

FEDERAL RESERVE BANK OF DALLAS
DALLAS, TEXAS 75222

Circular No. 67-220
November 2, 1967

TEXTS OF PROPOSED CHANGES IN MARGIN REGULATIONS

**To All Banks
in the Eleventh Federal Reserve District:**

In our Circular No. 67-215 of October 25, 1967, regarding proposed changes in margin regulations, it was mentioned that the texts of the proposed amendments to Regulations T (relating to extension of credit by brokers) and U (loans by banks), and the proposed new Regulation G (relating to securities credit extended by other lenders) would be available upon publication in the Federal Register. A copy of the proposed amendments and the proposed new Regulation G are attached.

Please note that interested persons are invited to submit, in writing, relevant data, views, or arguments. Comments should be addressed to the Board of Governors of the Federal Reserve System and sent to this bank to the attention of Thomas R. Sullivan, Vice President, by November 20, 1967.

Yours very truly,

Watrous H. Irons
President

Enclosures (3)

FEDERAL RESERVE SYSTEM

[12 CFR Part 220]

[Reg. T]

CREDIT BY BROKERS, DEALERS, AND MEMBERS OF
NATIONAL SECURITIES EXCHANGES

Notice of Proposed Rule Making

The Board of Governors is considering amending Part 220 in the following respects:

1. Section 220.2(a) would be amended to read as follows:

(a) The terms "person", "member", "broker", "dealer", "buy", "purchase", "sale", "sell", "security", "equity security", and "bank" have the meanings given them in section 3(a) of the Act (15 U.S.C. 78c(a)).

2. Section 220.2 would be further amended by adding a new paragraph as follows:

(f) The term "non-equity security" means any security other than an equity security or an exempted security.

3. Section 220.3 (a), (b), (c), (e), and (f) would be amended to read as follows:

(a) Contents of general account. All financial relations between a creditor and a customer, whether recorded in one record or in more than one record, shall be included in and be deemed to be parts of the customer's general account with the creditor, except that the relations which § 220.4 permits to be included in any special account provided for by that section may be included in the appropriate special account, and all transactions in commodities, and, except to the extent provided in

paragraph (b)(2) of § 220.3, all transactions in non-equity securities, exempted securities, and in other securities having no loan value in a general account under the provisions of § 220.3(c) and § 220.8 (except unissued securities, short sales, and purchases to cover short sales) shall be included in the appropriate special account provided for by § 220.4. During any period when § 220.8 specifies that registered equity securities shall have no loan value in a general account, any transaction consisting of a purchase of a security other than a purchase of a security to reduce or close out a short position shall be effected in the special cash account provided for by § 220.4(c) or in some other appropriate special account provided for by § 220.4.

(b) General rule. (1) A creditor shall not effect for or with any customer in a general account any transaction which, in combination with the other transactions effected in the account on the same day, creates an excess of the adjusted debit balance of the account over the maximum loan value of the securities in the account, or increases any such excess, unless in connection therewith the creditor obtains, as promptly as possible and in any event before the expiration of five full business days following the date of such transaction, the deposit into the account of cash or securities in such amount that the cash deposited plus the maximum loan value of the securities deposited equals or exceeds the excess so created or the increase so caused.

(2) Except as permitted in this subparagraph, no withdrawal of cash or registered or exempted securities shall be permissible if the adjusted debit balance of the account would exceed the maximum loan value of the securities in the account after such withdrawal. The exceptions are available only in the event no cash or securities need to be deposited in the account in connection with a transaction on a previous day and none would need to be deposited thereafter in connection with any withdrawal of cash or securities on the current day. The permissible exceptions are (i) registered non-equity or exempted securities held in the account on [effective date] may be withdrawn upon the deposit in the account of cash (or registered equity securities counted at their maximum loan value) at least equal to the "retention requirement" of such withdrawn securities, or (ii) registered equity securities may be withdrawn upon the deposit in the account of cash (or registered equity securities counted at their maximum loan value) at least equal to the "retention requirement" of those securities, or (iii) cash may be withdrawn upon the deposit in the account of registered equity securities having a maximum loan value at least equal to the amount of cash withdrawn, or (iv) upon the sale (other than the short sale) of registered equity securities in the account, there may be withdrawn in cash an amount equal to the difference between the current market value of the securities sold and the "retention requirement" of those securities, or (v) upon the sale (other than the short sale) of a registered non-equity security or an exempted security that was held in the account on [effective date] there may be withdrawn in cash an amount equal to the difference between the current market value of the securities sold and the "retention requirement"

or those securities. The "retention requirement" of an exempted security held in the account on [effective date] is the same as its maximum loan value as determined by the creditor in good faith, and the "retention requirement" of a registered non-equity security held in the account on [effective date] and of a registered equity security are prescribed from time to time in § 220.8(c) (the Supplement to Regulation T).

(3) Rules for computing the maximum loan value of the securities in a general account and the adjusted debit balance of such an account are provided in paragraphs (c) and (d) of this section, and certain modifications of and exceptions to the general rule stated in this paragraph are provided in the subsequent paragraphs of this section and in § 220.6.

