

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

X-9602

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD



June 2, 1936.

Dear Sir:

There are inclosed, for your information, copies of a letter dated April 14, 1936, and its inclosures, received from Mr. Clark, Assistant Federal Reserve Agent at the Federal Reserve Bank of Atlanta, and of the Board's reply thereto, with regard to the Board's Regulation U, Loans by Banks for the Purpose of Purchasing or Carrying Stocks Registered on a National Securities Exchange.

Very truly yours,

A handwritten signature in cursive script, reading "S. R. Carpenter".

S. R. Carpenter,
Assistant Secretary

Inclosures.

TO ALL FEDERAL RESERVE AGENTS.

COPY

X-9602-a

FEDERAL RESERVE BANK
OF ATLANTA

April 14, 1936.

Mr. Ronald Ransom,
Board of Governors of the
Federal Reserve System,
Washington, D. C.

Dear Mr. Ransom:

At the request of Mr. _____, Vice
President of The _____ National Bank of _____, I am trans-
mitting to you a memorandum that he has prepared of Regula-
tion U.

Mr. _____ is anxious to have a meeting
of branch managers and credit officials of the main office
for the purpose of studying Regulation U. Prior to that
meeting he would like to have the benefit of the Board's views
as to whether the statements contained in the memorandum are
in accordance with the provisions of the regulation, and have
answered the questions raised in the second paragraph of item
1 and item 5 under (A) and item 4 under (B).

Any further interpretations or rulings that
the Board might wish to give in this connection I know will
be greatly appreciated by Mr. _____.

With kindest regards, I am

Very truly yours,

(Signed) L. M. Clark

L. M. Clark,
Assistant Federal Reserve Agent.

enclosure

Under the above regulation the following points appear of interest and are apparently worthy of note:

A - Loans to brokers and dealers.

1. On all loans made to brokers and dealers accompanied by Certificate "A", 60% of the market value of the collateral pledged can be loaned if the collateral consists of listed stocks.

When Certificate "A" is used and the collateral tendered includes both listed and unlisted stocks, what percentage of the market value of the unlisted stocks can be used as the maximum loan value?

2. If accompanied by Certificate "B", a loan signed by a broker or dealer will not be subject to the regulation.
3. A loan which is not accompanied by either Certificate must not be in excess of 45% of the market value of the stocks offered as collateral.
4. A temporary loan to a dealer for the purpose of completing a transaction where securities are purchased against a bonafide order is not subject to the regulation.
5. Does Item "C" of Section Two refer to the distribution of new issues, exclusively, or will it include the distribution of issues already outstanding and presently listed on a national exchange?

B - Loans to others than dealers and brokers.

1. If the bank accepts in good faith Certificate "B", executed by a borrower, the loan in connection with which it is executed is not subject to the regulations and the margin to be required is optional to the bank.
2. After May 1, when both secured and unsecured loans are made to the same borrower at the same time or at different times, the total indebtedness of that borrower must not exceed the maximum loan value of the collateral as prescribed in the regulation and any loan not considered in the total must be accompanied by Certificate "B".
3. According to our attorneys and according to the attorneys of the Federal Reserve Bank, the regulation does not in any way restrict the substitution or release of collateral securing loans which were in existence prior to the effective date and which have not been increased except as provided for in the regulation.
4. Does item "L" of Section Three intend to include bonds convertible into stock at the option of the holder or carrying warrants entitling the holder to purchase stock under certain conditions?

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CERTIFICATE "A"

April 1936.

_____ National Bank of _____,
 _____, _____.

Dear Sirs:

For the purpose of enabling you to make a loan to me in excess of 45% of the current market value of certain stocks registered on a national securities exchange which I will pledge to you as security for said loan, I certify that

1. I am subject to the provisions of Regulation T of the Board of Governors of the Federal Reserve System, prescribed in pursuance of the Section 7 of the Securities Exchange Act of 1934

or (indicate which)

I do not extend or maintain credit to or for customers except in accordance with such Regulation T as if we were subject thereto,

and

2. That the securities hypothecated to secure said loan are securities carried for the account of my customers other than my partners.

Yours very truly,

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CERTIFICATE "B"

I hereby certify that the loan evidenced by this note is not being obtained for the purpose of purchasing or carrying stocks registered on a national securities exchange and that the proceeds will not be used for either of said purposes.

May 20, 1936.

Mr. L. M. Clark
Assistant Federal Reserve Agent
Federal Reserve Bank
Atlanta, Georgia

Dear Mr. Clark:

Reference is made to your letter of April 14 to Governor Ransom, enclosing a memorandum on the subject of Regulation U prepared by Mr. _____, Vice President, (national bank), and to the copy of Mr. Parker's letter to Mr. _____ of April 21 which was forwarded to the Board.

