

FEDERAL RESERVE BANK OF DALLAS

DALLAS, TEXAS 75222

Circular No. 69-34  
February 13, 1969

PROPOSED AMENDMENTS TO REGULATIONS G, T, AND U

To All Banks  
in the Eleventh Federal Reserve District:

There is attached for your information a copy of a press statement issued by the Board of Governors of the Federal Reserve System relating to proposed amendments to Regulations G, T, and U to implement the recently enacted "Over-The-Counter Margin Act".

Also attached are copies of the Notice of Proposed Rule Making and the proposed amended Regulation U in the form in which they are being submitted for publication in the Federal Register.

Written comments on the proposed amendments may be forwarded to this Bank, and should be received not later than March 17, 1969.

Yours very truly,

P. E. Coldwell

President

Enclosures (3)



# FEDERAL RESERVE

press release

For release in morning papers  
Tuesday, February 11, 1969.

February 10, 1969.

The Board of Governors of the Federal Reserve System announced today proposals to amend margin Regulations G, T, and U to implement the recent amendment to the Securities Exchange Act of 1934. Signed into law on July 29, 1968, the so called "Over-The-Counter Margin Act" (P.L. 90-437) broadens the Board's authority over stock market credit to cover certain securities that are not registered on a national securities exchange, and leaves to the Board the timing and selection of criteria for the application of margin requirements to such "over-the-counter" (OTC) stocks.

Regulation G applies to "Credit By Persons Other Than Banks, Brokers, or Dealers for Purpose of Purchasing or Carrying Registered Equity Securities," Regulation T concerns "Credit By Brokers, Dealers, and Members of National Securities Exchanges," while Regulation U covers "Credit By Banks for the Purpose of Purchasing or Carrying Registered Stocks."

The proposals, on which the Board has invited comment through the Federal Reserve Banks from interested persons by March 17, 1969, are principally designed to include in the regulations the criteria under which the Board would select the OTC stocks which would be subject to the margin and other requirements of the regulations.

Initially, "OTC margin stock" would be stock, not traded on a national securities exchange, which the Board determines to have the degree of national investor interest, the depth and breadth of market, the availability of information respecting such stocks and their issuers, and the character

and permanence of the issuers, to warrant treatment similar to stocks that are registered on such exchanges. The Board would publish a list of "OTC margin stocks" at the time the regulations became effective.

In a related change, bank loans to broker/dealers against inventory positions in OTC margin stocks used to make a bona fide market would be exempt from margin regulation in much the same way as are loans to specialists making a market in stocks registered on exchanges. The criteria used to determine which broker/dealers are entitled to the exemption are designed to ensure, so far as possible, that an "OTC Market Maker" does in fact make a market in the stock, stands ready at all times (within reason) to buy or sell the stock, and does not unjustifiably "back away" from the market. Any registered broker/dealer would be eligible for designation as an "OTC Market Maker" if he meets the standards set forth in Regulation U, files with the Securities and Exchange Commission a notice of his intent to begin or continue such market-making activity and continues to file such other reports as are required pursuant to a rule to be adopted by the Commission respecting market makers in OTC margin stocks.

In another change, the definition of "creditor" in Regulation T would be broadened to cover all brokers and dealers. This would bring under provisions of the new margin requirements brokers and dealers who now handle OTC accounts exclusively. In addition, exempt credit through a special omnibus account would be available only to brokers and dealers actually subject to the regulation.

At present, Regulation T applies to brokers and dealers who are members of an exchange or who transact business through a member firm. Credit which is exempt from margin requirements can be extended by broker-dealers

through a special omnibus account to persons, including foreign firms, who certify that they observe the regulation even though they are not subject to it.

The proposed change is not designed to make foreign banks or broker-dealers subject to U. S. supervision, but only to limit the use of the special omnibus account privilege to institutions that certify that they are actually subject to Regulation T. The privilege would no longer be available to organizations--including foreign financial institutions and others--that prefer not to make such a certification.

A special omnibus account is an account in which a member of an exchange may make wholesale transactions for other brokers without regard to margin requirements. These transactions involve customers' securities on which margin requirements have already been imposed at the retail level. The Department of Justice and the SEC recently presented to The House Banking and Currency Committee evidence of abuses whereby special omnibus accounts have been used by some foreign financial institutions to avoid U. S. margin requirements.

If the proposal is adopted, most firms borrowing in special omnibus accounts would not be affected. However, in the case of omnibus account credit extended to brokers or dealers who did not certify that they were subject to Regulation T, no further substitutions of collateral would be permitted after ninety days from the adoption of the amended regulation. Credit extended in such accounts would have to be brought into conformity with ordinary margin requirements within a year.

