58 This bank keeps a running list of the number of files which contain a specific stock. The amount of stock of any one firm held has not been sufficiently heavy to give the bank cause for concern. If such a situation should develop, however, the list can be used to make an analysis of the risk.

59 The bank does not find it necessary to keep a record of its overall position in specific securities held as collateral to all loans because of the diversification in securities held as collateral. The loan officer, however, has a somewhat general idea of the amount of securities of any one company held as collateral.

60 The bank maintains a register indicating all loans against each security.

61 Checks are made periodically on the request of the chairman of the loan committee. The checks may be called for at any time. They are not scheduled at regular intervals.

62 This bank does not check its overall position in specific securities to insure that the amounts are not so large as to raise a question about its ability to liquidate the collateral if necessary. The officer contacted in connection with this inquiry thought it should be done and such a program may be adopted at a later date.

81 A file is maintained of the names and amounts of all securities pledged as collateral and is periodically revalued.

82 No checking on overall position.

83 This bank makes no check on its overall position in specific securities, but rather relies on the marketability of stocks underlying its loans to provide liquidation if necessary. An exception to this general policy arises with respect to stocks of closely held corporations. Such securities may be taken by the bank as collateral for a loan but not relied upon ordinarily in liquidation.

84 A file is maintained of the names and amounts of all securities pledged as collateral and is periodically revalued.

85 Earlier concentration studies showed this to be no problem. No longer make such investigations.

86 The bank does not check its overall position in specific securities. Individual loans are watched for excessive concentrations and, invariably, loans supported by stocks of closely held corporations are scrutinized.

87 Concentration in specific securities are noted twice annually in a report made up by the bank's auditing department. This shows the amount of specific stocks held as collateral to the bank's loans.

Question

13. Are there any particular problems that arise or extra safeguards applied when you accept unlisted securities as collateral for a loan? Are there classes, types, or specific securities, listed or unlisted, to which you refuse to assign any value as collateral for loans? Please be as specific as possible.

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Answers

21 Not accepted. No security with value of less than $10 is accepted.

22 Unlisted securities with value of less than $5 a share not acceptable. Never take foreign securities. If a corporation is known to be in difficulties, its securities listed or unlisted would not be acceptable.

23 As a general rule no speculative stocks—uranium or electronics, for example—are acceptable. Nor is closed corporation stock acceptable. Sometimes an exception is made to the latter rule. That is when the shares pledged constitute over 50 percent of the outstanding stock.

24 No specific extra safeguards are applied when unlisted securities are accepted as collateral for a loan. The only problem is one of determining values. If a reasonable value can be determined, the loan can be made providing the individual is acceptable.

25 For stocks with virtually no marketability, the bank sometimes will obtain a repurchase agreement from either the company or some responsible individual within the company. Closely held stocks, with virtually no marketability, issued by companies on which the bank has little knowledge. The determining factor in granting the loan is the bank's knowledge of the borrower.

26 Have had no difficulties. Bank's comments on the other part of the question was as follows: "To my knowledge there are no special classes, etc., except for companies for which there is no market for the stock and no apparent value to the stock. There are some insurance companies that we will not accept and some local stocks that are not accepted. We would hesitate to make a loan if there were no market, we didn't know principal, and we did not know strength of company."

27 Use personal guarantees in some cases (usually local unlisted issues).

28 The bank has no set policies with reference to particular problems of making loans on unlisted securities. Each individual case is judged on its merits. The officer interviewed reported, however, that the bank is more careful in making loans on securities of small closely held corporations.

29 On a few occasions the bank has required a cosigner on the note as an additional hedge against possible decrease in the value of unlisted stocks. The policy is to make no loans on local stocks of companies that have not been in existence for 10 or more years. Also it is the policy not to make loans on unlisted stocks of closely held or family corporations, with the exception of a few loans on bank stocks.

30 Types of securities on which loans are not make are the lowest priced issues and shares in investment clubs.

31 The bank does not feel the presence of any particular problem in accepting unlisted securities as collateral that would distinguish such transactions as basically different from accepting listed securities as collateral. This bank will not accept as collateral for a loan the securities of any organization whose operations it regards as speculative or whose management is composed of individuals who are regarded as promoters rather than permanent builders of business.

32 This bank insisted that there must be a market for the stocks accepted as collateral for a loan. Stocks of a family-owned or closely held corporation are not given any collateral value for loan purposes.

51 Close tabs are kept on value of the few volatile unlisted stocks accepted for collateral loans. Bonds of closed corporations are not accepted and no stocks with a value of less than $5 are accepted.

