank, or

(2) permit the transfer of a loan from one borrower to another, or to others, as a bona fide incident to a transaction that is not undertaken for the purpose of avoiding the requirements of this part, provided that a statement signed by the transferor, describing the circumstances giving rise to the transfer, is accepted in good faith by an officer of the bank and is kept with each transferee loan account;

Provided, The loan is not increased and the collateral for the loan is not changed; and, after such transfer, a bank may permit such withdrawals and substitutions of collateral as the bank might have permitted if it had been the original maker of the loan or had originally made the loan to the new borrower.

(*f*) A loan need not be treated as collateralled by securities which are held by the bank only in the capacity of custodian, depositary or trustee, or under similar circumstances, if the bank in good faith has not relied upon such securities as collateral in the making or maintenance of the particular loan.

(*g*) Nothing in this part shall be construed to prevent a bank from permitting withdrawals or substitutions of securities to enable a borrower to participate in a reorganization.

(*h*) No mistake made in good faith in connection with the making or maintenance of a loan shall be deemed to be a violation of this part.

(*i*) Nothing in this part shall be construed as preventing a bank from taking such action as it shall deem necessary in good faith for its own protection.

(*j*) Every bank, and every person engaged in the business of extending credit who, in the ordinary course of business, extends credit for the purpose of purchasing or carrying securities registered on a national securities exchange, shall make such reports as the Board of Governor of the Federal Reserve System may require to enable it to perform the functions conferred upon it by the Securities Exchange Act of 1934 (48 Stat. 881; 15 U.S.C. Chapter 2B).

(*k*) Terms used in this part have the meanings assigned to them in a portion of section 3(a) of the Securities Exchange Act of 1934 (48 Stat. 882; 15 U.S.C. 78c(a)), except that the term "bank" does not include a bank which is a member of a national securities exchange.

(*l*) The term "stock" includes any security commonly known as a stock, any voting trust certificate or other instrument representing such a security, and any warrant or right to subscribe to or purchase such a security.

(*m*) Indebtedness "subject to § 221.1" is indebtedness which is secured directly or indirectly by any stock (or made to a person described in paragraph (*q*) of this section), is for the purpose of purchasing or carrying any stock registered on a national securities exchange, and is not excepted by § 221.2.

(*n*) (1) The bank shall identify all the collateral used to meet the collateral requirements of § 221.1 (entire indebtedness being considered a single loan and collateral being similarly considered, as required by § 221.1) and shall not cancel the identification of any portion thereof except in circumstances that would permit the withdrawal of that portion. Such identification may be made by any reasonable method, and in the case of indebtedness outstanding at the opening of business on June 15, 1959 need not be made until immediately before some change in that or other indebtedness of the borrower or in collateral therefor.

(2) Only the collateral required to be so identified shall have loan value for purposes of § 221.1 or be subject to the restrictions therein specified with respect to withdrawals and substitutions; and

(3) For any indebtedness of the same borrower that is not subject to § 221.1 (other than a loan described in § 221.2 (*d*), (*f*), (*g*) *or* (*h*)), the bank shall in good faith require as much collateral not so identified as the bank would require (if any) if it held neither the indebtedness subject to § 221.1 nor the identified collateral. This shall not be construed, however, to require the bank, after it has made any loan, to obtain any collateral therefor because of any deficiency in collateral already existing at the opening of business on June 15, 1959, or any decline in the value or quality of the collateral or in the credit rating of the borrower. It also does not require a bank to waive or forego any lien. In addition, it shall not apply to a loan to enable the borrower to meet emergency expenses not reasonably foreseeable, provided the loan is supported by a statement of the borrower describing the circumstances, accepted in good faith and signed by an officer of the bank as having been so accepted.

(*o*) In the case of a loan to a member of a national securities exchange who is registered and acts as a specialist in securities on the exchange for the purpose of financing such member's transactions as a specialist in such securities, the maximum loan value of any stock shall

be as determined by the bank in good faith provided that the specialist's exchange, in addition to other requirements applicable to specialists, is designated by the Board of Governors of the Federal Reserve System as requiring reports suitable for supplying current information regarding specialists' use of credit pursuant to this section.

