

FEDERAL RESERVE BANK OF DALLAS

DALLAS, TEXAS 75222

Circular No. 71-94

April 22, 1971

PROPOSED AMENDMENTS TO REGULATIONS G, T, AND U
(Provision of credit for broker-dealer capital)

AMENDMENT TO REGULATION U
(Interim exemption for broker-dealer credit by banks)

To All Banks, Broker/Dealers, Nonbank Lenders and
Others Concerned in the Eleventh Federal Reserve District:

Effective April 16, 1971, the Board of Governors of the Federal Reserve System announced proposed amendments to Regulations G, T, and U setting forth the conditions under which credit providing capital to broker-dealer firms may be obtained without regard to initial margin requirements.

The Board also amended section 221.2 of Regulation U by adding paragraph (m) to permit banks to extend credit to enable customers to contribute capital to broker-dealer firms without regard to initial margin requirements. Such credit extended after April 16, 1971, and prior to adoption of the proposals mentioned above would become subject upon renewal to any restrictions imposed by such amendments.

A copy of the amendment to Regulation U is enclosed. It should be filed in the Binder of Federal Reserve Regulations furnished to all member banks. A current version of the regulation consists of the pamphlet, revised effective July 8, 1969; the Supplement, effective May 6, 1970; amendments effective August 13, 1969, May 1, 1970, and March 30, 1971; and the enclosed amendment.

Copies of the proposed amendments to Regulations G, T, and U are also enclosed. Comments on the proposals should be submitted in order to reach the Board in Washington, D. C., by May 24, 1971.

Yours very truly,

P. E. Coldwell

President

Enclosures

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

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

AMENDMENT TO REGULATION U

Effective April 16, 1971, § 221.2 is amended by deleting "and" at the end of paragraphs (j) and (k), by deleting the period at the end of paragraph (l) and inserting in its place "; and", and by adding a new paragraph (m) as follows:

SECTION 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.

* * * * *

(m) Any credit extended to or maintained for a customer for the purpose of making a loan or contribution of capital to a broker or dealer subject to Part 220 (Regulation T) if the loan or contribution is in conformity with the requirements

regarding satisfactory subordination agreements or equities in the accounts of partners of a rule of the Securities and Exchange Commission (Rule 15c3-1(c)(2)(A), (c)(4), and (c)(7)) (17 CFR 240.15c3-1(c)(2)(A), (c)(4), and (c)(7)) or the capital rules of an exchange of which the broker or dealer is a member if the members thereof are exempt therefrom by Rule 15c3-1(b)(2) of the Commission (17 CFR 240.15c-1(b)(2)) or to purchase stock in a creditor which is a corporation: *Provided*, That any such credit extended after April 16, 1971, shall become subject upon renewal to such additional restrictions as the Board of Governors may impose by regulation concerning the conditions upon which credit may be extended for the purpose of making such loan or contribution: *And provided further*, That (i) all of the proceeds of such extension of credit are so loaned or contributed to the capital of the broker or dealer, and (ii) that the proceeds of any withdrawal of such loan or contribution of capital from the broker or dealer by the customer or redemption of such stock shall be used to reduce or retire said extension of credit.



FEDERAL RESERVE

press release

For immediate release

April 16, 1971

The Board of Governors of the Federal Reserve System today proposed amendments to its Regulations G, T, and U setting forth conditions under which credit may be obtained for the purpose of providing capital to broker-dealer firms without regard to initial margin requirements. The amendments are designed to facilitate the raising of longer term capital by such firms.

As proposed, the amendments would become effective in three months--on July 16. Comments on the proposals should be submitted to the Board by May 24.

As an interim measure, while it is considering these proposals, the Board granted an exemption from initial margin requirements for credit by banks for the purpose of providing capital to broker-dealer firms.

Regulation U applies to credit extended by banks for the purpose of purchasing or carrying margin stocks; Regulation T applies to such credit extended by brokers and dealers, while Regulation G applies to such credit extended by persons other than banks and brokers and dealers.

Under the proposed amendments a lender would be required to hold collateral sufficient to secure a loan before he could extend credit to a third party for the purpose of providing capital to a broker-dealer. The proposals would permit such a loan to be made if the providing of capital is subject to the applicable rules of either the

Securities and Exchange Commission or a stock exchange, or both, and if the capital is subject to the following five conditions:

1. It must be provided for at least one year.

2. It can be withdrawn after that only after six months' notice has been given to the broker-dealer, the SEC and the Securities Investor Protection Corporation.

3. A withdrawal of capital could only be made if it would not place the broker-dealer in violation of the net capital rule to which it is subject.

4. All proceeds of the loan must be contributed to a broker-dealer as capital.

5. Any withdrawal of capital must be used to reduce the amount of the loan.

As proposed, the amendments would apply not only to new credits extended after the effective date but also to renewals of credit initially made between today and July 16.

