FEDERAL RESERVE BOARD

WASHINGTON

ADDRESS OFFICIAL CORRESPONDENCE TO
THE FEDERAL RESERVE BOARD

X-7853

April 9, 1934

SUBJECT: Applicability of Section 8A of Clayton Act to Organizations Carrying Margin Accounts.

Dear Sir:

The Board's letter of March 27, 1934 (X-7837) contained a ruling which is believed to be of general interest, and the Board intends to publish a statement with regard thereto in the next number of the Federal Reserve Bulletin. However, in view of the period which must elapse before this ruling is available in the Federal Reserve Bulletin, a copy of the statement is being forwarded to you herewith and you are authorized to communicate its substance to all interested persons.

Very truly yours,

Chester Morrill

Chester Morrill,
Secretary.

Inclosure.

TO ALL FEDERAL RESERVE AGENTS.

X-7853-a

APPLICABILITY OF SECTION 8A OF CLAYTON ACT
TO ORGANIZATIONS CARRYING MARGIN ACCOUNTS.

A number of applications under Section 32 of the Banking Act of 1933 raise the question whether the carrying of what are commonly known as margin accounts involves the making of loans "secured by stock or bond collateral" within the meaning of Section 8A of the Clayton Act, which makes it unlawful for any director, officer, or employee of any "bank, banking association, or trust company, organized or operating under the laws of the United States" to be at the same time a director, officer, or employee of a corporation (other than a mutual savings bank) or a member of a partnership which makes loans secured by stock or bond collateral except to its own subsidiaries. This question was material because, as stated on page 123 of the Federal Reserve Bulletin for February, 1934, a permit issued pursuant to the provisions of Section 32 would not have the effect of making Section 8A of the Clayton Act inapplicable to the relationship in question, and such a permit would therefore serve no useful purpose if the relationship were prohibited by the Clayton Act and if no permit therefor had been issued by the Federal Reserve Board pursuant to the provisions of that Act.

The margin accounts which the Board had under consideration are carried in substantially the following manner:

The customer deposits with the broker margin in the form of cash or securities, and orders the broker to purchase or sell certain securities for him. The broker executes the order and furnishes the balance required for the execution of the order. The securities are acquired or sold by the broker for the account and risk of the customer, but all securities in the account are held by the broker. The customer authorizes the broker to pledge, as collateral for any indebtedness of the broker, all securities thus held by the broker, and such pledge may be for a greater sum than the amount which the customer owes to the broker. The broker usually avails himself of this right, in whole or in part, in order to supply himself with funds with which to carry out the orders thus received from his customer. The broker has the right to close the customer's account by sale or purchase, as the case may be, whenever he deems it necessary to protect himself from loss on the customer's obligation. Since the securities are purchased or sold for the account and risk of the customer, he is liable to the broker for any deficiency remaining after the closing of the account. Likewise, any appreciation in the value of the securities bought and any income therefrom during the life of the account are the property of the customer. Securities thus held by the broker for the account of the customer, except those issued in bearer form, are usually issued in the name of the broker or in "street names" and indorsed in blank in order to facilitate handling.

The legislative history of the Banking Act of 1933, and of Section 33 of that Act, which added Section 8A of the Clayton Act, reveals that one of the primary purposes of the Banking Act of 1933 was to prevent an undue use of credit for speculative purposes, and particularly to inhibit the diversion of funds into speculative dealings on the stock exchanges. Since margin accounts, and the brokers' loans by which they were financed to a large extent, constituted a principal source of the credit which was employed in such speculation, it is felt that a construction of Section 8A to the effect that the carrying of margin accounts does not involve the making of loans secured by stock or bond collateral within the meaning of that section would tend to defeat, in a large measure, the purpose of the law. Moreover, since the broker carrying margin accounts is advancing the balance of the funds needed to execute the orders of the customer and thereby furnishing credit for dealing in securities, and since the broker holds the stocks and bonds as security for such advances, it appears that the broker is the creditor of the customer and that his indebtedness is secured by the pledge of the securities in the account. Accordingly, it is the view of the Board that the carrying of such margin accounts involves the making of loans secured by stock or bond collateral within the meaning of Section 8A of the Clayton Act, and that the provisions of that section are therefore applicable to interlocking relationships between national banks and organizations carrying

such accounts.

Although the Federal Reserve Board is authorized by Section 8 of the Clayton Act to issue permits under certain circumstances covering relationships to which the provisions of the Clayton Act are applicable, its authority is limited to the issuance of permits covering the service of not more than three banking institutions of certain classes. Accordingly, a director, officer, or employee of a corporation (other than a mutual savings bank) or a member of a partnership which makes loans secured by stock or bond collateral except to its own subsidiaries, whether in connection with the carrying of margin accounts or otherwise, is prohibited from serving at the same time as a director, officer, or employee of a national bank, and the Board is not authorized to issue a permit for such interlocking services unless such corporation or partnership is a banking institution of one of the kinds referred to in Section 8. In this connection, it should be noted that the phrase "organized or operating under the laws of the United States" in Section 8A of the Clayton Act is not applicable to State member banks of the Federal Reserve System. See page 654 of the Federal Reserve Bulletin for October, 1933.