At the same time, the Board incorporated into the current proposal the broadened coverage of margin Regulations G and U that it originally proposed last December. This applied to loans on mutual fund shares and would

bring "equity funding" plans or programs under both regulations. Under the current proposal, all brokers or dealers, including those selling equity funding plans or programs, would be subject to Regulation T. Regulation T prohibits loans on mutual fund shares. The Board, at the request of some firms engaged in extending credit on such plans or programs, plans shortly to schedule an oral presentation on this aspect of its proposals.

A number of other conforming changes of a technical nature are also made throughout the regulation as necessary or appropriate.

In a change unrelated to the implementation of P.L. 90-437, the provision in Regulation G regarding stock options and employee stock purchase plans would be amended to make clear that an increase in the current market value of the collateral may be taken into consideration in determining whether its maximum loan value is equal to the outstanding credit owing pursuant to that provision's withdrawal requirements. In other unrelated changes, the time for retaining Federal Reserve Forms G-3 and U-1 (the "purpose statements" required by Regulations G and U) would be reduced from six to three years to ease the burden of record retention, and statements obtained by brokers and dealers in connection with "non-purpose" extensions of credit collateralized by regulated securities would be obtained on a new Federal Reserve Form T-4.

Attached are copies of the proposed amended regulations which, with the exception of the indications of textual changes, are in the form in which they will be submitted for publication to the Federal Register.

FEDERAL RESERVE SYSTEM

[12 CFR Part 221]

[Reg. U]

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

Notice of Proposed Rule Making

Pursuant to the authority contained in the Securities Exchange Act of 1934 (15 U.S.C. 78g), as amended by Act of July 29, 1968 (P.L. 90-437; 82 Stat. 452), the Board of Governors of the Federal Reserve System is considering amending Part 221 (Regulation U) as set forth below <sup>1/</sup> in order to regulate the amount of credit that may be extended with respect to certain stock that is not registered on a national securities exchange.

P.L. 90-437 broadens the Board's authority over stock market credit to cover "over-the-counter" (OTC) stocks. The legislation leaves to the Board the timing and selection of criteria for the implementation of OTC margin requirements.

The proposed amendments to Regulation U are principally designed to include in the regulation the criteria under which the Board will select the OTC stocks which would be subject to the margin and other requirements of the regulation. Initially, such "OTC margin stock" would be stock, not traded on a national securities exchange, which the Board has determined to have the degree of national investor interest, the depth and breadth of market, the availability of information

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<sup>1/</sup> Copies of the proposed amended regulation, indicating textual changes, are available at the offices of the Board of Governors of the Federal Reserve System, Washington, D. C. 20551.

respecting such stocks and their issuers, and the character and permanence of the issuers, to warrant treatment similar to stocks that are registered on such exchanges.

In a related change, bank loans to broker/dealers against inventory positions in OTC margin stocks used to make a bona fide market would be exempt from margin regulation.

It has been urged that the functioning of the OTC stock markets depends on individual broker/dealers who make a market in selected stocks. The market makers argue that, in order to make effective markets, they must be able to obtain credit on a liberal basis. The positions carried by broker/dealers are largely financed by bank loans. Accordingly, an exemption would be created for bank credit to finance such activities.

The criteria used to determine which broker/dealers are entitled to the exemption are designed to ensure, so far as possible, that an "OTC Market Maker" does in fact make a market in the stock, stands ready at all times (within reason) to buy or sell the stock, and does not unjustifiably "back away" from the market. Any broker/dealer, registered pursuant to section 15 of the Securities Exchange Act of 1934 (15 U.S.C. 78o) would be eligible if he met the standards set forth in the regulation (including maintaining certain minimum net capital), had filed with the Securities and Exchange Commission a notice of his intent to begin or continue such market making activity, and continued to file such other reports as were required pursuant to a rule respecting market makers in OTC margin stocks that the Commission would adopt. The bank would have to obtain a statement on a new form designated F. R. Form U-2, from the market maker that he is properly registered and will use the credit for such activities.

The proposal would also introduce to the regulation the term "regulated stock", which would encompass registered stock, OTC margin stock, shares of most investment companies registered pursuant to section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8), "equity funding" plans or programs, and debt securities convertible into or carrying warrants or rights to subscribe to or purchase a regulated stock. With the exception of OTC margin stock and equity funding plans or programs, virtually all credit for the purpose of purchasing such securities was previously subject to the requirements of this Part. A proposal to make credit extended in connection with equity funding plans or programs subject to this Part was published for comment in the Federal Register on December 17, 1968 (33 F.R. 18630). Accordingly, the term "regulated stock" would be substituted where appropriate for the term "registered stock" throughout this Part, with corresponding conforming changes.

