



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

R-337. 183

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

November 4, 1938.

Dear Sir:

Enclosed for your comments and suggestions are several copies of two proposed amendments to Regulation T, Extension and Maintenance of Credit by Brokers, Dealers, and Members of National Securities Exchanges, which have been prepared by the staff but not yet passed upon by the Board. Your comments should reach the Board of Governors if possible by Saturday, November 19, 1938. You should feel at liberty to consult confidentially with respect to these amendments anyone whom you may choose to consult, including any representatives of national securities exchanges or security dealers' associations.

The principal purpose of the proposed amendments is to further clarify and liberalize certain provisions of the regulation which relate to transactions other than margin transactions. They would amend sections 4(c) Special cash account and 4(f) Special miscellaneous account.

Changes in section 4(c) -- This section provides for handling without margin, on certain conditions, certain transactions which are defined as bona fide cash transactions. By the proposed amendment to this section, the broker who has sold securities for a customer (or the dealer who has bought securities from a customer) in a special cash account would no longer be required by the regulation to obtain the securities within a prescribed period. This change is coupled with the inclusion of a provision which makes it clear that to effect short sales for customers in the special cash account, instead of in a margin account, is not permissible.

In addition, the broker who has bought securities for (or the dealer who has sold securities to) a bank, insurance company or other customer on terms such as are common in the trade with respect to bona fide cash transactions for or with institutional customers -- "prompt delivery and payment on delivery" -- would be exempted from the requirement that he shall get payment, and consequently make

delivery, within a prescribed period. The safeguard with respect to such transactions, in lieu of a prescribed time limit, would be the proposed description of the transactions, which has been designed, after considerable study, to exclude all transactions which are not readily identifiable as "bona fide cash transactions" in the fullest sense of the term.

After these two changes, the specific time limit prescribed by section 4(c) would apply only to cases in which the customer is buying securities, and only to a limited class of these cases, with the consequence that many firms which do most of their business with institutions, carry no margin accounts, and extend very little credit, would no longer be much affected by Regulation T.

Another change in section 4(c) would require that the understanding or agreement for prompt payment that must underly any purchase by the customer that is to be made in the special cash account shall contain a reasonable safeguard against the customer's reselling the security without his first having paid for it, and still another would make it clear that the prescribed time limit does not apply to transactions in exempted securities.

Changes in section 4(f) -- One of the proposed new clauses to be added to section 4(f) would permit, under certain safeguards and with the approval of an appropriate committee of a national securities exchange, so-called "capital contribution loans". The other new clause would permit without restriction cash transactions, and certain other transactions of similar nature, between one broker (or dealer) and another. This would assume that such transactions need not be subjected, as they may be under the existing regulation, to the same restrictions as relations between each broker or dealer and his ordinary customers: for example, in case broker A (acting for one customer) makes a sale to broker B (acting for another customer), and B must obtain an extension of time within which to settle with his customer, A should not be required to get in addition an authorized extension of time for settling with B.

You will understand that the foregoing explanations, although available for use by you in consulting with others, are not for publication.

Very truly yours,



Chester Morrill,
Secretary.

Enclosure.

TO THE PRESIDENTS OF ALL FEDERAL RESERVE BANKS

CONFIDENTIAL

R-337-a

Proposed amendment to section 4(c) of
Regulation T

Subsection (c) of section 4 of Regulation T is amended to read as follows:

(c) Special cash account. - In a special cash account a creditor may effect for or with any customer bona fide cash transactions in which --

(1) The creditor sells any security for, or purchases any security from, any customer, provided the security is already held in the account or the purchase or sale is in reliance upon an agreement which the creditor shall have accepted in good faith that the security is then owned by the customer or his principal and is to be promptly deposited in the account;

(2) The creditor purchases any security for, or sells any security to, any customer, provided funds sufficient for the purpose are already held in the account;

(3) The creditor purchases any security for, or sells any security to, any bank, insurance company or other customer whose usual practice in purchasing securities is to make full cash payment therefor against delivery of the securities to him and to make such payment without in the meantime selling the securities or securing his obligation to the creditor by any collateral in addition to the securities being so purchased, provided the creditor effects the purchase or sale pursuant to a bona fide understanding by the creditor that he is to make delivery of the security to the customer as promptly as practicable in accordance with the ordinary usage of the trade and that the customer will make full cash payment for the security in accordance with his usual practice;

(4) The creditor effects any other purchase of any security for, or any other sale of any security to, any customer, provided the creditor effects the purchase or sale in reliance upon an agreement which the creditor shall have accepted in good faith that the customer will promptly make full cash payment for the security and that the customer does not contemplate selling the security prior to making such payment.

Except as otherwise provided in this section 4(c), in case a customer does not make full cash payment for a security (other than an exempted security) purchased by him pursuant to clause (4) of this section 4(c) within seven days after the date on which the security was purchased, the creditor shall promptly cancel or otherwise liquidate the transaction or the unsettled portion thereof.

If any regularly constituted committee of a national securities exchange having jurisdiction over the business conduct of its members, of which exchange the creditor is a member or through which his transactions are effected, is satisfied that the creditor is acting in good faith in making the application, that the application relates to a bona fide cash transaction, and that exceptional circumstances warrant such action, such committee, on application of the creditor, may (A) extend the period specified in the preceding paragraph for one or more limited periods commensurate with the circumstances, or (B) in the case of the purchase of a registered or exempted security which has been effected by the customer in the account, authorize the transfer of the transaction to a general account or special omnibus account and the completion of the transaction pursuant to the provisions of this regulation relating to such accounts.

The days specified in this section 4(c) are calendar days, but if the last day of the period specified herein is a Saturday, Sunday, or holiday, such period shall be considered to end on the next full business day. For the purposes of this section 4(c), a creditor may, at his option, disregard any sum due by the customer not exceeding \$50.

CONFIDENTIAL

R-337-b

Proposed amendment to section 4(f) of
Regulation T

Subsection (f) of section 4 of Regulation T is amended by inserting the following clauses after clause (1) of said subsection and renumbering the succeeding clauses accordingly:

(2) With the approval of any regularly constituted committee of a national securities exchange having jurisdiction over the business conduct of its members, make and maintain loans to or for any partner of a firm which is a member of such exchange to enable such partner to make a contribution of capital to such firm, provided the committee is satisfied in each instance (A) that the loan is not in the ordinary course of the lender's business and that neither the borrower nor his firm would be considered to be a customer of the lender or his firm according to the ordinary usage of the trade, and (B) that in view of the terms of the loan and other attendant circumstances it will not be detrimental either to the soundness of the securities business or to the best interests of persons having financial relations with the firm for the firm to be supplied with such capital in such manner;

(3) Purchase any security from any broker or dealer, or sell any security to any broker or dealer, provided the creditor acting in good faith purchases or sells the security for delivery, against full payment of the purchase price, as promptly as practicable in accordance with the ordinary usage of the trade;