X-7891

INTERPRETATION OF BANKING ACT OF 1933

(Copies to be sent to all Federal reserve banks)

May 11, 1934.

Mr. J. G. Fry,
Assistant Federal Reserve Agent,
Federal Reserve Bank of Richmond,
Richmond, Virginia.

Dear Mr. Fry:

This refers to your letter of April 25, 1934, with which you inclosed an opinion of your Counsel with reference to a question arising under section 23A of the Federal Reserve Act. A State member bank on June 16, 1933, had loans to and investments in its affiliates in excess of twenty per cent of its capital and surplus and, subsequent to that date, it extended credit to one of its affiliates by the discount of a note which was eligible for rediscount at the Federal reserve bank. The question arises whether this action constituted a violation of section 23A of the Federal Reserve Act.

Section 23A consists of three paragraphs. Under the first paragraph, loans and extensions of credit by a member bank to any of its affiliates, purchases under repurchase agreements from any such affiliates, investments in stock or obligations of any such affiliates and advances upon the security of stock or obligations of any such affiliates are prohibited, if the aggregate amount thereof outstanding will exceed, in the case of any one affiliate, ten per cent of the capital stock and surplus of such

member bank or, in the case of all its affiliates, twenty per cent of the capital stock and surplus of such bank. The second paragraph provides 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 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: Provided, That the provisions of this paragraph shall not apply to loans or extensions of credit secured by obligations of the United States Government, the Federal intermediate credit banks, the Federal land banks, the Federal Home Loan Banks, or the Home Owners' Loan Corporation, or by such notes, drafts, bills of exchange, or bankers' acceptances as are eligible for rediscount or for purchase by Federal reserve banks. * * *"

In the third paragraph, certain classes of affiliates are excepted from the provisions of the section.

It is clear that loans or extensions of credit to an affiliate secured by paper which is eligible for rediscount or for purchase by Federal reserve banks are not subject to the requirements of the second paragraph of section 23A with regard to the form and amounts of collateral security, but it is also manifest that loans or extensions of credit secured by such paper are not excepted from the limitations of the first paragraph of this section unless the word "paragraph" in the above quoted provision may be interpreted in a sense other than that in which it is ordinarily used. It is an established rule of statutory construction that, in the absence of ambiguity, words in a statute are to be read in the natural and

ordinary meaning commonly given to them. Moreover, it is to be observed that in the third paragraph of section 23A, in excepting certain classes of affiliates from all of the provisions of the section, the word "section" is used. In the circumstances it is not believed that it can be assumed that the word "paragraph" in the second paragraph of the section was inadvertently used or that it was intended to have the same meaning as the word "section" in the third paragraph. Accordingly, the Federal Reserve Board agrees with the opinion of your Counsel that a loan or extension of credit secured by paper eligible for rediscount or purchase at a Federal reserve bank is not excepted from the limitations of the first paragraph of section 23A of the Federal Reserve Act on the amount of such loans which may be made and that a member bank which already has outstanding loans and extensions of credit to its affiliates and investments in the stock or obligations of such affiliates in an amount up to twenty per cent of its capital stock and surplus (the limit prescribed by that paragraph) may not lawfully make an additional loan to an affiliate even though it is secured by paper eligible for rediscount or purchase at a Federal reserve bank.

Very truly yours,

(Signed) Chester Morrill

Chester Morrill,
Secretary.