The exception to the regulation in § 221.2(e) for credit on customers' securities would be limited to brokers or dealers who certify that they are subject to Part 220 of this Chapter (Regulation T) to reflect a proposed change in the coverage of that Part. Most firms borrowing under § 221.2(e) would not be affected. However, in the case of credit extended under this section to persons or firms who are not prepared to certify that they are actually subject to Part 220, (Regulation T), no substitutions of collateral would be permitted after 90 days from the adoption of this proposal; and such credit would be required to be extinguished within one year after that date, if the proposals are adopted.

The proposal would amend the regulation to conform with the above by including "equity funding" plans or programs within the definition of "stock", and also clarify that for the purpose of this Part it is



immaterial whether a debt security is convertible, with or without consideration, presently or in the future, into a regulated stock, clarify that credit is indirectly secured if there is any arrangement that may accelerate the maturity of the credit, and, in order to ease record retention burdens, reduce the time for retaining Federal Reserve Form U-1 (the "purpose statement" required pursuant to § 221.3(a)) from six to three years. The exception to the regulation in § 221.2(e) for credit on customers' securities would be limited to brokers or dealers who are subject to Part 220 of this Chapter (Regulation T) to reflect a proposed change in the coverage of that Part.

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 submitted to any Federal Reserve Bank, to be received not later than March 17, 1969. 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 10th day of February, 1969.

By order of the Board of Governors.

(Signed) Robert P. Forrestal

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Robert P. Forrestal,  
Assistant Secretary.

CREDIT BY BANKS FOR THE  
PURPOSE OF PURCHASING OR CARRYING  
~~REGISTERED~~ REGULATED STOCKS

REGULATIONS

Sec.

- 221.1 General rule.
- 221.2 Exceptions to general rule.
- 221.3 Miscellaneous provisions.
- 221.4 Supplement.

Authority: The provisions of this Part 221 issued under section 7 of the Securities Exchange Act of 1934 (15 U.S.C. 78g) as amended by P.L. 90-437 (82 Stat. 452).

§ 221.1 General rule.

(a) Purpose credit secured by stock. - No bank shall extend any credit secured directly or indirectly<sup>1/</sup> by any stock<sup>2/</sup> for the purpose of purchasing or carrying any ~~registered~~ regulated stock<sup>3/</sup> (and no bank shall extend any credit described in § 221.3(q) regardless of whether or not such credit 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 credit subject to § 221.3(s) for any collateral other than stocks: Provided, That unless held as collateral for such credit on October 20, 1967, and continuously thereafter, any collateral other than stock shall have loan value for the purpose of this Part only as collateral for a credit which is not secured by stock, as described in § 221.3(s), and any collateral consisting of convertible debt securities described in § 221.3(t) shall have loan value only for the purpose of that section, and not for other credit subject to this Part.

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<sup>1/</sup> As defined in § 221.3(c).

<sup>2/</sup> As defined in § 221.3(1).

<sup>3/</sup> Sometimes referred to as a "purpose credit". See § 221.3(b), and § 221.3(m)(d).

(b) Substitutions and withdrawals. - Except as permitted in paragraph (c), of this section, while a bank maintains any credit subject to this Part, whenever extended, the bank shall not at any time permit any withdrawal or substitution of collateral unless either (1) the credit would not exceed the maximum loan value of the collateral after such withdrawal or substitution, or (2) the credit 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) Same-day transactions. - Except as provided in § 221.3(r)(1), a bank may permit a substitution of stock whether ~~registered~~ regulated or ~~unregistered~~ unregulated, effected by a purchase and sale on orders executed within the same day: Provided, That (1) if the proceeds of the sale exceed the total cost of the purchase, the credit 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 (2) if the total cost of the purchase exceeds the proceeds of the sale, the credit 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 credit has become less than the amount of the credit, the amount of the credit may nonetheless be increased if there is provided additional collateral having maximum loan value at least equal to the amount of the increase.

(d) Single credit rule. - For the purpose of this Part, except for credit subject to § 221.3(s) or (t), the entire amount of the credit extended to any customer by any bank at any time for the purpose of purchasing or carrying ~~stocks-registered-on-a-national-securities-exchange~~ any regulated stock shall be considered a single credit; and all the collateral securing such indebtedness shall be considered in determining whether or not the loan complies with this Part.

§ 221.2 Exceptions to general rule.

Notwithstanding the provisions of § 221.1, a bank may extend and may maintain any credit for the purpose specified in § 221.1, without regard to the limitations prescribed therein, or in § 221.3(t), if the credit comes within any of the following descriptions.

