

FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 8383]
July 10, 1978

INTERPRETATION OF MARGIN REGULATIONS G AND U

Permitting Lenders to Accept "Purpose Statements" Through the Mail

*To All Persons Extending Securities Credit
in the Second Federal Reserve District:*

The Board of Governors of the Federal Reserve System has issued the following statement announcing a new interpretation of its margin Regulations G and U:

The Board of Governors of the Federal Reserve System today [June 30] withdrew a 1965 interpretation of its margin regulations that generally required face-to-face interviews for the acceptance of "purpose statements"—used to determine whether a loan is for the purpose of purchasing securities.

A new interpretation on the subject applicable to Regulation G (Margin Credit Extended by Parties Other than Banks, Brokers, and Dealers) and Regulation U (Margin Credit Extended by Banks) permits lenders to accept purpose statements through the mail under certain circumstances.

The Board stated that a lender may satisfy the good faith requirement of the margin regulations for acceptance of purpose statements, without face-to-face interviews, if the lender adopts a program that requires detailed information from the borrower and proper procedures to verify the truth of the information received.

The Board stated that lenders intending to embark on such a program should discuss proposed plans with their district Federal Reserve Banks.

Enclosed is a copy of the interpretation. Questions on this matter may be directed to our Regulations Division (Tel. No. 212-791-5914).

PAUL A. VOLCKER,
President.

Board of Governors of the Federal Reserve System

MARGIN REGULATIONS

INTERPRETATION OF REGULATIONS G AND U

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final Interpretation.

SUMMARY: This interpretation permits lenders, under certain conditions, to accept a purpose statement through the mail without a face-to-face interview. This replaces an interpretation adopted by the Board in 1965 (12 C.F.R. 221.115). The reconsideration was considered appropriate in light of changes in commercial practice and the law since the publication of the prior interpretation.

EFFECTIVE DATE: June 29, 1978.

FOR FURTHER INFORMATION CONTACT: Patsy Abelle, Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System, Washington, D.C. 20551, (202) 452-2781.

SUPPLEMENTARY INFORMATION:

(1) The Board was recently asked to review its 1965 Interpretation concerning loans by mail on security of mutual fund shares. Under that interpretation, purpose statements taken by the lender to determine whether the proceeds of the loan will be used to buy margin stock were required to be obtained in face-to-face interviews. The Board concluded that a review of the interpretation was desirable in light of the changes in commercial practice and the promulgation of Regulation X which makes the borrower liable for wilful violations of the margin regulations. (2) This action is taken pursuant to the Board's authority under sections 7 and 23 of the Securities Exchange Act, 12 U.S.C. 78(g) and (w).

INTERPRETATION OF REGULATION G

§ 207.110. *Accepting a purpose statement through the mail without benefit of face-to-face interview.*

(a) The Board has been asked whether the acceptance of a purpose statement submitted through the mail by a lender subject to the provisions of Regulation G will meet the good faith requirement of section 207.1(e). Section 207.1(e) states that in connection with any credit secured by collateral which includes any margin security, a lender must obtain a purpose

statement executed by the borrower and accepted by the lender in good faith. Such acceptance requires that the lender be alert to the circumstances surrounding the credit and if further information suggests inquiry, he must investigate and be satisfied that the statement is truthful.

(b) The lender is a subsidiary of a holding company which also has another subsidiary which serves as underwriter and investment advisor to various mutual funds. The sole business of the lender will be to make "non-purpose" consumer loans to shareholders of the mutual funds, such loans to be collateralized by the fund shares. Mutual fund shares are margin securities for purposes of Regulation G.

Solicitation and acceptance of these consumer loans will be done principally through the mail and the lender wishes to obtain the required purpose statement by mail rather than by a face-to-face interview. Personal interviews are not practicable for the lender because shareholders of the funds are scattered throughout the country. In order to provide the same safeguards inherent in face-to-face interviews, the lender has developed certain procedures designed to satisfy the good faith acceptance requirement of the regulation.

(c) The purpose statement will be supplemented with several additional questions relevant to the prospective borrower's investment activities such as purchases of any security within the last six months, dollar amount, and obligations to purchase or pay for previous purchases; present plans to purchase securities in the near future, participations in securities purchase plans, list of unpaid debts, and present income level. Some questions have been modified to facilitate understanding but no questions have been deleted. If additional inquiry is indicated by the answers on the form, a loan officer of the lender will interview the borrower by telephone to make sure the loan is "non-purpose." Whenever the loan exceeds the "maximum loan value" of the collateral for a regulated loan, a telephone interview will be done as a matter of course.

(d) Although the Board has expressed no views as to the necessity for face-to-face meetings between borrower and lending officer under Regulation G, an interpretation under Regulation U published in 1965 (12 CFR 221.115)

on the subject has usually been considered applicable. That view, however, was expressed before the adoption by the Board of Regulation X (12 CFR 224) in 1971. One of the stated purposes of Regulation X was to prevent the infusion of unregulated credit into the securities markets by borrowers falsely certifying the purpose of a loan. The Board is of the view that the existence of Regulation X, which makes the borrower liable for wilful violations of the margin regulations, will allow a lender subject to Regulation G or U to meet the good faith acceptance requirement of sections 207.1(e) and 221.3(a), respectively, without a face-to-face interview if the lender adopts a program, such as the one described above, which requires additional detailed information from the borrower and proper procedures are instituted to verify the truth of the information received. The 1965 interpretation has therefore been withdrawn. Lenders intending to embark on a similar program should discuss proposed plans with their district Federal Reserve Bank. Lenders may have existing or future loans with the prospective customers which could complicate the efforts to determine the true purpose of the loan. In addition, Regulation U differs from Regulation G in many important respects.

(e) Section 220.7(a) of Regulation T, in general, prohibits a broker/dealer from arranging any credit which he himself cannot extend. Therefore, the Board cautions that any prospectus or sales information for the mutual fund shares may not offer the services of the lending company, as any broker/dealer selling the fund shares would thereby be deemed to have "arranged" a loan in violation of Regulation T.

INTERPRETATION OF REGULATION U

The Board of Governors of the Federal Reserve System has reconsidered the interpretation originally published as § 221.115 on March 24, 1965, at 30 F.R. 3812. It is hereby rescinded and replaced with a citation to § 207.110, a new interpretation on the subject. The text of § 221.115 now reads as follows:

§ 221.115. *Accepting a purpose statement through the mail without benefit of face-to-face interview.*

For text of an interpretation on this subject, see § 207.110 of this subchapter (15 U.S.C. 78g). [*Interpretation of Regulation G printed above.*]