(c) Maximum loan value and current market value. (1) The maximum loan value of the securities in a general account is the sum of the maximum loan values of the individual securities in the account, including securities (other than unissued securities) bought for the account but not yet debited thereto, but excluding securities sold for the account whether or not payment has been credited thereto.

(2) Except as otherwise provided in this paragraph, the maximum loan value of a security in a general account shall be such maximum loan value as the Board shall prescribe for general accounts from time to time in § 220.8. No collateral other than an exempted security or a registered non-equity security held in the account on [effective date] and a registered equity security, shall have any loan value in a general account.

(3) A warrant or certificate which evidences only a right to subscribe to or otherwise acquire any security and which expires within ninety days of issuance shall have no loan value in a general account; but, if the account contains the security to the holder of which such warrant or certificate has been issued and such warrant or certificate is held in the appropriate account under § 220.4, the current market value of such security (if such security be a registered security) shall, for the purpose of calculating its maximum loan value, be increased by the current market value of such warrant or certificate.

(4) For the current market value of a security throughout the day of its purchase or sale, the creditor shall use its total cost or the net proceeds of its sale, as the case may be, and at any other time shall use the closing sale price of the security on the preceding business day as shown by any regularly published reporting or quotation service. In the absence of any such closing sale price, the creditor may use any reasonable estimate of the market value of such security as of the close of business on such preceding business day.

* * *

(e) Liquidation in lieu of deposit. In any case in which the deposit required by paragraph (b) of this section, or any portion thereof, is not obtained by the creditor within the five-day period specified therein, registered nonexempted securities shall be sold (or, to the extent that there are insufficient registered nonexempted securities in the account, other liquidating transactions shall be effected in the account), prior to the expiration of such five-day period, in such amount that the resulting

decrease in the adjusted debit balance of the account exceeds, by an amount at least as great as such required deposit or the undeposited portion thereof, the "retention requirement" of any registered or exempted securities sold.

(f) Extensions of time. In exceptional cases, the five-day period specified in paragraph (b) of this section may, on application of the creditor, be extended for one or more limited periods commensurate with the circumstances by any regularly constituted committee of a national securities exchange having jurisdiction over the business conduct of its members, of which exchange the creditor is a member or through which his transactions are effected, provided such committee is satisfied that the creditor is acting in good faith in making the application and that the circumstances are in fact exceptional and warrant such action.

4. Section 220.4(h) would be amended to read as follows:

(h) Special subscriptions account. In a special subscriptions account a creditor may effect and finance the acquisition of a registered security for a customer through the exercise of a right to acquire such security which is evidenced by a warrant or certificate issued to stockholders and expiring within 90 days of issuance, and such special subscriptions account shall be subject to the same conditions to which it would be subject if it were a general account except that:

(1) Each such acquisition shall be treated separately in the account, and prior to initiating the transaction the creditor shall obtain a deposit of cash in the account such that the cash deposited plus the maximum loan value of the securities so acquired equals or exceeds the subscription price, giving effect to a minimum loan value for the securities so acquired of 75 per cent of their current market value as determined by any reasonable method;

(2) After October 20, 1967, at the time when a loan is made pursuant to this paragraph, the creditor shall compute the amount by which the loan exceeds the maximum loan value of the collateral as prescribed by § 220.8 and the customer shall reduce the loan by an amount equal to one-fourth of such sum by the end of each of the four succeeding three-calendar-month periods or until the loan is equal to such maximum loan value, whichever shall occur first, and, if the creditor fails to obtain the required reduction with respect to a particular acquisition within five full business days after the reduction is due, the creditor shall promptly sell the collateral so acquired: Provided, That, as to loans made between October 20, 1967, and [effective date], such four succeeding periods shall begin on [effective date]; and

(3) The creditor shall not permit any withdrawal of cash or securities from the account so long as there is a debit balance in the account, except that when the debit connected with a given acquisition of securities in the account has become equal to or less than the maximum loan value of such securities as prescribed for general accounts (or in connection with an acquisition after October 20, 1967, the requirements of subparagraph (2) of this section have been fulfilled), such securities may be transferred to the general account together with any remaining portion of such debit.

In order to facilitate the exercise of a right in accordance with the provisions of this paragraph, a creditor may permit the right to be transferred from a general account to the special subscriptions account without regard to any other requirement of this Part.

5. Section 220.4 would be further amended by adding a new paragraph as follows:

(i) Special bond account. In a special bond account a creditor may effect and finance transactions in exempted securities and registered non-equity securities for any customer.

6. Section 220.8 (the Supplement to Regulation T) would be amended to read as follows:

§ 220.8 Supplement.

(a) Maximum loan value for general accounts. The maximum loan value of securities in a general account subject to § 220.3 shall be

(1) of a registered non-equity security held in the account on [effective date] and of a registered equity security, 30 per cent of the current market value of the security and

(2) of an exempted security held in the account on [effective date] the maximum loan value of the security as determined by the creditor in good faith.

(b) Margin required for short sales in general accounts. The amount to be included in the adjusted debit balance of a general account, pursuant to § 220.3(d)(3), as margin required for short sales of securities (other than exempted securities) shall be 70 per cent of the current market value of each such security.

