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purchasing or carrying registered stocks) given in connection with the loan where the circumstances are such that the broker from any source knows or has reason to know that the statement is incomplete or otherwise inaccurate as to the true purpose of the credit. The requirement of ''good faith'' is of vital importance. While the application of the requirement will necessarily vary with the facts of the particular case, the broker, like the bank for whom the loan is arranged to be made, must be alert to the circumstances surrounding the loan. Thus, for example, if a broker or dealer is to deliver registered stocks to secure the loan or is to receive the proceeds of the loan, the broker arranging the loan and the bank making it would be put on notice that the loan would probably be subject to part 221 of this subchapter. In any such circumstances they could not in good faith accept or rely upon a statement to the contrary without obtaining a reliable and satisfactory explanation of the situation. The foregoing, of course, applies the principles contained in §221.101 of this subchapter.

(d) In addition, when a broker is approached by another broker to arrange extensions of credit for customers of the approaching broker, the broker approached has a responsibility not to arrange any extension of credit which the approaching broker could not himself arrange. Accordingly, in such cases the statutes and regulations forbid the approached broker to arrange extensions of credit on unregistered securities for the purpose of purchasing or carrying either registered or unregistered securities. The approaching broker would also be violating the applicable requirements if he initiated or otherwise participated in any such forbidden transactions.

(e) The expression of views, set forth in this section, to the effect that certain specific transactions are forbidden, of course, should not in any way be understood to indicate approval of any other transactions which are not mentioned.

[18 FR 5505, Sept. 15, 1953]

§220.112 [Reserved]

§220.113 Necessity for prompt payment and delivery in special cash accounts.

(a) The Board of Governors recently received an inquiry concerning whether purchases of securities by certain municipal employees' retirement or pension systems on the basis of arrangements for delayed delivery and payment, might properly be effected by a creditor subject to this part in a special cash account under §220.4(c).

(b) It appears that in a typical case the supervisors of the retirement system meet only once or twice each month, at which times decisions are made to purchase any securities wished to be acquired for the system. Although the securities are available for prompt delivery by the broker-dealer firm selected to effect the system's purchase, it is arranged in advance with the firm that the system will not accept delivery and pay for the securities before some date more than seven business days after the date on which the securities are purchased. Apparently, such an arrangement is occasioned by the monthly or semimonthly meetings of the system's supervisors. It was indicated that a retirement system of this kind may be supervised by officials who administer it as an incidental part of their regular duties, and that meetings requiring joint action by two or more supervisors may be necessary under the system's rules and procedures to authorize issuance of checks in payment for the securities purchased. It was indicated also that the purchases do not involve exempted securities, securities of the kind covered by §220.4(c)(3), or any shipment of securities as described in §220.4(c).

(c) This part provides that a creditor subject thereto may not effect for a customer a purchase in a special cash account under §220.4(c) unless the use of the account meets the limitations of §220.4(a) and the purchase constitutes a ''bona fide cash transaction'' which complies with the eligibility requirements of §220.4(c)(1)(i). One such requirement is that the purchase be made ''in reliance upon an agreement accepted by the creditor (broker-dealer) in good faith'' that the customer

will ''promptly make full cash payment for the security, if funds sufficient for the purpose are not already in the account; and, subject to certain exceptions, §220.4(c)(2) provides that the creditor shall promptly cancel or liquidate the transaction if payment is not made by the customer within seven business days after the date of purchase. As indicated in the Board's interpretation at 1940 Federal Reserve Bulletin 1172, a necessary part of the customer's undertaking pursuant to §220.4(c)(1)(i) is that he ''should have the necessary means of payment readily available when he purchases a security in the special cash account. He should expect to pay for it immediately or in any event within the period (of not more than a very few days) that is as long as is usually required to carry through the ordinary securities transaction.''

(d) The arrangements for delayed delivery and payment in the case presented to the Board and outlined above clearly would be inconsistent with the requirement of §220.4(c)(1)(i) that the purchase be made in reliance upon an agreement accepted by the creditor in good faith that the customer will ''promptly'' make full cash payment for the security. Accordingly, the Board said that transactions of the kind in question would not qualify as a ''bona fide cash transaction'' and, therefore, could not properly be effected in a special cash account, unless a contrary conclusion would be justified by the exception in §220.4(c)(5).

(e) Section 220.4(c)(5) provides that if the creditor, ''acting in good faith in accordance with'' §220.4(c)(1), purchases a security for a customer ''with the understanding that he is to deliver the security promptly to the customer, and the full cash payment is to be made promptly by the customer is to be made against such delivery'', the creditor may at his option treat the transaction as one to which the period applicable under §220.4(c)(2) is not the seven days therein specified but 35 days after the date of such purchase. It will be observed that the application of §220.4 (c)(5) is specifically conditioned on the creditor acting in good faith in accordance with §220.4(c)(1). As noted above, the existence of the arrangements for delayed delivery and payment in the case presented would prevent this condition from being met, since the customer could not be regarded as having agreed to make full cash payment ''promptly''. Furthermore, such arrangements clearly would be inconsistent with the requirement of §220.4(c)(5) that the creditor ''deliver the security promptly to the customer''.

(f) Section 220.4(c)(5) was discussed in the Board's published interpretation, referred to above, which states that ''it is not the purpose of (§220.4 (c)(5)) to allow additional time to customers for making payment. The 'prompt delivery' described in (§220.4 (c)(5)) is delivery which is to be made as soon as the broker or dealer can reasonably make it in view of the mechanics of the securities business and the bona fide usages of the trade. The provision merely recognizes the fact that in certain circumstances it is an established bona fide practice in the trade to obtain payment against delivery of the security to the customer, and the further fact that the mechanics of the trade, unrelated to the customer's readiness to pay, may sometimes delay such delivery to the customer''.

(g) In the case presented, it appears that the only reason for the delay is related solely to the customer's readiness to pay and is in no way attributable to the mechanics of the securities business. Accordingly, it is the Board's view that the exception in §220.4(c)(5) should not be regarded as permitting the transactions in question to be effected in a special cash account.

[22 FR 5954, July 27, 1957]

§§ 220.114–220.116 [Reserved]

§ 220.117 Exception to 90-day rule in special cash account.

(a) The Board of Governors has recently interpreted certain of the provisions of §220.4(c)(8), with respect to the withdrawal of proceeds of a sale of stock in a ''special cash account'' when the stock has been sold out of the account prior to payment for its purchase.

(b) The specific factual situation presented may be summarized as follows: