FEDERAL RESERVE BOARD

WASHINGTON

April 5,1919.
X-1461

SUBJECT: Security Covering Acceptances in Excess of 10 per cent Limitation of Section 13.

Sir:

In an opinion of this office printed on page 254 of the March 1919 Bulletin, it was stated that although Section 13 of the Federal Reserve Act authorizes member banks to accept drafts drawn in domestic transactions only when secured at the time of acceptance, nevertheless, the security may properly be released after acceptance, provided, however, that in any case where the total amount accepted for any one customer exceeds ten per cent of the capital and surplus of the accepting bank the security cannot be released unless some other actual security growing out of the same transaction is substituted therefor.

The question has since been raised whether the accepting bank may release the security against drafts aggregating ten per cent of the capital and surplus of the bank in a case where the total amount of drafts accepted for one customer and outstanding at one time is in excess of that limit.

Section 13 provides in part that:

> "No member bank shall accept, whether in a foreign or domestic transaction, for any one person, company, firm, or corporation to an amount equal at any time in the aggregate to more than ten per centum of its paidup and unimpaired capital stock and surplus, unless the bank is secured either by attached documents or by some other actual security growing out of the same transaction as the acceptance: and no bank shall accept such bills to an amount equal at any time in the aggregate to more than one-half of its paid-up and unimpaired capital stock and surplus."

The question under consideration involving a construction of this paragraph may present itself in either one of two ways:

First: Under the provisions of the section quoted above, a bank may properly accept for one individual at one time, drafts aggregating as much as 50% of its capital and surplus if the bank is secured either by attached documents or by some other actual security growing out of the same transaction as the acceptance. In such a case may the bank after acceptance release the security covering drafts aggregating 10% of its capital and surplus if it retains the security covering the balance of the drafts?

Second: Under the provisions of the section quoted above, a bank may properly accept for one individual drafts aggregating 10% of its capital and surplus, and immediately thereafter release the security against that 10%. The question then is whether the bank may properly accept additional drafts for the customer before the first drafts have been liquidated if the bank holds some actual security to cover those additional acceptances?

A careful consideration of the provisions of the law indicates that Congress intended that the accepting bank may properly rely upon the general credit of the customer in acceptance transactions up to 10% of its capital and surplus but that for any acceptance liability in excess of that amount, incurred for the same customer, it must hold some actual security.

In the second case mentioned above, therefore, where a bank has accepted for a customer drafts aggregating 10% of its capital and surplus, it may accept additional drafts for that same customer even before the first drafts have been liquidated and even though it no longer holds any security against those first drafts, provided, of course, that it holds some actual security against the additional drafts.

It seems certain that Congress did not intend in any case of that character entirely to prohibit the additional acceptances but that it intended to authorize them only if the accepting bank retains some actual security against those additional acceptances so long as they constitute an acceptance liability in excess of 10% of its capital and surplus. If this were not the proper construction of the law a bank which unquestionably might have accepted for one customer drafts aggregating even as much as 50% of its capital and surplus when secured, would be limited to 10% for that same customer if it had outstanding any acceptances of the customer, no matter how small in amount, against which it had already released the security. Or to put it another way - a bank which had accepted for one customer unsecured drafts aggregating 10% of its capital and surplus growing out of an export transaction, would not be permitted to accept any domestic drafts whatever for that same customer, unless the law is construed to mean that the security provided for in the section quoted above is required only as to the amount over and above the 10% limitation.

I believe that both the letter and the spirit of the law authorize the accepting bank to rely upon the general credit of the customer on its acceptance liabilities up to an amount equal to 10% of its capital and surplus and that in the first case described above, it may release the security against drafts aggregating that amount provided it holds some actual security against the balance of the drafts accepted for that customer and that in the second case described above it may accept the additional drafts over and above the 10% limit even though it has previously released the security against the first drafts, provided that it retains some actual security against those additional drafts as long as they constitute an acceptance liability in excess of ten per cent. of the bank's capital and surplus.

Respectfully,

Hon. W.P.G. Harding,
Governor, Federal Reserve Board.

GEORGE L. HARRISON.
General Counsel.