Copies of the exemption and the proposed amendments are attached.

FEDERAL RESERVE SYSTEM

[12 CFR PARTS 207, 220, and 221]

[Regs. G, T, and U]

SECURITIES CREDIT BY PERSONS OTHER THAN BANKS, BROKERS, OR DEALERS
CREDIT BY BROKERS AND DEALERS
CREDIT BY BANKS FOR THE PURPOSE OF PURCHASING OR CARRYING MARGIN STOCK

Credit to Contribute Capital
to Brokers and Dealers

Pursuant to the authority contained in the Securities Exchange Act of 1934 (15 U.S.C. 78g), the Board of Governors proposes to amend Parts 207, 220, and 221 in the following respects:

1. Paragraph (f) of section 207.1 would be amended as set forth below:

§ 207.1 General Rule

* * * * *

(f) Credit extended to broker or dealer subject to Regulation T.

(1) No lender shall extend or maintain any credit for the purpose of purchasing or carrying any margin security to any broker or dealer who is subject to Part 220 of this Chapter (Regulation T), and after July 16, 1971, no lender shall extend any credit to any customer to enable the customer to contribute capital to any broker or dealer who is subject to such Part, whether such contribution is in the form of a loan to such broker or dealer (whether subordinated or not) or of equities in the account of partners, or to purchase stock in, any broker or dealer who is subject to such Part, whether with or without collateral Where the

credit or the proceeds of the loan or other contribution or purchase of stock is to be used in the ordinary course of business of such customer or such broker or dealer, such credit is presumed to be for the purpose of purchasing or carrying margin securities unless the lender has in his records a statement to the contrary obtained and executed in conformity with the requirements of paragraph (e) of this section.

(2) The prohibition of this paragraph (f) shall not apply to credit which is secured by collateral other than registered securities which is (i) made to a dealer^{1/}(whether or not secured) to aid in the distribution of securities to customers not through the medium of a national securities exchange, or (ii) extended to a broker or dealer subject to Part 220 or to a customer for the purpose of making a loan or contribution of capital to such a broker or dealer if the extension of credit, loan or other contribution is in conformity with the requirements regarding satisfactory agreements or equities in the account of partners of a rule of the Securities and Exchange Commission (Rule 15c3-1(c)(2)(A), (c)(4), and (c)(7) (17 CFR 240.15c3-1 (c)(2)(A), (c)(4), and (c)(7)) or of the capital rules of an exchange of which the broker or dealer is a member if the members thereof are exempt therefrom by Rule 15c3-1(b)(2) of the Commission (17 CFR 240.15c3-1(b)(2)) or to purchase stock in a broker or dealer which is a corporation: Provided,

^{1/} As defined in 15 U.S.C. 78c(a)(5).

That in the case of credit described in this paragraph that is extended after July 16, 1971, and in the case of any renewal of such credit extended between April 17, 1971 and July 17, 1971, such extension of credit is subject to the following conditions: (i) in the case of credit extended to enable a customer to make a loan or other contribution of capital to, or purchase stock in, such a broker or dealer the lender holds in its possession collateral adequate in good faith, to secure the amount of the credit, (ii) in no event other than the death, disability, or (in the case of a lender or customer who is a partner, officer, or employee of the broker or dealer) involuntary retirement of the lender or customer may the subordinated extension of credit, loan or contribution be repaid or the stock be redeemed until one year after the subordinated extension of credit, loan, or contribution was first made or stock first purchased and thereafter until six months after the giving of written notice by the lender (in the case of a subordinated extension of credit) or customer (in the case of a subordinated loan, contribution of capital, or purchase of stock) to such broker or dealer, the Commission, and the Securities Investor Protection Corporation of intent to demand repayment of the extension of credit, loan, or contribution or redemption of the stock, (iii) in no event may such credit, loan or contribution be repaid or the stock be redeemed if the effect of such payment or redemption would reduce the net capital of such broker or dealer below the amount

required by the net capital rule or capital rule to which such broker or dealer is subject, or would otherwise be inconsistent with such rule, (iv) all of the proceeds of such extension of credit are so loaned or contributed to the capital of such broker or dealer or used to purchase such stock, and (v) the proceeds of any withdrawal of such loan or contribution of capital from such broker or dealer by the customer or redemption of such stock shall be used to reduce or retire said extension of credit.

(3) The Board of Governors of the Federal Reserve System may by Order exempt from the prohibitions of this paragraph (f) and the requirements of this part, either unconditionally or upon specified terms and conditions or for stated periods, any loan for the purpose of making a loan or providing capital to a person who is subject to Part 220 of this Chapter (Regulation T), upon a finding that the granting of such an exemption is necessary or appropriate, in the public interest or for the protection of investors; Provided, That the Securities Investor Protection Corporation shall have certified to the Board that such action is appropriate under the circumstances.

