

§ 207.109

value equals \$300 the amount of the insurance premium which is also the amount of the credit extended).

(b) These guidelines also (1) clarify an earlier 1969 Board interpretation to show that the public offering price of mutual fund shares (which includes the front load, or sales commission) may be used as a measure of their current market value when the shares serve as collateral on a purpose credit throughout the day of the purchase of the fund shares, and (2) relax a 1965 Board position in connection with accepting purpose statements by mail. It is the Board's view that when it is clearly established that a purpose statement supports a purpose credit then such statement executed by the borrower may be accepted by mail, provided it is received and also executed by the lender before the credit is extended.

[39 FR 9425, Mar. 11, 1974]

§ 207.109 Extension of credit in certain stock option and stock purchase plans.

Questions have been raised as to whether certain stock option and stock purchase plans involve extensions of credit subject to Regulation G when the participant is free to cancel his participation at any time prior to full payment, but in the event of cancellation the participant remains liable for damages. It thus appears that the participant has the opportunity to gain and bears the risk of loss from the time the transaction is executed and payment is deferred. In some cases brought to the Board's attention damages are related to the market price of the stock, but in others, there may be no such relationship. In either of these circumstances, it is the Board's view that such plans involve extensions of credit. Accordingly, where the security being purchased is a margin security and the credit is secured, directly or indirectly, by any margin security, the creditor must register and the credit must conform with either the regular margin requirements of § 207.1(c) or the special "plan-lender" provisions set forth in § 207.4(a) of the regulation, whichever is applicable. This assumes, of course, that the amount of credit extended is such that the creditor is sub-

12 CFR Ch. II (1-1-98 Edition)

ject to the registration requirements of § 207.1(a) of the regulation.

[39 FR 43815, Dec. 19, 1974]

§ 207.110 Accepting a purpose statement through the mail without benefit of face-to-face interview.

(a) The Board has been asked whether the acceptance of a purpose statement submitted through the mail by a lender subject to the provisions of Regulation G will meet the good faith requirement of § 207.1(e). Section 207.1(e) states that in connection with any credit secured by collateral which includes any margin security, a lender must obtain a purpose statement executed by the borrower and accepted by the lender in good faith. Such acceptance requires that the lender be alert to the circumstances surrounding the credit and if further information suggests inquiry, he must investigate and be satisfied that the statement is truthful.

(b) The lender is a subsidiary of a holding company which also has another subsidiary which serves as underwriter and investment advisor to various mutual funds. The sole business of the lender will be to make "non-purpose" consumer loans to shareholders of the mutual funds, such loans to be collateralized by the fund shares. Mutual funds shares are margin securities for purposes of Regulation G. Solicitation and acceptance of these consumer loans will be done principally through the mail and the lender wishes to obtain the required purpose statement by mail rather than by a face-to-face interview. Personal interviews are not practicable for the lender because shareholders of the funds are scattered throughout the country. In order to provide the same safeguards inherent in face-to-face interviews, the lender has developed certain procedures designed to satisfy the good faith acceptance requirement of the regulation.

(c) The purpose statement will be supplemented with several additional questions relevant to the prospective borrower's investment activities such as purchases of any security within the last 6 months, dollar amount, and obligations to purchase or pay for previous purchases; present plans to purchase

securities in the near future, participations in securities purchase plans, list of unpaid debts, and present income level. Some questions have been modified to facilitate understanding but no questions have been deleted. If additional inquiry is indicated by the answers on the form, a loan officer of the lender will interview the borrower by telephone to make sure the loan is "non-purpose". Whenever the loan exceeds the "maximum loan value" of the collateral for a regulated loan, a telephone interview will be done as a matter of course.

(d) Although the Board has expressed no views as to the necessity for face-to-face meetings between borrower and lending officer under Regulation G, an interpretation under Regulation U published in 1965 (12 CFR 221.115) on the subject has usually been considered applicable. That view, however, was expressed before the adoption by the Board of Regulation X (12 CFR part 224) in 1971. One of the stated purposes of Regulation X was to prevent the infusion of unregulated credit into the securities markets by borrowers falsely certifying the purpose of a loan. The Board is of the view that the existence of Regulation X, which makes the borrower liable for willful violations of the margin regulations, will allow a lender subject to Regulation G or U to meet the good faith acceptance requirement of §§ 207.1(e) and 221.3(a), respectively, without a face-to-face interview if the lender adopts a program, such as the one described above, which requires additional detailed information from the borrower and proper procedures are instituted to verify the truth of the information received. The 1965 interpretation has therefore been withdrawn. Lenders intending to embark on a similar program should discuss proposed plans with their district Federal Reserve Bank. Lenders may have existing or future loans with the prospective customers which could complicate the efforts to determine the true purpose of the loan. In addition, Regulation U differs from Regulation G in many important respects.

(e) Section 220.7(a) of Regulation T, in general, prohibits a broker/dealer from arranging any credit which he himself cannot extend. Therefore, the

Board cautions that any prospectus of sales information for the mutual fund shares may not offer the services of the lending company, as any broker/dealer selling the fund shares would thereby be deemed to have "arranged" a loan in violation of Regulation T.

[43 FR 30038, July 13, 1978]

§207.111 Combined credit for exercising employee stock options and paying income taxes incurred as a result of such exercise.

(a) The Board of Governors has been asked whether §207.1(h) of Regulation G prevents a lender under an employee stock option plan that meets the requirements of §207.4(a) from extending credit to an employee to pay the income taxes incurred as a result of the exercise of the stock option, in addition to the credit to cover the purchase price of the stock.

(b) Section 207.1(h) prohibits a lender governed by Regulation G from extending purpose credit if it is secured by collateral including margin securities, which also secures any other credit to the same person in excess of \$5,000. Unless credit to pay income taxes is also treated as purpose credit, it could not be extended in an amount in excess of \$5,000 when the borrower also has a purpose loan outstanding with the lender, secured by margin securities, since such collateral would be deemed to be also securing the income tax loan. *Purpose credit* is defined in §207.2(c) of the regulation as credit which is for the purpose, whether immediate, incidental, or ultimate, of purchasing or carrying a margin security."

(c) Section 207.4(a), which provides special treatment for credit extended under employee stock option plans, was designed to encourage their use in recognition of their value in giving an employee a proprietary interest in the business. Taking a position that might discourage the exercise of options because of tax complications would conflict with the purpose of §207.4(a).

(d) Accordingly, the Board has concluded that the combined loans for the exercise of the option and the payment of the taxes in connection therewith under plans complying with §207.4(a) may be regarded as credit which is for