(c) Retention requirement for general accounts. In the case of a general account which would have an excess of the adjusted debit balance of the account over the maximum loan value of the securities in the account following a withdrawal of cash or securities from the account, pursuant to § 220.3(b)(2), the "retention requirement" of an

exempted security held in the account on [effective date] shall be equal to its maximum loan value as determined by the creditor in good faith, and the "retention requirement" of a registered non-equity security held in the account on [effective date] and of a registered equity security shall be 70 per cent of the current market value of the security.

(d) Securities having no loan value in general account.

No security other than an exempted security or a registered non-equity security held in the account on [effective date] and a registered equity security, shall have any loan value in a general account.

* * * * *

A principal purpose of these amendments is to change certain provisions through which excessive credit may be flowing into the securities markets. The changes that would be made to accomplish this purpose are described in the accompanying notice of proposed rule making with respect to amendments to Regulation U.

Another purpose of these amendments is to give creditors subject to Regulation T five full business days in which to obtain any additional deposit of margin required in connection with transactions in a general account. This is one day more than the four presently permitted under the regulation. Such change appears desirable in order to relieve the pressure on bookkeeping departments of brokerage firms by ensuring that a weekend will always be included in the period of time within which the required deposit must be obtained.

This notice is published pursuant to section 553(b) of Title 5, United States Code, and § 262.2(a) of the rules of procedure of the Board of Governors of the Federal Reserve System (12 CFR 262.2(a)).

To aid in the consideration of this matter by the Board, interested persons are invited to submit, in writing, relevant data, views, or arguments. Such material should be sent to the Secretary, Board of Governors of the Federal Reserve System, Washington, D. C. 20551, to be received not later than November 20, 1967. Under the Board's rules regarding availability of information (12 CFR 261), such materials will be made available for inspection and copying to any person upon request unless the person submitting the material requests that it be considered confidential.

Dated at Washington, D. C., this 20th day of October, 1967.

By order of the Board of Governors.

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

FEDERAL RESERVE SYSTEM

[12 CFR Part 221]

[Reg. U]

LOANS BY BANKS FOR THE PURPOSE OF PURCHASING
OR CARRYING REGISTERED STOCKS

The Board of Governors is considering amending Part 221 in the following respects:

1. Section 221.1 would be amended to read as follows:

§ 221.1 General rule.

(a) No bank shall extend any credit^{1/} secured directly or indirectly by any stock^{2/} for the purpose of purchasing or carrying any stock registered on a national securities exchange^{3/} (and no bank shall make any loan described in § 221.3(q) regardless of whether or not such loan is secured by any stock) in an amount exceeding the maximum loan value of the collateral, as prescribed from time to time for stocks in § 221.4 (the Supplement to Regulation U) and as determined by the bank in good faith for any collateral other than stocks: Provided, Any collateral other than stock shall have loan value only as collateral for a loan described in § 221.3(s), and not for any other loan subject to this Part unless held as collateral for such loan on October 20, 1967, and continuously thereafter.

(b) Except as permitted in the next subparagraph, while a bank maintains any loan subject to this Part, whenever made, the bank shall not at any time permit any withdrawal or substitution of collateral unless

^{1/} A "credit" is sometimes referred to hereinafter as a "loan".

^{2/} As defined in § 221.3(1).

^{3/} Commonly referred to as a "purpose loan". See §§ 221.3(b)(2) and (3), and 221.3(1).

either (i) the loan would not exceed the maximum loan value of the collateral after such withdrawal or substitution, or (ii) the loan is reduced by at least the amount by which the maximum loan value of any collateral deposited is less than the "retention requirement" of any collateral withdrawn. The "retention requirement" of collateral other than stock is the same as its maximum loan value and the "retention requirement" of collateral consisting of stock is prescribed from time to time in § 221.4 (the Supplement to Regulation U).

(c) A bank may permit a substitution of registered non-exempted stock effected by a purchase and sale on orders executed within the same day provided (i) if the proceeds of the sale exceed the total cost of the purchase, the loan is reduced by at least an amount equal to the "retention requirement" with respect to the sale less the "retention requirement" with respect to the purchase, or (ii) if the total cost of the purchase exceeds the proceeds of the sale, the loan may be increased by an amount no greater than the maximum loan value of the stock purchased less the maximum loan value of the stock sold. If the maximum loan value of the collateral securing the loan has become less than the amount of the loan, the amount of the loan may nonetheless be increased if there is provided additional collateral having maximum loan value at least equal to the amount of the increase.

(d) For the purpose of this Part, except for a loan subject to § 221.3(s), the entire indebtedness of any borrower to any bank incurred at any time for the purpose of purchasing or carrying stocks registered on a national securities exchange shall be considered a single

loan; and all the collateral securing such indebtedness shall be considered in determining whether or not the loan complies with this Part.

2. Section 221.2 would be amended by (a) eliminating the clause enumerated (b); (b) redesignating clauses (c), (d), (e), (f), (g), (h), (i), (j), and (k) as clauses (b), (c), (d), (e), (f), (g), (h), (i), and (j), respectively; and (c) amending the second proviso in redesignated clauses (e), (f), and (g) to read: And provided further, That it is either (1) made to a broker or dealer, or (2) made for a purpose other than to enable the borrower to pay for stock purchased in an account subject to Part 220 of this Chapter.