(a) Any credit extended to a bank or to a foreign banking institution;

(b) Any credit extended to a "plan-lender" as defined in § 207.4(a) of Part 207 of this Chapter (Regulation G) to finance a plan described therein: Provided, That in no event does the bank have recourse to any stock purchased pursuant to such plan;

(c) Any credit extended to a dealer, or to two or more dealers, to aid in the financing of the distribution of securities to customers not through the medium of a national securities exchange;

(d) Any credit extended to a broker or dealer that is extended in exceptional circumstances in good faith to meet his emergency needs;

(e) Any credit extended to a broker or dealer secured by any securities which, according to written notice received by the bank from

the broker or dealer pursuant to a rule of the Securities and Exchange Commission concerning the hypothecation of customers' securities (Rule 8c-1 (17 CFR § 240.8c-1) or Rule 15c2-1 (17 CFR § 240.15c2-1)), are securities carried for the account of one or more customers: Provided, That the bank accepts in good faith<sup>4/</sup> from the broker or dealer a signed statement to the effect that he is subject to the provisions of Part 220 of this Chapter (Regulation T) ~~(or that he does not extend or maintain credit to or for customers except in accordance therewith as if he were subject thereto)~~;

(f) Any credit extended to finance the purchase or sale of securities for prompt delivery which is to be repaid in the ordinary course of business upon completion of the transaction: Provided, That the advance is not made to a person described in § 221.3(q): And provided further, That it is either (1) extended to a broker or dealer, or (2) extended for a purpose other than to enable the borrower to pay for stock purchased in an account subject to Part 220 of this Chapter (Regulation T);

(g) Any credit extended against securities in transit, or surrendered for transfer, which is payable in the ordinary course of business upon arrival of the securities or upon completion of the transfer: Provided, That the credit is not extended to a person described in § 221.3(q): And provided further, That it is either (1) extended to a broker or dealer, or (2) extended for a purpose other than to enable the customer to pay for stock purchased in an account subject to Part 220 of this Chapter (Regulation T);

(h) Any credit which is to be repaid on the calendar day on which it is extended: Provided, That the credit is not extended to a person

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<sup>4/</sup> As described in § 221.3(a).

described in § 221.3(q): And provided further, That it is either (1) extended to a broker or dealer, or (2) extended for a purpose other than to enable the customer to pay for stock purchased in an account subject to Part 220 of this Chapter (Regulation T);

(i) Any credit extended outside the States of the United States and the District of Columbia;

(j) Any credit extended to a member of a national securities exchange for the purpose of financing his or his customers' bona fide arbitrage transactions in securities. For the purposes of this paragraph, the term "arbitrage" means (1) a purchase or sale of a security in one market together with an offsetting sale or purchase of the same security in a different market at as nearly the same time as practicable, for the purpose of taking advantage of a difference in prices in the two markets, or (2) a purchase of a security which is, without restriction other than the payment of money, exchangeable or convertible within 90 calendar days following the date of its purchase into a second security together with an offsetting sale at or about the same time of such second security, for the purpose of taking advantage of a disparity in the prices of the two securities; and

(k) Any credit extended to a member of a national securities exchange for the purpose of financing such members' transactions as an odd-lot dealer in securities with respect to which he is registered on such national securities exchanges as an odd-lot dealer.

§ 221.3 Miscellaneous provisions.

(a) Required statement as to stock-secured loan. - In connection with an extension of credit secured directly or indirectly by any stock,

the bank shall obtain and retain in its records for at least ~~six~~ three years after such credit is extinguished a statement in conformity with the requirements of Federal Reserve Form U-1 executed by the recipient of such extension of credit (sometimes referred to as the "customer") and executed and accepted in good faith by a duly authorized officer of the bank prior to such extension: Provided, That this requirement shall not apply to any credit described in paragraph (o) of this section or § 221.2 of this Part except for credit described in paragraphs 221.2(f), (g) and (h) extended to persons who are not brokers or dealers subject to Part 220 of this Chapter (Regulation T). In determining whether or not an extension of credit is for the purpose specified in § 221.1 or for any of the purposes specified in § 221.2 the bank may rely on the statement executed by the customer if accepted in good faith. To accept the customer's statement in good faith, the officer must (1) be alert to the circumstances surrounding the credit and (2) if he has any information which would cause a prudent man not to accept the statement without inquiry, have investigated and be satisfied that the customer's statement is truthful.

(b) Purpose of a credit. - The "purpose of a credit" is determined by substance rather than form.

(1) Credit which is for the purpose, whether immediate, incidental, or ultimate, of purchasing or carrying a regulated stock is "purpose credit", despite any temporary application of funds otherwise.

(2) Credit to enable the customer to reduce or retire indebtedness which was originally incurred to purchase a regulated stock is for the purpose of "carrying" such a security.

