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I

INTRODUCTION: PRESENT STATUS OF THE SECURITIES MARKET

EVEN a casual glance at the financial page of almost any daily newspaper will at once bring forcefully to the attention of the reader the fact that the inflationary trend now being experienced by the commodity, real estate, and labor markets is likewise a factor in the securities market. A tremendous increase in the market prices of many securities has recently been experienced. A large number are at or near all-time highs. Likewise, the volume of trading is almost without precedent in the annals of the securities business.

This inflationary trend is further aggravated insofar as the securities markets are concerned by several factors. One is that more money is in circulation today than at any time in the history of the nation. Wages and salaries have increased substantially although they have generally lagged behind the approximately 33⅓ per cent rise in the cost of living since January, 1941. Likewise individuals' savings as represented by savings bank deposits and war savings bonds have, during the same period, increased many fold.

A second factor is that an unusually large amount of the money in circulation is being attracted into the securities markets, for during the war and reconversion period many commodities, particularly consumer goods, which would normally absorb a large proportion of the money in circulation, have not been obtainable in sufficient quantity to satisfy public demand. Many people who never before owned securities are, therefore, trading in them for the first time. The more experienced are trading in securities in increased volume and adding to their holdings. These two factors, the increase of money in circulation accompanied by a shortage of consumer goods, have undoubtedly contributed to the increase in demand for securities.

A third factor is that the supply of securities has failed to increase in proportion to the increased demand. With wartime earnings high and interest on money at all-time lows, many corporations have reduced

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their bonded indebtedness and have retired preferred stocks bearing relatively high dividend rates. With the net working capital of corporations whose securities are listed on a national securities exchange doubled since 1939, corporations generally are possessed of abundant cash resources. As a result, although the number of new securities offered to the public has recently reached a new peak for the last decade, such offerings are considerably less than they otherwise would have been. Therefore, as bond and preferred stock issues were retired and new securities offerings failed to increase proportionately, the supply of securities available for trading has proved insufficient to meet public demand. Thus the ancient law of supply and demand, together with an inflationary trend throughout the nation's economy, has brought the securities markets to their present level of high prices and huge volume of trading.

II

GOVERNMENT CONTROL OF INFLATION IN THE SECURITIES MARKET THROUGH REGULATION T

Regulation T[1] is the instrumentality with which the government has sought, through control of extension of credit in the purchase and sale of securities, to maintain some semblance of order in the securities markets. The regulation was promulgated by the Board of Governors of the Federal Reserve System pursuant to powers derived from the Securities Exchange Act of 1934.[2] It applies to all brokers or dealers who are members of national securities exchanges[3] and to all brokers or dealers who transact a business in securities through the medium of any member of a national securities exchange.[4] The Securities Exchange Act also empowers the Federal Reserve Board to prescribe margin requirements for the purpose of preventing the excessive use of credit

[1] Regulation T was promulgated under §§ 7 and 8(a) of the Securities Exchange Act of 1934, the constitutionality and validity of which were sustained in United States v. McDermott, (C.C.A. 7th, 1942) 131 F. (2d) 313, cert. denied, 318 U.S. 765, 63 S. Ct. 664 (1943).

[2] 48 Stat. L. 881, 15 U.S.C. (1940) § 78(a) et seq. In this act, Congress set up the mechanism and prescribed the governing standards for the regulation of trading in securities, both on national securities exchanges and in the over-the-counter markets, in accordance with standards designed by Congress as essential to the proper protection of investors and the public.

[3] Stock exchanges registered with the Securities and Exchange Commission under § 6 of the Securities Exchange Act of 1934 are known as national securities exchanges.

[4] See § 7(c)(1) of the Securities Exchange Act and also § 1 of Regulation T. A companion regulation is Regulation U governing loans by banks for the purpose of purchasing or carrying stocks registered on national securities exchanges.

for the purchase of securities. The margin requirement for simplicity of exposition may be described as the initial down payment which must be deposited with a broker at the time of effecting a margin purchase of securities.[5]

The expressed purpose of the Congress in lodging with the Federal Reserve Board the power to promulgate the regulation and to prescribe margin requirements was:

> "...to give a Government credit agency an effective method of reducing the aggregate amount of the nation's credit resources which can be directed by speculation into the stock market and out of other more desirable uses of commerce and industry—to prevent a recurrence of the pre-crash situation where funds which would otherwise have been available at normal interest rates for uses of local commerce, industry, and agriculture were drained by the far higher rates into security loans and the New York call market."[6]

