

X-7866

INTERPRETATION OF BANKING ACT OF 1933

(Copies to be sent to all Federal reserve banks.)

April 16, 1934.

_____,
_____,
_____,
_____.

Dear Sir:

Your letter of November 2, 1933, addressed to the Deputy Comptroller of the Currency, has been referred to the Federal Reserve Board for reply. You ask whether the service of one of the directors of your bank as a director of the _____ Bond and Mortgage Guarantee Company at _____ is prohibited by the Banking Act of 1933. Your inquiry evidently has reference to the provisions of Section 32 of that Act.

You describe the business of that company as consisting in the making of mortgages on real estate and the selling of such mortgages, as well as certificates of participation issued in series against pools of such mortgages held in trust, to its customers, with its guarantee, deducting a part of the interest as its compensation.

Section 32 of the Banking Act of 1933 prohibits certain relationships between member banks and organizations engaged in the business of purchasing and selling "securities". The answer to your question therefore depends upon whether such mortgages and participation certificates are "securities" within the meaning of

that section.

One of the principal purposes of the Banking Act of 1933 was to effect a separation of commercial and investment banking, and it appears that Section 32 of that Act was designed to aid in the accomplishment of this purpose. Although there may be mortgage notes of a kind which should be classified as "securities" for the purposes of Section 32, the Federal Reserve Board is of the opinion that mortgage notes arising out of the ordinary type of direct loan on real estate are not "securities" within the intentment of Section 32, and that neither such notes nor the mortgages securing the same should be classified as "securities" in determining whether an organization engaged in dealing in such obligations comes within the scope of Section 32.

The Board has further reached the conclusion that it is not possible to lay down any general rule as to whether certificates of participation based on mortgages are included, or are not included, within the term "securities" in Section 32, since such certificates of participation vary so widely in character. Accordingly, if you desire a ruling on this question with respect to any particular certificates, it is suggested that there be submitted a sample copy of the form of certificate of participation employed, as well as a detailed description of the manner in which such participations are created and issued, and information as to the maturity of the obligation, whether it constitutes part

of an "issue", the total amount of such issue, if any, and the number and size of the units, the manner in which the certificates are distributed and sold to investors, the purpose for which the certificates are issued, whether they are designed to be more or less actively traded in, whether they are in form negotiable, whether they are "registered" and transferable on the books of the issuer, and whether they are commonly known as "securities" by persons dealing therein.

It is requested that such information be submitted to the Federal Reserve Agent at the Federal Reserve Bank of your district in order that he may transmit it to the Federal Reserve Board with his comments.

Your attention is called to the fact that Section 32 refers to organizations which are engaged "primarily" in the business of purchasing, selling, or negotiating securities, and it may be that even if the corporation to which you refer is engaged in that type of business it is not engaged "primarily" in such business. The question is essentially a question of fact which must be decided on the basis of all the facts and circumstances of each particular case; and no fixed rule based on percentages of business transacted or income received can be laid down for deciding whether or not an organization is engaged "primarily" in the business referred to. If you desire a ruling upon this question in connection with the corporation named in your letter, it is suggested that you

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furnish the Federal Reserve Agent at the Federal Reserve Bank of your district with a full description of the various types of business transacted and of their relation to each other, and, for each of the past three years, a statement of the gross and net profits derived from each type, of total gross and net profits, of the total volume of transactions in each type of business, and of total volume of business.

Very truly yours,

(Signed) Chester Morrill

Chester Morrill,
Secretary.