

INTERPRETATION OF LAW OR REGULATION

(Copies to be sent to all Federal reserve banks)

July 28, 1937.

Mr. _____,
Assistant Vice President,
Federal Reserve Bank of _____,
_____, _____.

Dear Mr. _____:

Reference is made to your correspondence regarding the inquiry presented by _____ Stock Exchange as to whether certain transactions constitute bona fide arbitrage transactions within the meaning of section 3(d) of Regulation T. As you know, a reply to your letter has been delayed while certain practical aspects of this problem were being investigated.

It is understood that the inquiry relates to transactions in two securities of which the first is an issued warrant of a particular corporation which evidences a right to subscribe, by the payment of a specified sum of money, to a security which is definitely to be issued by the corporation. The second security is the security that may be obtained by exercising the warrant, and it may conveniently be referred to as the subject security.

In order to take advantage of the disparity in the relative market prices of the warrant and the subject security, a customer of a member of a national securities exchange purchases the warrant through the member and simultaneously, or nearly simultaneously, sells short through the member that quantity of the subject security called for by the warrant.

In one case the subject security is part of an additional issue of outstanding securities of the corporation and is sold short as an issued security. In another case the subject security is part of an issue of which no portion is outstanding, and it is sold short on a "when issued" basis. In both cases the customer instructs the member to exercise the warrants and to cover the sales with the securities thus acquired, and the member advances the subscription funds for this purpose.

It is the opinion of the Board that if transactions of the type described are effected as outlined above in good faith and not for the purpose of evading or circumventing the provisions of the regulation, such transactions would constitute bona fide arbitrage

transactions in securities within the meaning of section 3(d) of Regulation T and, therefore, might be effected in a special account pursuant to the provisions of that section.

Very truly yours,

(Signed) L. P. Bethea

L. P. Bethea,
Assistant Secretary.