Control of the use of credit in the trading of securities has been employed by the government in its campaign to stem inflation and to assure full peace-time employment and production. This becomes evident from the fact that during the year 1945 three successively higher margin rates governing purchases of securities in customers' margin accounts were in effect for varying periods of time.[7] Until February 5, 1945 the margin requirement was 40 per cent.[8] Effective on that date the margin percentage was increased to 50 per cent of the market value of securities.[9] As of July 5, 1945 the margin figure was increased once more, this time to 75 per cent.[10] As the margin requirement has increased, the advantage in margin trading has decreased pro-

[5] Brokers who are members or who do business through members of a national securities exchange were not permitted to effect margin purchases in other than listed (or exempted) securities under provisions of the Regulation in effect prior to January 21, 1946. Effective on that day margin purchases were prohibited. Margin accounts, provided for in § 3 of Regulation T, are there designated as general accounts.

[6] H.R. Rep. No. 1383, 73d Cong., 2d sess. 6 (1934).

[7] The margin requirement is increased by the Federal Reserve Board by the device of reducing the percentage of the maximum loan value of securities. The broker, to effect a transaction on a margin basis, must secure from his customer a deposit of margin, i.e., cash or other securities duly discounted according to their current loan value, equal to the difference between the current market value and the maximum loan value of the securities purchased. For example, when the maximum loan value was 25 per cent, the broker was required to secure margin in the complementary amount of 75 per cent of market value.

[8] See Supplement to Regulation T effective January 1, 1938.

[9] See Supplement to Regulation T effective February 5, 1945.

[10] See Supplement to Regulation T effective July 5, 1945.

portionately, thus placing added emphasis on the cash trading section of Regulation T.

Two recent events, both of which have occurred since July, 1945, may be expected to emphasize the need for a better understanding of Regulation T, particularly, of course, among brokers and their customers. The most recent of the two events was a further increase by the Federal Reserve Board of the margin requirement to 100 per cent on January 21 of this year, thus in effect abolishing margin trading and placing securities transactions between brokers and their customers on a cash basis. Consequently, substantially all orders are now executed for customers in cash accounts.[11] The second of the two recent events was the filing of three companion cases in October of last year in a United States District Court[12] by the Securities and Exchange Commission, the agency charged with the enforcement of Regulation T, seeking injunctions against alleged violations of the provisions relating to cash transactions in securities. The purpose of the paragraphs which follow is to illustrate and clarify the application of the cash sections of the regulation to situations commonly encountered by the broker and his customer.

III

APPLICATION OF THE CASH SECTIONS OF REGULATION T

A. *Requirements for Use of Cash Account in Purchase and Sale of Securities*

1. *Good faith*

It cannot be too emphatically stated that a cash account established pursuant to section 4 may not be used "for the purpose of evading or circumventing any of the provisions of this regulation."[13] The language quoted is directed at unjustified delays in completing cash transactions. The cash sections, however, do not require cash in the strict sense of the term, for cash need not be paid when an order is placed. What is required is that cash be readily available so that after execution of the purchase order prompt payment may be made. Unjustified delays afford a credit advantage, for as a result of such delays the customer avoids either prompt payment for, or deposit of, the securities. Supplementing this provision against evasion and circumvention

[11] Cash accounts provided for by § 4(c) of Regulation T are there designated as special cash accounts.

[12] The cases referred to were filed in the Northern District of Ohio, Eastern Division, on October 16, 1945.

[13] See § 4(a) of Regulation T.

are the requirements found in various of the cash sections that transactions executed in cash accounts be *bona fide* and that the purchase or sale be in accordance with a *good faith* agreement between the broker and his customer. Use of the cash account provided for in section 4 is, therefore, a privilege for which the broker and his customer must qualify in order to avoid full cash payment at the time the order is placed.

2. *Payment for, or deposit of securities "promptly"*

Turning to the cash sections themselves, specifically the introductory language of section 4(c)(1), it will be seen that it is by virtue of the privilege made available by this section that a broker, as creditor, is permitted to effect with a customer under circumstances detailed in subsections (A) and (B)[14] *bona fide* cash transactions in a cash account. Thus, under subsection (A) of 4(c)(1) a broker, as creditor, may purchase a security for, or sell a security to, a customer in a cash account if he complies with various conditions contained in the subsection. This applies both to transactions in which securities are acquired by the broker-creditor as agent for delivery to a customer's cash account and as principal for sale to a customer's cash account. In general, therefore, section 4(c)(1)(A) relates to transactions in which a broker is buying securities.