2. Section 220.4 would be amended by revising subparagraph (f)(2) as set forth below:

§ 220.4 Special Accounts

* * * * *

(f) Special Miscellaneous account.

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(2)(i) Subject to the provisions of subdivisions (iii) and (iv) of this subparagraph extend and maintain credit, (a) to or for any partner of a firm which is a member of a national securities exchange to enable such partner to make a contribution of capital to such firm, or to purchase stock in an affiliated corporation of such firm, or (b) to or for any person who is or will become the holder of stock of a corporation which is a member of a national securities exchange to enable such person to purchase stock in such corporation, or to purchase stock in an affiliated corporation of such corporation; provided the lender as well as the borrower is a partner in such member firm or a stockholder in such member corporation, or the lender is a firm or a stockholder in such member corporation, or the lender is a firm or corporation which is a member of a national securities exchange and the borrower is a partner in such firm or a stockholder in such corporation;

(ii) Subject to the provisions of subdivisions (iii) and (iv) of this subparagraph extend and maintain subordinated credit to another creditor for capital purposes: Provided, That

(a) Either the lender or the borrower is a firm or corporation which is a member of a national securities exchange, the other party to the credit is an affiliated corporation of such member firm or corporation, and, in addition to the fact that an appropriate committee of the exchange is satisfied that the credit is not in contravention of any rule of the exchange, the credit has the approval of such committee, or

(b) The lender as well as the borrower is a member of such exchange, the credit has the approval of an appropriate committee of the exchange, and the committee, in addition to being satisfied that the credit is not in contravention of any rule of the exchange, is satisfied that the credit is outside the ordinary course of the lender's business, and that, if the borrower's firm or corporation or an affiliated corporation of such firm or corporation does any dealing in securities for its own account, the credit is not for the purpose of increasing the amount of such dealing.

(iii) For the purpose of subdivisions (i) and (ii) of this subparagraph, the term "affiliated corporation" means a corporation all the common stock of which is owned directly or indirectly by the member firm or general partners and employees of the firm, or by the member corporation or holders of voting stock and employees of the corporation and an appropriate committee of the exchange has approved the member firm's or member corporation's affiliation with such affiliated corporation.

(iv) No credit shall be extended pursuant to this subparagraph after July 16, 1971, and no such credit extended between April 16, 1971, and July 16, 1971, shall be renewed unless (a) in no event other than the death, disability, or (in the case of a borrower who is a partner, officer, or employee of the firm or corporation to which the subordinated loan or other contribution of capital is made or in which the stock is purchased) involuntary retirement of the borrower may the subordinated loan or contribution of capital be repaid or the stock be redeemed until one year after such loan or contribution was first made or such stock first purchased and thereafter until six months after the giving of written notice by the borrower to the firm, the Securities and Exchange Commission and the Securities Investor Protection Corporation of intent to demand repayment of such loan or contribution or redemption of such stock, (b) in no event may such loan or other contribution of capital be repaid or the stock be redeemed by a creditor to whom the loan or contribution was made or whose stock was the subject of purchase, if the effect of such payment or redemption would reduce the net capital of such creditor below the amount required by the net capital rule or capital rule to which such creditor is subject, or would otherwise be inconsistent with such rule; (c) all of the proceeds of such extensions of credit are so loaned or contributed to the capital of such firm or affiliated corporation or used to purchase such stock and (d) the proceeds of any withdrawal of such loan or contribution of capital from such creditor or redemption of such stock shall be used to reduce or retire said extension of credit.

3. Section 221.2 would be amended by revising paragraph (m) and section 221.3 would be amended by adding subparagraph (b) (4) and revising paragraph (c) by redesignating the first sentence as subparagraph (1) and adding a new subparagraph (2), as set forth below:

§ 221.2 Exceptions to General Rule.

* * * * *

(m) Any credit extended to a customer for the purpose of making a loan or contribution of capital to a broker or dealer subject to Part 220 (Regulation T) if the loan or contribution is in conformity with the requirements regarding satisfactory subordination agreements or equities in the accounts of partners of a rule of the Securities and Exchange Commission (Rule 15c3-1(c)(2)(a), (c)(4), and (c)(7) (17 CFR 240.15c3-1(c)(2)(a), (c)(4), and (c)(7)) or the capital rules of an exchange of which the broker or dealer is a member if the members thereof are exempt therefrom by Rule 15c3-1(b)(2) of the Commission (17 CFR 240.15c3-1(b)(2)) or to purchase stock in a broker or dealer which is a corporation:

Provided, That in the case of credit described in this paragraph that is extended after July 16, 1971, and any renewal of such credit extended between April 16, 1971 and July 16, 1971, such subordinated loan, contribution, or purchase of stock is subject to the following further conditions: (1) the bank holds in its possession collateral furnished by the customer adequate, in good faith, to secure the amount of the credit, (2) in no event other than the death, disability, or (in the case of a partner, officer, or employee of the broker or dealer involuntary retirement of the customer can the subordinated loan or contribution be repaid or the stock be redeemed until one year after the subordinated loan or contribution was first made or stock first purchased and thereafter until six months after the giving of written notice by the customer to the broker or dealer, the Commission, and the Securities Investor Protection Corporation of intent to demand repayment of the loan or contribution or redemption of the stock,

(3) in no event may such loan or contribution be repaid or the stock be redeemed if the effect of such payment or redemption would reduce the net capital of the broker or dealer below the amount required by any net capital or capital rule to which the broker or dealer is subject, or would otherwise be inconsistent with such rule, (4) all of the proceeds of such extension of credit are so loaned or contributed to the capital of such firm or affiliated corporation, or used to purchase such stock and (5) the proceeds of any withdrawal of such loan or contribution of capital from such broker or dealer or redemption of such stock shall be used to reduce or retire said extension of credit.

§ 221.3 Miscellaneous provisions

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(b) Purpose of a credit. * * *

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(4) Credit extended to enable a customer to contribute capital to a broker or dealer subject to Part 220 (Regulation T), whether such contribution is in the form of a loan to the broker or dealer whether subordinated or not), or of equities in the accounts of partners, or a purchase of stock in an incorporated broker or dealer, or otherwise, is "purpose" credit.

(c) Indirectly secured. (1) 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, depositary, 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.

(2) Credit described in § 221.3(b)(4) is deemed to be indirectly secured by any stock owned by the broker or dealer unless such credit is in conformity with the requirements of § 221.2(m)

4. The proposed revision of paragraph (f) in § 207.1 would restrict the ability of lenders to extend credit to broker/dealers, or to other customers for the purpose of providing capital to broker/dealers in conformity with proposed amendments to Parts 220 and 221 (Regulations T and U).

5. The proposed revision of subparagraph (f)(2) in § 220.4 would restrict the ability of creditors to extend credit to other creditors or to the partners, officers or employees of creditors (or the partners, officers or employees of affiliated corporations of creditors) for the purpose of purchasing the capital stock of or otherwise providing capital to a creditor or to an affiliated corporation of a creditor in conformity with proposed amendments to Parts 207 and 221 (Regulations G and U).

6. The proposed revision of paragraph (m) in § 221.2 would permit banks to extend credit for the purpose of enabling the customer to provide capital to a broker/dealer firm, whether

in the form of a subordinated loan, equities in the accounts of partners, or a purchase of stock in a corporation or otherwise, without regard to the initial margin requirements of §§ 221.1 and 221.4 (the Supplement to Regulation U) only on the following conditions. The bank must hold adequate collateral to secure the credit, so that the bank does not look to the broker/dealer for repayment as an assignee or successor in interest to the customer or otherwise. The terms under which the capital is provided to the broker/dealer, must be subject to the rules of the exchange of which the broker/dealer is a member or the net capital rule of the Securities and Exchange Commission. In addition, the capital must not be withdrawable (except in the event of the death, disability, or retirement by the customer from service with the broker/dealer) until a year has elapsed and only after an adequate period of notice so that the broker/dealer will not be forced to liquidate securities

in order to permit the withdrawal of such capital. All the proceeds of the extension of credit must be used to provide capital for the broker/dealer and the proceeds of any withdrawal of capital must be used to reduce or retire the credit. The Board considers that subjecting credit extended for the purpose of providing capital to broker/dealer firms to these conditions would tend to reduce the destabilizing potential of such credit.

The proposed new subparagraph (b)(4) of § 221.3 would codify an interpretation of the Board issued in 1946, and would apply the principle of the interpretation to credit extended to purchase stock in an incorporated broker/dealer.

The proposed subparagraph (c)(2) of § 221.3 would provide that bank credit extended to make it possible for the customer to contribute capital to a broker/dealer is deemed to be indirectly secured by any stock owned by the broker/dealer unless the conditions of proposed § 221.2(m) are satisfied.

If adopted by the Board, the changes will apply to credit extended by banks, broker/dealers, and persons subject to Regulation G after July 16, 1971, and to renewals after July 16, 1971, of credit extended by banks after April 16, 1971.

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 these matters by the Board, interested persons are invited to submit relevant data, views, or arguments. Any such material should be submitted in writing to the Secretary, the Board of Governors of the Federal Reserve System, Washington, D. C. 20551, to be received not later than May 24, 1971. Such material will be made available for inspection and copying upon request, except as provided in § 261.6(a) of the Board's Rules Regarding Availability of Information.

By order of the Board of Governors, April 16, 1971.

Kenneth A. Kenyon,
Deputy Secretary