52 The limited market for unlisted securities and the resulting wide fluctuations in prices are the biggest problems in accepting this kind of collateral. However, these factors are considered before a loan is granted. If questions remain, the loan card is tagged as a safeguard, and the loan tellers are required to watch the market swings in such securities. Securities with a value of less than $10 a share are generally not acceptable as collateral for a loan. Neither are securities issued by a closely held corporation or by local banks.

53 Bank tries to avoid stock of closed corporation or small company whose stock is never traded. Speculative stocks are definitely not acceptable.

54 No extra safeguards are applied in accepting unlisted securities as collateral. The only problem is one of valuation. The bank will not assign any value as collateral to the securities of closely held corporations.

55 None.

56 The bank reviews the market value of unlisted securities and determines what proportion of value should be lent as a regular matter of policy. (See No. 2.) Any bonds with a rating less than B are not assigned a value. Some unlisted stocks would not be assigned a value—this is determined on a stock-by-stock analysis.

57 No extra safeguards. Marketability an important consideration.

58 In making loans collateralized by unlisted securities, the bank always tries to be sure of a ready market for the stock or obtains a repurchase agreement from another party. There are classes and types of securities, both listed and unlisted, on which the bank refuses to assign any value as collateral for loans.

59 With respect to the larger loans on unlisted securities, the collateral value is determined more frequently and the line of credit of the borrower is reviewed more often than some loans on listed securities. There are no listed securities to which the bank would not assign collateral value. With respect to unlisted securities newly issued, local stocks are assigned no value in most cases. Local unlisted stocks of well-established concerns do have collateral value. Stock of closely held family companies

normally would have no loan value and would generally be taken only to improve the collateral position of a problem loan.

60 The bank will assign some value to any listed security. The principal cases where no value is assigned is the closely held security having no market.

61 This bank holds as collateral for loans few unlisted securities that are not actively traded. They are taken mainly to bolster collateral rather than the principal collateral. The bank sees no problems in accepting the unlisted securities in these circumstances. The bank would not accept as collateral the securities of an organization whose operations or management it does not approve.

62 This bank insists that there must be a market for all stocks accepted as collateral for loans. In the event that the market appears to the lending officer as being too thin to warrant the acceptance of a particular issue, the bank may create such a market through the medium of a repurchase agreement with a responsible individual. If a market cannot be established through the repurchase arrangement and does not otherwise exist, the bank will not accept the issue offered as security for a loan. Furthermore, the bank made the point that if stock lacked marketability, such an issue would not be accepted even as excess collateral for a loan.

81 There are no particular problems that arise with accepting unlisted securities as collateral.

82 Will not accept any share valued at less than $10. Will not accept a block (of as much as 1,000 shares) of stock that does not trade often.

83 Bank's principal concern in connection with the problems that arise in handling unlisted securities as collateral relate to marketability. The bank operates on the theory that if it makes the proper appraisal of the marketability of the securities when the loan is granted and periodically revalues such securities, it should be protected against a loss arising from the sale of unlisted securities supporting a loan. The bank will not accept so-called "25¢ mining stocks" or other stocks of questionable value as collateral for a loan. The only instances in which it will accept the stock of closely held corporations are those which have some elements present other than strictly the collateral value of the stocks.

85 Will not accept a security with a value under $10.

86 With ratings assigned to unlisted securities and maximum loan values based on the quality of unlisted securities, and a revaluation once each month as a minimum, the bank feels that additional safeguards are unnecessary. Those securities to which the bank will not assign any value as collateral for loans are classified under category D and described under Nos. 1 and 2 above. Ordinarily this bank does not accept such securities as collateral, but may under unusual circumstances accept them as additional collateral or for reasons other than as collateral to support a loan.

87 No value is assigned to stocks of companies on which it is impossible to acquire quotes either through those sources listed in 4 above or from a recognized broker. "Blocked" stocks are also unacceptable.

General Comments

22 In general, the same methods and standards are used at the other banks in the city. The president of the subject bank claims he knows of one banker in a nearby county that insists upon regular reduction of security loans. This procedure is unusual at banks in the area.

While not called for in the prescribed questions, the president of the subject bank made the following comment:

He stated that he does not like loans secured by this type of collateral because it is hard to find a real economic justification for a commercial bank to make a security loan. Furthermore, he is against speculators in markets, and if possible he shuns loans to such individuals. He realizes that his philosophy is too idealistic in view of today's competitive banking which requires business development techniques and broad customer services.

