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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:

Customer purchased stock in a special cash account with a member firm on Day 1. On Day 3 customer sold the same stock at a profit. On Day 8 customer delivered his check for the cost of the purchase to the creditor (member firm). On Day 9 the creditor mailed to the customer a check for the proceeds of the sale.

(c) Section 220.4(c)(8) prohibits a creditor, as a general rule, from effecting a purchase of a security in a customer's special cash account if any security has been purchased in that account during the preceding 90 days and has then been sold in the account or delivered out to any broker or dealer without having been previously paid for in full by the customer. One exception to this general rule reads as follows:

* * * The creditor may disregard for the purposes of this subparagraph (§220.4(c) (8)) a sale without prior payment provided full cash payment is received within the period described by subparagraph (2) of this paragraph (seven days after the date of purchase) and the customer has not withdrawn the proceeds of sale on or before the day on which such payment (and also final payment of any check received in that connection) is received. * * *

(d) Final payment of customer's check: (1) The first question is: When is the creditor to be regarded as having received ''final payment of any check received'' in connection with the purchase?

(2) The clear purpose of §220.4(c) (8) is to prevent the use of the proceeds of sale of a stock by a customer to pay for its purchase—i.e., to prevent him from trading on the creditor's funds by being able to deposit the sale proceeds prior to presentment of his own check to the drawee bank. Thus, when a customer undertakes to pay for a purchase by check, that check does not constitute payment for the purchase, within the language and intent of the above-quoted exception in §220.4(c)(8), until it has been honored by the drawee bank, indicating the sufficiency of his account to pay the check.

(3) The phrase ''final payment of any check'' is interpreted as above notwithstanding §220.6(f), which provides that:

For the purposes of this part (Regulation T), a creditor may, at his option (1) treat the receipt in good faith of any check or draft drawn on a bank which in the ordinary course of business is payable on presentation, * * * as receipt of payment of the amount of such check, draft or order; * * *

This is a general provision substantially the same as language found in section 4(f) of Regulation T as originally promulgated in 1934. The language of the subject exception to the 90-day rule of §220.4(c)(8), i.e., the exception based expressly on final ''payment of any check,'' was added to the regulation in 1949 by an amendment directed at a specific type of situation. Because the exception is a special, more recent provision, and because §220.6(f), if controlling, would permit the exception to undermine, to some extent, the effectiveness of the 90-day rule, sound principles of construction require that the phrase ''final payment of any check'' be given its literal and intended effect.

(4) There is no fixed period of time from the moment of receipt by the payee, or of deposit, within which it is certain that any check will be paid by the drawee bank. Therefore, in the rare case where the operation of the subject exception to §220.4(c)(8) is necessary to avoid application of the 90-day rule, a creditor should ascertain (from his bank of deposit or otherwise) the fact of payment of a customer's check given for the purchase. Having so determined the day of final payment, the creditor can permit withdrawal on any subsequent day.

(e) Mailing as ''withdrawal'': (1) Also presented is the question whether the mailing to the customer of the creditor's check for the sale proceeds constitutes a withdrawal of such proceeds by the customer at the time of mailing so that, if the check for the sale proceeds is mailed on or before the day on which the customer's check for the purchase is finally paid, the 90-day rule applies. It may be that a check mailed one day will not ordinarily be received by the customer until the next. The Board is of the view, however, that when the check for sale proceeds is issued and released into the mails, the proceeds are to be regarded as withdrawn by the customer; a more liberal interpretation would open a way for circumvention. Accordingly, the creditor's check should not be mailed nor the sale proceeds otherwise released to

the customer ''on or before the day'' on which payment for the purchase, including final payment of any check given for such payment, is received by the creditor, as determined in accordance with the principles stated herein.

(2) Applying the above principles to the schedule of transactions described in the second paragraph of this interpretation, the mailing of the creditor's check on ''Day 9'' would be consistent with the subject exception to §220.4(c)(8), as interpreted herein, only if the customer's check was paid by the drawee bank on ''Day 8''.

[27 FR 3511, Apr. 12, 1962]

§220.118 Time of payment for mutual fund shares purchased in a special cash account.

(a) The Board has recently considered the question whether, in connection with the purchase of mutual fund shares in a ''special cash account'' under the provisions of this part 220, the 7-day period with respect to liquidation for nonpayment is that described in §220.4(c)(2) or that described in §220.4(c)(3).

(b) Section 220.4(c)(2) provides as follows:

> In case a customer purchases a security (other than an exempted security) in the special cash account and does not make full cash payment for the security within 7 days after the date on which the security is so purchased, the creditor shall, except as provided in subparagraphs (3)–(7) of this paragraph, promptly cancel or otherwise liquidate the transaction or the unsettled portion thereof.

Section 220.4(c)(3), one of the exceptions referred to, provides in relevant part as follows:

> If the security when so purchased is an unissued security, the period applicable to the transaction under subparagraph (2) of this paragraph shall be 7 days after the date on which the security is made available by the issuer for delivery to purchasers.

(c) In the case presented, the shares of the mutual fund (open-end investment company) are technically not issued at the time they are sold by the underwriter and distributor. Several days may elapse from the date of sale before a certificate can be delivered by the transfer agent. The specific inquiry to the Board was, in effect, whether the 7-day period after which a purchase transaction must be liquidated or cancelled for nonpayment should run, in the case of mutual fund shares, from the time when a certificate for the purchased shares is available for delivery to the purchaser, instead of from the date of the purchase.

(d) Under the general rule of §220.4(c)(2) that is applicable to purchases of outstanding securities, the 7-day period runs from the date of purchase without regard to the time required for the mechanical acts of transfer of ownership and delivery of a certificate. This rule is based on the principles governing the use of special cash accounts in accordance with which, in the absence of special circumstances, payment is to be made promptly upon the purchase of securities.

(e) The purpose of §220.4(c)(3) is to recognize the fact that, when an issue of securities is to be issued at some fixed future date, a security that is a part of such issue can be purchased on a ''when-issued'' basis and that payment may reasonably be delayed until after such date of issue, subject to other basic conditions for transactions in a special cash account. Thus, unissued securities should be regarded as ''made available for delivery to purchasers'' on the date when they are substantially as available as outstanding securities are available upon purchase, and this would ordinarily be the designated date of issuance or, in the case of a stock dividend, the ''payment date''. In any case, the time required for the mechanics of transfer and delivery of a certificate is not material under §220.4(c)(3) any more than it is under §220.4(c)(2).

(f) Mutual fund shares are essentially available upon purchase to the same extent as outstanding securities. The mechanics of their issuance and of the delivery of certificates are not significantly different from the mechanics of transfer and delivery of certificates for shares of outstanding securities, and the issuance of mutual fund shares is not a future event in a sense that would warrant the extension of the time for payment beyond that afforded in the case of outstanding securities. Consequently, the Board has concluded that a purchase of mutual fund shares