

INTERPRETATION OF LAW OR REGULATION

(Copies to be sent to all Federal reserve banks)

November 5, 1936

Mr. \_\_\_\_\_, Vice President,  
Federal Reserve Bank of \_\_\_\_\_,  
\_\_\_\_\_, \_\_\_\_\_.

Dear Mr. \_\_\_\_\_:

This refers to your letter of October 29, 1936, with which you inclosed a letter dated October 28, 1936, from Messrs. \_\_\_\_\_,

\_\_\_\_\_ counsellors for the \_\_\_\_\_ Bank and Trust Company, \_\_\_\_\_. The letter of Messrs. \_\_\_\_\_ presents the question whether Regulation U applies to a certain loan to a corporate investment trust on stocks to enable the borrower to retire certain debenture bonds issued by it prior to the enactment of the Securities Exchange Act of 1934. It is understood that the debentures were originally issued to obtain funds for the usual operations of the investment trust which consist very largely of purchasing listed stocks.

As you state in your letter, since the loan is to retire the debentures of the investment trust, it appears not to be for the purpose of purchasing a stock registered on a national securities exchange, and therefore the question is whether the loan is for the purpose of carrying a registered stock.

From the nature of the loan, it would seem to be for the purpose of carrying registered stocks unless some provision of the regulation removes it from that category. In this connection, section 5(b)

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of the regulation provides:

"No loan, however it may be secured, need be treated as a loan for the purpose of 'carrying' a stock registered on a national securities exchange unless the purpose of the loan is to enable the borrower to reduce or retire indebtedness which was originally incurred to purchase such a stock, or, if he be a broker or dealer, to carry such stocks for customers."

It will be seen that section 3(b) was intended to exempt from the regulation loans which might otherwise be considered to be for the purpose of "carrying" registered stocks merely because they happen to be secured by such stocks. This was to afford the banks more certainty in their operations under the regulation and to avoid any interference with ordinary commercial loans.

Careful consideration has been given to the views expressed in your letter and that of Messrs. \_\_\_\_\_ . However, the Board feels that the debentures constitute indebtedness within the meaning of section 3(b) and that the purpose of the loan must be considered to be the retirement of these debentures rather than merely their purchase. It also seems that in connection with questions regarding the carrying of stocks registered on a national securities exchange the present status of the stocks should be considered and that, therefore, the debentures should be considered to be indebtedness originally incurred to purchase registered stocks within the meaning of section 3(b). Furthermore, the reference in the section to brokers and dealers indicates that the section was not intended to exempt loans which are closely connected with trading in registered stocks and emphasizes the fact that the present loan does not come within the general

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purposes of the exemption contained in the section.

In view of these facts, the Board feels that the present loan is subject to the provisions of the regulation, and it will be appreciated if you will advise Messrs. \_\_\_\_\_ of the Board's views on the question.

Very truly yours,

(Signed) Chester Morrill

Chester Morrill,  
Secretary.