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known to the bank or to the officer who processes the loan.

(e) The interpretation set forth in § 221.101 contains an example of the application of the ''good faith'' test. There it was stated that ''if the loan is to be made to a customer who is not a broker or dealer in securities, but such a broker or dealer is to deliver margin stock to secure the loan or is to receive the proceeds of the loan, the bank would be put on notice that the loan would probably be subject to this part. It could not accept in good faith a statement to the contrary without obtaining a reliable and satisfactory explanation of the situation''.

(f) Moreover, and as also stated by the interpretation contained in § 221.101, the purpose of a loan, of course, ''cannot be altered by some temporary application of the proceeds. For example, if a borrower is to purchase Government securities with the proceeds of a loan, but is soon thereafter to sell such securities and replace them with margin stock, the loan is clearly for the purpose of purchasing or carrying margin stock''. The purpose of a loan therefore, should not be determined upon a narrow analysis of the immediate use to which the proceeds of the loan are put. Accordingly, a bank acting in ''good faith'' should carefully scrutinize cases in which there is any indication that the borrower is concealing the true purpose of the loan, and there would be reason for special vigilance if margin stock is substituted for bonds or nonmargin stock soon after the loan is made, or on more than one occasion.

(g) Similarly, the fact that a loan made on the borrower's signature only, for example, becomes secured by margin stock shortly after the disbursement of the loan usually would afford reasonable grounds for questioning the bank's apparent reliance upon merely a statement that the purpose of the loan was not to purchase or carry margin stock.

(h) The examples in this section are, of course, by no means exhaustive. They simply illustrate the fundamental fact that no statement accepted by a lender is of any value for the purposes of this part unless the lender accepting the statement is ''acting in good faith'', and that ''good faith'' requires, among other things, reasonable diligence to learn the truth.

§ 221.107 Arranging loan to purchase open-end investment company shares.

For text of the interpretation on Arranging loan to purchase open-end investment company shares, see 12 CFR 220.112.

§ 221.108 Effect of registration of stock subsequent to making of loan.

(a) The Board recently was asked whether a loan by a bank to enable the borrower to purchase a newly issued nonmargin stock during the initial over-the-counter trading period prior to the stock becoming registered (listed) on a national securities exchange would be subject to this part. The Board replied that, until such stock qualifies as margin stock, this would not be applicable to such a loan.

(b) The Board has now been asked what the position of the lending bank would be under this part if, after the date on which the stock should become registered, such bank continued to hold a loan of the kind just described. It is assumed that the loan was in an amount greater than the maximum loan value for the collateral specified in this part.

(c) If the stock should become registered, the loan would then be for the purpose of purchasing or carrying a margin stock, and, if secured directly or indirectly by any margin stock, would be subject to this part as from the date the stock was registered. Under this part, this does not mean that the bank would have to obtain reduction of the loan in order to reduce it to an amount no more than the specified maximum loan value. It does mean, however, that so long as the loan balance exceeded the specified maximum loan value, the bank could not permit any withdrawals or substitutions of collateral that would increase such excess; nor could the bank increase the amount of the loan balance unless there was provided additional collateral having a maximum loan value at least equal to the amount of the increase. In other words, as from the date the stock should become a

margin stock, the loan would be subject to this part in exactly the same way, for example, as a loan subject to this part that became under-margined because of a decline in the current market value of the loan collateral or because of a decrease by the Board in the maximum loan value of the loan collateral.

§ 221.109 Loan to open-end investment company.

In response to a question regarding a possible loan by a bank to an open-end investment company that customarily purchases stocks registered on a national securities exchange, the Board stated that in view of the general nature and operations of such a company, any loan by a bank to such a company should be presumed to be subject to this part as a loan for the purpose of purchasing or carrying margin stock. This would not be altered by the fact that the open-end company had used, or proposed to use, its own funds or proceeds of the loan to redeem some of its own shares, since mere application of the proceeds of a loan to some other use cannot prevent the ultimate purpose of a loan from being to purchase or carry registered stocks.

§ 221.110 Questions arising under this part.

(a) This part governs ''any purpose credit'' extended by a lender ''secured directly or indirectly by margin stock'' and defines ''purpose credit'' as ''any credit for the purpose, whether immediate, incidental, or ultimate, of buying or carrying margin stock, '' with certain exceptions, and provides that the maximum loan value of such margin stock shall be a fixed percentage ''of its current market value.''

(b) The Board of Governors has had occasion to consider the application of the language in paragraph (a) of this section to the two following questions:

(1) *Loan secured by stock.* First, is a loan to purchase or carry margin stock subject to this part where made in unsecured form, if margin stock is subsequently deposited as security with the lender, and surrounding circumstances indicate that the parties originally contemplated that the loan should be so secured? The Board answered that in a case of this kind, the loan would be subject to this part, for the following reasons:

(i) The Board has long held, in the closely related purpose area, that the original purpose of a loan should not be determined upon a narrow analysis of the technical circumstances under which a loan is made. Instead, the fundamental purpose of the loan is considered to be controlling. Indeed, ''the fact that a loan made on the borrower's signature only, for example, becomes secured by registered stock shortly after the disbursement of the loan'' affords reasonable grounds for questioning whether the bank was entitled to rely upon the borrower's statement as to the purpose of the loan. 1953 Fed. Res. Bull. 951 (*See*, § 221.106).

(ii) Where security is involved, standards of interpretation should be equally searching. If, for example, the original agreement between borrower and lender contemplated that the loan should be secured by margin stock, and such stock is in fact delivered to the bank when available, the transaction must be regarded as fundamentally a secured loan. This view is strengthened by the fact that this part applies to a loan ''secured directly or indirectly by margin stock.''

(2) *Loan to acquire controlling shares.* (i) The second question is whether this part governs a margin stock-secured loan made for the business purpose of purchasing a controlling interest in a corporation, or whether such a loan would be exempt on the ground that this part is directed solely toward purchases of stock for speculative or investment purposes. The Board answered that a margin stock-secured loan for the purpose of purchasing or carrying margin stock is subject to this part, regardless of the reason for which the purchase is made.

(ii) The answer is required, in the Board's view, since the language of this part is explicitly inclusive, covering ''any purpose credit, secured directly or indirectly by margin stock.'' Moreover, the withdrawal in 1945 of the original section 2(e) of this part, which exempted ''any loan for the purpose of purchasing a stock from or through a person who is not a member of a national securities exchange . . .'' plainly