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March 11, 1970.

To: Board of Governors

Subject: Subordinated notes.

From: Governor Robertson

The proposal announced by the Board on March 2, 1970, to amend Regulations D and Q to cover subordinated notes with maturities of less than five years or denominations of less than \$20,000 would exempt from the amendments any instrument issued before March 9, 1970, that complies with the present requirements of the Regulations, i.e., that has an original maturity of more than two years, is unsecured, and states expressly that it is subordinated to the claims of depositors. This would mean, if the proposed amendments are finally adopted, that notes issued after March 9, 1970, that comply with the present Regulations would become subject to reserve requirements and interest-rate ceilings on the effective date of the amendments, even though they were issued pursuant to a public offering made by a member bank before March 9. 1C

Some banks (we know of only seven or eight) have raised strong objections to this feature of the proposal. These are banks that announced an offering of subordinated notes before March 9 but that have not yet completed the sale of such notes. In one instance, a member bank states that its proposal was submitted to its Reserve Bank for comment in January of 1970 and that a final draft of its offering circular was also reviewed by the Reserve Bank in February. This member bank further states that it had incurred expenses of drafting, printing, and advertising in good faith "and within the purview of the regulations at the time they were incurred".

As the Board will recall, it was agreed that the proposal should cover notes issued after a specified cutoff date since otherwise it seemed likely that many banks would endeavor to sell large volumes of such notes before adoption of the proposal by the Board.

On the other hand, there is some merit on equity grounds to the objections raised by banks that had announced offerings of subordinated notes before March 9 in reliance upon the provisions of present regulations but had not yet sold all notes pursuant to such offerings. The Board may wish to consider some modification of its proposal that would alleviate the inequity in such cases.

One possibility would be announcement now of a change in the proposal that would exempt from the amendments notes that may be issued prior to the effective date of the amendments and pursuant to a public offering made prior to March 9, 1970. This could be accomplished by changing the relevant language of the proposed amendments to read:

"... This subparagraph (3) shall not affect (A) any instrument issued before _____ [the effective date] pursuant to a public offering made prior to March 9, 1970, that has an original maturity of more than two years, is unsecured, and states expressly that it is subordinated to the claims of depositors,"

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If this were the Board's decision, we could immediately notify the inquiring banks and thus free them to proceed with sales of such offerings. From a public relations point of view, this move might be worth while, especially since we doubt many millions of dollars are involved.

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