3. Section 221.3 (b), (c) (1), (p), and (r) would be amended to read as follows:

(b)(1) No loan, however it may be secured, need be treated as a loan for the purpose of "carrying" a stock registered on a national securities exchange unless the loan is as described in this paragraph or the purpose of the loan is to enable the borrower to reduce or retire indebtedness which was originally incurred to purchase such a stock, or, if he be a broker or a dealer, to carry such stocks for customers.

(2) A loan for the purpose of purchasing or carrying a "redeemable security" (i.e., a redeemable proportionate interest in the issuer's assets) issued by an "open-end company," as defined in the Investment Company Act of 1940, whose assets customarily include stocks registered on a national securities exchange, shall be deemed to be for the purpose of purchasing or carrying a stock so registered.

(3) A loan made after October 20, 1967, for the purpose of purchasing or carrying a "security convertible into a stock registered on a national securities exchange" shall be deemed to be for the purpose of purchasing or carrying a stock so registered.

(c) In determining whether a security is a "stock registered on a national securities exchange" or a "redeemable security" described in paragraph (b)(2) of this section, a bank may rely upon any reasonably current record of such securities that is published or specified in a publication of the Board of Governors of the Federal Reserve System. A bank may also rely upon such a record to determine whether a stock into which a security is convertible is a stock registered on a national securities exchange.

* * *

(1) The term "stock" includes any security commonly known as a stock, any voting trust certificate or other instrument representing such a security, any security convertible into such security, certificate, or other instrument, and any warrant or right to subscribe to or purchase such a security.

* * *

(p) A loan need not comply with the other requirements of this Part if it is to enable the borrower to acquire a stock by exercising a right to acquire such stock which is evidenced by a warrant or certificate issued to stockholders and expiring within 90 days of issuance: Provided,

That (1) each such acquisition under this paragraph shall be treated separately, and the loan when made shall not exceed 75 per cent of the current market value of the stock so acquired as determined by any reasonable method, (2) after October 20, 1967, at the time a loan is made pursuant to this paragraph, the bank shall compute the amount by which the loan exceeds the maximum loan value of the collateral as prescribed by § 221.4 and the borrower shall reduce the loan by an amount equal to one-fourth of such sum by the end of each of the four succeeding three-calendar-month periods or until the loan is equal to the maximum loan value of the stock, whichever shall occur first, and if the borrower shall fail to make the required reduction with respect to a particular acquisition within five full business days after such payment is due, the bank shall promptly sell the collateral so acquired, Provided, That, as to loans made between October 20, 1967, and [effective date] such four succeeding periods shall begin on [effective date], and (3) while the borrower has any loan outstanding at the bank under this paragraph no withdrawal or substitution of stock used to make such loan shall be permissible, except that when the loan has become equal to or less than the maximum loan value of the stock as prescribed for § 221.1 in § 221.4 (or with respect to a loan made after October 20, 1967, the requirements of the preceding clause have been fulfilled) the stock and indebtedness may thereafter be treated as subject to § 221.1 instead of this paragraph. In order to facilitate the exercise of a right under this paragraph, a bank may permit the right to be withdrawn from a loan subject to § 221.1 without regard to any other requirement of this Part.

* * *

(r)(1) If, prior to and including October 20, 1967, but on or after June 15, 1959, a loan was made for the purpose of purchasing or carrying a security other than a stock registered on a national securities exchange and the loan is secured by the security, but subsequently there is substituted as direct or indirect collateral for the loan a stock so registered which is acquired by the borrower through the conversion or exchange of the security pursuant to its terms, the loan shall thereupon be deemed to be for the purpose of purchasing or carrying a stock so registered. In any such case, the amount of the outstanding loan, or such amount plus any increase therein to enable the borrower to acquire the stock so registered, shall not be permitted on the date such stock is substituted as collateral to exceed the maximum loan value of the collateral for the loan on such date, and thereafter such indebtedness shall be treated as subject to § 221.1: Provided, however, That any reduction in the loan or deposit of collateral required on that date to meet this requirement may be brought about within 30 days of such substitution.

(2) If, after October 20, 1967, but prior to [effective date], a loan is made by a bank for the purpose of purchasing or carrying a "security convertible into a stock registered on a national securities exchange", the amount of the outstanding loan shall not be permitted on [effective date] to exceed the maximum loan value of the collateral for the loan on such date: Provided, however, That any reduction in the loan or deposit of collateral required to meet this requirement may be brought about within 30 days of [effective date].

4. Section 221.3 would be further amended by adding three new paragraphs as follows:

(s) A bank may make a loan for the purpose of purchasing or carrying a stock registered on a national securities exchange secured by collateral other than stock, and, in the case of such a loan, the maximum loan value of the collateral shall be as determined by the bank in good faith.

(t) No bank shall perform any services in respect to a loan which is for the purpose of purchasing or carrying a stock registered on a national securities exchange and is secured by any stock unless such loan is made and maintained in conformity with the provisions of Part 207, 220, or 221 (Regulation G, T, or U).

(u) No bank shall arrange for the extension or maintenance of any credit for the purpose of purchasing or carrying any stock registered on a national securities exchange, except upon the same terms and conditions on which the bank itself could extend or maintain such credit under the provisions of this Part.

