

FEDERAL RESERVE BANK OF DALLAS

DALLAS, TEXAS 75222

Circular No. 69-142

June 9, 1969

AN INTERPRETATION - REGULATION G

To Nonbank Lenders and Others Concerned
in the Eleventh Federal Reserve District:

Enclosed is a copy of an interpretation under Regulation G. This interpretation is based on a recent letter ruling of the Board as to whether an extension of credit is made by a contribution to a joint venture when the contribution is disproportionate to the contributor's share in the venture's profits or losses.

This interpretation will be published shortly in the ~~Federal Register and Federal Reserve Bulletin~~.

Yours very truly,

P. E. Coldwell

President

Enclosure (1)

TITLE 12--BANKS AND BANKING

CHAPTER II--FEDERAL RESERVE SYSTEM

SUBCHAPTER A--BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

[Reg. G]

PART 207--CREDIT BY PERSONS OTHER THAN BANKS, BROKERS,
OR DEALERS FOR THE PURPOSE OF PURCHASING OR
CARRYING REGISTERED EQUITY SECURITIES

Contribution to Joint Venture as Extension of Credit

§ 207.104 Contribution to joint venture as extension of credit when the contribution is disproportionate to the contributor's share in the venture's profits or losses.

(a) The Board recently considered the question whether a joint venture, structured so that the amount of capital contribution to the venture would be disproportionate to the right of participation in profits or losses, constitutes an "extension of credit" for the purpose of Regulation G.

(b) An individual and a corporation plan to establish a joint venture to engage in the business of buying and selling securities, including registered equity securities. The individual would contribute 20 per cent of the capital and receive 80 per cent of the profits or losses; the corporate share would be the reverse. In computing profits or losses, each participant would first receive interest at the rate of 8 per cent on his respective capital contribution. Although purchases and sales would be mutually agreed upon, the corporation could liquidate the joint portfolio if the individual's share of the losses equaled or

exceeded his 20 per cent contribution to the venture. The corporation would hold the securities, and upon termination of the venture, the assets would first be applied to repayment of capital contributions.

(c) In general, the relationship of joint venture is created when two or more persons combine their money, property, or time in the conduct of some particular line of trade or some particular business and agree to share jointly, or in proportion to capital contributed, the profits and losses of the undertaking.

(d) The incidents of the joint venture described above, however, closely parallel those of an extension of margin credit, with the corporation as lender and the individual as borrower. The corporation supplies 80 per cent of the purchase price of securities in exchange for a net return of 8 per cent of the amount advanced plus 20 per cent of any gain. Like a lender of securities credit, the corporation is insulated against loss by retaining the right to liquidate the collateral before the securities decline in price below the amount of its contribution. Conversely, the individual--like a customer who borrows to purchase securities--puts up only 20 per cent of their cost, is entitled to the principal portion of any appreciation in their value, bears the principal risk of loss should that value decline, and does not stand to gain or lose except through a change in value of the securities purchased.

(e) The Board is of the opinion that where the right of an individual to share in profits and losses of such a joint venture is disproportionate to his contribution to the venture,

(1) the joint venture involves an extension of credit by the corporation to the individual,

(2) the extension of credit is to purchase or carry registered equity securities, and is collateralized by such securities, and

(3) if the corporation is neither a bank subject to Regulation U nor a broker or dealer subject to Regulation T, the credit is of the kind described by section 207.1(a) of Regulation G.

(15 U.S.C. 78g. Interprets or applies 15 U.S.C. 78g.)

Dated at Washington, D. C., this 13th day of May 1969.

By order of the Board of Governors.

(Signed) Robert P. Forrestal

Robert P. Forrestal,
Assistant Secretary.

(SEAL)