BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

S-257
Sec.2(b) B.A.of 1933-1

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

March 22, 1941

Dear Sir:

For your information there are enclosed copies of certain correspondence between the Office of the Comptroller of the Currency and the Board with respect to the existence of affiliate relationships, within the meaning of section 2(b) of the Banking Act of 1933, where corporate stock is pledged with member banks to secure loans made by them.

Very truly yours,

Chester Morrill

Chester Morrill,
Secretary.

Enclosures 2

TO THE PRESIDENTS OF ALL FEDERAL RESERVE BANKS

S-257-a
Sec.2(b) B.A.of 1933-1

TREASURY DEPARTMENT

Comptroller of the Currency

Washington

October 7, 1940

The Board of Governors of
The Federal Reserve System
Washington, D. C.

Gentlemen:

We have recently received an inquiry from a national bank and also from the Reconstruction Finance Corporation regarding the proper construction of the statute relating to affiliates of member banks (U.S.C. title 12, sec. 221a) (Banking Act of 1933, sec. 2 as amended by Banking Act of 1935, sec. 301), as applied to certain loan transactions. Since the Reconstruction Finance Corporation participates in loans made by national banks and state member banks, it is deemed advisable to ascertain whether the Board concurs or is at variance with the tentative conclusions reached by this office on the questions presented.

In the first case presented the bank loans a substantial amount to a private corporation and accepts as collateral security more than 51% of the stock of that corporation. The collateral form agreement prescribes that the holder can transfer the stock to its nominee or to itself at any time and thereupon can vote the stock for all purposes. The certificates evidencing such stock are delivered to the bank endorsed in blank, in transferrable form, but there is no actual transfer on the books of the corporation. The question propounded is whether under these circumstances the corporation must be considered an affiliate of the bank. This office is inclined to answer this question in the affirmative, feeling that the case is clearly within the provisions of subsection (b) (1) of section 221a of the above-mentioned statute. The bank undoubtedly controls a majority of the voting shares of the borrowing corporation. However, it is felt that if the collateral agreement with the borrowing corporation provided that the right to vote the stock would vest in the holder of the note only in the event of default on the part of the borrower, then the affiliate relationship would occur only if and when such default occurred.

Under the second set of facts, the loan is the same and the collateral provisions are identical but, coincidental with the making of the loan, the Reconstruction Finance Corporation enters into a participation agreement with the bank, using RFC Form L-298 or RFC Form L-300,

The Board of Governors of the
Federal Reserve System, Wash., D. C.

copies of which forms are enclosed. Under the provisions of both form agreements the Reconstruction Finance Corporation agrees to participate in the loan, but under RFC Form L-298 it is contemplated that the participation will be immediate, whereas under RFC Form L-300 the participation is deferred. In both agreements there are provisions to the effect that at any time after the Reconstruction Finance Corporation has actually distributed its participation in the loan it may call upon the bank to transfer the note and the collateral security to it, whereupon the Reconstruction Finance Corporation would merely issue a certificate of participation to the bank. We have been advised by the General Counsel of the Reconstruction Finance Corporation that when the Corporation takes possession of the note and collateral it automatically acquires all rights of the bank under the proxies and that the bank becomes bound to place the Corporation in position to exercise all such rights, and that the right of possession vested in the Corporation includes the legal right of the Corporation to vote the stock in its independent discretion.

Whereas the provisions of the participation agreements are not altogether clear on the matter of the voting control, this office has reached the tentative conclusion that if the bank is subject at all times to be called upon to transfer the note and stock to the Corporation, giving to the Corporation the right and power at its own discretion to vote the stock for all purposes, the measure of control over the borrowing corporation available to the bank is not such as requires that the borrowing corporation be classified as an affiliate of the bank in such cases.

This office would appreciate the reaction of the Board to these tentative conclusions.

Yours very truly,

(Signed) E. H. Gough

Deputy Comptroller

Encs. 2

S-257-b
Sec. 2(b) B.A. of 1933-1
March 18, 1941

Honorable Preston Delano,
Comptroller of the Currency,
Washington, D. C.

Dear Mr. Delano:

This refers to Mr. Gough's letter of October 7, 1940 which sets forth certain tentative conclusions of your office with respect to the existence of affiliate relationships where corporate stock is pledged with member banks to secure loans made by them. A reply has been delayed pending receipt of advice as to the views of Counsel for the Federal Reserve Bank of _____, in whose district the case prompting your inquiry arose, and the discussion of the opinion of Counsel for that bank with Mr. Roberts of your office.

The Board concurs in the tentative conclusions expressed in Mr. Gough's letter, which are to the effect --

1. That where more than 51 per cent of the stock of a corporation is taken as security for a loan and the bank has the right under a collateral agreement to have the stock transferred to its name and vote it, an affiliate relationship exists;

2. That if the right of the bank to vote the stock can not be exercised prior to default by the borrower, an affiliate relationship would not exist under the collateral agreement prior to such default; and

3. That where the Reconstruction Finance Corporation, through an agreement with the bank with respect to participation in the loan, has the right to have the stock transferred to it and vote it, an affiliate relationship does not exist under the collateral agreement.

With respect to the last conclusion, it would necessarily follow that if in similar circumstances a Federal Reserve Bank, under an agreement with respect to participation in the loan pursuant to section 13b of the Federal Reserve Act, has the right to have the stock transferred to it and vote it, an affiliate relationship would not exist.

It is felt that under the provisions of the statutes relating to affiliates of member banks these conclusions are unavoidable. In acting on the questions presented, the Board has been concerned as to whether the rulings might discourage or prevent banks from making proper loans, especially in connection with national defense. However, in view of the different ways in which loans of the kind under discussion can be handled under the foregoing rulings, it is not believed that the position of the Board and your office should cause undue difficulty. It is assumed that in any case where an examiner has any doubt as to whether these rulings are applicable he will fully inform the bank as to the basis for the position of the Board and your office and, before requiring any action by the bank involved, will consult with your office, or the appropriate Federal Reserve Bank if a State member bank is involved.

Very truly yours,

(Signed) Chester Morrill

Chester Morrill,
Secretary.