* * * * *

A principal purpose of these amendments is to change certain provisions through which excessive credit may be flowing into the securities markets. The changes relate principally to the following:

(1) Special subscription accounts. Under the current margin regulations, special subscription accounts are intended to facilitate equity financing by corporations, and to help stockholders retain their proportionate interest in the issuer, by making it possible to borrow

for the purpose of exercising subscription rights on more favorable terms than those generally available under the margin regulations. The Board's rules relating to such accounts contemplate, however, that such loans shall be brought up to a fully margined status within nine months.

It has come to the Board's attention that in many instances this improvement in the margin status of subscription account loans does not take place, leaving the account vulnerable to margin calls in any subsequent general stock price decline, and the proposed amendments relating to such accounts would require that the difference between the amount of the loan and the maximum loan value of the securities serving as collateral for the loan shall be paid off in four equal quarterly instalments (unless the loan becomes fully margined before this has been done, due to a change in margin requirements or an increase in the loan value of the collateral), and that the loan shall then be eligible for transfer to the general (margin) account. If the borrower failed to make a required payment, the loan would be liquidated.

(2) Convertible bonds. At present, Regulation U permits a bank to lend as much as it sees fit against non-equity securities (chiefly bonds), but all registered securities, whether equities or non-equities, are subject to ordinary margin requirements under T. At the same time, there appears to have been a substantial increase in credit extended by banks to finance the purchase of certain convertible bonds. The present section 221.3(r) of U provides that a bank loan to purchase a convertible bond, where the bond is pledged to secure the loan, must be brought into conformity with ordinary margin requirements within 30 days after conversion takes place.

The proposed amendments would treat any security convertible into a registered stock as "stock" for purposes of Regulation U, so that loans by banks to purchase or carry such securities would be subject to ordinary margin requirements from the outset.

At the same time, the proposed changes would give good faith loan value to non-convertible registered bonds under Regulation T, thus removing, to the extent permitted by section 7 of the Securities Exchange Act of 1937, the unequal treatment of banks, brokers, and dealers, under the two regulations.

(3) Separate bond accounts. Under the law, the Board has authority to require that margin accounts maintain minimum margin status at all times, but for reasons discussed, for example, in the Special Study of the Securities Markets, submitted to Congress in 1963 by the Securities and Exchange Commission, it has not done so. However, in 1959, the Board adopted the so-called "retention requirement" under which it was expected that undermargined accounts would gradually tend to be brought into conformity with the current level of margin requirements, thus reducing the aggregate amount of credit in the market due to existing accounts, and minimizing to some extent the unfairness to an investor newly entering the market of requiring him to put up more margin than is demanded of an investor with an existing account.

In order to provide some investment flexibility in undermargined accounts, the Board permitted substitutions by means of offsetting purchases and sales, executed on the same day, without the deposit of additional margin--the "same-day" rule. However, abuses have occurred through substitution into bonds or exempted securities under this rule.

In order to prevent abuses of this kind, the proposed amendments would require that collateral consisting of registered non-convertible bonds or exempted securities be segregated in a separate account, under a new section 221.3(s). Such collateral would have good-faith loan value but no stock (and no securities convertible into stock) could be held as collateral for a loan in such an account, and there could be no exchange of collateral between the "bond account" and the general, or margin, account under either regulation. To minimize the burden of having to transfer all non-equity and exempted securities already held in margin accounts, as to Regulation U, only transactions after October 20, 1967, and as to Regulation T, after the effective date of the amendments would be affected.

(4) Additional proposed changes in Regulation U. The "same-day" rule discussed above does not appear explicitly in Regulation U. The proposed changes would insert into the regulation the substance of an interpretation published in 1959 Federal Reserve Bulletin 590 (12 CFR 221.111) stating that the "same-day" rule obtains under U.

In addition, the proposed changes would close a loophole in the present sections 221.2(f), (g), and (h) of Regulation U which appears to permit a bank to make a "clearance loan" in respect to transactions with a broker that are carried in some account other than the special

cash account. The changes would make it clear that such loans are not exempt if made to enable a borrower to pay for equity securities purchased in any account subject to Regulation T.

A proposed new section 221.3(t) of Regulation U would forbid a bank to perform services in connection with any loan that is for the purpose of purchasing or carrying equity securities, and secured by such securities, unless the loan is made and maintained in conformity with Part 207, 220, or 221 (Regulation G, T, or U).

Finally, a new section 221.3(u) of Regulation U would prohibit a bank from arranging credit for a customer on terms more favorable than could be provided by the bank itself.

This notice is published pursuant to section 553(b) of Title 5, United States Code, and § 262.2(a) of the rules of procedure of the Board of Governors of the Federal Reserve System (12 CFR 262.2(a)).

To aid in the consideration of this matter by the Board, interested persons are invited to submit, in writing, relevant data, views, or arguments. Such material should be sent to the Secretary, Board of Governors of the Federal Reserve System, Washington, D. C. 20551, to be received not later than November 20, 1967. Under the Board's rules regarding availability of information (12 CFR 261), such materials will be made available for inspection and copying to any person upon request unless the person submitting the material requests that it be considered confidential.

Dated at Washington, D. C., this 20th day of October, 1967.

By order of the Board of Governors.

(signed) Merritt Sherman

Merritt Sherman,
Secretary.

