

INTERPRETATION OF LAW OR REGULATION

(Copies to be sent to all Federal Reserve banks)

October 19, 1937.

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

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

Reference is made to your letter of October 13, 1937, regarding the inquiry submitted to your bank by Mr. \_\_\_\_\_, Vice President of \_\_\_\_\_ Trust Company of \_\_\_\_\_, relating to section 3(i) of Regulation U.

It is understood that the \_\_\_\_\_ Trust Company made a loan to an individual pursuant to Regulation U, and that by reason of depreciation in the market value of the collateral the margin behind the loan became less than the bank customarily requires to be maintained for its own protection. In reply to the bank's call for additional margin, the borrower advised the bank that his wife had an ordinary securities account at a brokerage office and was willing to transfer her account to the bank in order to give the bank the protection of her equity in the account. The wife's account at the brokerage office has a substantial equity but is a restricted account and, therefore, could not be taken over by the bank as an ordinary increase in the bank's loan to the husband. Section 3(e) of the regulation, which makes special provision for transfers between lenders, provides only for transfers from one bank to another bank.

Section 3(i) of Regulation U provides:

"Nothing in this regulation shall be construed as preventing a bank from taking such action as it shall deem necessary in good faith for its own protection."

Mr. \_\_\_\_\_ indicates that, while the taking over of the wife's account to strengthen the husband's loan would afford the bank additional protection, the bank would like the Board's views as to whether this would be considered to be "necessary" for the bank's protection within the meaning of section 3(i). In this connection he points out that there are, at least in theory, three other methods by which the bank could be protected. The bank could take an assignment of the equity in the wife's account, securities could be liquidated from the husband's loan, or securities could be liquidated from the wife's account sufficient to make the account unrestricted and the account could then be transferred as an ordinary increase in the husband's loan. In

other words, the transfer is not indispensable to the protection of the bank, although it probably would be more satisfactory than any of the other methods.

"The word 'necessary' has not a fixed meaning or character peculiar to itself, but is flexible and relative. \* \* \* It may mean something which in order to accomplish a given object cannot be dispensed with, or it may mean something reasonably useful and proper." Marshall County v. Rokke, (Minn. 1916) 159 N.W. 791; Words and Phrases (Series 1-4); Black's Law Dictionary Third Edition (1933). From this scale of meanings, the word, as used in section 3(i), should, of course, receive that graduation of meaning that is most appropriate in the light of the general purposes of the regulation.

The Board feels that a particular action might be "necessary" for the bank's protection even though it might not be indispensable for such protection. On the other hand, the Board is of the opinion that an action should not be considered to be "necessary" for the bank's protection, within the meaning of section 3(i), merely because it might afford some incidental protection to the bank.

The Board believes that the proper test to be applied under section 3(i) is, in effect, whether the action is reasonable and appropriate as one whose only important purpose is to strengthen the collateral for one of the bank's existing loans. While this does not mean that the action must be indispensable to the safety of the loan, it necessarily means that the action could not be actively engaged in with a view to increasing the bank's loan portfolio and could not be promotional or competitive in nature.

Mr. \_\_\_\_\_'s caution in wishing to be certain that his bank operates in strict conformity with the spirit and purpose of Regulation U, as well as its letter, is, of course, highly commendable. The Board believes, however, that the possibility of protecting the bank by some other methods, as indicated in Mr. \_\_\_\_\_'s inquiry, does not prevent the proposed transfer from being "necessary" for the bank's protection. On the basis of the facts indicated, and assuming the absence of promotional or competitive features as discussed above, the Board is of the opinion that the transfer would be permissible under the provisions of section 3(i).

Very truly yours,

(Signed) L. P. Bethea

L. P. Bethea,  
Assistant Secretary.