

(INTERPRETATION OF BANKING ACT OF 1933)

X-7540

Copies to be sent to all Federal Reserve Banks.

August 7, 1933.

Mr. Frederic H. Curtiss,
Federal Reserve Agent,
Federal Reserve Bank of Boston,
Boston, Massachusetts.

Dear Mr. Curtiss:

Reference is made to your letter of July 18, 1933, designated "Inquiry No. 29", wherein you inquire whether, under the provisions of Section 23A of the Federal Reserve Act, as amended by Section 13 of the Banking Act of 1933, a member bank may make loans to an affiliate secured by real estate mortgages.

You state that, "The affiliate in question is a company to which the member trust company has transferred assets or property taken over from time to time on debts previously contracted, including certain parcels of real estate, the affiliate managing and operating such properties until they can be disposed of in a satisfactory way. The loans by the member trust company to the affiliate would be secured by mortgages on the real estate, which, in the opinion of the officers of the member trust company, would have a market value of at least 20 per cent in excess of the amount of the credit."

Section 23A reads, in part, as follows:

"Within the foregoing limitations, each loan or extension of credit of any kind or character to an affiliate shall be secured by collateral in the form of stocks, bonds, debentures, or other such obligations having a market value at the time of making the loan or extension of credit of at least 20 per centum more than the amount of the loan or extension

Mr. Frederic H. Curtiss -- 2

X-7540

of credit, or of at least 10 per centum more than the amount of the loan or extension of credit if it is secured by obligations of any State, or of any political subdivision or agency thereof."

In view of the requirement that each loan to an affiliate be secured by "collateral in the form of stocks, bonds, debentures, or other such obligations" having a certain "market value", the answer to your inquiry depends upon whether the real estate mortgages in question are "other such obligations having a market value" within the meaning of the above provision.

Since it follows the words, "stocks, bonds, debentures", the phrase "other such obligations" clearly includes only obligations which are of the same general character as stocks, bonds and debentures -- i.e., obligations of the kind commonly known as "investment securities", which ordinarily do not arise out of direct loans but are issued for sale to investors on the open market. Furthermore, the phrase "having a market value * * * of at least 20 per centum more than the amount of the loan or extension of credit" indicates strongly that the law refers to obligations for which there are sufficient price quotations on the open market to make it possible to determine their market value with reasonable accuracy.

While it is not impossible for real estate mortgages to conform to the above requirements, it is believed that those arising out of the ordinary type of direct loans on real estate usually are not obligations of the kind contemplated by the statute; and, where a member

Mr. Frederic H. Curtiss -- 3

X-7540

bank transfers to an affiliated corporation real estate which the bank has acquired in satisfaction of debts and either takes a mortgage from the corporation as consideration for such transfer or subsequently makes a loan to the affiliate secured by a mortgage on such real estate, such a mortgage is not an obligation of the kind contemplated by the statute.

Very truly yours,

Chester Morrill,
Secretary.