FEDERAL RESERVE SYSTEM

[12 CFR Part 207]

[Reg. G]

LOANS BY PERSONS OTHER THAN BANKS, BROKERS, OR DEALERS

Notice of Proposed Rule Making

The Board of Governors of the Federal Reserve System is considering the adoption of a new Part 207 (Regulation G), to be issued pursuant to authority contained in the Securities Exchange Act of 1934 (15 U.S.C. 78g), as follows:

REGULATIONS

- Sec.
207.1 General rule.
207.2 Definitions.
207.3 Reports and records.
207.4 Miscellaneous provisions.
207.5 Supplement.

AUTHORITY: The provisions of this Part 207 issued under 15 U.S.C. 78g.

§ 207.1 General rule.

(a) Every person who, in the ordinary course of his business, after October 20, 1967, makes or arranges for the making or maintenance of any loan for the purpose ^{1/} of purchasing or carrying any registered security ^{2/} (hereinafter called "purpose loan") and who is not subject to Part 220 of this chapter (Regulation T) or Part 221 of this chapter (Regulation U) is a "lender" subject to this Part.

1/ As defined in § 207.2(c).

2/ As defined in § 207.2(d).

(b) After October 20, 1967, no lender shall, (1) make or arrange for the making or maintenance of any purpose loan which is secured directly or indirectly,^{3/} in whole or in part, by any registered security (other than an exempted security^{4/}) without first having registered with the Board of Governors of the Federal Reserve System by filing Federal Reserve Form G-1 with the Federal Reserve Bank of the district in which the principal office of the lender is located, or (2) make any such loan in an amount exceeding the maximum loan value of the collateral, as prescribed from time to time for registered equity securities in § 207.5 (the Supplement to Regulation G), and as determined by the lender in good faith for any collateral other than registered equity securities: Provided, however, That in respect to a loan made after October 20, 1967, and before [effective date] such form shall be filed by, and any reduction in the loan or deposit of collateral required to meet this requirement shall be accomplished by [effective date].

(c) No lender shall make any purpose loan to any person who is a creditor subject to Part 220 of this chapter (Regulation T) except loans on exempted securities and loans to dealers (as defined in § 220.2(a) of Regulation T) to aid in the financing of the distribution of securities to customers not through the medium of a national securities exchange. Where the proceeds of a loan are to be used in the ordinary course of business of a creditor, the loan is presumed to be for the purpose of purchasing or carrying registered securities unless the lender has in his records a statement signed by the creditor which affirmatively describes a different purpose for the loan.

3/ As defined in § 207.2(i).

4/ As defined in § 207.2(e).

(d) For the purpose of this Part, the aggregate of all outstanding purpose loans to a borrower by a lender shall be considered a single loan; and all the collateral securing such a loan shall be considered in determining whether the loan complies with this Part.

(e) No lender shall make or maintain any purpose loan if the loan is secured directly or indirectly by any registered or exempted security which also serves to secure directly or indirectly any other loan to the borrower, and no lender shall make or maintain any purpose loan which is to be secured by both registered equity securities and any other collateral.

(f)(1) Except as permitted in the next subparagraph, while a lender maintains any purpose loan, whenever made, the lender shall not at any time permit any withdrawal or substitution of collateral unless either (i) the loan would not exceed the maximum loan value of the collateral after such withdrawal or substitution, or (ii) the loan is reduced by at least the amount by which the maximum loan value of any collateral deposited is less than the "retention requirement" of any collateral withdrawn. The retention requirement of collateral other than registered equity securities is the same as its maximum loan value and the retention requirement of collateral consisting of registered equity securities is prescribed from time to time in § 207.5 (the Supplement to Regulation G).

(2) A lender may permit a substitution of registered non-exempted securities effected by a purchase and sale on orders executed within the same day provided (i) if the proceeds of the sale exceed the total cost of the purchase, the loan is reduced by at least an amount equal to the retention requirement in respect to the sale less the retention requirement in respect to th.

purchase, or (ii) if the total cost of the purchase exceeds the proceeds of the sale, the loan may be increased by an amount no greater than the maximum loan value of the securities purchased less the maximum loan value of the securities sold. If the maximum loan value of the collateral securing the loan has become less than the amount of the loan, the amount of the loan may nonetheless be increased if there is provided additional collateral having maximum loan value at least equal to the amount of the increase.

(g) A loan which is secured in whole or in part by a registered security is presumed to be for the purpose of purchasing or carrying such security, unless the lender has in his records a statement signed by the borrower which affirmatively describes the purpose of the loan, and a statement signed by the lender that he has exercised reasonable diligence in acquainting himself with the circumstances surrounding the loan and has no information which would put a prudent man upon inquiry and if investigated with reasonable diligence would lead to the discovery of the falsity of the borrower's statement. Circumstances which would indicate that the lender has not exercised reasonable diligence in so acquainting himself and so investigating would include, but are not limited to, facts such as that (1) the proceeds of the loan were paid to a broker or to a bank against delivery of registered securities, (2) there were frequent substitutions of registered securities serving as collateral for the loan, or (3) the amount and terms of the loan were disproportionate to the stated purpose.

§ 207.2 Definitions.

