INTERPRETATION OF REGULATION A
Types of Bankers’ Acceptances Eligible for Discount

To All Member Banks, and Others Concerned,
in the Second Federal Reserve District:

Following is the text of a statement by the Board of Governors of the Federal Reserve System announcing the adoption of an interpretation of its Regulation A, “Extensions of Credit by Federal Reserve Banks”:

The Board of Governors of the Federal Reserve System today [May 10] announced adoption of a regulatory interpretation that extends the kinds of bankers’ acceptances eligible for discount by Federal Reserve Banks.

The interpretation makes bankers’ acceptances secured by field warehouse receipts covering readily marketable staples eligible for discount. That is, such acceptances may be used as collateral for Federal Reserve loans to member banks.

The interpretation was adopted as proposed by the Board last December, with some technical changes based on comment received. Comment was generally favorable.

A 1933 interpretation by the Board held that acceptances backed by field warehouse receipts were not eligible for discount and therefore could not be used as collateral for loans to member banks.

In reviewing the matter, the Board concluded that changes in commercial law and in commercial practices since 1933 made revision of the interpretation desirable.

A bankers’ acceptance is a time draft usually used to finance the shipment or storage of goods.

Enclosed is a copy of the interpretation. Questions may be directed to our Discount Division (Tel. No. 212-791-5395).

PAUL A. VOLCKER,
President.
Board of Governors of the Federal Reserve System

EXTENSIONS OF CREDIT BY FEDERAL RESERVE BANKS

INTERPRETATION OF REGULATION A

Eligible Bankers' Acceptances

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final Interpretation.

SUMMARY: This Interpretation provides that a bankers' acceptance secured by a field warehouse receipt covering readily marketable staples is eligible for discount by a Federal Reserve Bank even though the warehouse manager is an employee of the owner of the goods. This supersedes an Interpretation adopted by the Board in 1933. (¶ 1445 Published Interpretations)

DATE: Effective immediately.

ADDRESS: Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551.

FOR FURTHER INFORMATION CONTACT: Allen L. Raiken, Associate General Counsel, Legal Division, Board of Governors of the Federal Reserve System, Washington, D.C. 20551 [(202) 452-3625].

SUPPLEMENTARY INFORMATION:
(1) The Board was recently asked to review its 1933 Interpretation concerning the eligibility for discount of bankers' acceptances secured by field warehouse receipts. Under that Interpretation, such acceptances were determined to be not eligible for discount because the actual custodian of the goods was so closely identified with the owner of the goods that, in the Board's view, the lending bank's security might be impaired. The Board concluded that a review of the Interpretation was desirable in light of the changes in commercial practice and commercial law in the 45 years since the publication of the old Interpretation. Furthermore, this matter is of significance to member banks because, under the Board's Regulation D, the sale of such acceptances by member banks could result in additional reserve liability for the member bank if the acceptance sold were not eligible for discount.
(2) A proposed Interpretation was issued for public comment in December, 1977 (42 Federal Register 63897-8). Comments were received from all twelve Federal Reserve Banks, seven commercial banks, two law firms, a bankers association, and a field warehousing company. All of the comments except two were favorable to adoption of the proposed Interpretation.

As a result of the comments received, certain technical changes have been made to the proposed Interpretation. The Interpretation stated that if a bankers' acceptance were offered for discount or as collateral for an advance, a Reserve Bank could require proof of adequate insurance and proof of the existence of a written security agreement and a filed financing statement. This language has been deleted from the final Interpretation for two reasons: (1) A Reserve Bank has broad discretion in accepting collateral that may be presented at its discount window and the deleted provisions could have been misinterpreted as somehow limiting the types of inquiry that a Reserve Bank could make regarding acceptances; and (2) the deleted language, which pertained only to the acceptability of the acceptance as collateral, might have been misinterpreted as also having an impact on the eligibility of the acceptance for discount. In other words, a bankers' acceptance that meets the requirements of the Interpretation is eligible for discount even though it may be subject to further scrutiny before a Reserve Bank would find it acceptable as collateral for an advance.

The proposed Interpretation indicated that a warehouse receipt issued pursuant to a properly conducted field warehousing operation provides the lending bank with a perfected security interest in the goods and that a perfected security interest satisfies the "securing title" requirement of the Federal Reserve Act, Section 13, ¶ 7. These statements may have led some readers to the erroneous conclusion that if the lender has a perfected security interest (regardless of how the interest was created and perfected), the acceptance is properly secured. The Act, however, clearly requires that an acceptance be secured "by a warehouse receipt or other such document," and contemplates that at the time of acceptance the goods will be held in the custody of a third party. Consequently, the Board has determined that
receipts issued by an independent custodian of the goods may be treated as warehouse receipts [¶ 1470 Published Interpretations], but has reached the opposite conclusion in regard to documents such as chattel mortgages that leave the borrower in possession of the goods [¶ 1475 Published Interpretations]. Therefore, while it may be desirable for a lending bank to seek the added protection of a security interest created by a written security agreement and perfected by the filing of a financing statement, this perfected security interest alone, without a field warehouse receipt, does not satisfy the requirements of the Act.

Finally it should be noted that not all field warehousing operations will necessarily satisfy the requirements of the Interpretation and it is incumbent upon each lender to insure that the policies and procedures adopted and followed by a field warehousing company provide the lender with satisfactory security.

