

FEDERAL RESERVE BANK OF DALLAS

DALLAS, TEXAS 75222

Circular No. 71-159
July 14, 1971

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

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

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

On July 9, 1971, the Board of Governors of the Federal Reserve System announced revisions to the proposed amendments to Regulations G, T, and U which were initially announced on April 16, 1971. The proposals set out conditions under which credit to provide capital to broker-dealer firms may be obtained without regard to initial margin requirements.

Copies of the Board's press release and the proposed amendments are enclosed. Comments by interested parties should be submitted in order to reach the Board by August 20.

The Board also amended, effective July 10, 1971, §221.2(m) of Regulation U, clarifying that exempt credit is not available for public purchases of publicly traded stock in broker-dealer firms. A copy of the amendment is enclosed for filing in the binder of Federal Reserve Regulations furnished to all member banks.

A current version of Regulation U 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.

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 July 10, 1971, § 221.2 is amended by revising 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 broker or dealer which is a corporation when such stock is purchased directly from the issuer and not as part of a public distribution: *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 all of 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

July 9, 1971

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

The amendments were initially proposed on April 16, 1971, and would have become effective on July 16. Under the re-issued proposals, the amendments would become effective October 1. Comments on the revised proposals should be submitted to the Board by August 20.

The Board also revised its exemption -- originally issued April 16 as an interim measure while it considers these proposals -- from initial margin requirements for credit by banks for the purpose of providing capital to broker-dealer firms. The revision makes it clear that this exemption is not available to finance public trading in stock of such 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.

The Board's proposed revisions of the amendment to its regulations included the following:

(1) Elimination of the requirement that lenders hold collateral sufficient to secure a loan before they could extend credit for the purpose of providing capital to a broker-dealer. Instead, a requirement would be substituted that a committee of a stock exchange or national securities association of which the broker-dealer is a member approve the loan, on the basis of a finding that the credit will not increase the amount of the broker-dealer's trading in securities for its own account.

(2) Provide that credit extended by banks directly to broker-dealers would be subject to the same conditions as loans made to third persons for the purpose of providing capital to the broker-dealers.

Copies of the revised proposals are attached, together with the amendment to Regulation U, effective July 10, clarifying that exempt credit is not available for public purchases of publicly traded stock in broker-dealer firms.

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 revise its proposals to amend Parts 207, 220, and 221 (36 Federal Register 7754-7756, April 24, 1971) 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 October 1, 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 (other than exempted securities). 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 unsecured or secured by collateral other than registered securities which is (i) made to a dealer^{1/} to aid in the distribution of securities to customers not through the medium of a national securities exchange, or (ii) extended to a customer who is 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 broker or dealer or to purchase stock in a broker or dealer when such stock is purchased directly from the issuer and not as part of a public distribution if the extension of credit, loan or other contribution is in conformity with the requirements regarding satisfactory subordination agreements or equities in the account of partners of a rule of the Securities and Exchange Commission (Rule 15c-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

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

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 October 1, 1971, and in the case of any renewal of such credit extended between April 17, 1971 and October 1, 1971, such extension of credit is subject to the following further conditions: (i) such credit has the approval of an appropriate committee of a national securities exchange or a national securities association, and the committee, in addition to being satisfied that the credit is not in contravention of any rule of the exchange or association, is satisfied that, if the broker or dealer or an affiliated corporation of such broker or dealer does any dealing in securities for its own account, the credit is not for the purpose of increasing the amount of such dealing, (ii) in no event can the subordinated loan or contribution be repaid or the stock be redeemed except (a) with the approval of an appropriate committee of a national securities exchange or national securities association in the case of the death, disability, or (in the case of a partner, officer, or employee of the broker dealer) involuntary retirement (or if the amount of such repayment or redemption is \$10,000 or less, any retirement, whether voluntary or involuntary) of the customer, or (b) until one year after the subordinated extension of credit, loan, or contribution was first made or stock first purchased and until six months after the giving of written notice by the customer to such broker or dealer, the