(*p*) A loan need not comply with the other requirements of this part if it is to enable the borrower to acquire a stock by exercising a right to acquire such stock which is evidenced by a warrant or certificate issued to stockholders and expiring within 90 days of issuance: *Provided,* That (1) each such acquisition under this paragraph shall be treated separately, and the loan when made shall not exceed 75 per cent of the current market value of the stock so acquired as determined by any reasonable method, (2) while the borrower has any loan outstanding at the bank under this paragraph no withdrawal or substitution of stock used to make such loan shall be permissible, except that when the loan has become equal to or less than the maximum loan value of the stock as prescribed for § 221.1 in § 221.4 the stock and indebtedness may thereafter be treated as subject to § 221.1 instead of this paragraph, and (3) no loan shall be made under this paragraph at any time when the borrower has any such loan at the bank which has been outstanding more than 9 months without becoming eligible to be treated as subject to § 221.1. In order to facilitate the exercise of a right under this paragraph, a bank may permit the right to be withdrawn from a loan subject to § 221.1 without regard to any other requirement of this part.

(*q*) Any loan to a person not subject to this part (Regulation U) or to Part 220 (Regulation T) engaged principally, or as one of the person's important activities, in the business of making loans for the purpose of purchasing or carrying stocks registered on a national securities exchange, is a loan for the purpose of purchasing or carrying stocks so registered unless the loan and its purposes are effectively and unmistakably separated and disassociated from any financing or refinancing, for the borrower or others, of any purchasing or carrying of stocks so registered. Any loan to any such borrower, unless the loan is so separated and disassociated or is excepted by § 221.2, is a loan "subject to § 221.1" regardless of whether or not the loan is secured by any stock; and no bank shall make any such loan subject to § 221.1 to any such borrower on or after June 15, 1959 without collateral or without the loan being secured as would be required by this Part 221 if it were secured by any stock. Any such loan subject to § 221.1 to any such borrower, whether or not made after June 15,

1959, shall be subject to the other provisions of this Part 221 applicable to loans subject to § 221.1, including provisions regarding withdrawal and substitution of collateral.

(*r*) If, on or after June 15, 1959, a loan is made for the purpose of purchasing or carrying a security other than a stock registered on a national securities exchange and the loan is secured by the security, but subsequently there is substituted as direct or indirect collateral for the loan a stock so registered which is acquired by the borrower through the conversion or exchange of the security pursuant to its terms, the loan shall thereupon be deemed to be for the purpose of purchasing or carrying a stock so registered. In any such case, the amount of the oustanding loan, or such amount plus any increase therein to enable the borrower to acquire the stock so registered, shall not be permitted on the date such stock is substituted as collateral to exceed the maximum loan value of the collateral for the loan on such date, and thereafter such indebtedness shall be treated as subject to § 221.1; *Provided, however,* That any reduction in the loan or deposit of collateral required on that date to meet this requirement may be brought about within 30 days of such substitution.

(Section 221.4, Supplement, containing maximum loan values and retention requirements, which are changed from time to time, is printed separately.)

APPENDIX

There are printed below certain provisions of the Securities Exchange Act of 1934:

Sec. 3.(a) * * *

(3) The term "member" when used with respect to an exchange means any person who is permitted either to effect transactions on the exchange without the services of another person acting as broker, or to make use of the facilities of an exchange for transactions thereon without payment of a commission or fee or with the payment of a commission or fee which is less than that charged the general public, and includes any firm transacting a business as broker or dealer of which a member is a partner, and any partner of any such firm.

(4) The term "broker" means any person engaged in the business of effecting transactions in securities for the account of others, but does not include a bank.

(5) The term "dealer" means any person engaged in the business of buying and selling securities for his own account, through a broker or otherwise, but does not include a bank, or any person insofar as he buys or sells securities for his own account, either individually or in some fiduciary capacity, but not as a part of a regular business.

(6) The term "bank" means (A) a banking institution organized under the laws of the United States, (B) a member bank of the Federal Reserve System, (C) any other banking institution, whether incorporated or not, doing business under the laws of any State or of the United States, a substantial portion of the business of which consists of receiving deposits or exercising fiduciary powers similar to those permitted to national banks under section 11(k) of the Federal Reserve Act, as amended, and which is supervised and examined by State or Federal authority having supervision over banks, and which is not operated for the purpose of evading the provisions of this title, and (D) a receiver, conservator, or other liquidating agent of any institution or firm included in clauses (A), (B), or (C) of this paragraph.

