

INTERPRETATION OF LAW OR REGULATION

(Copies to be sent to all Federal Reserve banks)

October 29, 1937.

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

Dear Mr. _____:

Reference is made to your letter of October 18, 1937, regarding Regulation U.

It is understood that a bank made a loan to a brokerage firm pursuant to Regulation U and that subsequently, when the market value of the collateral declined below that which the bank customarily requires to be maintained for its own protection, the bank issued a demand for margin, although such margin was not required by the regulation. Since the brokerage firm received the margin call on Saturday and it was customary with the firm to eliminate the routine operations incident to entering vaults to obtain securities on Saturdays when deliveries and clearances of securities are not usually effected, the firm proposed that it be permitted to deposit a certified check on Saturday in temporary satisfaction of the demand for margin, and that on Monday it be permitted to replace the certified check with stocks.

The certified check would be made for an amount equal to the current market value of the securities to be deposited rather than the maximum loan value of such securities, since a certified check limited to the maximum loan value of the securities might not afford the bank as much protection as the securities. The question presented is whether this procedure may be followed.

As indicated in the Board's letters S-26 and S-32 of August 5 and September 3, 1937, the withdrawal of a certified check against the deposit of an equal market value of stocks ordinarily would not be permissible when the amount of the loan exceeds the maximum loan value of the collateral, since the substitution would reduce the maximum loan value of the collateral and thus increase the deficiency. It appears in the present case, however, that margin would be deposited to satisfy the bank's maintenance requirements rather than any requirement of Regulation U, that the entire transaction would be completed within what amounts to only a comparatively few business hours, that the procedure would be followed in entire good faith and not for the purpose of evading the regulation, and that the net effect of the procedure, which would

facilitate the usual operations of the brokerage firm, would be the same as if the securities had originally been deposited on Saturday or the margin call had not been met until Monday.

In the circumstances, the Board is of the opinion that the substitution of the securities for the certified check need not be separated from the other portions of the transaction and that the entire transaction may be considered according to its net results and be treated for the purposes of the regulation as if the securities had been deposited on Saturday or the margin call had not been met until Monday. The Board believes the transaction would be permissible on this basis although, of course, an entirely different situation might be presented if any of the circumstances were altered.

In view of the discussion above, it is believed that it is not necessary at this time to express any opinion as to the other considerations referred to in your letter.

Very truly yours,

(Signed) L. P. Bethea

L. P. Bethea,
Assistant Secretary.