

X would be acquiring mutual fund shares at a cost that would exceed the net earnings it would normally have accumulated, and would become indebted to the lending bank in an amount approximately 70 percent of the prices of said shares.

(c) The Board held that the loans were for the purpose of purchasing the shares, and therefore subject to the limitations prescribed by this part. As pointed out in §221.114 with respect to a similar program for putting a high proportion of cash income into stock, then borrowing against the stock to meet needs for which the cash would otherwise have been required, a contrary conclusion could largely defeat the basic purpose of the margin regulations.

(d) Also considered was an alternative proposal under which X would deposit proceeds from accounts receivable in a time account for 1 year, before using those funds to purchase mutual fund shares. The Board held that this procedure would not change the situation in any significant way. Once the arrangement was established, the proceeds would be flowing into the time account at the same time that similar amounts were released to purchase the shares, and over any extended period of time the result would be the same. Accordingly, the Board concluded that bank loans made under the alternative proposal would similarly be subject to this part.

[32 FR 8357, June 10, 1967]

§221.117 When bank in “good faith” has not relied on stock as collateral.

(a) The Board has received questions regarding the circumstances in which an extension or maintenance of credit will not be deemed to be “indirectly secured” by stock as indicated by the phrase, “if the bank in good faith has not relied upon such stock as collateral,” contained in clause (2) of a recent amendment to §221.3(c) of Regulation U. A similar phrase is contained in §207.2(g) of Regulation G of this chapter and the following applies to that paragraph, insofar as appropriate and consistent.

(b) In response, the Board noted that in amending this portion of the regulation it was indicated that one of the

purposes of the change was to make clear that §221.3(c) does not apply to certain routine negative covenants in loan agreements. Also, while the question of whether or not a bank has relied upon particular stock as collateral is necessarily a question of fact to be determined in each case in the light of all relevant circumstances, some indication that the bank had not relied upon stock as collateral would seem to be afforded by such circumstances as the fact that (1) the bank had obtained a reasonably current financial statement of the borrower and this statement could reasonably support the loan, and (2) the loan was not payable on demand or because of fluctuations in market value of the stock, but instead was payable on one or more fixed maturities which were typical of maturities applied by the bank to loans otherwise similar except for not involving any possible question of stock collateral.

[33 FR 7485, May 21, 1968]

§221.118 Bank arranging for extension of credit by corporation.

For text of this interpretation, see §207.103 of this subchapter.

[34 FR 7005, Apr. 29, 1969]

§221.119 Status after July 8, 1969, of credit extended prior to that date to purchase or carry mutual fund shares.

(a) Prior to July 8, 1969, the margin and other requirements of Regulations G and U applied to credit extended to purchase or carry shares of a mutual fund (secured by certain described collateral), if (1) the portfolio of the fund did “customarily include” securities that would themselves have been subject to the regulations and (2) the fund was included in a list of such funds that the Board published for this purpose.

(b) It was found that virtually all mutual funds met the “customarily include” test. Accordingly, for administrative reasons, the Board discontinued publication of the list and restated the rule to cover all mutual funds except those at least 95 percent of whose assets are continuously invested in exempted securities.

(c) The Board made these changes, effective July 8, 1969, in Regulation G (Code of Federal Regulations, title 12, part 207) by adding a new §207.2(d) (while eliminating former §207.2(c)(3) and §207.4(b)), and in Regulation U (Code of Federal Regulations, title 12, part 221) by adding a new §221.3(v) (while eliminating former §221.3(b)(3) and §221.3(d)).

(d) The Board has received several questions respecting the effect of the amendments on certain stock-secured credits that were extended prior to July 8, 1969, to purchase or carry mutual fund shares and were treated as not subject to Regulations G or U at the time of extension on the ground that the funds were not on the Board's published list.

(e) The Board has held that whether a loan is for the purpose of purchasing or carrying a stock not registered on a national securities exchange depends on the present status of the stock. Thus, a credit is treated as one for such a purpose if used to purchase or carry a stock that became registered after the loan was made (1937 Federal Reserve Bulletin 955; Published Interpretations Par. 6435). The converse is also true (1938 Federal Reserve Bulletin 90; Published Interpretations Par. 6445).

(f) The same principle applies to the closely parallel question in the present case. Credits extended before July 8, 1969, to purchase or carry shares in the mutual funds in question were for the purpose of purchasing or carrying "margin stocks" (Regulation U) or "margin securities" (Regulation G) even though at the time of extension, the funds were not on the Board's published list. Accordingly, if collateralized as specified in the regulations, the credits were subject to the pertinent regulation from the effective date of the amendments, July 8, 1969.

(g) In applying the above interpretation, it should be borne in mind that the Board's margin regulations are based on (1) the requirement of an initial deposit in connection with the original extension of a credit, and (2) limitations on substitutions or withdrawals of the collateral securing a credit.

