S-216
Reg. T-91

INTERPRETATION OF LAW OR REGULATION

(Copies to Be Sent to All Federal Reserve Banks)

April 24, 1940

Mr. _____,
_____,
_____, _____.

Dear Mr. _____:

This is in reply to your letter of April 6 in which you present some further inquiries with respect to the questions discussed in the Board's letter of April 3, 1940, regarding the effect of Regulation T on a stock-lending transaction.

Assuming that a broker has received registered nonexempted stocks from a customer and has loaned these stocks in the "loan crowd" on a national securities exchange, you inquire as to the application of Regulation T to payments by the broker to the customer in connection with premiums received on the lending of stock, in connection with the payment of a cash dividend on the stock, in connection with the stock being "marked to the market" in case it increases in value, or in connection with the payment of a stock dividend on the stock.

With respect to the broker's payment to the customer of a sum equal to a premium which the broker received on the lending of the stock, it is assumed that the customer is not to return such amount when he receives his stock back from the broker. If this is the case, it may be stated as a general proposition that such a payment by the broker would not be limited by any provision of the regulation. So far as concerns the procedure or mechanics of the matter, it may be noted that if the premium is credited to a general account and is not withdrawn on the same day it may, as a part of the account, become subject to withdrawal restrictions at a later date; but any difficulty on this point could be avoided by transferring the sum on the same day from the general account to a special miscellaneous account pursuant to section 4(f)(6) of the regulation.

It is assumed that any amounts paid by the broker to the customer in connection with a cash dividend on the stock also would not be repaid by the customer to the broker. If such is the case, their status would be the same as that of payments connected with a premium on the lending of the stock, with the minor exception that in case the dividends had been credited to a general account section 6(g) would permit

the withdrawal of such dividends at any time within 35 days thereafter if the crediting had not served in the meantime to permit any transaction which could not otherwise have been effected in the account.

A different situation would, however, be presented by any payments which the broker might make to the customer as a result of the stock being "marked to the market", since it is assumed that the customer would repay such funds to the broker when his stock was returned to him by the broker. Accordingly, such payments to the customer would be subject to the same requirements as those indicated in the Board's letter of April 3 for payments in connection with an original deposit of the stock.

With respect to stock dividends, the result would depend on whether the broker delivers to the customer the actual stock dividend, or cash based on the stock dividend. If stock is delivered, presumably the customer would not return it to the broker. If this is the case, it would have the same status as that discussed above in connection with a premium on the lending of the shares, since section 6(g) allowing 35 days for the payment of cash dividends does not apply to stock dividends. However, if the broker advances cash to the customer on the basis of the stock which was received as a dividend and the customer is later to repay such amount and receive the stock, the requirements stated in the Board's letter of April 3 with respect to the original deposit of stock would apply.

As the basis for a further question, you state that the customer here involved has not purchased or carried or traded in securities through the lending broker or to his knowledge within several months. You ask whether this would justify the broker in concluding that the customer is able to qualify under sections 4(f)(8) and 7(c) of Regulation T, and whether, if this is the case, the customer could deposit the proceeds in his general account. The answer to this must be in the negative. The mere fact that the customer has not purchased or carried or traded in securities through the lending broker or to his knowledge within several months in the past would clearly not be sufficient to justify a conclusion that a future extension of credit would not be for such purpose. As indicated in the Board's letter of April 3, this is a question of fact which must turn upon all the relevant facts of the case, of which that stated in your inquiry is but one. In addition, the fact that the customer deposited the proceeds in his general account would be a strong indication that the funds were obtained for the purpose of purchasing or carrying or trading in securities.

Very truly yours,

(Signed) L. P. Bethea

L. P. Bethea,
Assistant Secretary.