

FEDERAL RESERVE BOARD
WASHINGTON

X-3480

July 21, 1922.

SUBJECT: Act of July 1, 1922 amending Section 9 of the
Federal Reserve Act.

Dear Sir:

For your information, there is enclosed herewith a copy of a memorandum which has been approved by the Board and which will be published in the Law Department of the Federal Reserve Bulletin for August, 1922, explaining the effect of the Act of Congress approved July 1, 1922, amending Section 9 of the Federal Reserve Act.

The memorandum contains also an analysis of the provisions of Section 5200 of the Revised Statutes and a brief discussion of the limitation on the amount of paper of any one borrower that a Federal Reserve Bank may discount for any one member bank.

Yours very truly,

G o v e r n o r .

TO ALL FEDERAL RESERVE AGENTS
AND GOVERNORS.

UNDER THE ACT APPROVED JULY 1, 1922, THE
REDISCOUNT PRIVILEGE OF MEMBER STATE BANKS
IS CONDITIONAL ONLY ON COMPLIANCE WITH THE
TERMS OF SECTION 5200 REVISED STATUTES.

The Act approved July 1, 1922, the text of which was published in the Law Department of the Federal Reserve Bulletin for July, 1922, amended Section 9 of the Federal Reserve Act by striking out the following proviso in the 10th paragraph:

"That no Federal reserve bank shall be permitted to discount for any State bank or trust company notes, drafts, or bills of exchange of any one borrower who is liable for borrowed money to such State bank or trust company in an amount greater than ten per centum of the capital and surplus of such State bank or trust company, but the discount of bills of exchange drawn against actually existing value and the discount of commercial or business paper actually owned by the person negotiating the same shall not be considered as borrowed money within the meaning of this section".

and substituting in lieu thereof the following:

"That no Federal reserve bank shall be permitted to discount for any State bank or trust company notes, drafts, or bills of exchange of any one borrower who is liable for borrowed money to such State bank or trust company in an amount greater than that which could be borrowed lawfully from such State bank or trust company were it a national banking association".

The provisions of Section 5200 of the Revised Statutes determine the amount which a single customer may legally borrow from a national bank and the effect of the amendment to Section 9 of the Federal Reserve Act is, therefore, to permit a Federal Reserve Bank to rediscount for a member State bank the eligible paper of a customer of that State bank whenever the total loans of the State bank to that customer are not in excess of the limits prescribed by Section 5200 of the Revised Statutes. This section excludes from consideration as money borrowed, as did the old provision of Section 9 of the Federal Reserve Act, the discount of bills of exchange

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drawn in good faith against actually existing values, and the discount of commercial or business paper actually owned by the person negotiating the same, and provides also that certain other kinds of paper, which were not referred to in Section 9, may be discounted in excess of the normal limit of ten per cent of the bank's capital and surplus. The effect of the amendment is, therefore, to broaden the rediscount privilege of member State banks and to place these banks on an equality with national banks in this respect. The amendment does not, of course, affect any part of Section 9 except the proviso which is specifically referred to, and under the terms of the sentence that immediately follows this proviso it is still necessary that "The Federal reserve bank, as a condition of the discount of notes, drafts, and bills of exchange for such State bank or trust company, shall require a certificate or guaranty to the effect that the borrower is not liable to such bank in excess of the amount provided by this section, and will not be permitted to become liable in excess of this amount while such notes, drafts, or bills of exchange are under discount with the Federal reserve bank."

Analysis of Section 5200 R. S.

In view of this amendment, and for the information of member State banks particularly, the Federal Reserve Board deems it appropriate at this time to re-publish the analysis of the provisions of Section 5200 of the Revised Statutes which was previously published on page 1055 of the Federal Reserve Bulletin for November, 1919.

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The analysis states the amount which may be loaned to any person, company, firm or corporation (including in the liability of a company or firm the liability of the several members thereof) under the various clauses of Section 5200, as last amended by the Act approved October 22, 1922. These amounts are stated in terms of the percentage of the paid-in and unimpaired capital and surplus of the lending bank.

<u>Character of Loans</u>	<u>Amount Loanable.</u>
(A) Accommodation or straight loans, whether or not single name,	Maximum limit, 10% of bank's paid-up and unimpaired capital and surplus.
(B) "Bills of exchange drawn in good faith against actually existing values". The law expressly provides that this phrase shall also include: (a) Drafts and bills of exchange secured by shipping documents conveying or securing title to goods shipped. (b) Demand obligations, when secured by documents covering commodities in actual process of shipment. (c) Bankers' acceptances of the kinds described in Section 13 of the Federal Reserve Act.	No limit imposed by law.
(C) Commercial or business paper (of other makers) actually owned by the person, company, corporation or firm negotiating the same	No limit imposed by law.
(D) Notes secured by shipping documents, warehouse receipts or other such documents, conveying or securing title covering readily marketable non-perishable staples, including live stock. No bank may make any loan under (D), however, (a) Unless the actual market value of the property securing	15% of bank's capital and surplus <u>in addition to</u> the amount allowed under (A): or if the full amount allowed under (A) is not loaned then the amount which may be loaned in the manner described under (D) is increased by the loanable amount not used under (A). In other words, the amount loaned under (A) must never be more than 10% but the

Character of LoansAmounts Loanable.

<p>the obligation is not at any time less than 115% of the face amount of the note, and</p> <p>(b) Unless the property is fully covered by insurance, and in no event shall the privilege afforded by (D) be exercised for any one customer for more than six months in any consecutive twelve months.</p>	<p>aggregate of (A) and (D) may equal, but not exceed, 25%.</p>
<p>(E) Notes secured by not less than a <u>like face amount</u> of bonds or notes of the United States issued since April 24, 1917, or by certificates of indebtedness of the United States.</p>	<p>10% of bank's capital and surplus, <u>in addition to</u> the amount allowed under (A), or if the full amount allowed under (A) is not loaned, then the amount which may be loaned in the manner described under (E) is increased by the loanable amount not used under (A). In other words, the amount loaned under (A) must never be more than 10%, but the aggregate of (A) and (E) may equal, but not exceed, 20%</p>
<p>(F) Notes secured by U.S. Government obligations of the kinds described under (E) the face amount of which is at least equal to 105% of the amount of the customer's notes.</p>	<p>No limit, but this privilege, under regulations of the Comptroller of the Currency, expires December 31, 1922.</p>

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Some examples of what may be loaned to any one customer under Section 5200 of the Revised Statutes, expressed in terms of percentage of the lending bank's capital and surplus.

	<u>Illustration 1</u>	<u>Illustration 2</u>	<u>Illustration 3</u>
(A) Accommodation or straight loans,	10%	5%	5%
(D) Notes secured by warehouse receipts, etc.	15%	20%	15%
(E) Notes secured by a like face amount of Government obligations	10%	10%	15%
Total	35%	35%	35%
(B) Bills of exchange drawn against actually existing values		No limit imposed by law.	
(C) Commercial or business paper	"	"	"
(F) Notes secured by at least 105% of U. S. Government obligations,	"	"	"

What a Federal Reserve Bank may re-
discount for its member banks.

A Federal Reserve Bank may not, of course, under any circumstances, rediscount paper other than that which is eligible under the terms of the Federal Reserve Act. So also the limitations imposed upon the amounts of rediscounts which Federal Reserve Banks may make for member banks, whether State or national, are determined by the provisions of the Federal Reserve Act and are not in any way affected by the amendment to Section 5200.

Under the provisions of Section 13 of the Federal Reserve Act any Federal Reserve Bank may rediscount for any member bank, whether State or national, eligible paper of any one borrower to the extent of ten per cent of the member bank's capital and surplus but it is expressly provided that "this restriction shall not apply to the discount of bills of exchange drawn against actually existing values".

In the opinion of the Federal Reserve Board this phrase "bills of exchange drawn against actually existing values" includes "drafts or bills of exchange secured by shipping documents conveying or securing title to goods shipped" and "bankers' acceptances of the kinds described in Section 13 of the Federal Reserve Act" even though Section 13 (unlike the amendment to Section 5200) does not expressly state that those two classes of paper are bills of exchange drawn against actually existing values. In the opinion of the Board, however, accepted demand bills on which the drawer is released from liability are not "bills of exchange" within the meaning of Section 13 and must, therefore, be included in determining the limits on the amount of paper of any one borrower which a Federal Reserve Bank may rediscount for any member bank.