§ 221.121 Extension of credit in certain stock option and stock purchase plans.

Questions have been raised as to whether certain stock option and stock purchase plans involve extensions of credit subject to this part when the participant is free to cancel his participation at any time prior to full payment, but in the event of cancellation the participant remains liable for damages. It thus appears that the participant has the opportunity to gain and bears the risk of loss from the time the transaction is executed and payment is deferred. In some cases brought to the Board’s attention damages are related to the market price of the stock, but in others, there may be no such relationship. In either of these circumstances, it is the Board’s view that such plans involve extensions of credit. Accordingly, where the security being purchased is a margin security and the credit is secured, directly or indirectly, by any margin security, the creditor must register and the credit must conform with either the regular margin requirements of §221.3(a) or the special “plan-lender” provisions set forth in §221.4, whichever is applicable. This assumes, of course, that the amount of credit extended is such that the creditor is subject to the registration requirements of §221.3(b).

§ 221.122 Applicability of margin requirements to credit in connection with Insurance Premium Funding Programs.

(a) The Board has been asked numerous questions regarding purpose credit in connection with insurance premium funding programs. The inquiries are included in a set of guidelines in the format of questions and answers. (The guidelines are available pursuant to the Board’s Rules Regarding Availability of Information, 12 CFR part 261.) A glossary of terms customarily used in connection with insurance premium funding credit activities is included in the guidelines. Under a typical insurance premium funding program, a borrower acquires mutual fund shares for cash, or takes fund shares which he already owns, and then uses the loan value (currently 50 percent as set by the Board) to buy insurance. Usually, a funding company (the issuer) will sell both the fund shares and the insurance through either independent broker/dealers or subsidiaries or affiliates of the issuer. A typical plan may run for 10 or 15 years with annual insurance premiums due. To illustrate, assuming an annual insurance premium of $300, the participant is required to put up mutual fund shares equivalent to 250 percent of the premium or $750 ($600 × 50 percent loan value equals $300 the amount of the insurance premium which is also the amount of the credit extended).

(b) The guidelines referenced in paragraph (a) of this section also:

(1) Clarify an earlier 1969 Board interpretation to show that the public offering price of mutual fund shares (which includes the front load, or sales commission) may be used as a measure of their current market value when the shares serve as collateral on a purpose credit throughout the term of the purchase of the fund shares; and
§ 221.124 Purchase of debt securities to finance corporate takeovers.

(a) Petitions have been filed with the Board raising questions as to whether the margin requirements in this part apply to two types of corporate acquisitions in which debt securities are issued to finance the acquisition of margin stock of a target company.

(b) In the first situation, the acquiring company, Company A, controls a shell corporation that would make a tender offer for the stock of Company B, which is margin stock (as defined in §221.2). The shell corporation has virtually no operations, has no significant business function other than to acquire and hold the stock of Company B, and has substantially no assets other than the margin stock to be acquired. To finance the tender offer, the shell corporation would issue debt securities which, by their terms, would be unsecured. If the tender offer is successful, the shell corporation would seek to merge with Company B. However, the tender offer seeks to acquire fewer shares of Company B than is necessary under state law to effect a short form merger with Company B, which could be consummated without the approval of shareholders or the board of directors of Company B.

(c) The purchase of the debt securities issued by the shell corporation to finance the acquisition clearly involves purpose credit (as defined in §221.2). In addition, such debt securities would be purchased only by sophisticated investors in very large minimum denominations, so that the purchasers may be lenders for purposes of this part. See §221.3(b). Since the debt securities contain no direct security agreement involving the margin stock, applicability of the lending restrictions of this part turns on whether the arrangement constitutes an extension of credit that is secured indirectly by margin stock.

(d) As the Board has recognized, indirect security can encompass a wide variety of arrangements between lenders and borrowers with respect to margin stock collateral that serve to protect the lenders' interest in assuring that a credit is repaid where the lenders do not have a conventional direct security interest in the collateral. See §221.124. However, credit is not "indirectly secured" by margin stock if the lender in good faith has not relied on the margin stock as collateral extending or maintaining credit. See §221.2.

(e) The Board is of the view that, in the situation described in paragraph (b) of this section, the debt securities would be presumed to be indirectly secured by the margin stock to be acquired by the shell acquisition vehicle. The staff has previously expressed the view that nominally unsecured credit extended to an investment company, a substantial portion of whose assets consist of margin stock, is indirectly secured by the margin stock. See Federal Reserve Regulatory Service 5–917.12. (See 12 CFR 261.10(f) for information on how to obtain Board publications.) This opinion notes that the investment company has substantially no assets other than margin stock to support indebtedness and thus credit...