* * * * *

(9) The term "person" means an individual, a corporation, a partnership, an association, a joint-stock company, a business trust, or an unincorporated organization.

(10) The term "security" means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in

any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

* * * * *

Sec. 7.(a) For the purpose of preventing the excessive use of credit for the purchase or carrying of securities, the Board of Governors of the Federal Reserve System shall, prior to the effective date of this section and from time to time thereafter, prescribe rules and regulations with respect to the amount of credit that may be initially extended and subsequently maintained on any security (other than an exempted security) registered on a national securities exchange. For the initial extension of credit, such rules and regulations shall be based upon the following standard: An amount not greater than whichever is the higher of—

(1) 55 per centum of the current market price of the security, or

(2) 100 per centum of the lowest market price of the security during the preceding thirty-six calendar months, but not more than 75 per centum of the current market price.

Such rules and regulations may make appropriate provision with respect to the carrying of undermargined accounts for limited periods and under specified conditions; the withdrawal of funds or securities; the substitution or additional purchases of securities; the transfer of accounts from one lender to another; special or different margin requirements for delayed deliveries, short sales, arbitrage transactions, and securities to which paragraph (2) of this subsection does not apply; the bases and the methods to be used in calculating loans, and margins and market prices; and similar administrative adjustments and details. For the purposes of paragraph (2) of this subsection, until July 1, 1936, the lowest price at which a security has sold on or after July 1, 1933, shall be considered as the lowest price at which such security has sold during the preceding thirty-six calendar months.

(b) Notwithstanding the provisions of subsection (a) of this

section, the Board of Governors of the Federal Reserve System, may, from time to time, with respect to all or specified securities or transactions, or classes of securities, or classes of transactions, by such rules and regulations (1) prescribe such lower margin requirements for the initial extension or maintenance of credit as it deems necessary or appropriate for the accommodation of commerce and industry, having due regard to the general credit situation of the country, and (2) prescribe such higher margin requirements for the initial extension or maintenance of credit as it may deem necessary or appropriate to prevent the excessive use of credit to finance transactions in securities.

(c) It shall be unlawful for any member of a national securities exchange or any broker or dealer who transacts a business in securities through the medium of any such member, directly or indirectly to extend or maintain credit or arrange for the extension or maintenance of credit to or for any customer—

(1) On any security (other than an exempted security) registered on a national securities exchange, in contravention of the rules and regulations which the Board of Governors of the Federal Reserve System shall prescribe under subsections (a) and (b) of this section.

(2) Without collateral or on any collateral other than exempted securities and/or securities registered upon a national securities exchange, except in accordance with such rules and regulations as the Board of Governors of the Federal Reserve System may prescribe (A) to permit under specified conditions and for a limited period any such member, broker, or dealer to maintain a credit initially extended in conformity with the rules and regulations of the Board of Governors of the Federal Reserve System, and (B) to permit the extension or maintenance of credit in cases where the extension or maintenance of credit is not for the purpose of purchasing or carrying securities or of evading or circumventing the provisions of paragraph (1) of this subsection.

(d) It shall be unlawful for any person not subject to subsection (c) to extend or maintain credit or to arrange for the extension or maintenance of credit for the purpose of purchasing or carrying any security registered on a national securities exchange, in contravention of such rules and regulations as the Board of Governors of the Federal Reserve System shall prescribe to prevent the excessive use of credit for the purchasing or carrying of or trading in securities in circumvention of the other provisions of this section. Such rules and regulations may impose upon all loans made for the purpose of purchasing or carrying

securities registered on national securities exchanges limitations similar to those imposed upon members, brokers, or dealers by subsection (c) of this section and the rules and regulations thereunder. This subsection and the rules and regulations thereunder shall not apply (A) to a loan made by a person not in the ordinary course of his business, (B) to a loan on an exempted security, (C) to a loan to a dealer to aid in the financing of the distribution of securities to customers not through the medium of a national securities exchange, (D) to a loan by a bank on a security other than an equity security, or (E) to such other loans as the Board of Governors of the Federal Reserve System shall, by such rules and regulations as it may deem necessary or appropriate in the public interest or for the protection of investors, exempt, either unconditionally or upon specified terms and conditions or for stated periods, from the operation of this subsection and the rules and regulations thereunder.

