S-38
Reg. A-1

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

October 22, 1937.

SUBJECT: Comments of Federal Reserve Banks on Regulation A.

Dear Sir:

Pursuant to the Board's letter of July 30, 1937 (R-41), all of the Federal Reserve banks submitted their comments and suggestions with regard to the proposed revision of Regulation A. The suggestions and criticisms received from the Reserve banks were of much assistance to the Board and to its staff in working out the final form of the regulation, and the Board wishes to express appreciation to the banks for the thorough consideration which was given by them to the proposed regulation.

It seems appropriate to refer to the more important suggestions which were made by the banks, especially those which were not incorporated in the final regulation, and to state some of the considerations which influenced the Board and its staff in reviewing these suggestions.

General Principles. - Several banks made suggestions as to the elimination or modification of the preface to the regulation entitled "General Principles", and in the light of these comments certain changes have been made in the statement of General Principles in the final form of the regulation.

Section 1. Discount of notes, drafts and bills for member banks. - Two of the Federal Reserve banks suggested that sections 1 and 2 be reversed so that the provisions relating to discounts would come first and those relating to advances would be next in order in the regulation. This suggestion has been adopted, as well as a suggestion that the subsection entitled "Advances on eligible paper" precede that entitled "Advances on Government obligations" in what is now section 2 of the regulation.

Section 1(a). Commercial, agricultural and industrial paper. - One of the Federal Reserve banks suggested that the question

whether paper the proceeds of which are loaned to some other borrower be made eligible for discount should be submitted to a committee of Presidents for study and recommendation before any change was adopted. The subject is one which has had thorough consideration over a number of years past, and it was felt that additional study would develop little important information not already available on the subject. Accordingly, it was considered that no sufficient reason existed for deferring a decision with respect to the matter.

Section 1(c). Construction loans. - Two of the Federal Reserve banks suggested that what is now footnote 4 under "Construction loans" be changed so as to exclude the offering member bank from the "persons" who may enter into the agreement to advance the full amount of the loan upon the completion of the construction financed by the note offered for discount. Since member banks are permitted to make mortgage loans it was not thought that a member bank should be excluded from entering into such an agreement merely because it was extending the construction loan. The question whether a member bank is an acceptable "person" in any given case is essentially one of credit, to be considered by the Federal Reserve bank in the light of the facts in the particular case rather than one of eligibility.

Section 1(i) Limitations. - Two of the Federal Reserve banks called attention to the last sentence of this subsection with regard to the amount of the paper of one borrower discountable for a State member bank. The law itself contains a provision in the twelfth paragraph of section 9 that no Federal Reserve bank shall be permitted to discount for any State bank or trust company notes, drafts or bills of exchange of any one borrower who is liable for borrowed money to such State bank or trust company in an amount greater than that which could be borrowed lawfully from such State bank or trust company were it a national banking association, and the regulation merely restates the provision of the statute. The same limitation is not applicable with respect to national banks, because a Federal Reserve bank is forbidden by the law to discount for a national bank only the amount of paper of one borrower which is in excess of the limitations of section 5200 of the Revised Statutes. The distinction is one which occurs in the statute itself, and it did not seem desirable to make the limitation of the regulation with respect to national banks more stringent than provided in the law merely because the law subjects State member banks to the more restrictive provision.

Section 2(c). Advances on other security under section 10(b) of the Federal Reserve Act. - It was suggested that the words

"highest rate applicable to discounts for member banks under the provisions of sections 13 and 13a of the Federal Reserve Act" be changed to "highest discount rate". This change was not adopted because it was thought that the regulation should conform to the existing practice and to the manner in which the statute has been consistently interpreted.

One of the Federal Reserve banks suggested a rewording of clause (2) at the end of this subsection so that it would read "on demand at the option of the Federal Reserve bank". This particular clause of the regulation is one which has been rephrased several times and has been made the subject of careful study in the light of suggestions previously received from the Federal Reserve banks. It is believed that the language as incorporated in the final form of the regulation accurately reflects the statute and will work out satisfactorily in practice. It did not seem clear that the substitute language suggested was in accord with the intention of the statute.

Section 2(d). Kinds of collateral which may be used as security for advances under section 10(b) of the Federal Reserve Act. - The views of the Federal Reserve banks with regard to the provisions of this subsection were not uniform, one or two feeling that the provisions were undesirable, while others offered no objection to them. Certain suggestions for specific changes in phrasing were made. The Board felt it desirable to retain the provisions in the final regulation as an indication of a preferred list of collateral for advances by Federal Reserve banks under section 10(b) of the Federal Reserve Act, but with the general provision that such advances may be made against any collateral satisfactory to the Federal Reserve bank when in its judgment circumstances make it advisable to do so.

Several banks suggested that the wording of the subparagraph relating to loans upon the security of stock made in conformity with Regulation U be changed so that it would apply to obligations evidencing loans upon the security of stock which are not made in violation of the provisions of Regulation U. It was thought that such a change would make the provision more comprehensive than it should be, and inasmuch as the paragraph constitutes merely a preferred class of collateral, without rendering ineligible as collateral other nonconforming loans on stock, there was no sufficient reason for broadening the subsection in the manner suggested.