Commission, the Securities Investor Protection Corporation, and any national securities exchange or national securities association of which such broker or dealer is a member 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 withdrawals 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 paragraph (f)(2) as set forth below:

§ 220.4 Special Accounts

* * * * *

(f) Special miscellaneous account. * * *

(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 stock holder 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 subdivision (iii) and with respect to credit described in subdivision (ii) (b) subject to subdivision (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), (ii) and (iv) 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 October 1, 1971, and no such credit extended between April 16, 1971, and October 1, 1971, shall be renewed unless (a) in no event can the subordinated loan or contribution be repaid or the stock be redeemed except (A) with the approval of an appropriate committee of a national securities exchange or national securities association in the case of the death, disability, or (in the case of a partner, officer, or employee of the broker or dealer) involuntary retirement (or if the amount of such repayment or redemption is \$10,000 or less, any retirement, whether voluntary or involuntary) of the borrower, or (B) until one year after such loan or contribution was first made or such stock first purchased and until six months after the giving of written notice by the borrower to the firm, the Securities and Exchange Commission, the Securities Investor Protection Corporation, and any national securities exchange or national securities association of which such broker or dealer is a member 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 extension 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 (q) as set forth below:

§ 221.2 Exceptions to General Rule.

* * * * *

(m) Any credit extended to a broker or dealer subject to Part 220 (Regulation T) or to a customer for the purpose of making a loan or contribution of capital to such broker or dealer 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 when such stock is purchased directly from the issuer and not as part of a public distribution: Provided, That in the case of

credit described in this paragraph that is extended after October 1, 1971, and any renewal of such credit extended to a broker or dealer between July 9, 1971, and October 1, 1971, or extended to a customer to make such a loan or contribution of capital to, or to purchase such stock in a broker or dealer between April 16, 1971 and October 1, 1971, such subordinated loan, contribution, or purchase of stock is subject to the following further conditions: (1) such credit has the approval of an appropriate committee of a national securities exchange or a national securities association and the committee, in addition to being satisfied that the credit is not in contravention of any rules of the exchange or association, is satisfied that, if the broker or dealer or an affiliated corporation of such broker or dealer does any dealing in securities for its own account, the credit is not for the purpose of increasing the amount of such dealing; (2) in no event can the subordinated loan or contribution be repaid or the stock be redeemed except (i) with the approval of an appropriate committee of a national securities exchange or national securities association in the case of the death, disability, or (in the case of a partner, officer, or employee of the broker or dealer) involuntary retirement (or if the amount of such repayment or redemption is \$10,000 or less, any retirement, whether voluntary or involuntary) of the customer, or (ii) until one year after the subordinated loan or contribution was first made or stock first purchased and until six months after the giving of written notice by the customer to the broker or dealer, the Commission, the Securities Investor Protection

Corporation, and any national securities exchange or national securities association of which such broker or dealer is a member 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

* * * * *

(b) Purpose of a credit. * * *

(4) Credit extended to a broker or dealer subject to Part 220 (Regulation T), or to enable a customer to contribute capital to such a broker or dealer, 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 when such stock is purchased directly from the issuer and not as part of a public distribution^{2/} is "purpose" credit.

^{2/} When credit is extended to purchase stock in a broker or dealer other than directly from the issuer or other than in a public distribution such credit of course is "purpose" credit if the stock is "margin stock" as described in § 221.3(v).

* * * * *

(q) Credit required to be secured. Any credit extended (1) for a purpose described in subparagraph (b)(4) of this section or (2) to a customer not subject to this Part or to Part 220 of this Chapter (Regulation T) who is engaged principally, or as one of the customer's important activities, in the business of extending credit for the purpose of purchasing or carrying margin stocks, is a credit for the purpose of purchasing or carrying such stocks unless the credit and its purposes are effectively and unmistakably separated and disassociated from any financing or refinancing of any purchasing or carrying of or trading in such stocks. Any such credit described in subparagraph (b)(4) of this section or 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 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 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.