(e) The provisions of this section or the rules and regulations thereunder shall not apply on or before July 1, 1937, to any loan or extension of credit made prior to the enactment of this title or to the maintenance, renewal, or extension of any such loan or credit, except to the extent that the Board of Governors of the Federal Reserve System may by rules and regulations prescribe as necessary to prevent the circumvention of the provisions of this section or the rules and regulations thereunder by means of withdrawals of funds or securities, substitutions of securities, or additional purchases or by any other device.

Sec. 29.(a) Any condition, stipulation, or provision binding any person to waive compliance with any provision of this title or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void.

(b) Every contract made in violation of any provision of this title or of any rule or regulation thereunder, and every contract (including any contract for listing a security on an exchange) heretofore or hereafter made the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this title or any rule or regulation thereunder, shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, or regulation, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contract was in violation of any such provision, rule or regulation. * * *

(c) Nothing in this title shall be construed (1) to affect the validity of any loan or extension of credit (or any extension or renewal thereof) made or of any lien created prior or subsequent to the enactment of this title, unless at the time of the making of such loan or extension of credit (or extension or renewal thereof) or the creating of such lien, the person making such loan or extension of credit (or extension or renewal thereof) or acquiring such lien shall have actual knowledge of facts by reason of which the making of such loan or extension of credit (or extension or renewal thereof) or the acquisition of such lien is a violation of the provisions of this title or any rule or regulation thereunder, or (2) to afford a defense to the collection of any debt or obligation or the enforcement of any lien by any person who shall have acquired such debt, obligation, or lien in good faith for value and without actual knowledge of the violation of any provision of this title or any rule or regulation thereunder affecting the legality of such debt, obligation, or lien.

Sec. 32.(a) Any person who willfully violates any provision of this title, or any rule or regulation thereunder the violation of which is made unlawful or the observance of which is required under the terms of this title, or any person who willfully and knowingly makes, or causes to be made, any statement in any application, report, or document required to be filed under this title or any rule or regulation thereunder or any undertaking contained in a registration statement as provided in subsection (d) of section 15 of this title, which statement was false or misleading with respect to any material fact, shall upon conviction be fined not more than $10,000, or imprisoned not more than two years, or both, except that when such person is an exchange, a fine not exceeding $500,000 may be imposed; but no person shall be subject to imprisonment under this section for the violation of any rule or regulation if he proves that he had no knowledge of such rule or regulation.

* * * * *

AT 5068

FEDERAL RESERVE BANK OF NEW YORK

NEW YORK 45, N.Y.

RECTOR 2-5700

August 3, 1961

To the Chief Executive Officer of each Member Bank
in the Second Federal Reserve District:

Enclosed is a reprint of a letter that appeared in the American Banker on July 14, 1961. The letter discusses the problems incident to the issuance of municipal bonds in bearer form in the conventional $1,000 denomination and urges the issuance of such bonds in the $5,000 denomination.

This proposal interests us because municipal bonds constitute the major portion of all securities held by this Bank in safekeeping for account of our member banks. The increasing volume of these bearer bonds placed in our custody during recent years has been attended by growing problems in the servicing of the securities and providing vault space for them.

It seems to us that the issuance by political subdivisions of bearer securities in units of $5,000 would go far toward meeting the problems we have mentioned. We realize, of course, that adoption of the proposal depends ultimately upon investor acceptance generally.

Consequently, we should be interested in learning your views regarding the proposal that municipal bonds in bearer form be issued in the $5,000 denomination rather than in the $1,000 denomination. For this purpose, we should appreciate your completing and returning to us the enclosed questionnaire. We should also welcome any additional comments you may have regarding the subject of these questions.

Very truly yours,

H. A. Bilby

H. A. Bilby,
Vice President.

Enclosures

Questionnaire Regarding Issuance of Municipal Bonds in Units of $5,000 Instead of the Conventional $1,000 Denomination

In answering the questions appearing below please assume that there is being offered a municipal security in bearer form in only the $5,000 denomination and that your bank regards the issue as attractive from an investment standpoint.

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1. Could your bank adapt itself to the $5,000 unit in purchasing and selling this issue for its own account?

   _____ Yes.
   _____ Possibly, it depends.
   _____ No.

   If your answer to the preceding question was "No" or "Possibly", please state the reason.

2. To what extent could purchases and sales for account of your customers be made in units of $5,000?

   Institutional investors:

   All or almost all _____, half or more _____, less than half _____, it depends _____.

