

FEDERAL RESERVE BANK OF DALLAS
DALLAS, TEXAS 75222

Circular No. 70-125
May 21, 1970

STATUS AFTER JULY 8, 1969, OF CREDIT EXTENDED PRIOR
TO THAT DATE TO PURCHASE OR CARRY MUTUAL FUND SHARES
(Regulations G and U)

To All Banks, Regulation G Registrants, and Others Concerned
in the Eleventh Federal Reserve District:

The Board of Governors of the Federal Reserve System approved
on April 21, 1970, an interpretation of Regulations G and U regarding
the status after July 8, 1969, of credit extended prior to that date
to purchase or carry mutual fund shares.

The text of the interpretation, as it appeared in the
Federal Register on May 1, 1970, is reproduced on the reverse for
your information.

Yours very truly,

P. E. Coldwell

President

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 retention requirement 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.

By order of the Board of Governors,
April 21, 1970.

[SEAL] KENNETH A. KENYON,
Deputy Secretary.

[F.R. Doc. 70-5336; Filed, Apr. 30, 1970;
8:46 a.m.]

Title 12—BANKS AND BANKING

Chapter II—Federal Reserve System

SUBCHAPTER A—BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

[Regs. U and G]

PART 207—SECURITIES CREDIT BY PERSONS OTHER THAN BANKS, BROKERS OR DEALERS

PART 221—CREDIT BY BANKS FOR THE PURPOSE OF PURCHASING OR CARRYING MARGIN STOCKS

Credit Extended To Carry Mutual Fund Shares

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

For the text of interpretation, see § 221.119 of this subchapter.

§ 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