Section 4(c)(1)(B) governs transactions in which a broker is selling a customer's securities. This section, like 4(c)(1)(A), has application to both principal and agent transactions. It differs, however, from section 4(c) (1) (A) in that the primary action required is the deposit of the security to be sold, while under section 4(c)(1)(A) the primary action required is payment for the security purchased.[15]

[14] Sections 4(c)(1), 4(c)(1)(A), and 4(c)(1)(B) are as follows:

"(c) Special cash account.—(1) In a special cash account, a creditor may effect for or with any customer *bona fide* cash transactions in securities in which the creditor may—

"(A) purchase any security for, or sell any security to, any customer, provided funds sufficient for the purpose are already held in the account or the purchase or sale is in reliance upon an agreement accepted by the creditor in good faith that the customer will promptly make full cash payment for the security and that the customer does not contemplate selling the security prior to making such payment; or

"(B) sell any security for, or purchase any security from, any customer, provided the security is held in the account or the creditor is informed that the customer or his principal owns the security and the purchase or sale is in reliance upon an agreement accepted by the creditor in good faith that the security is to be promptly deposited in the account."

[15] In discussing the provisions of both 4(c)(1)(A) and 4(c)(1)(B) it has been assumed that neither sufficient funds for the purchase of a security nor the security sold are held in the cash account.

Presumably, the Federal Reserve Board in promulgating these two sections was of the opinion that it is just as much an extension of credit for a broker to sell for a customer a security which has not been deposited by the customer as it is for a broker to buy for a customer a security for which no payment has been made by the customer. In the one instance there is definitely a direct extension of credit by the broker to the customer because the customer has not paid any money to the broker. In the other it may be argued, at least theoretically, that there is an indirect extension of credit to the customer because the customer has not deposited his securities with the broker. In any event, the regulation clearly and unmistakably provides that in both instances the failure of the broker to require the customer promptly to perform his agreement, either to pay for or to deposit the securities in question, constitutes a violation of either section 4(c)(1)(A) or 4(c)(1)(B), depending on whether a purchase or sale is involved.

The most practical aspect of sections 4(c)(1)(A) and 4(c)(1)(B) is, of course, the answer to the question—When must payment or deposit of the securities by the customer be effected in order to constitute compliance? The rule in both sections is that the broker must require his customer to pay or deposit "promptly," that is to say, as quickly as possible under the circumstances. This follows from the provisions of 4(c)(1)(A) making it necessary for the broker to require that the customer "promptly make full cash payment" for the security he has ordered his broker to buy and for the broker to be assured under 4(c)(1)(B) that the customer has "promptly deposited" the security he has ordered his broker to sell.

3. *Requirement barring "Matched Trades"*

Prompt payment for securities purchased is not, however, the only requirement contained in 4(c)(1)(A). In fact it is only one of two matters that must be contained in a good faith agreement[16] between the broker and his customer. The other matter that must be embraced by the good faith agreement between the broker-creditor and his customer is that the customer does not contemplate selling the security purchased prior to making payment of the purchase price to the broker. The intention of the Federal Reserve Board in prescribing this requirement was to prevent the customer from creating funds from which to pay the purchase price of the security by selling the same security. Thus, in effect the customer is compelled to have or obtain promptly

[16] It is not required that the good faith agreement be in writing. An oral agreement is, therefore, sufficient.

adequate cash with which to make payment from a source other than proceeds derived from the sale of the security purchased. This provision, therefore, bars matched trades in which the same securities are sold by the customer before they are paid for by the customer.

Such matched trades give a false appearance of active trading in a security because the customer avoids using any cash to effect its purchase. As can be readily appreciated, such trades stimulate further trades and a resultant excessive increase in the use of credit. The danger of this artificial stimulation and the need for its prevention, particularly when an inflationary trend is being experienced, are too obvious to require further comment.