   Trusts and estates:

   All or almost all _____, half or more _____, less than half _____, it depends _____.

   Individuals:

   All or almost all _____, half or more _____, less than half _____, it depends _____.

   If any of your answers were "it depends", please explain.

August 1961

_____
Name of Bank

Reprinted from **American Banker** July 14, 1961

Institutional Favor for $5,000 Unit Municipal Bonds Seen by Dillistin

Editor, AMERICAN BANKER:

The article on "Municipal Bonds in $5,000-Units" in your issue of May 11 was of considerable interest to me for it was during my term of office last year as Mayor of Paterson, N. J., that probably the first practical offering of coupon bonds of such a denomination was made in the metropolitan New York area. In May, 1958, however, Franklin County, O., had sold $10 million of coupon bonds in the denomination of $5,000.

The subject of bonds of the denomination of $5,000 has had my attention for the past two or three years as a result of a question asked of me by the trust officer of a large bank whose earlier training had been in the legal profession. He inquired, "Why don't we have a municipal bond of the denomina ion of $5,000? Others have suggested registered bonds in $100,-000 denominations, where big issues are concerned.

After careful thought and consideration, I submitted to Messrs. Hawkins, Delafield & Wood, municipal bond attorneys, a suggested change in the usual form of notice of sale of municipal bonds in order to provide, in a limited manner, for bonds of the denomination of $5,000. The proposed change, after minor revisions, was found acceptable to them, permissive under the Laws of New Jersey, and was subsequently incorporated in a notice of sale in June 1960 of approximately $5 million water revenue bonds of the Cities of Paterson, Passaic, and Clifton (New Jersey) for the joint benefit of the Passaic Valley Water Commission. The successful bidder had the option of taking all the bonds of any maturity in the denomination of $5,000. No requests for bonds of that denomination were received.

On April 13 last the City of Paterson offered $1,857,000 of general obligations under the same conditions and approximately 12% of the total were taken in the denomination of $5,000.

With respect to that sale, the "Weekly Bond Buyer" stated April 24, "A major breakthrough in the tradition of issuing State and local government securities in $1,000 units took place recently. . . ."

Again on May 3 last the County of Passaic (New Jersey) offered $1,090,-000 general obligations under the same conditions and $50,000 of that issue were taken in the denomination of $5,000.

Favorable Factors Ignored

While these sales were a breakthrough I feel that this program has not as yet had the necessary publicity to bring its favorable factors before the banks, various trustees, insurance companies, corporation executives, and others. Many individuals and others who might be interested in such a denomination were not aware that bonds of the denomination of $5,000 were available.

My impression, gained after talking with several underwriters and dealers in municipal securities, is that many of them display a rather apathetic attitude and it is not receiving the backing that I think it deserves. They appear satisfied to go along as in the "horse and buggy days" when one, two, or three $1,000 bonds were a common delivery as compared to frequent sales today in units of five, ten, and 20 bonds.

In support of this apathetic attitude, a smoke screen has been set up since there has been no provision so far for exchange of denominations, due to the cost involved and a question as to the ability of a trustee to divide equally—for example, three $5,000 bonds among four heirs of an estate. The latter makes little sense since a trustee would be faced with the same problem if called upon to divide three $1,000 bonds among four heirs. Furthermore the relatively small percentage of outstanding bonds that might be involved in such a situation should not outweigh the many favorable factors otherwise presented.

There will continue to be many issues of $1,000 bonds and in sufficient number to satisfy prospective purchasers who desire to look ahead for a split-up in years to come. Investors with such a program in mind constitute an extremely small percentage, and as to dollar volume, an infinitesimal sum is involved as compared to the total of such bonds outstanding.

A question has also been raised with respect to smaller municipalities where statutory maturities make it impractical or impossible to have the total of each annual maturity a multiple of $5,000. There are many such issues and this over-all program does not contemplate that every future issue of State and municipal bonds be offered in the denomination of $5,000.

Underwriters Polled

Last September the Comptroller of the City of St. Louis took a poll of the underwriters and others who had submitted bids at previous sales of their bonds. The underwriters were asked, in effect, to indicate whether they would prefer that bonds of the denomination of $5,000 be offered at a forthcoming sale. Letters went out to 113 previous bidders, 98 replies were received, 68 were not in favor of such a bond and 25 indicated that they favored such a denomination.

