

INTERPRETATION OF LAW OR REGULATION

(Copies to be sent to all Federal reserve banks)

September 3, 1937.

Mr. _____,
Assistant Vice President,
Federal Reserve Bank of _____,
_____, _____.

Dear Mr. _____:

Reference is made to your letter of August 25, 1937 forwarding a copy of a letter regarding Regulation U from Mr. _____, Assistant Cashier, The _____ Trust Company, _____.

It is understood that Mr. _____ is interested in a loan which was made prior to May 1, 1936 but which is subject to Regulation U since Amendment No. 3 became effective on September 1, 1937. Certain cashier's checks are held as collateral for the loan, but when the cashier's checks are given a maximum loan value of 100 per cent of their face the maximum loan value of the collateral is less than the amount of the loan. Mr. _____ wishes to know whether the Board agrees with his view that in such circumstances the reinvestment of the cashier's checks in an equal market value of stocks would be forbidden as a substitution that would increase the deficiency in the maximum loan value.

The Board's letters (X-9655, S-26) of July 20, 1936 and August 5, 1937 are to the effect that it is permissible to hold cashier's checks as collateral for a loan subject to Regulation U. As indicated in the last paragraph of S-26, however, cashier's checks held as such collateral would have a higher maximum loan value than stocks. The replacement of cashier's checks by stocks having an equal market value would, of course, be a substitution of collateral, and such a substitution necessarily would reduce the maximum loan value of the collateral for the loan. If such a reduction caused the maximum loan value of the collateral to be less than the amount of the loan, or increased an existing deficiency, the substitution would be forbidden by the last paragraph of section 1 of the regulation.

In the present case there is an existing deficiency which would be increased by the substitution here in question and, therefore, the substitution would not be permissible. It is to be noted, of course, that the regulation would not forbid the purchase of the securities desired by the borrower if the borrower deposits, either in the form of cash or additional collateral, sufficient margin to cover such a purchase.

Very truly yours,

(Signed) L. P. Bethea

L. P. Bethea,
Assistant Secretary.