S-177
Reg. T-87

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

August 18, 1939

Dear Sir:

There is attached a copy of a ruling which will be published in the Federal Reserve Bulletin regarding "Capital Contribution Loans Between Members of a National Securities Exchange".

It will be noted that the attached ruling is in the form of a statement for the press which, however, is not to be released until the time specified on the statement.

Very truly yours,

L. P. Bethea,
Assistant Secretary.

Enclosure

TO PRESIDENTS OF ALL FEDERAL RESERVE BANKS

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

STATEMENT FOR THE PRESS

For release in morning papers,
Tuesday, August 22, 1939.

The following ruling will appear in the Federal Reserve Bulletin:

Capital Contribution Loans Between Members of a National Securities Exchange

Section 4(f)(2) of Regulation T, as added to the regulation effective May 22, 1939, provides as follows:

"In a special miscellaneous account, a creditor may---

"(2) Make loans, and may maintain loans, to or for any partner of a firm which is a member of a national securities exchange to enable such partner to make a contribution of capital to such firm provided (A) the lender as well as the borrower is a partner in such firm, or (B) the lender as well as the borrower is a member of such exchange, the loan has the approval of an appropriate committee of the exchange, and the committee, in addition to being satisfied that the loan is not in contravention of any rule of the exchange, is satisfied that the loan is outside the ordinary course of the lender's business, and that, if the borrower's firm does any dealing in securities for its own account, the loan is not for the purpose of enabling the firm to increase the amount of such dealing;"

The Board recently considered a case in which such a capital contribution loan was originally made between partners in the same firm, and thus qualified under clause (A) of the provision, but the lender later proposed to withdraw from the partnership. The

Board was asked whether the loan, because of its one-time status under clause (A), might be continued after the lender's withdrawal from the partnership, or whether the loan must then be terminated if it is not authorized by some other provision of the regulation.

It is the view of the Board that the permission granted by clause (A) continues only while the conditions specified therein are met. Accordingly, such a loan between partners in the same firm may not be continued after the lender withdraws from the partnership unless the loan can qualify under some other provision of the regulation.

In the particular case presented, the lender after withdrawal from the partnership was to continue to be a member of the national securities exchange of which the borrower was a member. Therefore, if the loan is approved by an appropriate committee of the exchange pursuant to clause (B) of section 4(f)(2), it could, of course, be continued pursuant to that provision.

For the sake of completing the answer to the question presented, however, it is necessary to consider one other possible alternative, that is, the possibility that the loan could qualify under section 4(f)(8) of the regulation, which provides for loans that are "for any purpose other than purchasing or carrying or trading in securities".

The reason section 4(f)(8) may be relevant to the question presented in this case is that while the exact relation of

the instant loan to the business of the borrower's firm was not entirely clear, it appeared that the borrower's firm was engaged not only in the securities business but also, and to a very considerable extent, in the commodity business. There would, therefore, be at least some possibility that the loan in question could qualify as a loan for a "purpose other than purchasing or carrying or trading in securities".

Whether the loan could in fact so qualify would depend, of course, upon the facts of the particular case, and instances where capital contribution loans could so qualify would be rather rare. In certain cases, of which the present case involving a considerable amount of commodity business might turn out to be an example, it might be possible for a loan to be made under such conditions that it could actually be identified as being for a "purpose other than purchasing or carrying or trading in securities". It is evident, however, that it would be rather unusual for a capital contribution loan to be thus identifiable. The business of the average securities brokerage firm is so bound up with purchasing, carrying or trading in securities - either for its own account or for the account of customers - that a loan to a partner in such a firm to enable him to make a contribution of capital to the firm usually could not qualify as being for a "purpose other than purchasing or carrying or trading in securities".