This was a poll, not of the institutional buyers, but of underwriters, who have little or nothing to do with the physical handling of the bonds at the time of issue, their subsequent safekeeping, the cutting of coupons, and handling of maturing bonds.

A survey of institutional buyers who actually hold physical possession of such bonds, would present a generally favorable showing as to whether bonds of a larger denomination would be welcome.

In Special Convention Issue No. 1, of the "Daily Bond Buyer," dated Nov. 28, 1960, issued in connection with the convention of the Investment Bankers Association of America, an excellent article appeared by the late George Wanders, editor of that publication entitled "Sizes of Debt Issues Getting to Be Critical."

Favorable Resolution

He pointed out in effect that from all over the country murmurs are heard and municipal organizations are taking action with respect to bonds of larger denominations than $1,000. He stated that incidental to the New York convention of the Municipal Finance Officers Association held in New York City in June, 1960, Daniel B. Goldberg, General Solicitor of the Port of New York Authority, presented a motion which was adopted unanimously by committeemen members from the Investment Bankers Association, the Municipal Law Section of the American Bar Association, the National Institute of Municipal Law Officers and the Municipal Forum of New York, along with the Municipal Finance Officers Association.

Mr. Goldberg noted in his motion that larger investors in tax-exempts are finding the handling and storage of $1,000 pieces "irritating" and he proposed legal steps empowering issuers to make $5,000 pieces and multiples available, along with $1,000 pieces. His resolution included a reference to laws in some States which restrict a municipal issuer to $1,000 pieces, and he urged changes so that larger pieces could be issued if desired by investors.

Such a program is legal in New Jersey and has been tried out. Why do not other municipalities where $5,000 bonds are legal, offer bonds of the denomination of $5,000 on an optional or other basis in order to bring them before the larger investors? Why does this program need further study? The investing public, if such denominations are available, will soon indicate whether or not they are acceptable.

Space Problem Grows

The late Mr. Wanders in his article referred to herein pointed out that, "Bank vaults bulge with the vast accumulation [of State and municipal bonds] and still the call is for more space and manpower for processing the bonds." Accompanying that article is an illustration of a building for the storage of bonds which depicts an enormous stack of bonds bursting through the roof of the building and reaching high into the sky.

As to the vast accumulation of such bonds, the Special Conference Issue No. 1, of the "Daily Bond Buyer" May 22, 1961, sets forth a tabulation showing "Comparative Statistics on Municipal Finance," which shows among other information that the total of State and municipal debt has risen in the last 20 years from $19.8 billion to $68.4 billion, an increase of 235%.

A recent single issue of State bonds will serve to illustrate a vivid and outstanding example of the practical problems involved with reference to storage and physical operations necessary to service the maturing coupons and bonds of that particular issue.

In April last the State of California sold an issue of $190 million of bonds of the denomination of $1,000 each—190,000 separate pieces if all were taken in coupon bonds. Registered bonds were also available.

On the basis of coupon bonds, 27,-200 separate bonds mature in the first five years and the detaching of 1,930,000 coupons will be necessary to collect the interest on these bonds during the same five-year period.

This issue of bonds at inception, if stacked one on top of the other would make a pile approximately 99 feet high and stacked solid in a vault compartment a space six and one-half feet long, four feet wide, and eight feet high would be required. The cubic content of such bonds is approximately 208 cubic feet.

If these bonds were issued in the denomination of $5,000, the cubic content would be reduced to approximately 41.6 feet and the pile would be reduced to approximately 19.8 feet, a reduction of 80% in both instances.

The California bonds are of the "wing" type, that is, one flat sheet with coupons to the right side of the indenture. It has been estimated that the verification and count of coupons from this type of bond would be at the rate of 100 coupons in five and one-half minutes, and to detach and verify the count of coupons for one six-month period from the entire issue would require about 160 man hours.

The "book" type of bond, that is, a sheet of coupons attached to the sheet setting forth the indenture, requires that each coupon be detached in a separate operation, and in such cases considerably more time would be necessary.

How long will it be before the cubic content of new issues of State and municipal bonds will absorb existing vault facilities? There should be more offerings of bonds of larger denominations and greater efforts should be made to bring the availability of such denominations to the attention of the investing public.

The writer has some practical knowledge of the storage and operating problems involved, having served the Federal Reserve Bank of New York for nearly 30 years, the last ten years previous to retirement having been in the capacity of General Auditor.

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