

FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 7541]
January 2, 1975

INTERPRETATION OF MARGIN REGULATION G

Extensions of Credit in Certain Stock Option and Stock Purchase Plans

*To All Regulation G Registrants, and Others Concerned,
in the Second Federal Reserve District:*

On December 2, 1974, the Board of Governors of the Federal Reserve System issued an interpretation of Regulation G, "Securities Credit by Persons Other Than Banks, Brokers or Dealers," to the effect that certain stock option and employee stock purchase plans involve extensions of credit subject to that Regulation.

In the typical employee stock purchase plan contemplated by the Board's interpretation certain shares of stock are offered to some or all employees at the current market value. Payment for such shares is made by the employee through payroll deductions over a period of weeks or months. The purchaser generally is not entitled to any dividends, has no rights as a stockholder until payment for the shares has been made in full, and may cancel the subscription at any time prior to making such full payment; upon full payment, stock certificates are issued in the employee's name.

If during the term of scheduled payroll deductions the issuer is unable to make such authorized deductions (because of low earnings due to furloughs, lay-offs, failure to earn sufficient commissions, termination of employment, etc.), or in the event a subscription is cancelled, the issuer is empowered to sell the stock allocated to the purchaser and apply the proceeds of the sale to the subscription price. Any excess of the proceeds of sale over the unpaid portion of the total subscription price is remitted to the purchaser, and any deficiency remaining after application of the sales proceeds to the unpaid portion of the total purchase price is immediately payable by the purchaser to the issuer. Since the purchaser bears the risk of the market price of the stock from the time he enters into the agreement to purchase the shares, the plan is considered to involve an extension of credit.

Enclosed is a copy of the Board's interpretation of Regulation G. Additional copies of the enclosure will be furnished upon request.

ALFRED HAYES,
President.

Board of Governors of the Federal Reserve System

SECURITIES CREDIT BY PERSONS OTHER THAN
BANKS, BROKERS, OR DEALERS

INTERPRETATION OF REGULATION G

Stock Option and Stock Purchase Plans

§ 207.109—Extensions of credit in certain
stock option and stock purchase plans.

Questions have been raised as to whether certain stock option and stock purchase plans involve extensions of credit subject to Regulation G when the participant is free to cancel his participation at any time prior to full payment, but in the event of cancellation the participant remains liable for damages. It thus appears that the participant has the opportunity to gain and bears the risk of loss from the time the transaction is executed and payment is deferred. In some cases brought to the Board's attention damages are related to the market price of the stock but in others, there may be no such relationship. In either of these circum-

stances, it is the Board's view that such plans involve extensions of credit. Accordingly, where the security being purchased is a margin security and the credit is secured, directly or indirectly, by any margin security, the creditor must register and the credit must conform with either the regular margin requirements of section 207.1(c) or the special "plan-lender" provisions set forth in section 207.4(a) of the regulation, whichever is applicable. This assumes, of course, that the amount of credit extended is such that the creditor is subject to the registration requirements of section 207.1(a) of the regulation.

By order of the Board of Governors, December 2, 1974.