B. *Cash Sections Relating to Purchase of Securities*

The substantially parallel treatment accorded to the purchase and sale of securities in sections 4(a), 4(c)(1), 4(c)(1)(A), and 4(c)(1)(B) is not carried forward into the cash sections of Regulation T that follow. Indeed, all of the remaining cash sections have application only to the *purchase of securities* in cash accounts. The regulation prescribes no specific period of time within which *securities ordered sold must be deposited* wtih the broker if the broker is to avoid cancellation or liquidation of the transaction or a charge of having violated the regulation. The only requirement applicable to the sale of securities not held in a customer's cash account is that they must be owned by the customer or his principal and be deposited promptly.

The situation as to the *purchase of securities* in cash accounts is, as has been implied, much different. Provisions are made for time limits and extension periods within which full cash payment must be made in order to avoid cancellation or liquidation of the transaction. There are two basic periods of time within which the broker-creditor may permit the customer to make payment and thus avoid cancellation or liquidation of the transaction, assuming, of course, that the transaction is *bona fide*. One period is seven days[17] and the other is thirty-five days[18] in duration.[19]

[17] Seven days are permitted both under § 4(c)(2) and § 4(c)(3) before the broker must cancel or liquidate. Under the former, time is computed from the date of the execution of the purchase order, while under the latter, which applies only to unissued securities, time is computed from the date on which the security is made available by the issuer for delivery to purchasers.

[18] The thirty-five day provision is found in § 4(c)(5).

[19] In computing time, reference should be made to section 4(c)(7) which, insofar as here pertinent, is as follows:

"(7) The days specified in this section 4(c) are calendar days, but if the last day of any period specified herein is a Saturday, Sunday, or holiday, such period shall be considered to end on the next full business day."

1. *Cancellation of purchase required after seventh day in absence of prompt payment*

Section 4(c)(2)[20] provides for a seven-day period by stating in effect that the broker-creditor is not required, even though full cash payment has not been made, to cancel or otherwise liquidate a purchase until immediately after the seventh day following the day of execution of the purchase order. However, a customer does not have as a matter of right seven days under 4(c)(2) or any other of the cash sections within which to effect payment. Rather, it is cancellation or liquidation by the broker, in the absence of full cash payment by the customer, that need not take place until immediately after the seventh day. Payment, on the contrary, must be effected promptly, as stipulated by 4(c)(1)(A), without reference to the duty of the broker under 4(c)(2) to cancel or liquidate immediately after the seventh day following execution of the purchase order. Payment, therefore, must be obtained as promptly as possible under the circumstances, notwithstanding the seven-day provisions of 4(c) (2). Clearly, if the broker has the security available for delivery to the customer at any time before the seventh day, payment must be obtained from his customer at once.

2. *Automatic extension of time where shipment is necessary*

Because of the prompt payment requirement of 4(c)(1)(A), a broker is required, as has been pointed out, to compel payment immediately or, depending upon the circumstances, on the date when the ordered securities become available for delivery by him to his customer. This obligation, moreover, may compel the broker to require his customer to pay even though seven days have not elapsed since the execution of the order. However, under certain circumstances the broker may properly accept payment even after the seventh day and without reference to reliance upon the thirty-five day rule provided for in section 4(c)(5). This results from the fact that various extension periods provided for in the cash sections may have the effect of allowing the broker to accept payment from his customer for a number of days in addition to the time otherwise permissible under the regulation. These extension periods are of two general types. One type is

[20] Section 4(c)(2) reads as follows:

"(2) 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 the succeeding subdivisions of this section 4(c), promptly cancel or otherwise liquidate the transaction or the unsettled portion thereof."

available automatically simply as the result of the presence of certain circumstances and without the necessity of the broker taking any affirmative action. The other type, however, is not automatic and becomes available only when the broker makes application, predicated upon exceptional circumstances, to an appropriate committee of either a national securities exchange or association.[21]

Provision for the automatic extension period is found in section 4(c)(4).[22] It becomes available when, and only when, a shipment of securities is incidental to the consummation of the transaction. As used in this provision the word "incidental" means "necessary." Consequently, shipment of securities by a circuitous route would not operate to extend the period of time that could be taken before the broker would be compelled by section 4(c)(2) to cancel or otherwise liquidate the transaction. Likewise, additional time could not be claimed if shipment was made to accomplish a purpose not necessary to the consummation of the transaction. Thus, extensions may be claimed only for necessary shipments of the securities purchased.