~~(3) Credit-for-the-purpose-of-purchasing-or-carrying-a-security issued-by-an-investment-company-registered-pursuant-to-section-3-of-the~~

~~Investment Company Act of 1940 (15 U.S.C. 80a-8), whose assets customarily include registered stocks, is for the purpose of purchasing or carrying such stocks.~~

(c) Indirectly secured. - The term "indirectly secured" includes any arrangement with the customer under which the customer's right or ability to sell, pledge, or otherwise dispose of stock owned by the customer is in any way restricted so long as the credit remains outstanding, or under which the exercise of such right, whether by written agreement or otherwise, is or may be cause for acceleration of the maturity of the credit: Provided, That the foregoing shall not apply (1) if such restriction arises solely by virtue of an arrangement with the customer which pertains generally to the customer's assets unless a substantial part of such assets consists of stock, or (2) if the bank in good faith has not relied upon such stock as collateral in the extension or maintenance of the particular credit: And provided further, That the foregoing shall not apply to stock held by the bank only in the capacity of custodian, depository, or trustee, or under similar circumstances, if the bank in good faith has not relied upon such stock as collateral in the extension or maintenance of the particular credit.

~~(d)--List of registered stocks.--In determining whether a security is a "stock registered on a national securities exchange" or a security described in paragraph (b) (3) 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, warrant, or right is convertible or exchangeable is a stock registered on a national securities exchange.~~



(d) OTC margin stock. - (1) The term "OTC margin stock" means stock, not traded on a national securities exchange, which the Board of Governors of the Federal Reserve System has determined to have the degree of national investor interest, the depth and breadth of market, the availability of information respecting the stock and its issuer, and the character and permanence of the issuer to warrant such treatment.

(2) The Board will from time to time publish a list of OTC margin stocks as to which the Board has made the determinations described in subparagraph (1) of this paragraph (d). Except as provided in subparagraph (4) of this paragraph (d) such stocks shall meet the requirements that:

(i) The stock is subject to registration under § 12(g)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 781(g)(1)), or if issued by an insurance company subject to § 12(g)(2)(G) (15 U.S.C. 781(g)(2)(G)) the issuer had at least \$1 million of capital and surplus,

(ii) Five or more dealers, stand willing to, and do in fact, make a market in such stock including making regularly published bona fide bids and offers for such stock for their own accounts, or the stock is registered on a securities exchange that is exempted by the Securities and Exchange Commission from registration as a national securities exchange pursuant to section 5 of the Act (15 U.S.C. 78e),

(iii) There are 1500 or more holders of record of the stock who are not officers, directors, or beneficial owners of 10 per cent or more of the stock,

(iv) The issuer, or a predecessor in interest, has been in existence for at least three years,

(v) The stock has been publicly traded for at least six months, and

(vi) Daily quotations for both bid and asked prices for the stock are continuously available to the general public,

and shall meet three of the four additional requirements that:

(vii) There are 500,000 or more shares of such stock outstanding in addition to shares held beneficially by officers, directors, or beneficial owners of more than 10 per cent of the stock,

(viii) The shares described in subdivision (vii) of this subparagraph have a market value in the aggregate of at least \$10 million,

(ix) The minimum average bid price of such stock as determined by the Board in the latest month, is at least \$10 per share, and

(x) The issuer had at least \$5 million of capital, surplus, and undivided profits.

(3) The Board shall from time to time remove from the list described in subparagraph (2) of this paragraph (d) stocks that cease to:

(i) Exist or for which the issuer ceases to exist, or

(ii) Meet substantially, the provisions of subparagraphs (1) and (2) of this paragraph (d).

(4) The foregoing notwithstanding, the Board may, upon its own initiative, or upon application by any interested party, omit or remove any stock that is not traded on a national securities exchange from or add any such stock to such list of OTC margin stocks, if in the judgment of the Board, such action is necessary or appropriate in the public interest.

(5) It shall be unlawful for any bank to make, or cause to be made, any representation to the effect that the inclusion of a security on such list of OTC margin stocks is evidence that the Board or the Securities and Exchange Commission has in any way passed upon the merits of, or given approval to:

such security or any transaction therein. Any statement, advertisement, or other similar communication containing a reference to the Board in connection with such stocks or such list shall constitute such an unlawful representation.

(e) Renewals and extensions of maturity. - The renewal or extension of maturity of a credit need not be treated as the extension of a credit if the amount of the credit is not increased except by the addition of interest or service charges in respect to the credit or of taxes on transactions in connection with the credit.

(f) Transfers. - A bank may, without following the requirements of this Part as to the extension of a credit, ~~may~~

(1) Permit the transfer of a credit from one customer to another, or to others: Provided, That a statement by the transferor, describing the circumstances giving rise to the transfer, is accepted in good faith<sup>5/</sup> and signed by an officer of the bank as having been so accepted, and kept with each such transferee account, or

(2) Accept the transfer of a credit originally extended in conformity with the requirements of this Part directly from another bank: Provided, That the statement of purpose, executed by the customer in connection with the original extension of credit and accepted in good faith and signed by an officer of the bank originally extending such credit in conformity with the requirements of § 221.3(a), is obtained and kept with each such transferee account, And provided further, That any transfer pursuant to this paragraph is made as a bona fide incident to a transaction not undertaken for the purpose of avoiding the requirements of this Part, the amount of the credit

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<sup>5/</sup> As described in § 221.3(a).

is not increased and the collateral for the credit is not changed; and, after such transfer, a bank may permit such withdrawals and substitutions of collateral as are permitted in respect to a credit it extends subject to this Part.

