

X-4484

December 30, 1925.

SUBJECT: Eligibility for Rediscount of Notes of Corporation  
Representing Borrowings of Funds to be Advanced to  
Subsidiaries.

Dear Sir:

The Federal Reserve Board has recently had occasion to rule upon the eligibility for rediscount at a Federal reserve bank of notes of a parent corporation representing borrowings by the parent corporation of funds to be advanced to its own subsidiaries.

In the particular case presented to the Board for a ruling it appeared that formerly member banks took the notes of the subsidiaries with the endorsement of the parent corporation and that such notes were considered eligible for rediscount at Federal reserve banks; but that recently the parent corporation had decided that it would be better and simpler financing for it to borrow all funds to be used by it or its subsidiaries on its own notes and to make advances from such borrowings to its subsidiaries. Two of the Federal reserve banks, however, took the position that, under the regulations of the Federal Reserve Board, notes of the parent corporation given for funds borrowed for the purpose of making advances to its own subsidiaries must be classed as "finance paper" which is ineligible for rediscount at Federal reserve banks; and a member bank requested the Board to reconsider the question with a view of ascertaining whether a more liberal interpretation could be placed upon that provision of its regulations which pertains to finance paper.

The position taken by the Federal reserve banks in this matter is in accordance with a strict technical interpretation of that provision of the Board's regulations which provides that in order for paper to be eligible for rediscount the proceeds of such paper must have been used "in the first instance" for an eligible purpose and that paper "the proceeds of which have been or are to be advanced or loaned to some other borrower" is not eligible for rediscount. Upon further consideration of this question, however, the Board reached the conclusion that this is an unnecessarily strict interpretation of its regulations in cases of this kind, and the Board ruled that where a parent corporation owns at least 75 per cent of the stock of each of a number of subsidiary corporations the notes of such parent corporation the proceeds of which

have been advanced or loaned to its subsidiary corporations will not be considered finance paper within the meaning of the Board's regulations; provided that (1) the parent corporation makes no advances except to its own subsidiaries, (2) the subsidiaries borrow no money except from the parent corporation, and (3) the proceeds of such advances have been or are to be used by the subsidiary corporation for an industrial, commercial, or agricultural purpose, within the meaning of the Federal Reserve Act and the Board's regulations. It is understood, of course, that in order to be eligible for rediscount such paper must also comply in all other respects with the requirements of the law and the Board's regulations.

The Board has heretofore published several rulings to the effect that paper representing borrowings by one person, firm, or corporation of funds to be advanced to an independent person, firm, or corporation, is "finance paper" and is therefore ineligible for rediscount; and this ruling is not intended as a reversal or qualification of those rulings. There is a clear distinction, however, between cases such as those covered in the rulings above mentioned and the case here presented; because, where the borrower is a parent corporation and makes advances only to subsidiary corporations owned by it, the parent corporation and the subsidiaries are in practical effect one single organization and may with propriety be viewed as a single borrower.

Very truly yours,

D. R. CRISSINGER,  
Governor.

TO GOVERNORS AND FEDERAL RESERVE AGENTS OF ALL F. R. BANKS