Questions have been raised whether certain periods required for the shipment of securities are covered by this provision. Inquiry has likewise been made whether such periods may be added together to permit a total extension period not exceeding the seven additional days specified in the provision. These questions have been presented as to time in shipment from the place of purchase to the broker, from the broker to his customer, and to and from the transfer office. If shipment is not a subterfuge and is actually incidental to the consummation of the transaction, such periods are covered by 4(c)(4) and, therefore, have the effect of extending the time which may expire before the broker is obligated to cancel or liquidate. In addition, all such periods may be added together, provided, of course, that the total extension for any one transaction does not exceed the additional seven-day maximum specified in 4(c)(4).[23]

Assuming, therefore, that a shipment of securities is necessary to

[21] The organization and operation of a national securities association are provided for by § 15A of the Securities Exchange Act of 1934.

[22] Section 4(c)(4) reads:

"(4) If any shipment of securities is incidental to the consummation of the transaction, the period applicable to the transaction under subdivision (2) of this section 4(c) shall be deemed to be extended by the number of days required for all such shipments, but not by more than 7 days."

[23] See NEW YORK STOCK EXCHANGE DIRECTORY AND GUIDE, p. H-586.3 for excerpt of letter dated July 23, 1940 from Federal Reserve Bank of New York to the New York Stock Exchange.

the completion of the transaction, an automatic extension may be claimed. Thus, if a broker obtains securities for his customer from a correspondent or other broker and he has not received payment, he is allowed additional time equal to the number of days the securities were in transit before he need cancel or liquidate as required by 4(c)(2). However, the additional time available because of shipments cannot exceed seven days. Accordingly, a total of no more than fourteen days can be taken before liquidation or cancellation in any transaction under the provisions of 4(c)(2) and 4(c)(4). However, fourteen days are not permitted as a matter of right, for the seven-day period found in 4(c)(2) is extended only for the number of days the securities are actually in shipment. Thus, where shipment requires only one day, cancellation or liquidation would become mandatory immediately following the eighth day.

While shipping time extends the time for cancelling or otherwise liquidating, the shipment of securities does not have the effect of permitting the broker and his customer to wait until the seventh day before payment is made. For example, if in a given transaction the securities were available for delivery to the customer in five days, two days of which had been devoted to shipping, the broker would not, even in the absence of payment, have to cancel or liquidate until the ninth day, for he would be permitted seven days under 4(c)(2) plus a two day extension period under 4(c)(4). However, as has been observed, in order to meet the prompt payment requirement of 4(c)(1)(A), the broker would, nevertheless, be obligated to obtain payment from his customer no later than the fifth day, the date upon which the securities became available for delivery to his customer.

3. *Extension of time by special permission*

It has been noted that, in addition to the automatic extension provisions found in 4(c)(4), extensions may be obtained by applications submitted to an appropriate committee of a national securities exchange or association. Authority for the granting of such extensions is found in 4(c)(6).[24] This means of extending the time at which a transaction

[24] Section 4(c)(6) reads as follows:

"(6) If an appropriate committee of a national securities exchange or a national securities association is satisfied that the creditor is acting in good faith in making the application, that the application relates to a *bona fide* cash transaction, and that exceptional circumstances warrant such action, such committee, on application of the creditor, may (A) extend any period specified in subdivision (2), (3), (4) or (5) of this section 4(c) for one or more limited periods commensurate with the circumstances, or (B), in case a security purchased by the customer in the special cash account is a registered must be cancelled or liquidated has application only to those situations in which the broker can satisfy the appropriate committee that "exceptional circumstances warrant such action." An additional prerequisite to obtaining extensions by application is the requirement that the creditor act in *good faith* in making the application and that a *bona fide* cash transaction is involved. The presence of these two factors is compelled by the express terms of section 4(c)(6) and consequently affords further emphasis to the general obligation of good faith in claiming the privileges of a cash account.

Applications showing "exceptional circumstances" will also, under the terms of 4(c)(6), constitute sufficient justification for the extension by the appropriate committee of time periods other than the seven days permitted under 4(c)(2). The seven-day provision as to unissued securities,[25] the automatic extension for up to seven days for shipment,[26] and the thirty-five day period applicable to certain C.O.D. transactions[27] may all be extended by application upon satisfying the appropriate committee that exceptional circumstances warrant such action.