(g) Reorganizations and recapitalizations. - Nothing in this Part shall be construed to prevent a bank from permitting withdrawals or substitutions of securities to enable a customer to participate in a reorganization or recapitalization.

(h) Mistakes in good faith. - No mistake made in good faith in connection with the extension or maintenance of a credit shall be deemed to be a violation of this Part.

(i) Action for bank's own protection. - Nothing in this Part shall be construed as preventing a bank from taking such action as it shall deem necessary in good faith for its own protection.

(j) Reports. - Every bank, and every person engaged in the business of extending credit who, in the ordinary course of business, extends credit for the purpose of purchasing or carrying securities registered on a national securities exchange or OTC margin stocks, shall make such reports as the Board of Governors of the Federal Reserve System may require to enable it to perform the functions conferred upon it by the Securities Exchange Act of 1934 (15 U.S.C. 78).

(k) Definitions. - Except as otherwise provided in this Part, terms herein have the meanings assigned to them in section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)), except that the term "bank" does not include a bank which is a member of a national securities exchange.

(1) Stock. - 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, with or without consideration, presently or in the future, into such security, certificate or other instrument, or carrying any warrant or right to subscribe to or purchase such a security; or any such warrant or right; or any plan, program, or investment contract offered or sold after April 30, 1969, which provides for the acquisition both of any regulated stock<sup>6/</sup> and of goods, services, other securities, or investments.

(m) Credit subject to § 221.1. - A "credit subject to § 221.1" is a credit which is (1) secured directly or indirectly by any stock (or made to a person described in paragraph (q) of this section), (2) extended for the purpose of purchasing or carrying any regulated stock registered on a national securities exchange; or any security convertible<sup>6/</sup> with or without consideration into such a stock or carrying any warrant or right to subscribe to or purchase or carry such a stock; or any such warrant or right (such security, warrant or right is sometimes referred to as a "security convertible into a stock registered on a national securities exchange"), and (3) not excepted by § 221.2.

(n) Segregation of collateral. - (1) The bank shall identify all the collateral used to meet the requirements of § 221.1 (the entire credit being considered a single credit and collateral being similarly considered, as required by § 221.1(d)) and shall not cancel the identification of any portion thereof except in circumstances that would permit the withdrawal of

<sup>6/</sup> See also § 221.3(r) and (t). As defined in § 221.3(v).

that portion. Such identification may be made by any reasonable method, and in the case of a credit outstanding at the opening of business on June 15, 1959, need not be made until immediately before some change in that or other indebtedness of the customer or in collateral therefore.

(2) Only the collateral required to be so identified shall have loan value for purposes of § 221.1 or be subject to the restrictions therein specified with respect to withdrawals and substitutions; and

(3) For any credit extended to the same customer that is not subject to § 221.1 (other than a credit described in § 221.2(b), (d), (f), (g), or (h)), the bank shall in good faith require as much collateral not so identified as the bank would require (if any) if it held neither the indebtedness subject to § 221.1 nor the identified collateral. This shall not be construed, however, to require the bank, after it has extended any credit, to obtain any collateral therefor because of any deficiency in collateral already existing at the opening of business on June 15, 1959, or any decline in the value or quality of the collateral or in the credit rating of the customer.

(4) Nothing in this Part shall require a bank to waive or forego any lien, and nothing in this Part shall apply to a credit extended to enable the customer to meet emergency expenses not reasonably foreseeable, provided the extension of credit is supported by a statement executed by the customer and accepted in good faith and signed by an officer of the bank as having been so accepted in conformity with the requirements of § 221.3(a). For this purpose, such emergency expenses shall include expenses arising from circumstances such as the death or disability of the customer, or some other

change in his circumstances involving extreme hardship, not reasonably foreseeable at the time the credit was extended. The opportunity to realize monetary gain is not a "change in his circumstances" for this purpose.

(o) Specialist. - In the case of a credit extended to a member of a national securities exchange who is registered and acts as a specialist in securities on the exchange for the purpose of financing such member's transactions as a specialist in such securities, the maximum loan value of any stock shall be as determined by the bank in good faith: Provided, That the specialist's exchange, in addition to other requirements applicable to specialists, is designated by the Board of Governors of the Federal Reserve System as requiring reports suitable for supplying current information regarding specialists' use of credit pursuant to this section.