4. The proposed revision of paragraph (f) in § 207.1 would delay the effective date of the amendment to October 1, 1971; clarify that the prohibition of this paragraph does not apply to credit on exempted securities; clarify that the exemption provided by subparagraph

(f)(2) is not available for publicly traded stock in an incorporated broker or dealer; remove the requirement that credit of the kind described therein be actually secured and substitute a requirement that an appropriate committee of the exchange or national securities association of which the broker or dealer is a member be satisfied that the proceeds of the credit will not be used to increase the amount of dealing in securities by the broker or dealer for its own account; provide that credit is eligible for the exemption even though an amount up to \$10,000 is withdrawable with the permission of an appropriate committee of an exchange or national securities association upon the retirement of a partner, officer, or employee of the broker or dealer before expiration of the one year waiting period; provide that notice of withdrawal of the contribution may be given after six months of the initial one-year waiting period have passed; and provide that such notice must be given to any exchange or national securities association of which the broker or dealer is a member, as well as to the broker or dealer itself, the Commission, and the Securities Investor Protection Corporation.

5. The proposed revision of paragraph (f)(2) in § 220.4 would clarify that the restrictions imposed by subdivision (iv) do not apply to credit extended by a firm to its partners or by an incorporated broker/dealer to its officers or employees, or officers or employees of its affiliated corporations; would delay the effective date of the amendment to October 1, 1971; provide that credit is eligible for the exemption

even though an amount up to \$10,000 is withdrawable with the permission of appropriate committee of an exchange or national securities association upon the retirement of a partner, officer, or employee of the broker or dealer before the expiration of the one-year waiting period; provide that notice of withdrawal of the contribution may be given after six months of the initial one-year waiting period have passed; and provide that such notice must be given to any exchange or national securities association of which the broker or dealer is a member, as well as to the broker or dealer itself, the Commission, and the Securities Investor Protection Corporation.

6. The proposed revision of paragraph (m) in § 221.2 would provide that credit extended directly by banks to brokers and dealers would be subject to the same restrictions on withdrawal as credit extended to third persons for the purpose of making contributions of capital to the brokers and dealers; clarify that the exemption is not available for publicly traded stock in an incorporated broker or dealer; remove the requirement that credit of the kind described therein be actually secured and substitute a requirement that an appropriate committee of the exchange or national securities association of which the broker or dealer is a member be satisfied that the proceeds of the credit will not be used to increase the amount of dealing in securities by the broker or dealer for its own account; provide that credit is eligible for the exemption even though an amount up to \$10,000 is withdrawable upon the retirement of a partner, officer, or employee of the broker or dealer before expiration of the one-year waiting period;

provide that notice of withdrawal of the contribution may be given after six months of the initial one-year waiting period have passed; and provide that such notice must be given to any exchange or national securities association of which the broker or dealer is a member, as well as to the broker or dealer itself, the Commission, and the Securities Investor Protection Corporation.

7. The revision to the proposed new subparagraph (b)(4) of § 221.3 would clarify that credit extended directly to a broker or dealer, by a bank, for the purpose of providing capital to the broker or dealer is "purpose" credit, but that credit to purchase or carry publicly traded stock of a broker or dealer is not "purpose" credit (unless the stock is itself a margin stock).

8. The proposed new subparagraph (c)(2) of § 221.3 is deleted.

9. Paragraph (q) of § 221.3 would be amended to provide that credit extended for the purpose of providing capital to a broker or dealer, as described in subparagraph (b)(4) of § 221.3, must be secured by collateral held by the bank unless segregated and disassociated from the business of purchasing and carrying securities, or exempted by § 221.2.

If adopted by the Board, the changes will apply to credit extended by banks, broker/dealers, and persons subject to Regulation G after October 1, 1971, and to renewals after October 1, 1971, of credit extended by banks after April 16, 1971, except in the case of credit

extended by banks directly to broker/dealers where the restrictions would apply to such credit extended after October 1, 1971, and to renewals after October 1, 1971, of such credit extended after July 9, 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 August 20, 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, July 6, 1971.

(Signed) Kenneth A. Kenyon

Kenneth A. Kenyon,
Deputy Secretary.

[SEAL]