For the purposes of this Part, unless the context otherwise requires:

(a) The term "person" means an individual, a corporation, a partnership, an association, a joint stock company, a trust, or an unincorporated organization.

(b) The term "in the ordinary course of his business" means occurring or reasonably expected to occur in the course of any activity of the lender for livelihood or profit or the management and preservation of property or in addition, in the case of a lender other than an individual, carrying out or in furtherance of a purpose for which the lender was formed.

(c)(1) Substance, rather than form, determines whether a loan is for the "purpose", whether immediate, incidental, or ultimate, of purchasing or carrying registered securities. If the loan is made for such purpose, it is a purpose loan despite any temporary application of the funds otherwise.

(2) A loan is for the purpose of "carrying" a security registered on a national securities exchange if the purpose of the loan is to enable the borrower to reduce or retire indebtedness which was originally incurred to purchase such a security.

(3) A loan is for the purpose of purchasing or carrying a registered security if the loan is for the purpose of purchasing or carrying a security issued by a unit investment trust or management company as defined in the Investment Company Act of 1940, whose assets customarily include registered securities.

(d) The term "registered security" means any security which (1) is registered on a national securities exchange; or (2) has unlisted trading privilege on a national securities exchange and is not suspended from trading thereon; or (3) is exempted by the Securities and Exchange Commission from

the operation of section 7(c)(2) of the Securities Exchange Act (15 U.S.C. 78g(c)(2)) only to the extent necessary to render lawful any direct or indirect extension or maintenance of credit on such security or any direct or indirect arrangement therefor which would have been lawful if such security had been a security (other than an exempted security) registered on a national securities exchange.

(e) The term "exempted security" includes securities which are direct obligations of or obligations guaranteed as to principal or interest by the United States; such securities issued or guaranteed by corporations in which the United States has a direct or indirect interest as shall be designated for exemption by the Secretary of the Treasury as necessary or appropriate in the public interest or for the protection of investors; securities which are direct obligations of or obligations guaranteed as to principal or interest by a State or any political subdivision thereof or any agency or instrumentality of a State or any political subdivision thereof or any municipal corporate instrumentality of one or more States; and such other securities (which may include, among others, unregistered securities, the market in which is predominantly intrastate) as the Securities and Exchange Commission may exempt pursuant to the Securities Exchange Act (15 U.S.C 78) as amended.

(f) The term "equity security" means any stock or similar security; or any security convertible, with or without consideration, into such a security; or carrying any warrant or right to subscribe to or purchase such a security; or any such warrant or right; or any other security which the Securities and Exchange Commission shall deem to be of similar nature and consider necessary or appropriate, by such rules and regulations as it may prescribe in the public interest or for the protection of investors, pursuant to section 3(a)(11) of the Securities Exchange Act (15 U.S.C. 78c(a)(11)) to treat as an equity security.

(g)(1) The term "purchase" includes any contract to buy, purchase, or otherwise acquire.

(2) The term "sale" includes any contract to sell or otherwise dispose of.

(h) The term "borrower" includes a borrower and any other person to whom a loan is made for the use of the borrower, and also includes any person engaged in a joint venture with the borrower with respect to a purpose loan.

(i) Any arrangement as to assets of the borrower which (1) serves to protect the interest of the lender in the loan, (2) serves to make assets of the borrower more readily available to the lender than to other creditors of the borrower, or (3) under which the borrower surrenders the right to dispose of assets so long as the loan remains outstanding, makes such assets indirect "collateral" for the loan.

§ 207.3 Reports and records.

(a) Every lender who (1) lends in any one calendar quarter a total

of twenty-five thousand dollars (\$25,000) or more against collateral which includes registered or exempted securities, or (2) had outstanding at any time during the calendar quarter fifty thousand dollars (\$50,000) or more in loans against collateral which included registered or exempted securities, shall within thirty (30) days following the end of such calendar quarter file a report on Federal Reserve Form G-2 with the Federal Reserve Bank of the district in which the principal office of the lender is located.

(b) Every lender shall maintain such records as shall be prescribed by the Board of Governors of the Federal Reserve System to enable it to perform the functions conferred upon it by the Securities Exchange Act.

§ 207.4 Miscellaneous provisions.

(a) In determining whether a security is a registered security or a security of the kind described in § 207.2(c)(3), a lender may rely upon the latest list of such securities issued by the Board of Governors of the Federal Reserve System. Copies may be obtained from the Board or from any Federal Reserve Bank.

(b) The renewal or extension of maturity of a loan need not be treated as the making of a loan if the amount of the loan is not increased except by the addition of interest or service charges on the loan or of taxes on transactions in connection with the loan.

(c) Nothing in this Part shall be construed to prohibit withdrawal or substitution of securities to enable a borrower to participate in a reorganization.

(d) Failure to comply with this Part due to a mistake made in good faith in determining, recording, or calculating any loan, balance, market

price or loan value, or other similar matter, shall not constitute a violation of this Part if promptly after discovery of the mistake the lender takes whatever action is practicable to remedy the non-compliance.

(e) No lender shall perform any services in respect to a loan which is secured directly or indirectly by any registered security unless such loan is made and maintained in conformity with the provisions of this Part.