The statements made and the questions asked in the memorandum appear to relate to matters upon which you may receive further inquiries, and for this reason they will be discussed somewhat fully. They will be treated in the order in which they appear in the memorandum.

A-1. Stocks which are not registered on a national securities exchange have a maximum loan value of 45 percent when serving as collateral for a regulated loan, even in the case of a loan to a broker made in accordance with the second paragraph of the supplement to Regulation U. It is only registered stocks that have, in this case, a loan value of 60 percent.

A-2. The Board does not feel that it should attempt to approve or disapprove, at the present time at least, the forms which banks may employ in complying with the provisions of Regulation U. To do so in any particular instance might have the result that requests for approval of many forms would be made of the Board by many banks. In this connection it should be pointed out that such certificates are not required by the regulation but the bank is permitted to rely upon them if it obtains them in good faith.

A -3. It may be noted that neither "Certificate 'A'" nor "Certificate 'B'" attached to the memorandum relates to loans which are excepted by the provisions of section 2 of Regulation U. It is not, therefore, correct to say that a "loan which is not accompanied by either certificate must not be in excess of 45 percent of the market value of the stocks offered as collateral."

A-4. A loan of the following description comes within the provisions of section 2(f) of Regulation U:

A dealer in securities receives an offer from a customer to purchase a registered stock. It is agreed between the dealer and the customer that the dealer will deliver the stock to the

customer promptly, and that the customer will pay for the stock promptly upon delivery of the security. The dealer purchases the security, instructing the seller to deliver it to a designated bank against payment. The bank, knowing the facts of the case and understanding that it will be repaid by the dealer as soon as the dealer can arrange for his customer to take delivery of and pay for the stock, makes a loan to the dealer for the purpose of paying the seller of the stock.

If Mr. _____ has in mind a case differing from that described above, it is suggested that he address a new question to you, giving you the facts of his case.

A-5. It is suggested that in order to assist the Board in answering this question, which relates to the interpretation of section 2(c) of Regulation U, you ask Mr. _____ to give you a specific case, describing in some detail the exact nature of the operation which the bank is being asked to finance.

B-1. If a given loan is not "for the purpose of purchasing or carrying a stock registered on a national securities exchange", a bank may make the loan without being required to obtain the margin prescribed by Regulation U. Withdrawals and substitutions of collateral securing any such loan are not subject to the regulation unless the collateral secures also a loan for the purpose specified in section 1 of the regulation.

B-2. The question which the memorandum seeks to answer is not altogether clear. If this question is how a loan which is made after May 1 for the purpose of purchasing or carrying registered stocks, but which is unsecured, shall be treated in the event that the bank makes, or has made, another loan to the same borrower after May 1 for the same purpose secured by a stock, the answer is as follows:

If a bank has outstanding to a borrower no loan whatever which is secured directly or indirectly by any stock, any loan by the bank to such borrower, even if the purpose of the loan be to purchase or carry registered stocks, is not subject to the regulation, if it is itself not secured by any stock. If, however, a bank has outstanding a loan to a borrower which, by reason of its purpose and its collateral, is subject to Regulation U, the bank may not make to the borrower any additional loan secured, under a general loan agreement, by stock securing the first loan or by other stock and for the purpose of purchasing or carrying registered stock unless the bank obtains the margin on the additional loan required by the regulation.

If a bank has outstanding a loan to a borrower which is unsecured or which is not secured by any stock, and is, therefore, not subject to Regulation U, it may make a second loan which is subject to the regulation, without regard to the status of the first loan,

i.e., if the bank obtains additional collateral with a maximum loan value at least equal to the amount of the second loan. Thereafter, however, if the bank permits withdrawals or substitutions of collateral for either loan, it is obliged to ascertain the purpose of the first loan. If the first loan was for the purpose of purchasing or carrying registered stocks, the two loans must be treated as a single loan, and all the collateral securing both loans must be considered in determining whether or not the contemplated withdrawals or substitutions may be made.

B-3. As a general rule, the provisions of Regulation U are not applicable to the withdrawal or substitution of collateral for any loan made prior to May 1, 1936. This general rule is subject, however, to one qualification: If a bank has made another loan on or after that date (other than a loan excepted by section 2 of the regulation) which is secured directly or indirectly by any stock and is for the purpose of purchasing or carrying a stock registered on a national securities exchange, and if the terms of the bank's agreements with the borrower are such that the collateral securing the first loan also secures the second loan, the bank must then combine the collateral for both loans in determining whether any of the collateral for either loan may be withdrawn. The bank may not, in this case, permit withdrawal of such an amount of collateral as would cause the maximum loan value of the remainder to be less than the amount of the second loan.

B-4. The term "stock" as used in section 3(1) of Regulation U does not include any bond, even a bond convertible into stock, or a bond carrying stock purchase warrants.

Very truly yours,

(Signed) Chester Morrill

Chester Morrill
Secretary