4. *Extension of time by transfer to "special omnibus account"*

An alternative to the granting of an extension of the various periods provided for in 4(c)(2), 4(c)(3), 4(c)(4), and 4(c)(5) is also contained in section 4(c)(6). In order to claim the alternative, the same requirements of exceptional circumstances warranting the action, *good faith* in making the application, and the existence of a *bona fide* cash transaction are required. Under these conditions, the appropriate committee may authorize transfer of the transaction to other specified accounts and completion of the transaction in accordance with the sections relating to such accounts. Formerly, such a transfer could be authorized either to a general or margin account or to the special omnibus account[28] provided for in sections 3 and 4(b) respectively. In view of the prohibition against margin trading in effect since Janu-

or exempted security, authorize transfer of the transaction to a general account or special omnibus account and completion of the transaction pursuant to the provisions of this regulation relating to such an account."

[25] This provision is found in § 4(c)(3).

[26] It is, of course, § 4(c)(4) that so provides.

[27] The thirty-five day provision is set forth in 4(c)(5).

[28] Special omnibus accounts are established by a broker for the purpose of executing a customer's transaction through another broker. Such accounts, for example, are opened with member brokers by non-member brokers whose customers are buying and selling listed securities.

ary 21 of this year, this transfer provision now has application in practice only to the special omnibus account. It should also be noted that this alternative procedure for disposing of applications filed under 4(c)(6) is limited to transactions in which a registered or exempted security is involved.

5. *Application of thirty-five day rule*

Various references have already been made to the thirty-five day period permitted by section 4(c)(5).[29] It has been referred to as one of the two basic periods of time which are provided for in the cash provisions of the regulation. However, it cannot be overemphasized that the provision does not in all cases afford the broker and his customer the privilege of extending credit in a cash account for the entire duration of the thirty-five day period. It, like the seven-day period, is simply an outside limit beyond which, in the absence of extensions, the broker has no choice but to cancel or liquidate the transaction where prompt payment has not been made for securities purchased. The broker and customer must still have, and are bound by, the "good faith" agreement that the customer will "promptly make full cash payment." As the Federal Reserve Board has stated in an administrative interpretation of the thirty-five day provision of 4(c)(5):

> "It should be noted at the outset that it is not the purpose of section 4(c)(5) to allow additional time to customers for making payment. The 'prompt delivery' described in section 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.
>
> "The customer should have the necessary means of payment readily available when he purchases a security in the special cash

[29] Section 4(c)(5) is as follows:

"(5) If the creditor, acting in good faith in accordance with subdivision (1) of this section 4(c), purchases a security for a customer, or sells a security to a customer, with the understanding that he is to deliver the security promptly to the customer, and the full cash payment 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 subdivision (2) of this section 4(c) is not the 7 days therein specified but 35 days after the date of such purchase or sale."

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.

"Such an undertaking is a necessary part of the customer's agreement, under section 4(c)(1)(A), that he 'will promptly make full cash payment.' Furthermore, any delay by the customer may cast doubt on the original status of the transaction and should be explainable by exceptional circumstances that justify the delay. Repetition of delays by the customer would be especially hard to justify. Such repetition would almost conclusively label his transactions as unable to qualify as *bona fide* cash transactions and would almost conclusively disqualify them for inclusion in the special cash account."[80]

From the foregoing it will be seen that it is not the purpose of the thirty-five day rule to allow additional time to customers for making payment. The provision merely recognizes the fact that, in certain circumstances which do not occur with the regularity of the ordinary securities transactions, longer periods of time are needed for the broker to obtain securities purchased by his customer. Thus the object of 4(c)(5) is to allow further time, where needed, for delivery, and only incidentally to afford further time for payment by the customer. Again, the thirty-five day provision authorizes the broker to take the full thirty-five days only where thirty-five days are required for delivery. If delivery can be obtained in less than thirty-five days, it permits him to allow his customer to take only that portion of the thirty-five day period necessary in order to obtain delivery of the securities and to make them available in turn for delivery to the customer.

C. *Penalty Provision for "Matched Trades"*

There is one other cash section which requires attention here. This section, 4(c)(8),[81] like the similar provision found in 4(c)(1)(A), has

[80] See 26 FED. RES. BUL. 1173 (November 1940).