(3) This action is taken pursuant to the Board’s authority under section 13 of the Federal Reserve Act (12 U.S.C. 342 et seq.).

INTERPRETATION OF REGULATION A

¶ 1445—Goods held by persons employed by owner (12 CFR 201.110)

(a) The Board has been asked to review an Interpretation it issued in 1933 concerning the eligibility for rediscount by a Federal Reserve Bank of bankers’ acceptances issued against field warehouse receipts where the custodian of the goods is a present or former employee of the borrower. [¶ 1445 Published Interpretations, 1933 BULLETIN 188] The Board determined at that time that the acceptances were not eligible because:

such receipts do not comply with the requirement of section 13 of the Federal Reserve Act that a bank’s acceptance be “secured at the time of acceptance by a warehouse receipt or other such document conveying or securing title covering readily marketable staples,” nor with the requirement of section XI of the Board’s Regulation A that it be “secured at the time of acceptance by a warehouse, terminal, or other similar receipt, conveying security title to such staples, issued by a party independent of the customer.”

The requirement that the receipt be “issued by a party independent of the customer” was deleted from Regulation A in 1973, and thus the primary issue for the Board’s consideration is whether a field warehouse receipt is a document “securing title” to readily marketable staples.

(b) While bankers’ acceptances secured by field warehouse receipts are rarely offered for rediscount or as collateral for an advance, the issue of “eligibility” is still significant. If an ineligible acceptance is discounted and then sold by a member bank, the proceeds are deemed to be “deposits” under section 204.1(f) of Regulation D and are subject to reserve requirements.

(c) In reviewing this matter, the Board has taken into consideration the changes that have occurred in commercial law and practice since 1933. Modern commercial law, embodied in the Uniform Commercial Code, refers to “perfecting security interests” rather than “securing title” to goods. The Board believes that if, under State law, the issuance of a field warehouse receipt provides the lender with a perfected security interest in the goods, the receipt should be regarded as a document “securing title” to goods for the purposes of § 13 of the Federal Reserve Act. It should be noted, however, that the mere existence of a perfected security interest alone is not sufficient; the Act requires that the acceptance be secured by a warehouse receipt or its equivalent.

(d) Under the U.C.C., evidence of an agreement between the secured party and the debtor must exist before a security interest can attach. [U.C.C. § 9-202] This Agreement may be evidenced by: (1) a written security agreement signed by the debtor, or (2) the collateral being placed in the possession of the secured party or his agent [U.C.C. § 9-203]. Generally, a security interest is perfected by the filing of a financing statement. [U.C.C. § 9-302] However, if the collateral is in the possession of a bailee, then perfection can be achieved by: (1) having warehouse receipts issued in the name of the secured party; (2) notifying the bailee of the secured party’s interest; or (3) having a financing statement filed. [U.C.C. § 9-304(3)]

(e) If the field warehousing operation is properly conducted, a security interest in the goods is perfected when a warehouse receipt is issued in the name of the secured party (the lending bank). Therefore, warehouse receipts issued pursuant to a bona fide field warehousing operation satisfy the legal requirements of section 13 of the Federal Reserve Act. Moreover, in a properly conducted field warehousing operation, the warehouse manager will be trained, bonded, supervised and audited by the field warehousing company. This procedure tends to insure that he will not be impermissibly controlled by his former (or sometimes present) employer, the borrower, even though he may look to the borrower for reemployment at some future time. A prudent lender will, of course, carefully review the field warehousing
operation to ensure that stated procedures are satisfactory and that they are actually being followed. The lender may also wish to review the field warehousing company’s fidelity bonds and legal liability insurance policies to ensure that they provide satisfactory protection to the lender.

(f) If the warehousing operation is not conducted properly, however, and the manager remains under the control of the borrower, the security interest may be lost. Consequently, the lender may wish to require a written security agreement and the filing of a financing statement to insure that the lender will have a perfected security interest even if it is later determined that the field warehousing operation was not properly conducted. It should be noted, however, that the Federal Reserve Act clearly requires that the bankers’ acceptance be secured by a warehouse receipt in order to satisfy the requirements of eligibility, and a written security agreement and a filed financing statement, while desirable, cannot serve as a substitute for a warehouse receipt.

(g) This Interpretation is based on facts that have been presented in regard to field warehousing operations conducted by established, professional field warehouse companies, and it does not necessarily apply to all field warehousing operations. Thus ¶ 1430 and ¶ 1440 of the Published Interpretations [1918 BULLETIN 31 and 1918 BULLETIN 862] maintain their validity with regard to corporations formed for the purpose of conducting limited field warehousing operations. Furthermore, the prohibition contained in ¶ 1435 Published Interpretations [1918 BULLETIN 634] that “the borrower shall not have access to the premises and shall exercise no control over the goods stored” retains its validity, except that access for inspection purposes is still permitted under ¶ 1450 [1926 BULLETIN 666]. The purpose for the acceptance transaction must be proper and cannot be for speculation [¶ 1400, 1919 BULLETIN 858] or for the purpose of furnishing working capital [¶ 1405, 1922 BULLETIN 52].

(h) This interpretation supersedes only the previous ¶ 1445 of the Published Interpretations [1933 BULLETIN 188], and is not intended to affect any other Board Interpretation regarding field warehousing.