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§ 221.117 When bank in "good faith" has not relied on stock as collateral.

(a) The Board has received questions regarding the circumstances in which an extension or maintenance of credit will not be deemed to be ''indirectly secured'' by stock as indicated by the phrase, ''if the lender, in good faith, has not relied upon the margin stock as collateral,'' contained in paragraph (2)(iv) of the definition of *indirectly secured* in § 221.2.

(b) In response, the Board noted that in amending this portion of the regulation in 1968 it was indicated that one of the purposes of the change was to make clear that the definition of *indirectly secured* does not apply to certain routine negative covenants in loan agreements. Also, while the question of whether or not a bank has relied upon particular stock as collateral is necessarily a question of fact to be determined in each case in the light of all relevant circumstances, some indication that the bank had not relied upon stock as collateral would seem to be afforded by such circumstances as the fact that:

(1) The bank had obtained a reasonably current financial statement of the borrower and this statement could reasonably support the loan; and

(2) The loan was not payable on demand or because of fluctuations in market value of the stock, but instead was payable on one or more fixed maturities which were typical of maturities applied by the bank to loans otherwise similar except for not involving any possible question of stock collateral.

§ 221.118 Bank arranging for extension of credit by corporation.

(a) The Board considered the questions whether:

(1) The guaranty by a corporation of an ''unsecured'' bank loan to exercise an option to purchase stock of the corporation is an ''extension of credit'' for the purpose of this part;

(2) Such a guaranty is given ''in the ordinary course of business'' of the corporation, as defined in § 221.2; and

(3) The bank involved took part in arranging for such credit on better terms than it could extend under the provisions of this part.

(b) The Board understood that any officer or employee included under the corporation's stock option plan who wished to exercise his option could obtain a loan for the purchase price of the stock by executing an unsecured note to the bank. The corporation would issue to the bank a guaranty of the loan and hold the purchased shares as collateral to secure it against loss on the guaranty. Stock of the corporation is registered on a national securities exchange and therefore qualifies as ''margin stock'' under this part.

(c) A nonbank lender is subject to the registration and other requirements of this part if, in the ordinary course of his business, he extends credit on collateral that includes any margin stock in the amount of $200,000 or more in any calendar quarter, or has such credit outstanding in any calendar quarter in the amount of $500,000 or more. The Board understood that the corporation in question had sufficient guaranties outstanding during the applicable calendar quarter to meet the dollar thresholds for registration.

(d) In the Board's judgment a person who guarantees a loan, and thereby becomes liable for the amount of the loan in the event the borrower should default, is lending his credit to the borrower. In the circumstances described, such a lending of credit must be considered an ''extension of credit'' under this part in order to prevent circumvention of the regulation's limitation on the amount of credit that can be extended on the security of margin stock.

(e) Under § 221.2, the term *in the ordinary course of business means* ''occurring or reasonably expected to occur in carrying out or furthering any business purpose. * * *'' In general, stock option plans are designed to provide a company's employees with a proprietary interest in the company in the form of ownership of the company's stock. Such plans increase the company's ability to attract and retain able personnel and, accordingly, promote the interest of the company and its stockholders, while at the same time providing the company's employees with additional incentive to work toward

the company's future success. An arrangement whereby participating employees may finance the exercise of their options through an unsecured bank loan guaranteed by the company, thereby facilitating the employees' acquisition of company stock, is likewise designed to promote the company's interest and is, therefore, in furtherance of a business purpose.

(f) For the reasons indicated, the Board concluded that under the circumstances described a guaranty by the corporation constitutes credit extended in the ordinary course of business under this part, that the corporation is required to register pursuant to § 221.3(b), and that such guaranties may not be given in excess of the maximum loan value of the collateral pledged to secure the guaranty.

(g) Section 221.3(a)(3) provides that ''no lender may arrange for the extension or maintenance of any purpose credit, except upon the same terms and conditions on which the lender itself may extend or maintain purpose credit under this part''. Since the Board concluded that the giving of a guaranty by the corporation to secure the loan described above constitutes an extension of credit, and since the use of a guaranty in the manner described could not be effectuated without the concurrence of the bank involved, the Board further concluded that the bank took part in ''arranging'' for the extension of credit in excess of the maximum loan value of the margin stock pledged to secure the guaranties.

§ 221.119 Applicability of plan-lender provisions to financing of stock options and stock purchase rights qualified or restricted under Internal Revenue Code.

(a) The Board has been asked whether the plan-lender provisions of § 221.4(a) and (b) were intended to apply to the financing of stock options restricted or qualified under the Internal Revenue Code where such options or the option plan do not provide for such financing.

(b) It is the Board's experience that in some nonqualified plans, particularly stock purchase plans, the credit arrangement is distinct from the plan. So long as the credit extended, and particularly, the character of the plan-lender, conforms with the requirements of the regulation, the fact that option and credit are provided for in separate documents is immaterial. It should be emphasized that the Board does not express any view on the preferability of qualified as opposed to nonqualified options; its role is merely to prevent excessive credit in this area.

(c) Section 221.4(a) provides that a plan-lender may include a wholly-owned subsidiary of the issuer of the collateral (taking as a whole, corporate groups including subsidiaries and affiliates). This clarifies the Board's intent that, to qualify for special treatment under that section, the lender must stand in a special employer-employee relationship with the borrower, and a special relationship of issuer with regard to the collateral. The fact that the Board, for convenience and practical reasons, permitted the employing corporation to act through a subsidiary or other entity should not be interpreted to mean the Board intended the lender to be other than an entity whose overriding interests were coextensive with the issuer. An independent corporation, with independent interests was never intended, regardless of form, to be at the base of exempt stock-plan lending.

§ 221.120 Allocation of stock collateral to purpose and nonpurpose credits to same customer.

(a) A bank proposes to extend two credits (Credits A and B) to its customer. Although the two credits are proposed to be extended at the same time, each would be evidenced by a separate agreement. Credit A would be extended for the purpose of providing the customer with working capital (nonpurpose credit), collateralized by margin stock. Credit B would be extended for the purpose of purchasing or carrying margin stock (purpose credit), without collateral or on collateral other than stock.

(b) This part allows a bank to extend purpose and nonpurpose credits simultaneously or successively to the same customer. This rule is expressed in § 221.3(d)(4) which provides in substance that for any nonpurpose credit to the same customer, the lender shall in good faith require as much collateral