

Federal Reserve System

§ 221.108

(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

not permit any withdrawals or substitutions of collateral that would increase such excess; nor could the bank increase the amount of the loan balance unless there was provided additional collateral having a maximum loan value at least equal to the amount of the increase. In other words, as from the date the stock should become registered, the loan would be subject to this part in exactly the same way, for example, as a loan subject to this part that became under-margined because of a decline in the current market value of the loan collateral or because of a decrease by the Board in the maximum loan value of the loan collateral.

[21 FR 1094, Feb. 17, 1956]

§ 221.109 Loan to open-end investment company.

In response to a question regarding a possible loan by a bank to an open-end investment company that customarily purchases stocks registered on a national securities exchange, the Board stated that in view of the general nature and operations of such a company, any loan by a bank to such a company should be presumed to be subject to this part as a loan for the purpose of purchasing or carrying registered stocks. This would not be altered by the fact that the open-end company had used, or proposed to use, its own funds or proceeds of the loan to redeem some of its own shares, since mere application of the proceeds of a loan to some other use cannot prevent the ultimate purpose of a loan from being to purchase or carry registered stocks.

[23 FR 8945, Nov. 18, 1958]

§ 221.110 Questions arising under Regulation U.

(a) Regulation U governs “any loan” made by a bank “secured directly or indirectly by any stock for the purpose of purchasing or carrying any stock registered on a national securities exchange”, with certain exceptions, and provides that the maximum loan value of such stock shall be a fixed percentage “of its current market value, as determined by any reasonable method.”

(b) The Board of Governors has recently had occasion to consider the ap-

plication of this language to the three following questions:

(1) *Loan secured by stock.* First, is a loan to purchase or carry registered stock subject to Regulation U where made in unsecured form, if stock is subsequently deposited as security with the lending bank, and surrounding circumstances indicate that the parties originally contemplated that the loan should be so secured? The Board answered that in a case of this kind, the loan would be subject to the Regulation, for the following reasons.

(i) The Board has long held, in the closely related *purpose* area, that the original purpose of a loan should not be determined upon a narrow analysis of the technical circumstances under which a loan is made. Instead, the fundamental purpose of the loan is considered to be controlling. Indeed, “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” affords reasonable grounds for questioning whether the bank was entitled to rely upon the borrower’s statement as to the purpose of the loan. 1953 Bull. 951.

(ii) Where security is involved, standards of interpretation should be equally searching. If, for example, the original agreement between borrower and bank contemplated that the loan should be secured by registered stock, and such stock is in fact delivered to the bank when available, the transaction must be regarded as fundamentally a secured loan. This view is strengthened by the fact that the regulation applies to a loan “secured directly or indirectly by any stock.”

(2) *Loan to acquire controlling shares.*

(i) The second question is whether the Regulation governs a stock-secured loan made for the business purpose of purchasing a controlling interest in a corporation, or whether such a loan would be exempt on the ground that the Regulation is directed solely toward purchases of stock for speculative or investment purposes. The Board answered that a stock-secured loan for the purpose of purchasing or carrying registered stock is subject to the Regulation, regardless of the reason for which the purchase is made.