

INTERPRETATION OF LAW OR REGULATION

(Copies to be sent to all Federal Reserve banks)

June 7, 1938.

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

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

This refers to your letter of May 10, 1938, in which you request advice on the question whether, in connection with the limitations on the discount of the paper of one borrower, which are contained in section 1(i) of Regulation A, it is proper to consider reserves for dividends payable in common stock as a part of capital and surplus.

This question has not heretofore arisen under the provisions of Regulation A, and, accordingly, the Board has not previously had occasion to express any viewpoint concerning it.

Section 1(i) of Regulation A reads as follows:

"(i) Limitations. - The aggregate of notes, drafts, and bills upon which any person, copartnership, association, or corporation is liable as maker, acceptor, indorser, drawer, or guarantor, discounted for any member bank shall at no time exceed the amount for which such person, copartnership, association, or corporation may lawfully become liable to a national bank under the terms of section 5200 of the Revised Statutes of the United States, as amended. The law forbids a Federal Reserve bank to discount for any State member bank notes, drafts, or bills of exchange of any one borrower who is liable for borrowed money to such State member bank in an amount greater than that which could be borrowed lawfully from such State member bank were it a national bank."

It will be noted that the limitations contained in both the first and second sentences of the above provision, which are derived from the provisions of section 13 and section 9 of the Federal Reserve Act, are based upon the maximum amount for which one person may lawfully become liable to a national bank. In determining such maximum amount, it is necessary to consider both the statute and the rulings of the Comptroller of the Currency in administering the law. Since the Comptroller has taken the position that reserves for dividends

payable in common stock may not be considered as capital or surplus under the provisions of section 5200 of the United States Revised Statutes, such reserves should not be considered as a part of capital or surplus in determining the maximum amount of the borrowings or liabilities of one person to a member bank under section 1(i) of Regulation A.

It may also be pointed out in this connection that, in order to comply with the spirit of the law, a Federal Reserve bank, in making advances to a member bank secured by paper eligible for discount, as well as in discounting paper for a member bank, should not acquire paper upon which one person is liable in an aggregate amount in excess of the limitations prescribed in section 1(i) of the regulation. On the other hand, however, in view of the fact that section 10(b) of the Federal Reserve Act was enacted subsequently to the provisions of the Federal Reserve Act relating to the amount of paper discountable for one borrower and in view of the purposes sought to be accomplished by the provisions of section 10(b), it is the Board's opinion that the limitations of section 1(i) of Regulation A and the provisions of law upon which they are based are not applicable to advances made under the provisions of section 10(b). It is assumed, of course, that a Federal Reserve bank, in extending credit in any case, will avoid the acquisition of an undue amount of paper upon which any one person is liable.

Very truly yours,

(Signed) Chester Morrill

Chester Morrill,  
Secretary.