BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

May 8, 1936.

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

X-9581

Subject: Rulings by the Comptroller of the Currency interpreting his regulations governing the purchase of investment securities.

Dear Sir:

There is inclosed herewith for your information a copy of a letter which has been addressed to the Assistant Federal Reserve Agent at the Federal Reserve Bank of San Francisco, setting forth the views expressed by the Comptroller of the Currency with regard to certain questions presented by a State member bank concerning the interpretation of the regulations governing the purchase of investment securities issued by the Comptroller under the provisions of section 5136 of the Revised Statutes.

Very truly yours,

Chester Morrill

Chester Morrill,
Secretary.

Inclosure.

TO PRESIDENTS OF ALL FEDERAL RESERVE BANKS

X-9581-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 your letter dated March 24, 1936 with which was inclosed a copy of a letter from Mr. ________ ________, Auditor of the ________ Bank, ________, ________, a State member bank, presenting certain questions concerning the interpretation of the regulations governing the purchase of investment securities, issued by the Comptroller of the Currency under the provisions of section 5136 of the Revised Statutes. Several of the questions presented in Mr. ________'s letter were answered by the Board's letter to you dated April 25, 1936.

Question numbered 2 and the second and third questions under the heading "Additional Questions" have been submitted to the Comptroller of the Currency for an expression of his views thereon. The questions and the Comptroller's views thereon are set forth below.

Question numbered 2 in Mr. ________'s letter reads as follows:

> "Item 4(a) of Section 2 of the Regulations covering the purchase of investment securities reads in part, 'Purchase of investment security at a price exceeding par is prohibited unless the bank shall: provide for the regular amortization of the premium paid - - - - and the security (including premium) shall at no intervening date be carried at an amount in excess of that at which the obligor may legally redeem such security.' Is it the intention of the Regulations that any bonds bearing a call provision may not be carried at a price in excess of the call price, so that an immediate writedown is required of any such bonds carried in excess of the call price, or is it the intent that such bonds be amortized so that they shall be written down to the call price by the date upon which a call may legally be made?"

With regard to the above question, the Comptroller of the Currency stated the following:

> "The first inquiry refers to Item 4(a) of Section 2 of the regulations, relative to amortization of premium bonds. The question is whether or not an immediate writedown is required to call price on such bonds.
>
> "It was not the intention that an immediate writedown of the call price need be made but it was the intent of the regulation that the premium be gradually written down to the call price by the call date so that at the call date the bond will be carried at an amount not in excess of the call price."

The second question under the heading "Additional Questions" reads as follows:

> "Do the regulations intend that no bond can be carried in excess of call price, whether or not a call has been made? What about premium above call price on bonds purchased after call date is set (and is within - say 6 months or less), where the bonds are usually purchased on a low yield basis, as a temporary investment,

"and the entire investment will be liquidated on the near future call date?"

With reference to this question, the Comptroller made the following statement:

"The second inquiry is as to whether or not a bond can be carried in excess of call price, regardless of whether or not a call has been made, and refers particularly to the purchase of bonds at a premium above call where the call date has been set and is within six months of purchase.

"The first part of the inquiry is not clearly understood but it is our position as respects bonds which are callable within a short time after purchase, as for instance bonds that may be callable on thirty days' notice, or may be callable on any semi-annual payment date, that in such cases the premium should be immediately amortized down to the call price. Usually such a bond is purchased at a very slight premium above the call price due to the imminence of the call date."

The third question under the heading "Additional Questions" reads thus:

"Where bonds have been amortized to the call price by the earliest possible call date (which was in the past, and no call was made), and such amortization is in excess of normal amortization as ordinarily calculated, is it necessary to amortize balance of premium (which equals the excess of call price over par) over the remaining life of bonds to maturity, or can credit be taken for excess premium therefor set up?"

The Comptroller stated the following with reference to the above question:

"Inquiry is made with reference to bonds purchased at a time when a call could have been made prior to purchase, but was not. It is assumed that the type of "callable bond contemplated is one that is callable on any semi-annual interest date. After such bond has been amortized to call price, the question is submitted as to whether or not it is necessary to amortize the balance of the premium (which equals the excess of call price over par) over the remaining life of the bond to maturity, or can credit be taken for excess premium theretofore set up.

"It is our position that the amount of premium represented by the excess of call price over par should be gradually amortized over the remaining life of the bonds, without taking credit for the excess premium over call price theretofore amortized."

Very truly yours,

(Signed) Chester Morrill

Chester Morrill,
Secretary.