

(d) Furthermore, the *purpose* of a loan means just that. It cannot be altered by some temporary application of the proceeds. For example, if a borrower is to purchase Government securities with the proceeds of a loan, but is soon thereafter to sell such securities and replace them with registered stocks, the loan is clearly for the purpose of purchasing or carrying registered stocks.

[12 FR 40, Jan. 3, 1947]

§ 221.102 Designation of New York Stock Exchange for purposes of specialists transactions.

(a) As amended effective July 20, 1949, § 221.3(o) removes the maximum loan level requirements applicable to credit for financing the functions of “specialists” on an exchange designated by the Board of Governors of the Federal Reserve System.

(b) Effective July 20, 1949, the Board of Governors of the Federal Reserve System has designated the New York Stock Exchange pursuant to § 221.3(o), as amended, this designation to be effective until further notice.

[14 FR 4665, July 27, 1949]

§ 221.103 Loans to brokers or dealers.

Questions have arisen as to the adequacy of statements received by lending banks under § 221.3(a) in the case of loans to brokers or dealers secured by stock where the proceeds of the loans are to be used to finance customer transactions involving the purchasing or carrying of registered stocks.

While some such loans may qualify for exemption under § 221.2, unless they do qualify for such an exemption they are subject to this part. For example, if a loan so secured is made to a broker to furnish cash working capital for the conduct of his brokerage business (i.e., for purchasing and carrying securities for the account of customers), the maximum loan value prescribed in § 221.4 would be applicable unless the loan should be of a kind exempted by § 221.2. This result would not be affected by the fact that the stock given as security for the loan was or included stock owned by the brokerage firm.

In view of the foregoing, the statement referred to in § 221.3(a) which the

lending bank may accept and rely upon in good faith in determining the purpose of the loan would be inadequate if the form of statement accepted or used by the bank failed to call for answers which would indicate whether or not the loan was of the kind discussed above.

[17 FR 191, Jan. 8, 1952]

§ 221.104 Federal credit unions.

For text of this interpretation, see § 220.110 of this subchapter.

[18 FR 4592, Aug. 5, 1953]

§ 221.105 Arranging for extensions of credit to be made by a bank.

For text of this interpretation, see § 220.111 of this subchapter.

[18 FR 5505, Sept. 15, 1953]

§ 221.106 Reliance in “good faith” on statement of purpose of loan.

(a) Certain situations have arisen from time to time under this part wherein it appeared doubtful that, in the circumstances, the lending banks may have been entitled to rely upon the statements accepted by them in determining whether the purposes of certain loans were such as to cause the loans to be not subject to the part.

(b) The use by a lending bank of a statement in determining the purpose of a particular loan is, of course, provided for by § 221.3(a). However, under that paragraph a lending bank may “rely” upon any such statement only if it is “accepted by the bank in good faith.” As the Board stated in the interpretation contained in § 221.101, the “requirement of ‘good faith’ is of vital importance”; and, to fulfill such requirement, “it is clear that the bank must be alert to the circumstances surrounding the loan”.

(c) Obviously, such a statement would not be accepted by the bank in “good faith” if at the time the loan was made the bank had knowledge, from any source, of facts or circumstances which were contrary to the natural purport of the statement, or which were sufficient reasonably to put the bank on notice of the questionable reliability or completeness of the statement.

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(d) Furthermore, the same requirement of “good faith” is to be applied whether the statement accepted by the bank is signed by the borrower or by an officer of the bank. In either case, “good faith” requires the exercise of special diligence in any instance in which the borrower is not personally known to the bank or to the officer who processes the loan.

(e) The interpretation set forth in §221.101 contains an example of the application of the “good faith” test. There it was stated that “if the loan is to be made to a customer who is not a broker or dealer in securities, but such a broker or dealer is to deliver registered stocks to secure the loan or is to receive the proceeds of the loan, the bank would be put on notice that the loan would probably be subject to this part. It could not accept in good faith a statement to the contrary without obtaining a reliable and satisfactory explanation of the situation”.

(f) Moreover, and as also stated by the aforementioned interpretation contained in §221.101, the *purpose* of a loan, of course, “cannot be altered by some temporary application of the proceeds. For example, if a borrower is to purchase Government securities with the proceeds of a loan, but is soon thereafter to sell such securities and replace them with registered stocks, the loan is clearly for the purpose of purchasing or carrying registered stocks”. The purpose of a loan therefore, should not be determined upon a narrow analysis of the immediate use to which the proceeds of the loan are put. Accordingly, a bank acting in “good faith” should carefully scrutinize cases in which there is any indication that the borrower is concealing the true purpose of the loan, and there would be reason for special vigilance if registered stocks are substituted for bonds or unregistered stocks soon after the loan is made, or on more than one occasion.

(g) Similarly, the fact that a loan made on the borrower’s signature only, for example, becomes secured by registered stock shortly after the disbursement of the loan usually would afford reasonable grounds for questioning the bank’s apparent reliance upon merely a statement that the purpose of

the loan was not to purchase or carry registered stock.

(h) These examples are, of course, by no means exhaustive. They simply illustrate the fundamental fact that no statement accepted by a bank is of any value for the purposes of the regulation unless “accepted by the bank in good faith”, and that “good faith” requires, among other things, reasonable diligence to learn the truth.

[18 FR 5505, Sept. 15, 1953]

§221.107 Arranging loan to purchase open-end investment company shares.

For text of this interpretation, see §220.112 of this subchapter.

[20 FR 1643, Mar. 18, 1955]

§221.108 Effect of registration of stock subsequent to making of loan.

(a) The Board recently was asked whether a loan by a bank to enable the borrower to purchase a newly issued stock during the initial over-the-counter trading period prior to the stock becoming registered (listed) on a national securities exchange would be subject to this part. The Board replied that, until such stock is so registered, this would not be applicable to such a loan.

(b) The Board has now been asked what the position of the lending bank would be under this part if, after the date on which the stock should become registered, such bank continued to hold a loan of the kind just described. It is assumed that the loan was in an amount greater than the maximum loan value for the collateral specified in this part.

(c) If the stock should become registered, the loan would then be for the purpose of purchasing or carrying a registered stock, and, if secured directly or indirectly by any stock, would be subject to this part as from the date the stock was registered. Under this part, this does not mean that the bank would have to obtain reduction of the loan in order to reduce it to an amount no more than the specified maximum loan value. It does mean, however, that so long as the loan balance exceeded the specified maximum loan value, the bank could