One of the Federal Reserve banks suggested that it would be appropriate to include in this subsection reference to the fact that the loan value of assets acceptable under section 10(b) is

subject to determination of the Reserve bank. In view of the provision which has been included in section 3(d) with reference to the amount of assets required as collateral "at their reasonable value determined in a manner satisfactory to the reserve bank", it is believed that the purpose of this suggestion has been substantially met.

It was also suggested that all obligations of the kinds enumerated in this subsection as security for advances under section 10(b) should be negotiable in form. Inasmuch as the law permits a Federal Reserve bank to accept any assets satisfactory to it as collateral security for advances under section 10(b), it was thought that the regulation should not make any specific requirement with respect to negotiability of assets securing such advances but that the question whether non-negotiable assets should be taken as such security should be treated as one affecting acceptability from a credit standpoint for consideration by the Federal Reserve bank in each case.

Section 3(a). Applications for discounts or advances. - One Federal Reserve bank called attention to the fact that this subsection does not require that the applying bank shall certify in its application that the paper offered is eligible for discount under the terms of the regulation. Under the regulation each Federal Reserve bank is free to use its own discretion as to whether it will include such a requirement in its discount application forms. It appeared unnecessary from the standpoint of the Board to make the inclusion of such a requirement mandatory.

Section 3(d). Marginal Collateral. - Comments were made by the Federal Reserve banks upon the question whether it was desirable that the Board make any statement regarding the amount of marginal collateral required by the Reserve banks. Some objected and others offered suggestions as to the phraseology which might be used in this connection. This point was thoroughly discussed by the Board and its staff and consideration was given to the desirability of making any such statement, whether such a statement should be incorporated in a letter to the Federal Reserve banks or in the regulation itself, and what specific limitation on the amount of marginal collateral should be prescribed. As you know, the regulation as adopted does not forbid a Federal Reserve bank to accept collateral in excess of the percentages named, but provides that Federal Reserve banks shall report to the Board in the loan schedule the facts of any case

in which the amount of collateral exceeds 25 per cent of the amount of a discount or 125 per cent of the amount of an advance.

Section 3(e). Credit on security of obligations of the United States. - A number of the Federal Reserve banks offered objection to the provision contained in the draft of the regulation inclosed with R-41 relating to the amount of credit extended on security of obligations of the United States, and indicated a number of administrative difficulties in connection with any such provision. This provision has been considerably modified in the final regulation and requires merely that where the amount advanced on the security of obligations of the United States is less than par, the bank must report the facts to the Board in the loan schedule. This is not intended to mean that such a report must be made in a case in which a member bank obtains the full amount requested by it, but if the member bank requests an advance in the full par amount of the Government obligations offered as security and the advance is made at less than par the facts and circumstances should be reported in accordance with the regulation.

Section 4(a). Prohibition upon acceptance of nonmember bank paper. - Some of the Federal Reserve banks suggested the desirability of revising the exception to the prohibition upon the acceptance of nonmember bank paper as it appeared in the draft of the regulation submitted with R-41. After consideration of these suggestions, the prohibition has been reworded so as to except therefrom assets otherwise eligible which were purchased by the offering bank on the open market or otherwise acquired in good faith and not for the purpose of obtaining credit for a nonmember bank.

The subject of the acceptance of nonmember bank paper for discount or as security for advances under section 10(b) of the Federal Reserve Act is now governed exclusively by the provisions of section 19 of the Federal Reserve Act and section 4 of the revised Regulation A, the prohibition in the revised regulation being intended as a revocation of the blanket authority heretofore outstanding which was granted by the Board's telegrams of March 11 and March 13, 1933 (Trans Nos. 1620 and 1659) and which authorized Federal Reserve banks under certain conditions to discount or accept as security for advances paper acquired from or bearing the signature or indorsement of nonmember banks.

Section 6. Bankers' acceptances. - In accordance with the suggestions of several Federal Reserve banks, there have been restored to the regulation as finally approved the words "between foreign countries" in paragraph (1) of subsection (b) and the words "or issued by a grain elevator or warehouse company duly bonded and licensed and regularly inspected by State or Federal authorities with whom all receipts for such staples and all transfers thereof are registered and without whose consent no staples may be withdrawn" in paragraph (3) of subsection (b). The restoration of these provisions brings the new regulation into conformity in these respects with the old regulation.

Recommendations as to minimum standards in making real estate loans and installment loans. - Some of the Federal Reserve banks recommended the elimination from the Appendix of the recommendations of the Board regarding minimum standards for installment paper and real estate loans used as collateral security for advances to member banks, while others favored their retention. After being modified in several respects to meet specific suggestions of the Federal Reserve banks with regard to the provisions of these recommendations, they have been retained in the Appendix in the hope that they may serve to encourage sound practices by member banks.

General. - Several suggestions as to wording or phraseology made by the Federal Reserve banks were not adopted because of the desire to have the language of the regulation follow the language of the statute where this was practicable, unless the use of other language appeared to be desirable for some special reason. It may also be said that in a very general way the provisions of the old regulation which are found in the new regulation have been carried forward in substantially the same form unless some material reason for changing the language appeared to make modifications desirable.

Very truly yours,

Chester Morrill

Chester Morrill,
Secretary.

TO PRESIDENTS OF ALL FEDERAL RESERVE BANKS