

FEDERAL RESERVE BANK OF NEW YORK

[Circular No. 5992]
June 15, 1967

Interpretation of Regulation U

To All Banks in the
Second Federal Reserve District:

Printed below is an excerpt from the *Federal Register* of June 10, 1967, containing an interpretation, issued by the Board of Governors of the Federal Reserve System, on the question of whether bank loans to replenish working capital that has been used to purchase mutual fund shares are subject to the requirements of Regulation U, Loans by Banks for the Purpose of Purchasing or Carrying Registered Stocks.

Additional copies of this circular will be furnished upon request.

ALFRED HAYES,
President.

Title 12—BANKS AND BANKING

Chapter II—Federal Reserve System

SUBCHAPTER A—BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

[Reg. U]

PART 221—LOANS BY BANKS FOR PURPOSE OF PURCHASING OR CARRYING REGISTERED STOCKS

Loans Subject to Margin Requirements

§ 221.116 Bank loans to replenish working capital used to purchase mutual fund shares.

(a) In a situation recently considered by the Board of Governors, a business concern ("X") proposed to purchase mutual fund shares, from time to time, with proceeds from its accounts receivable, then pledge the shares with a bank in order to secure working capital.

The bank was prepared to lend amounts equal to 70 percent of the current value of the shares as they were purchased by X. If the loans were subject to this part (Regulation U), only 30 percent of the current market value of the shares could be lent.

(b) The immediate purpose of the loans would be to replenish X's working capital. However, as time went on, 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.

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

Dated at Washington, D. C., this 5th day of June 1967.

By order of the Board of Governors.

[SEAL] MERRITT SHERMAN,
Secretary.

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