

## Federal Reserve System

## § 221.116

provide the same safeguards inherent in face-to-face interviews, the lender has developed certain procedures designed to satisfy the good faith acceptance requirement of this part.

(c) The purpose statement will be supplemented with several additional questions relevant to the prospective borrower's investment activities such as purchases of any security within the last 6 months, dollar amount, and obligations to purchase or pay for previous purchases; present plans to purchase securities in the near future, participations in securities purchase plans, list of unpaid debts, and present income level. Some questions have been modified to facilitate understanding but no questions have been deleted. If additional inquiry is indicated by the answers on the form, a loan officer of the lender will interview the borrower by telephone to make sure the loan is "non-purpose". Whenever the loan exceeds the "maximum loan value" of the collateral for a regulated loan, a telephone interview will be done as a matter of course.

(d) One of the stated purposes of Regulation X (12 CFR part 224) was to prevent the infusion of unregulated credit into the securities markets by borrowers falsely certifying the purpose of a loan. The Board is of the view that the existence of Regulation X (12 CFR part 224), which makes the borrower liable for willful violations of the margin regulations, will allow a lender subject to this part to meet the good faith acceptance requirement of § 221.3(c) without a face-to-face interview if the lender adopts a program, such as the one described in paragraph (c) of this section, which requires additional detailed information from the borrower and proper procedures are instituted to verify the truth of the information received. Lenders intending to embark on a similar program should discuss proposed plans with their district Federal Reserve Bank. Lenders may have existing or future loans with the prospective customers which could complicate the efforts to determine the true purpose of the loan.

### **§ 221.116 Bank loans to replenish working capital used to purchase mutual fund shares.**

(a) In a situation considered by the Board of Governors, a business concern (X) proposed to purchase mutual fund shares, from time to time, with proceeds from its accounts receivable, then pledge the shares with a bank in order to secure working capital. The bank was prepared to lend amounts equal to 70 percent of the current value of the shares as they were purchased by X. If the loans were subject to this part, only 50 percent of the current market value of the shares could be lent.

(b) The immediate purpose of the loans would be to replenish X's working capital. However, as time went on, X would be acquiring mutual fund shares at a cost that would exceed the net earnings it would normally have accumulated, and would become indebted to the lending bank in an amount approximately 70 percent of the prices of said shares.

(c) The Board held that the loans were for the purpose of purchasing the shares, and therefore subject to the limitations prescribed by this part. As pointed out in § 221.114 with respect to a similar program for putting a high proportion of cash income into stock, the borrowing against the margin stock to meet needs for which the cash would otherwise have been required, a contrary conclusion could largely defeat the basic purpose of the margin regulations.

(d) Also considered was an alternative proposal under which X would deposit proceeds from accounts receivable in a time account for 1 year, before using those funds to purchase mutual fund shares. The Board held that this procedure would not change the situation in any significant way. Once the arrangement was established, the proceeds would be flowing into the time account at the same time that similar amounts were released to purchase the shares, and over any extended period of time the result would be the same. Accordingly, the Board concluded that bank loans made under the alternative proposal would similarly be subject to this part.