(p) Subscriptions issued to stockholders. - An extension of credit need not comply with the other requirements of this Part if it is to enable the customer 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 credit when extended 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 credit is extended pursuant to this paragraph, the bank shall compute the amount by which the credit exceeds the maximum loan value of the collateral as prescribed by § 221.4 and the customer shall reduce the credit by an amount at least equal to

one-fourth of such sum by the end of each of the four succeeding three-calendar month periods or until the credit does not exceed the current maximum loan value of the stock, whichever shall occur first, and if the bank fails to obtain the required quarterly reduction or a portion thereof with respect to a particular acquisition within five full business days after such reduction is due, the bank shall promptly sell a portion of the collateral so acquired and apply the proceeds of the sale to reduce the credit, in an amount at least equal to twice the required payment or portion thereof for the first two such reductions, at least equal to the required payment or portion thereof for the third such reduction, and at least sufficient so that the remaining credit does not exceed the current maximum loan value of the remaining collateral after the fourth such reduction: Provided, That no such reduction need be in an amount greater than is necessary so that the remaining credit does not exceed the maximum loan value of the remaining collateral determined as of the date when the credit was extended: And provided further, That as to credit extended between October 20, 1967, and March 11, 1968, such four succeeding periods shall begin on March 11, 1968, and

(3) While the customer has any credit outstanding at the bank under this paragraph no withdrawal of cash or substitution or withdrawal of stock used as collateral for such extension of credit shall be permissible, except that when the remaining credit has become equal to or less than the maximum loan value of the remaining stock as prescribed for § 221.1 or § 221.3(t) in § 221.4 (the Supplement to Regulation U) whichever is applicable (or with respect to credit extended after October 20, 1967, the



requirements of the preceding clause have been fulfilled) the remaining stock and related indebtedness shall thereafter be treated as subject to § 221.1 or § 221.3(t), whichever is applicable, 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 credit subject to § 221.1 without regard to any other requirement of this Part.

(q) Credit to certain lenders. - Any credit extended to a customer not subject to this Part or to Part 220 of this Chapter (Regulation T) engaged principally, or as one of the customer's important activities, in the business of extending credit for the purpose of purchasing or carrying regulated stocks ~~registered-on-a-national-securities-exchange~~; is a credit for the purpose of purchasing or carrying such stocks ~~so-registered~~ unless the credit and its purposes are effectively and unmistakably separated and disassociated from any financing or refinancing, for the customer or others, of any purchasing or carrying of stocks so registered. Any credit extended to any such customer, unless the credit is so separated and disassociated or is excepted by § 221.2, is a credit "subject to § 221.1" regardless of whether or not the credit is secured by any stock; and no bank shall extend any such credit subject to § 221.1 to any such customer on or after June 15, 1959, without collateral or without the credit being secured as would be required by this Part if it were secured by any stock. Any such credit subject to § 221.1 to any such customer, whether or not made after June 15, 1959, shall be subject to the other provisions of this Part applicable to credit subject to § 221.1, including provisions regarding withdrawal and substitution of collateral.

(r) Convertible securities. - (1) If, after June 15, 1959, and prior to October 21, 1967, credit was extended for the purpose of purchasing or carrying a security convertible into a stock registered on a national securities exchange and the credit was secured by such a security, and after October 20, 1967, there is substituted any stock as direct or indirect collateral for such credit, the credit shall thereupon be treated as subject to § 221.1 or § 221.3(t), whichever is applicable. In any such case, the amount of the outstanding credit, or such amount plus any increase therein to enable the customer to acquire a stock so registered through the conversion of the security pursuant to its terms, shall not be permitted on the date of such substitution to exceed the maximum loan value of the collateral for the credit: Provided, That any reduction in the credit or deposit of collateral required on that date to meet this requirement may be brought about within 30 days of such substitution, ~~or by April 10, 1968, whichever is later.~~

(2) Any credit extended after October 20, 1967, for the purpose of purchasing or carrying a security convertible into a stock registered on a national securities exchange, and any credit extended after [date OTC margin stock list is published] for the purpose of purchasing or carrying a security convertible into regulated stock, if the credit is secured, directly or indirectly, by any stock, is a credit subject to § 221.1 or § 221.3(t), whichever is applicable: ~~---Provided;--That--any--reduction--of--the--credit--or--deposit--of--collateral--necessary--to--meet--the--requirements--of--§--221.4--(the Supplement-to-Regulation-U);--in--respect--to--such--credit--extended--before March-11,-1968,-need-not-be-brought-about-before-April-10,-1968.~~

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

(t) Credit on convertible debt securities. - (1) A bank may extend credit for the purpose specified in § 221.1 on collateral consisting of any debt security convertible into a regulated stock registered-on-a-national securities-exchange or any debt security carrying a warrant or right to subscribe to or purchase such a stock ~~se-registered~~ (such a debt security is sometimes referred to herein as a "convertible security").