24 The officers of the bank feel they know the people who are requesting the loans. In this situation, moral standards and ability to repay seem to be much more important than any stock that may be pledged as collateral. If the individual is not a good risk, the bank will not make a loan regard-

less of any collateral that might be pledged. Therefore, it is likely that, in the large majority of cases, any stock pledged as collateral for a loan is incidental security for the bank.

27 The interviewed officer considered his standards to be comparable to those of other banks in the area. He expressed the opinion that his bank was perhaps more lenient in making margin calls than some banks but that this policy was justified by the careful screening of loan applications and consideration of borrower characteristics as well as the collateral.

29 Based on information received from loan applicants, the loan officer believed that competitors in the area have a general policy of loaning not more than 60 percent of value of listed stocks when making nonpurpose loans. The officer believed that policies of competing banks with respect to the amount loaned on unlisted stocks was approximately the same as followed by the subject bank.

59 The loan officer interviewed stated that he believed that the methods and policies were basically quite similar to those of its competitors.

82 The interviewed officer considered the bank's policy to be more conservative than most.

85 Interviewed officer considered that the bank's standards were comparable to those of other banks in the area but perhaps somewhat more rigid.

Appendix X–E

Bank Margin Call Survey

BANK MARGIN CALLS DURING THE STOCK MARKET BREAK

On July 19, 1962, the Board of Governors authorized an informal survey of margin calls by banks during the stock market break of May 1962. In response to this request, the Federal Reserve Banks asked a number of large banks—at least five in each Reserve district—for information on the number and dollar amount of loans on which calls were issued during the 2 weeks from May 21 to June 1. Respondents were also asked the extent to which these calls resulted in sales of collateral (whether by bank or borrower) and the regulatory status of the loans on which calls were issued.

Of 81 banks approached, 78 were able to supply quantitative estimates for the magnitudes sought. Taken together, these banks accounted—at the end of 1961—for a third of all loans outstanding at member banks and nearly half of all "purpose" loans—those to others than brokers and dealers for the purpose of purchasing or carrying securities.

Number of calls.—During the 2 weeks covered by the survey, the 78 banks reported that margin calls in one form or another were issued on a total of 15,124 loans. For purposes of comparison, each bank was asked also to indicate how many calls on the average had been made in February and March, prior to the market break. At that time, respondent banks were issuing calls on less than 400 loans during an average 2-week period. The loans on which calls were issued from May 21 through June 1 amounted to $383 million—slightly more than 1 percent of the total loans of all kinds as reported by these banks at the end of 1961. Since banks do not report separately on all loans collateralized by securities, a comparison of margin calls with this more relevant total is not available.

Only 94 of the loans called in late May were regulated loans (loans to purchase or carry listed stocks extended in conformity with the initial margin requirements of Regulation U), and of these, 41 had been made to permit exercise of AT&T subscription rights. Since the regulation permitted initial margins as low as 25 percent in the latter cases, calls on loans initially margined at 70 percent appear to have been negligible. (It should also be remembered that regulated loans of long standing may have been extended at some period when 50-percent margins prevailed.)

Sale of collateral.—Most of the calls reported in the survey were settled through deposit of cash or additional collateral without sale of securities pledged. Only one-eighth of all calls (1,895 loans) resulted in any sales, and the amount of collateral sold as a result of calls was reported to be about $35 million. More than a third of this was accounted for by a single bank where 70 percent of all calls in the 2-week period resulted in sales of collateral. The banks emphasized strongly that most collateral sales were initiated voluntarily by the customer. Of those volunteering information on this point, only about two dozen loans were reported by banks as having been "sold out."

Distribution of calls.—Of the calls reported, nearly 7,000, or 45 percent, were issued by the five New York banks interviewed. These loans were, on the average, somewhat larger than those elsewhere so that slightly more than half of the dollar volume of loans called were from New York. This appears to reflect aggregate size of the respondent banks more than a difference in patterns of experience, since the incidence of calls relative to total loans for the New York banks was not significantly greater than for the reporting group as a whole. About the same proportion of calls were settled through sale of collateral in New York and in other parts of the country if the one bank whose heavy ratio of sales was noted earlier is excluded from the latter group.

Incidence of calls varied widely among banks, with 4 banks (all in New York City) each issuing more than a thousand and 6 of the 78 respondents making none. Again, much of this concentration can be accounted for by bank size. Only one bank issued calls involving more than 3 percent of its loans, and for most the ratio was under 1 percent. Three-fifths of all calls reported (both as to number and amount) originated with the 8 banks making more than 500 calls; a larger share—close to three-fourths—of the reported sales of collateral were associated with these loans. Twenty-four of the seventy-eight respondents issued between 100 and 500 calls; the other 46 made less than 100 during the period covered by the survey.