[81] Section 4(c)(8) states:

"(8) Unless funds sufficient for the purpose are already in the account, no security other than an exempted security shall be purchased for, or sold to, any customer in a special cash account with the creditor if any security other than an exempted security has been purchased by such customer in such an account during the preceding 90 days, and then, for any reason whatever, without having been previously paid for in full by the customer, the security has been sold in the account or delivered out to any broker or dealer: *Provided*, That an appropriate committee of a national securities exchange or a national securities association, on application of the creditor, may authorize the application to matched trades in which the security purchased is paid for out of proceeds created by the sale of the same security. Section 4(c)(1)(A) is, however, not only prospective but subjective, for it merely states that there must be a *good faith* agreement that "the customer does not contemplate selling the security prior to making such payment." Section 4(c)(8) is more susceptible to immediate practical application. Its effect is to penalize a customer for whom securities have been sold in a cash account or delivered out to another broker "for any reason whatever"[32] prior to payment by barring the customer's broker from executing for his customer during the following ninety days any further transactions in a cash account. The obvious purpose of this section is to provide an effective method of curtailing trading by brokers and customers who make payment for securities purchased from funds made available by the sale or delivery out of the same securities. However, if the broker and customer are acting in *good faith* and the circumstances warrant such action, an appropriate committee, upon application by the broker, may grant an exception, thus permitting the broker and his customer to continue trading in a cash account, notwithstanding the occurrence of such sales or deliveries during the preceding ninety days.

IV

CONCLUSION

In summarizing, the gist of the cash provisions of section 4 of Regulation T is that a customer buying and selling securities in a *bona fide* cash account with a broker, who is a member or doing business through the medium of a member of a national securities exchange, must make prompt payment for securities purchased and must deposit promptly with his broker the securities ordered sold.

As has been pointed out, the customer in selling securities need only deposit promptly the securities he has ordered his broker to sell. However, when a customer is purchasing securities, up to seven days are made available for the purpose of making prompt payment in full to the broker, but, of course, the seven-day period is not an outright

creditor to disregard for the purposes of this section 4(c)(8) any given instance of the type therein described if the committee is satisfied that both creditor and customer are acting in good faith and that circumstances warrant such authorization."

[32] The words "for any reason whatever" include not only voluntary sales in an account and deliveries out to another broker before payment, but also involuntary sales resulting from cancellation or liquidation in compliance with the requirements of § 4(c)(2).

grant of time in which to make payment. It is merely the outside time limit available to the broker and his customer where various justified mechanics in the brokerage business have the effect of making it impossible for the broker to have the securities immediately available for delivery to the customer. Where shipment of securities is incidental to the consummation of the transaction, such additional period of time as is necessary for shipment, but not in excess of seven days, may be taken into consideration in determining when cancellation of the transaction is required.

For the purpose of providing an opportunity for a broker to fill a customer's order for the purchase of securities not readily obtainable for various reasons, section 4(c)(5) permits the broker in *good faith* to take up to thirty-five days, providing the customer makes payment promptly against the delivery of the securities.

Where prompt payment is not made by the customer under the provisions just mentioned, the broker must either cancel or liquidate the transaction at the expiration of the applicable period or obtain an extension of time for payment from the appropriate committee of a national securities exchange or association.

Section 4 of the regulation, as has been noted, does not permit the use of the privileges made available by its cash provisions where a customer contemplates selling a security prior to paying the purchase price. This is aimed at the practice, which was at one time very commonly employed, whereby a customer could take a profit advantage from a rising market without the use of any funds. In addition, such transactions cause unwarranted activity in a security and create a false impression as to the demand for the security.

Not only must a customer not contemplate the sale of a security before its payment, but where a security purchased in a customer's cash account, without full cash payment being made, is sold in the account or delivered out to another broker before payment is made, no other security may be bought for or sold to the customer in a cash account for a period of ninety days from the date the security was purchased.

It becomes the duty of every broker, who is a member or doing business through the medium of a member of a national securities exchange, to conscientiously conduct his business within the spirit of the cash provisions of Regulation T. Disregard of the regulation may not only result in actionable violations, but would undoubtedly affect the securities markets in an adverse manner. Although the burden of complying with Regulation T is placed directly on the broker, legal responsibility may be imposed upon the customer under the regulation, if he "aids, abets... or procures" its violation.[33]

In a period in which an inflationary trend is being experienced, strict adherence to principles tending to "brake" the upward spiral whether in the commodities, real estate, labor or securities markets becomes, for the sake of economic self-preservation, a prime necessity.

[33] 18 U.S.C. (1940) § 550 reads as follows:
"Whoever directly commits any act constituting an offense defined in any law of the United States, or aids, abets, counsels, commands, induces, or procures its commission, is a principal."