(2) Credit extended under this paragraph shall be subject to the same conditions as if it were subject to § 221.1 except: (i) the entire amount of such credit shall be considered a single credit treated separately from the single credit specified in § 221.1(d) and all the collateral securing such credit shall be considered in determining whether or not the credit complies with this Part, and (ii) the maximum loan value of the collateral shall be as prescribed from time to time in § 221.4 (the Supplement to Regulation U).

(3) Any convertible security originally eligible as collateral for a credit extended under this paragraph shall be treated as such as long as continuously held as collateral for such credit even though it ceases to be convertible or to carry warrants or rights.

(4) In the event that any stock other than a convertible security is substituted for a convertible security held as collateral for a credit

extended under this paragraph, the stock and any credit extended on it in compliance with this Part shall thereupon be treated as subject to § 221.1 and the credit extended under this paragraph shall be reduced by an amount equal to the maximum loan value of the security withdrawn.

(u) Arranging for credit. - No bank shall arrange for the extension or maintenance of any credit for the purpose of purchasing or carrying any regulated 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.

(v) The term "regulated stock" means any stock<sup>7/</sup> which is (1) a stock registered on a national securities exchange, (2) an OTC margin stock<sup>8/</sup>, (3) a debt security (i) convertible with or without consideration, presently or in the future, into a regulated stock or (ii) carrying any warrant or right to subscribe to or purchase, presently or in the future, a regulated stock, (4) any such warrant or right, (5) a security issued by an investment company registered pursuant to § 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8), unless at least 95 per cent of the assets of such company are continuously invested in exempted securities<sup>9/</sup>, and (6) a plan, program, or investment contract offered or sold after April 30, 1969, which provides for the acquisition both of any security described in this paragraph (v) and of goods, services, other securities, or investments.

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7/ As defined in § 221.3(1).

8/ As defined in § 221.3(d).

9/ As defined in 15 U.S.C. 78c(a)(12).

(w) OTC Market Maker Exemption. - In the case of credit extended to an OTC Market Maker, as defined in subparagraph (2) of this paragraph (w), for the purpose of purchasing or carrying an OTC margin stock in order to conduct the market making activity of such a market maker, the maximum loan value of any OTC margin stock (except stock that has been identified as a security held for investment pursuant to a rule of the Commissioner of Internal Revenue (Regs. Section 1-1236-1(d)) shall be determined by the bank in good faith: Provided, That in respect of each such stock he shall have filed with the Securities and Exchange Commission a notice of his intent to begin or continue such market making activity (Securities and Exchange Commission Form X-17A-12(1)) and all other reports required to be filed by market makers in OTC margin stocks pursuant to a rule of the Securities and Exchange Commission (Rule 17a-12 (17CFR240.17a-12)) and shall not have ceased to engage in such market making activity: And provided further, That the bank shall obtain and retain in its records for at least three years after such credit is extinguished a statement in conformity with the requirements of Federal Reserve Form U-2, executed by the OTC Market-Maker who is the recipient of such credit and executed and accepted in good faith<sup>10/</sup> by a duly authorized officer of the bank prior to such extension.

(2) An OTC Market Maker with respect to an OTC margin stock is a dealer who has and maintains minimum net capital, as defined in a rule of the Securities and Exchange Commission (Rule 15c-3-1(17CFR240.15c3-1)) of \$25,000 plus \$5,000 for each such stock in excess of 5 in respect of

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10/ As described in § 221.3(a).

which he has filed and not withdrawn the notice on Securities and Exchange Commission Form X-17A-12(1), (except that he shall not be required to have net capital of more than \$250,000 to be an OTC market maker under the provisions of this subparagraph (2)), who is in compliance with such rule of the Commission, and who, except when such activity is unlawful, meets all of the following conditions with respect to such stock: (i) he regularly publishes bona fide, competitive bid and offer quotations, in a recognized inter-dealer quotation system, (ii) he furnishes bona fide, competitive bid and offer quotations to other broker/dealers on request, (iii) he is ready, willing, and able to effect transactions in reasonable amounts, and at his quoted prices, with other brokers and dealers, (iv) he has a reasonable average rate of inventory turnover.

§ 221.4 Supplement.

(a) Maximum loan value of stocks. - For the purpose of § 221.1, the maximum loan value of any stock, whether or not registered on a national securities exchange, shall be 20 per cent of its current market value, as determined by any reasonable method.

(b) Maximum loan value of convertible debt securities subject to § 221.3(t). - For the purpose of § 221.3(t), the maximum loan value of any security against which credit is extended pursuant to § 221.3(t) shall be 40 per cent of its current market value, as determined by any reasonable method.

(c) Retention requirement. - For the purpose of § 221.1, 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 stock, whether or not registered on a national securities exchange, and of a convertible debt security subject to § 221.3(t), shall be 70 per cent of its current market value, as determined by any reasonable method.