(h) In the latter category, the Board's margin regulations apply a re-

quirement to proceeds of a sale of collateral in an undermargined loan (except for a same-day sale-and-purchase substitution) in order to strengthen the margin status of the loan (§207.1(j) of Regulation G and §221.1(b) of Regulation U). While this requirement became applicable on July 8, 1969, to credit previously extended to purchase shares in mutual funds that had not been on the Board's list prior to that date, the Board, in view of all the circumstances, will not insist upon reconstitution of loans to take account of withdrawals and substitutions of collateral before April 27, 1970, the date of issuance of this interpretation, even though henceforth all withdrawals and substitutions must comply with the requirement.

(i) Application of §221.3(q): Section 221.3(q) of Regulation U provides that credit extended by banks to a customer who is engaged "principally, or as one of the customer's important activities," in the business of extending credit to purchase or carry margin securities is considered to be extended for that purpose. Banks extending credit to such customers must treat the credit as subject to that regulation, and the credit must comply with all the requirements thereof "unless the credit and its purposes are effectively and unmistakably separated and disassociated from any financing or refinancing, for the customer or others, of any purchasing or carrying of [margin] stocks."

(j) Since credit to purchase or carry mutual fund shares (no matter when extended) is credit to purchase or carry margin stocks, any person or organization that engages, as an important activity, in extending credit to purchase or carry such shares (with the exception mentioned) is a lender subject to §221.3(q) even though the funds were not on the Board's list prior to July 8, 1969. However, as stated above, as an administrative matter the retention requirements of the regulations need apply only to all substitutions and withdrawals, occurring on or after April 27, 1970, of collateral securing such credit.

(k) In view of the likelihood that §221.3(q) applies to any loan to any financial institution which has pledged

or offers to pledge mutual fund shares, particularly shares which were not on the Board's list prior to July 8, 1969, a bank should treat any such loan as being subject to the requirements of the regulation unless the borrower supplies clear proof, to be preserved in the files of the bank, that § 221.3(q) does not apply or that the loan is "separated and disassociated" as specified in the section. In this connection, a general statement, such as that the credit is for "working capital" or "general corporate purposes", is insufficient evidence that the requirements of the regulation are not applicable.

[35 FR 6959, May 1, 1970]

§ 221.120 Allocation of stock collateral to purpose and nonpurpose credits to same customer.

(a) A bank proposes to extend two credits (Credits "A" and "B") to its customer. Although the two credits are proposed to be extended at the same time, each would be evidenced by a separate agreement. Credit A would be extended for the purpose of providing the customer with working capital (nonpurpose credit), collateralized by stock. Credit B would be extended for the purpose of purchasing or carrying margin stock (purpose credit), without collateral or on collateral other than stock.

(b) Regulation U allows a bank to extend purpose and nonpurpose credits simultaneously or successively to the same customer. This rule is expressed in § 221.3(n)(3) which provides in substance that for any nonpurpose credit to the same customer, the bank shall in good faith require as much collateral not already identified to the customer's purpose credit as the bank would require if it held neither the purpose loan nor the identified collateral. This rule also takes into account that the bank would not necessarily be required to hold collateral for the nonpurpose credit if, consistent with good faith banking practices, it would normally make this kind of nonpurpose loan without collateral.

(c) The Board views § 221.3(n)(3) of Regulation U, when read in conjunction with § 221.3(n)(1), as requiring that whenever a bank extends two credits to the same customer, one a purpose cred-

it and the other nonpurpose, any stock collateral must first be identified with and attributed to the purpose loan by taking into account the maximum loan value of such collateral as prescribed in § 221.4 (the Supplement) of Regulation U.

(d) The Board is further of the opinion that under the foregoing circumstances Credit B would be indirectly secured by stock, despite the fact that there would be separate loan agreements for both credits. This conclusion flows from the circumstance that the bank would hold in its possession stock collateral to which it would have access with respect to Credit B, despite any ostensible allocation of such collateral to Credit A.

[36 FR 25150, Dec. 29, 1971]

§ 221.121 Computation of time periods for acquiring and holding blocks of stock by block positioners.

(a) The Board recently considered two questions in connection with § 221.3(z)(2) and (3) of Regulation U providing for bank credit to block positioners which is exempt from the normal margin requirements as prescribed from time to time in that regulation.

(b) The first question pertained to the period of time in which a block positioner, in order to qualify for the exemption, must position a block of stock when such positioning results from several transactions at approximately the same time from a single source, as set forth in § 221.3(z)(2)(ii).

(c) The Board is of the view that the aggregate of several transactions from a single source would ordinarily be carried out within a timespan of one-half hour in order for such aggregate to be considered one block of stock eligible for exempt credit. In extraordinary circumstances, however, the block positioner could consult the Reserve Bank in whose district its office is situated as to whether stock positioned over a slightly longer period constitutes a single block. In such a case the block positioner should, of course, disclose all relevant circumstances to the Reserve Bank.

(d) The second question related to the computation of the period of 20 business days, specified in § 221.3(z)(3), in which exempt credit may remain