(f) A lender may arrange for the extension or maintenance of credit by any person upon the same terms and conditions as those upon which the lender, under the provisions of this Part, may himself extend or maintain such credit, but only upon such terms and conditions, except that this limitation shall not apply with respect to the arranging by a lender for a bank subject to Part 221 of this chapter (Regulation U) to extend or maintain credit on registered securities or exempted securities.

§ 207.5 Supplement.

(a) Maximum loan value of registered equity securities. For the purpose of § 207.1, the maximum loan value of any registered equity security shall be 30 per cent. of its current market value, as determined by any reasonable method.

(b) Retention requirement. For the purpose of § 207.1, in the case of a loan which would exceed the maximum loan value of the collateral following a withdrawal of collateral, the "retention requirement" of a registered equity security shall be 70 per cent of its current market value, as determined by any reasonable method.

* * * * *

The purpose of the proposed regulation is to bring lenders other than banks, brokers, or dealers within the coverage of the Board's rules governing margin requirements on securities transactions. Available indications suggest that excessive credit may flow into the securities markets from such lenders.

The proposed regulation is designed to apply to any loan by any "person" that is made in the ordinary course of such person's business (1) if the collateral for the loan includes any registered security and (2) if the purpose of the loan is to purchase or carry any registered security (referred to as a "purpose loan"). The regulation would presume that a loan secured by registered securities was made for the purpose of purchasing or carrying those securities, unless the lender could demonstrate the contrary.

The term "person" would be defined to include, for example, partnerships, tax-exempt organizations, and corporations, and a loan would be considered to be made in the ordinary course of a person's business if it was an event occurring or reasonably expected to occur in the course of any profit-making activity, or the management and preservation of property, or in the case of a lender other than an individual, carrying out an objective for which the lender was formed. A loan by a corporation out of working capital, for example, or made to a key executive to enable him to exercise a stock option, would be subject to the regulation if collateral for the loan included any registered security.

Because of the lack of comprehensive information about lenders who would be subject to the proposed regulation, no lender would be permitted, at least until appropriate information and enforcement techniques had been

developed, to make both "purpose" and "non-purpose" loans, or purpose loans secured by both equity and non-equity securities, to the same borrower. However, lenders could make non-purpose loans, or loans whose collateral did not include any equity securities (a term which, as explained above, would include any security convertible into an equity security), without regard to initial margin requirements.

In addition, lenders would be forbidden to make loans to brokers or dealers except for loans on exempted securities and loans to dealers to aid in the financing of distributions off the exchange. Instances of loans by non-bank sources, made on an unsecured basis to creditors subject to Regulation T, have been reported in the press. The Board considers that such loans constitute a potential source of excessive credit in that they are inherently unstable, and if called in large numbers at or about the same time, might contribute to a market decline.

Except as stated above, same-day substitutions of equity collateral, or of non-security collateral, securing a regulated loan by a Regulation G lender, would be permitted to the same extent as under Regulation U. Regulation G would also contain retention and withdrawal restrictions on undermargined accounts comparable to those in T and U.

Under Regulation G, any lender who after today makes any loan that would be subject to the regulation would, if the regulation is adopted, have to file a registration statement with the Federal Reserve Bank in whose district the lender's head office is located. This statement would have to be filed by the effective date of the regulation, thirty days after adoption.

A form for the registration statement would be promulgated at the time of adoption. Lenders would also be required to file periodic reports and keep their records in such a way that examiners could verify the accuracy of the registration statement and the periodic reports.

In general, Regulation G would place lenders who were subject to it on an equal footing with other regulated lenders as to such matters as renewals and extensions of loans, permitting withdrawals or substitutions of collateral to enable borrowers to participate in reorganizations, and the correction of certain bookkeeping errors. However, the regulation would not permit the transfer of regulated loans between one lender and another, or one borrower and another, nor would it provide special terms for subscription loans. It is believed that most lenders would have little occasion to make use of such provisions, and that the record-keeping and reporting problems of lenders would be unduly complicated if such provisions were included in the regulation.

Foreign lenders making loans that are used to purchase or carry securities in this country would be subject to Regulation G. In most such cases, as well as in many instances involving domestic lenders subject to the regulation, a reliable agency in this country, usually but not always a bank, must be employed to hold the collateral for the loan, effect substitutions, collect interest, and otherwise represent the interest of the lender. Accordingly, a lender would be prohibited from performing any services in respect to a loan that was secured directly or indirectly by any registered security unless the loan was made and maintained in conformity

with the requirements of the regulation. (A corresponding provision is proposed for insertion into Regulation U; Regulation T already forbids brokers or dealers to perform such services.)

This notice is published pursuant to section 553(b) of Title 5, United States Code, and § 262.2(a) of the rules of procedure of the Board of Governors of the Federal Reserve System (12 CFR 262.2(a)).

To aid in the consideration of this matter by the Board, interested persons are invited to submit, in writing, relevant data, views, or arguments. Such material should be sent to the Secretary, Board of Governors of the Federal Reserve System, Washington, D. C. 20551, to be received not later than November 20, 1967. Under the Board's rules regarding availability of information (12 CFR 261), such materials will be made available for inspection and copying to any person upon request unless the person submitting the material requests that it be considered confidential.

Dated at Washington, D. C., this 20th day of October, 1967.

By order of the Board of Governors.

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.