Limitations of survey.—Certain reservations should be noted in interpreting the results of this survey:

1. Individual reports vary widely in completeness and reliability. Some banks had or were able to reconstruct substantially complete records of their experience, while others had to rely principally on the memories of lending officers.

2. Variations in the reported incidence of calls to some extent may reflect ambiguities of definition. The survey was designed to cover all cases in which a borrower was contacted by the bank, formally or informally, concerning the unsatisfactory margin status of his loan. Where questions arose, this appears to have been explained to respondent banks, but it is possible that some banks may have included loans on which no customer contact was made but which were flagged through an internal audit for the attention of a loan officer. Conversely, other banks may have treated as "calls" only formal demands for additional margin to avoid a forced sale.

3. One known distortion arises from the time limitations of the survey. Banks interviewed in Los Angeles and San Francisco reported relatively few calls between May 21 and June 1 but indicated that calls were running substantially higher in mid-June. This may have been true in other cases also, though some respondents volunteered the information that further price declines in June resulted in few additional calls since corrective action in late May had been adequate.

4. Probably the most important reservation concerning the survey is that the banks involved cannot in any sense be regarded as a representative sample. While data are collected regularly on "purpose" loans, no current information is available concerning either the magnitude or the distribution among banks of other loans secured by stock, and it appears to have been unregulated loans—presumably made on lower initial margins—that were principally subject to calls.

Almost without exception, the banks in this survey are large banks, and those which accounted for the bulk of both loans and calls are located in major financial centers. There is no reason for supposing the respondents' margin call experience was similar either to that of banks in different types of locations—smaller cities, suburban and rural areas—or to the experience of smaller banks in the large metropolitan centers.

Conclusions.—In the light of these reservations, the experience reported by the 78 respondents should not be generalized too broadly. In particular, no inference is warranted that the calls covered by this survey constitute, even approximately, a third of those issued throughout the country during the last 2 weeks of May. More strongly supportable is the conclusion that while the overall number and magnitude of calls was substantial, a large majority (not necessarily seven-eighths) were settled without sales of collateral and without, therefore, direct impact on the market. The survey would seem to indicate with a high degree of certainty that loans extended subject to Regulation U's initial margin requirements of 70 percent did not, in general, become subject to call despite the severity of the market decline.

APPENDIX X–E: TABLE I.—*Total loans and margin calls on stock-secured bank loans, May 21 to June 1, 1962, 78 large reporting member banks*

[Dollar amounts in thousands]

	All banks reporting	New York City	All others reporting
Number of banks	78	5	73
Total loans, Dec. 31, 1961	$35,955,404	$13,635,371	$22,320,033
Total 3b [1] loans, Dec. 31, 1961	$870,506	$281,837	$588,669
Margin calls:			
Number	15,124	6,805	8,319
Amount	$383,109	$197,838	$185,271
Loans called as percentage of total loans	1.1	1.5	0.8
Biweekly average of margin calls, February-March 1962	388	152	236

[1] Loans classified in schedule A of the call report as loans to others than brokers and dealers "for the purpose of purchasing or carrying securities."

APPENDIX X–E: TABLE II.—*Margin calls on stock-secured bank loans, May 21 to June 1, 1962, 78 large reporting member banks*

[Dollar amounts in thousands]

	All banks reporting	New York City	All others reporting
Number of margin calls	15,124	6,805	8,319
Collateral sales:			
Number of loans involved	1,895	737	1,158
Amount of collateral sold	$34,698	$13,179	$21,519
Percentage of calls resulting in sales	12.5	10.8	13.9
Number of calls on regulated loans:			
Regulation U loans	94	74	20
AT&T subscription accounts (included above)	41	33	8

APPENDIX X–E: TABLE III.—*Distribution of margin calls by reporting banks, by total number of calls issued*

[Dollar amounts in thousands]

	Number of calls, May 21 to June 1, 1962		
	More than 500	100 to 500	Less than 100
Number of banks	8	24	46
Total loans, December 1961	$13,463,002	$11,455,661	$11,036,741
Margin calls:			
Number	8,929	4,935	1,261
Amount	$229,359	$121,867	$31,889
Collateral sales:			
Number of loans involved	1,405	387	103
Amount of collateral sold	$24,741	$8,012	$1,949
Number of calls on regulated loans:			
Regulation U loans	73	14	7
AT&T subscription accounts (included above)	32	5	4
Biweekly average of margin calls, February-March 1962	271	71	46

CHAPTER XI

OPEN-END INVESTMENT COMPANIES (MUTUAL FUNDS)

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