

## INTERPRETATION OF BANKING ACT OF 1933

(Copies to be sent to all Federal reserve banks)

January 18, 1934.

Messrs. \_\_\_\_\_,  
\_\_\_\_\_,  
\_\_\_\_\_.

Dear Sirs:

Receipt is acknowledged of your letter of January 12, 1934, in which you ask whether it is necessary under the provisions of Section 32 of the Banking Act of 1933 for The "R" Company, a member bank, to obtain a permit from the Federal Reserve Board to participate with The "X" Company and other investment houses in the purchase of bonds issued by the State of "J" and by various municipalities in the State of "J". Your letter contains a detailed description of the dealings upon which your question is based.

It appears that it has heretofore been the practice of a group, headed by The "X" Company and including as the other three principals The "R" Company, The "S" Company and The "T" Company, to bid for bonds issued by the State of "J". Other dealers, selected by The "X" Company as manager of the group, have been associated with these principals from time to time, but such dealers have not always been the same.

The State of "J" did not issue any bonds from 1926 until the latter part of 1933. In November 1933 the State of "J" asked for bids for \$ \_\_\_\_\_ of its \_\_\_\_\_ Bonds. The group which made the successful bid for these bonds was headed by The "X"

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Company and had as its other principals The "R" Company, and the other two organizations named in the second paragraph of this letter. A number of other dealers who were selected by The "X" Company participated.

No officer or director of The "R" Company is an officer, director or manager of any other member of the group named in the second paragraph of this letter. The "T" Company carry a small cash account with The "R" Company, which sells letters of credit issued by The "T" Company. The "X" Company also carry an account with The "R" Company. With these exceptions there are no regular business relationships between The "R" Company and any other member of the group referred to in the second paragraph of this letter.

On December 27, 1933, The "R" Company headed a group which included as the other principals The "S" Company and The "M" Company, and this group was a bidder for \$ \_\_\_\_\_, \_\_\_\_\_ Bonds issued by the City of \_\_\_\_\_, although, as you state in your letter of January 13, 1934, it was not the successful bidder. The "T" Company headed another group, which submitted a competing bid for these bonds. You state that The "M" Company, which joined The "R" Company in the bid for these bonds, is usually in a group which bids against the group which The "R" Company joins for the purpose of bidding for bonds issued by the State of "J".

You point out that the membership of the "bidding group", which participates with the principals in bidding for such bonds,

varies with each transaction, and that such membership is usually not fixed until the last minute before the bid is made.

You suggest that the term "correspondent bank" in Section 32 refers to a bank which regularly performs banking functions for a dealer in securities. However, as you will note from the definition in Section II of the Board's Regulation R, the Board has decided that this term does not include a bank which shall merely perform ordinary banking functions for a dealer in securities. You suggest that, if Congress had intended to refer to underwritings in Section 32, it would have done so as it did in Section 16 of the Banking Act of 1933. However, it does not appear that these sections were inserted in the bill at even approximately the same time, and it is felt that an argument such as you suggest can be given little weight in this connection.

You also contend that Section 5136, Revised Statutes, as amended by Section 16 of the Banking Act of 1933, authorizes national banks to underwrite securities issued by States and political subdivisions of States, this provision being made applicable to all member banks, and you suggest that it would be unreasonable to require a member bank to obtain a permit in order to participate in an underwriting when it would be authorized to underwrite the whole issue, by the statutory provisions above referred to. However, those statutory provisions relate to dealings in investment securities by member banks; whereas Section 32 is concerned with relationships between member banks and dealers in securities.

Therefore, it seems that even if a transaction would be

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permissible under the provisions of Section 5136, Revised Statutes, if standing alone, it might nevertheless fall within the prohibitions of Section 32 if it formed part of a regular association between a member bank and a dealer in securities.

It appears that it is the established practice for The "R" Company to be one of the principals of a group headed by The "X" Company which bids for bonds issued by the State of "J", and that the association is as regular as the nature of such dealings permits. It would seem possible that a less regular association might also come within the prohibitions of Section 32, but the Federal Reserve Board is of the opinion that, on the basis of the facts appearing from your letter, The "R" Company is a "correspondent bank" of The "X" Company in connection with the purchase, underwriting, and/or flotation of bonds of the State of "J", and that the continuation of such relationship would, therefore, be prohibited by the provisions of Section 32 unless the Federal Reserve Board should issue a permit therefor.

Very truly yours,

(Signed) Chester Morrill

Chester Morrill,  
Secretary.