

S-209  
Reg. T-90INTERPRETATION OF LAW OR REGULATION

(Copies to be sent to all Federal Reserve banks)

April 3, 1940

Mr. \_\_\_\_\_,  
\_\_\_\_\_,  
\_\_\_\_\_,  
\_\_\_\_\_.

Dear Mr. \_\_\_\_\_:

Reference is made to your letter of March 20 addressed to Dr. Parry in which you request a ruling on a question relating to Regulation T.

You describe a case in which a customer plans to deliver certain registered nonexempted stocks to a broker with the understanding that the broker will offer to lend this stock in the "loan crowd" on a national securities exchange. Questions are presented as to how the transaction must be handled under the regulation, including the question of what restrictions the regulation imposes on the customer's later withdrawal of the shares.

You state that the customer has no intent to use this stock as collateral for brokerage transactions. In view of this fact it should be stated at the outset that the regulation would permit the broker to receive the securities in a special miscellaneous account under the provisions of section 4(f)(6) if the customer desires merely to deposit the stock with the creditor for lending purposes and also is willing to leave with the broker the funds received by the broker on lending the stock. Such an arrangement in which the stockholder received no funds as a result of depositing the stock with the broker would clearly be authorized under section 4(f)(6), which provides that in a special miscellaneous account a creditor may "(subject to any other applicable provisions of law) receive from or for any customer, and pay out or deliver to or for any customer, any money or securities". If such procedure were followed, the regulation would permit the stock to be freely withdrawn at any time.

If the stockholder wishes to receive funds from the broker as a result of depositing the shares, further questions arise. He could receive the standard maximum loan value of the stock, now 60 per cent of current market value, in a general account. Assuming no other transactions in the account which cause any demand for margin

under the regulation to be outstanding, the stock could be withdrawn at any time by depositing in the account the then maximum loan value of the shares withdrawn, or enough to reduce the adjusted debit balance of the account to the maximum loan value of the securities in the account, whichever deposit would be smaller. The regulation does not permit any less restrictive arrangement if the stockholder wishes to obtain funds for the general purpose of purchasing or carrying or trading in securities.

However, section 4(f)(8) and its related provision, section 7(c), provide that:

"4(f) Special miscellaneous account. - In a special miscellaneous account, a creditor may--

"(8) Extend and maintain credit to or for any customer without collateral or on any collateral whatever for any purpose other than purchasing or carrying or trading in securities."

\* \* \* \* \*

"7(c) Declaration as to purpose of loan. - Every extension of credit on a registered security (other than an exempted security) shall be deemed to be for the purpose of purchasing or carrying or trading in securities, unless the customer shall file with the creditor a written declaration signed by the customer which shall state the use to be made of such credit and which shall state specifically that such credit is neither for the purpose of purchasing or carrying or trading in securities nor for the purpose of evading or circumventing the provisions of this regulation. In connection with any extension of credit, a creditor may rely upon such a written declaration unless he knows the statement to be false or has information which would put a prudent man upon inquiry and if investigated with reasonable diligence would lead to the discovery of the falsity of the statement."

Under these provisions the broker could receive the stock in a special miscellaneous account and could advance to the customer all or any part of the funds the broker received in lending the stock, but in such event the advance to the customer could not be for the purpose of purchasing or carrying or trading in securities, and since the securities are registered and nonexempted the broker would have to obtain

an appropriate declaration in accordance with section 7(c).

The question whether a particular loan is for the purpose of purchasing or carrying or trading in securities and whether the broker is justified in accepting a declaration under section 7(c) in a particular case is necessarily a question of fact that must turn on all the relevant circumstances involved in the case.

It appears that although the present customer might as a matter of policy prefer not to leave the funds with the broker, he nevertheless might not wish to use the funds for any purpose except to withdraw them and put them in safekeeping pending the return of the stock. If such is the case and the customer keeps the funds in a safe deposit box, special deposit, or other similar form until the return of the shares, the broker would clearly be justified in accepting a declaration under section 7(c).

If, on the other hand, the customer does not treat the funds in this manner and also purchases or carries or trades in securities near the time of the loan, it would seem that as a general proposition the broker should assume the loan to be for such purpose. While it is of course conceivable that in some such circumstances the loan might not be for the purpose, there is a very strong likelihood that it is, and it should be carefully scrutinized as probably being unable to qualify under sections 4(f)(8) and 7(c).

You suggest in your letter the possibility that the loan of the stock might be regarded as a sale and the return of the stock as a purchase by the customer, so that the entire transaction might be handled by the broker in a special cash account subject to the provisions of section 4(c) of Regulation T. In the opinion of the Board, however, such a use of a special cash account is not permitted by the regulation.

It is understood that the national securities exchange on which the stock is registered has requested the issuing corporation, of which the customer is a substantial stockholder, to use its best efforts to make reasonable amounts of the stock available for loaning purposes, and that the customer's placing of the stock with the broker would be the result of such request. This fact, however, does not seem to affect the views expressed above.

Very truly yours,

(Signed) S. R. Carpenter

S. R. Carpenter,  
Assistant Secretary.