

FEDERAL RESERVE BANK
OF NEW YORK

Circular No. 6469
January 20, 1970

INTERPRETATION OF REGULATION A
Eligibility for Discount of Mortgage Company Notes

To the Member Banks of the Second Federal Reserve District:

Printed below is an excerpt from the Federal Register of January 15, containing the text of an interpretation of Regulation A of the Board of Governors of the Federal Reserve System. The interpretation contains the Board's holding that notes meeting the maturity requirements of Regulation A and issued to finance the temporary "warehousing" of real estate mortgage loans are eligible for discount by Reserve Banks.

Additional copies of this circular will be furnished upon request.

Alfred Hayes,
President.

Title 12—BANKS AND BANKING

Chapter II—Federal Reserve System

**SUBCHAPTER A—BOARD OF GOVERNORS OF
THE FEDERAL RESERVE SYSTEM**

[Reg. A]

PART 201—ADVANCES AND DISCOUNTS BY FEDERAL RESERVE BANKS

Eligibility for Discount of Mortgage Company Notes

§ 201.109 Eligibility for discount of mortgage company notes.

(a) The question has arisen whether notes issued by mortgage banking companies to finance their acquisition and temporary holding of real estate mortgages are eligible for discount by Reserve Banks.

(b) Under section 13 of the Federal Reserve Act the Board has authority to define what are "agricultural, industrial, or commercial purposes", which is the statutory criterion for determining the eligibility of notes and drafts for discount. However, such definition may not include paper "covering merely investments or issued or drawn for the purpose of carrying or trading in stocks, bonds, or other investment securities".

(c) The legislative history of section 13 suggests that Congress intended to make eligible for discount "any paper drawn for a legitimate business purpose of any kind"¹ and that the Board, in determining what paper is eligible, should place a "broad and adaptable

construction"² upon the terms in section 13. It may also be noted that Congress apparently considered paper issued to carry investment securities as paper issued for a "commercial purpose", since it specifically prohibited the Board from making such paper eligible for discount. If "commercial" is broad enough to encompass investment banking, it would also seem to include mortgage banking.

(d) In providing for the discount of commercial paper by Reserve Banks, Congress obviously intended to facilitate the current financing of agriculture, industry, and commerce, as opposed to long-term investment.³ In the main, trading in stocks and bonds is investment-oriented; most securities transactions do not directly affect the production or distribution of goods and services. Mortgage banking, on the other hand, is essential to the construction industry and thus more closely related to industry and commerce. Although investment bankers also perform similar functions with respect to newly issued securities, Congress saw fit to deny eligibility to all paper issued to finance the carrying of securities. Congress did not distinguish between newly issued and outstanding securities, perhaps covering the larger area in order to make certain that the area of principal concern (i.e., trading in outstanding stocks and bonds) was fully included. Speculation was also a major Congressional concern, but speculation is not a material element in mortgage banking operations. Mortgage

loans would not therefore seem to be within the purpose underlying the exclusions from eligibility in section 13.

(e) Section 201.3(a) provides that a negotiable note maturing in 90 days or less is not eligible for discount if the proceeds are used "for permanent or fixed investments of any kind, such as land, buildings or machinery, or for any other fixed capital purpose". However, the proceeds of a mortgage company's commercial paper are not used by it for any permanent or fixed capital purpose, but only to carry temporarily an inventory of mortgage loans pending their "packaging" for sale to permanent investors that are usually recurrent customers.

(f) In view of the foregoing considerations the Board concluded that notes issued to finance such temporary "warehousing" of real estate mortgage loans are notes issued for an industrial or commercial purpose, that such mortgage loans do not constitute "investment securities", as that term is used in section 13, and that the temporary holding of such mortgages in these circumstances is not a permanent investment by the mortgage banking company. Accordingly, the Board held that notes having not more than 90 days to run which are issued to finance the temporary holding of mortgage loans are eligible for discount by Reserve Banks.

(Interprets and applies 12 U.S.C. 343)

By order of the Board of Governors,
December 30, 1969.

[SEAL] KENNETH A. KENYON,
Deputy Secretary.

[F.R. Doc. 70-531; Filed, Jan. 14, 1970;
8:46 a.m.]

¹ 50 Cong. Rec. 4675 (1913) (remarks of Rep. Phelan).

² 50 Cong. Rec. 5012 (1913) (remarks of Rep. Thompson of Oklahoma); 50 Cong. Rec. 4731-32 (1913) (remarks of Rep. Borland).

³ House Report No. 69, 63d Cong., p. 48.