

INTERPRETATION OF LAW OR REGULATION

(Copies to be sent to all Federal Reserve Banks)

October 24, 1941

Mr. _____,

Washington, D. C.

Dear Mr. _____:

This refers to your letter of October 14, 1941, in which you request an expression of the Board's views with regard to an affiliate question raised by one of your examiners.

It appears that a national bank has during the past several years made loans to a realty company and also to a subsidiary company owned by the first company. In order to obtain additional protection against loss on loans to both concerns, the bank acquired from the first company approximately 80 per cent of the outstanding stock of its subsidiary as additional collateral and as a result such subsidiary became an affiliate of the bank. Your examiner inquired whether advances to this affiliate are exempted from the provisions of section 23A of the Federal Reserve Act by the provision in section 23A which makes the requirements of that section inapplicable to an affiliate "where the affiliate relationship has arisen out of a bona fide debt contracted prior to the date of the creation of such relationship".

The Board has not heretofore had occasion to make a ruling on a question of this kind but it would appear that in view of the circumstances described the affiliate would clearly come within the provisions of the exemption quoted above.

The above exemption was enacted by Congress in the Banking Act of 1935. We have been unable to find any statements in the legislative history of this Act relating to this exemption. However, an identical provision was contained in the omnibus banking bill of 1934 but was not enacted into law at that time, and it is of interest to note that the Committee on Banking and Currency of the Senate, in its Report No. 1260, made the following statement with regard to this provision:

"Section 14: This amends section 23A of the Federal Reserve Act, which prescribes certain limitations and conditions on loans by member banks to their affiliates.

"Subsection (a) exempts from such limitations and conditions loans where the affiliate relationship has arisen out of a bona fide debt contracted prior to the creation of the relationship. The object of this amendment is to avoid the severe loss that may be occasioned by banks under the present law where they control an affiliate through having obtained its stock by foreclosure or otherwise in satisfaction of a previously contracted debt. It is frequently found necessary to advance funds to such an affiliate either for the purpose of continuing its operation or of assisting its liquidation, so as to salvage the real value out of the assets and reduce or avoid loss by the bank on the debt which had been secured."

While the situation described in this report is not precisely the same as that described by your examiner, it is believed that the exemptive provision is broad enough to include the case described by your examiner.

Very truly yours,

(Signed) L. P. Bethea

L. P. Bethea,
Assistant Secretary.