

BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
WASHINGTON

X-9575

ADDRESS OFFICIAL CORRESPONDENCE  
TO THE BOARD

May 6, 1936.



Dear Sir:

For your information there is inclosed a copy of a letter sent to the Assistant Federal Reserve Agent at San Francisco pertaining to certain questions raised regarding responsibilities of examiners for the Federal reserve banks in connection with loans made by banks under the provisions of the Securities Exchange Act of 1934.

Very truly yours,

A handwritten signature in dark ink, appearing to read "L. P. Bethea". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

L. P. Bethea,  
Assistant Secretary.

Inclosure.

TO ALL FEDERAL RESERVE AGENTS.

X-9575-a

May 6, 1936.

Mr. S. G. Sargent,  
Assistant Federal Reserve Agent,  
Federal Reserve Bank of San Francisco,  
San Francisco, California.

Dear Mr. Sargent:

This refers to the letter of Mr. A. H. Sonne, Assistant Chief Examiner, dated December 3, 1935, regarding certain questions raised by Mr. Swengel, one of your examiners, with regard to bank loans which come under the provisions of the Securities Exchange Act of 1934 and as to examining procedure in connection with such loans. Specifically, Mr. Swengel asks:

1. Is a bank on notice to restrict such credits as it may grant to members of national security exchanges and/or brokers and/or dealers to the margin requirements, as set forth in Regulation T?
2. To what extent is an examiner, as incidental to an examination of a bank, expected to investigate loans to brokers and dealers? In particular, is it necessary to investigate all transactions in connection with a loan, including substitutions and withdrawals of collateral made since inception of the loan or since previous examination?

Since Mr. Swengel's letter was written the Board has issued Regulation U which relates to loans made by banks on and after May 1, 1936, for the purpose of purchasing or carrying stocks registered on a national securities exchange and Regulation U, rather than Regulation T, is the regulation governing bank loans under the Securities Exchange Act.

In their examinations of a member or nonmember bank, your

examiners should see that all loans outstanding on the date of examination and subject to Regulation U comply with the provisions thereof, and any violations of the regulation should be reported. The compliance or noncompliance of a loan with the regulation depends upon the circumstances at the time a loan was made or increased and the circumstances in connection with the withdrawal or substitutions of collateral, and not upon subsequent variations in the value of the collateral. As a practical matter it would seem that in most cases if a loan were found to comply at the time of the examination with the requirements of the regulation as of that date, no further investigation under the regulation need be made. However, if the examiner has reason to believe that the loan may have been made or handled in violation of Regulation U, because the loan value of the collateral at the time of examination is barely sufficient and there has been a substantial rise in its value since the date of the loan, or for other reasons, he should then make appropriate investigation to determine whether such has been the case. Also, if the examiner has reason to believe that in connection with loans no longer held other violations of Regulation U have occurred since the previous examination, he should make appropriate investigation of such transactions and report any violations disclosed.

Under the provisions of the Securities Exchange Act of 1934 itself, it is unlawful for any member of a national securities exchange or any broker or dealer who transacts a business in securities through

the medium of any such member, to borrow in the ordinary course of business as a broker or dealer on any registered security other than an exempted security from any nonmember bank unless such nonmember bank shall have filed with the Board of Governors of the Federal Reserve System an agreement which is still in force and which is in the form prescribed by the Board's Regulation T. Your examiners, therefore, should report any instances discovered in their examinations of nonmember banks (in connection with applications for membership or because of affiliate relationships or for other special reasons) where nonmember banks which have not executed the agreement referred to in Regulation T have made loans of the type described above.

It is to be noted also that those few member or nonmember banks which are members of registered securities exchanges are subject to Regulation T to the same extent as other members of such an exchange, in their loans to other members, or to brokers or dealers.

This letter relates to the specific questions discussed and does not attempt to cover all possible implications of the Securities Exchange Act and Regulation U as they may affect bank loans. It is contemplated that, after Regulation U has been in effect and rulings and interpretations have been issued thereunder, further instructions will be forwarded as a guide to examiners.

Very truly yours,

(Signed) Chester Morrill

Chester Morrill,  
Secretary.