

# FEDERAL RESERVE BANK OF DALLAS

DALLAS, TEXAS 75222

Circular No. 71-251  
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REGULATION X  
"RULES GOVERNING BORROWERS WHO OBTAIN SECURITIES CREDIT"  
(Effective November 1, 1971)

To All Banks, Brokers/Dealers, Regulation G Registrants  
and Others Concerned in the Eleventh Federal Reserve District:

Enclosed is a pamphlet containing new Federal Reserve Regulation X, "Rules Governing Borrowers Who Obtain Securities Credit", effective November 1, 1971, and an explanatory press release prepared by the Board of Governors of the Federal Reserve System.

The regulation, issued pursuant to Title III of P.L. 91-508, imposes responsibility for compliance with the Board's margin regulations (Regulations G, T and U) on borrowers of securities credit as well as lenders.

The cooperation of banks and firms engaged in extending securities credit is requested in advising borrowers, particularly those outside the United States, of the requirements of Regulation X. Because of the increased difficulty of informing borrowers outside the United States, banks and firms in this Federal Reserve District with foreign branches and subsidiaries are particularly encouraged to inform their U. S. borrowers residing abroad.

A pamphlet containing the present margin regulations G, T and U as well as new Regulation X, will soon be available for distribution. You may request copies of this pamphlet for internal use and for distribution to customers here and overseas from the Regulations Department, Federal Reserve Bank of Dallas, Station K, Dallas, Texas 75222. Requests will be filled as soon as the pamphlets are available.

Yours very truly,

P. E. Coldwell

President

Enclosures



# FEDERAL RESERVE

press release

The Board of Governors of the Federal Reserve System today issued a new regulation to implement legislation that requires borrowers to comply with margin regulations in securities transactions. The regulation is effective November 1.

The new regulation is entitled "Rules Governing Borrowers Who Obtain Securities Credit" and is designated Regulation X. It will carry out provisions of Title III of the Foreign Bank Secrecy Act (Public Law 91-508 enacted October 26, 1970) that relate to margin credit requirements. That Act for the first time specifically requires borrowers to comply with margin regulations in securities transactions. The regulations previously applied primarily to lenders.

Establishment of a separate regulation differs in form from the proposal issued on July 26 which would have amended the three existing margin regulations to cover borrowers.

Margin regulations are designed to prevent the excessive use of credit in financing securities transactions. Regulation T applies to all securities credit extended by brokers and dealers; Regulation U applies to credit by banks for the purpose of purchasing or carrying margin stocks, while Regulation G applies to such credit by persons other than banks, brokers, or dealers.

As in the July proposal, the new regulation will require persons borrowing in the United States to comply with the margin regulation applicable to the lender extending him credit on securities. If

a U.S. person borrows abroad, he must comply with the provisions of the margin regulation that would apply if the credit were obtained in the United States.

The regulation will apply to credit extended, arranged or maintained after October 31. Commencing May 1, 1972, six months after the effective date, restrictions on substitutions and withdrawals from margin accounts will apply to credit extended after October 26, 1970, the date the legislation became law.

The new Regulation X will exempt the following from its provisions:

1. U. S. citizens permanently residing outside the United States who obtain or have outstanding abroad no more than \$5,000 in purpose credit per year.
2. Credit obtained by foreign affiliates of U. S. firms to finance clearing, market-making or arbitrage transactions in offshore debt securities that are convertible into margin securities.
3. Foreign borrowers who are controlled by or acting on behalf of U. S. persons, provided the Board determines that an exemption is warranted by exceptional circumstances and is consistent with the Securities Exchange Act of 1934 and Regulation X.

Under the new regulation, certain borrowers who obtain securities credit abroad must retain in their records for six years a statement describing the transaction.

The Board still has under consideration certain aspects of the proposals issued on July 26, particularly those relating to the application of margin regulations to foreign branches of U. S. banks and U. S. broker-dealers. A copy of Regulation X is attached.



## REGULATION X

**AUTHORITY:** The provisions of this Part 224 (Regulation X), issued under sec. 7(f) of the Securities Exchange Act of 1934, as amended (15 U.S.C. 78a-jj, particularly 78g(f)).

### § 224.1 Scope of part.

This Part 224 (Regulation X) contains rules and regulations promulgated by the Board of Governors of the Federal Reserve System (the Board) under the Securities Exchange Act of 1934 as amended (the Act) and applies to all persons described below who obtain, receive, or enjoy the beneficial use of credit for the purpose of purchasing or carrying securities.<sup>1</sup> For definitions of technical terms see § 224.5, Parts 207, 220, and 221 of this chapter (Margin Regulations G, T, and U) and the Statutory Appendix. The purpose of this part (Regulation X) is to prevent the infusion of unregulated credit obtained both outside and within the United States into U.S. securities markets in circumvention of the provisions of the Board's margin regulations or by borrowers falsely certifying the purpose of a loan or otherwise wilfully and intentionally evading the provisions of those regulations. When the term "obtain credit" is used in this part (Regulation X) it means "obtain, receive, or enjoy the beneficial use of credit" and when the term "purpose credit" is used, it means "credit for the purpose of purchasing or carrying securities". When the term "borrower" is used, it means a person who obtains credit. This part (Regulation X) implements section 7(f) of the Act, and generally applies to borrowers who are:

(a) Persons who obtain credit from within the United States, or

(b) Those persons who obtain credit from outside the United States who are:

- (1) U.S. persons,<sup>2</sup>
- (2) Foreign persons who are controlled by U.S. persons,<sup>3</sup> or
- (3) Foreign persons acting on behalf of or in conjunction with<sup>4</sup> U.S. persons.

### § 224.2 General rule.

(a) *Credit obtained from within the United States.* A borrower shall not obtain any purpose credit from within the United States unless he does so in compliance with the following conditions:

(1) Credit obtained from a G-lender shall conform to the provisions of Part 207 of this chapter (Regulation G), which is hereby incorporated in this part

(Regulation X). When the term "G-lender" is used in this part (Regulation X), it means a person who is not a broker/dealer or bank, who in the ordinary course of his business extends, maintains, or arranges credit that is secured, directly or indirectly, in whole or in part, by collateral that includes any margin securities, and who is subject to the registration requirement of § 207.1 (a) of this chapter (Regulation G).

(2) Credit obtained from a broker/dealer shall conform to the provisions of Part 220 of this chapter (Regulation T), which is hereby incorporated in this part (Regulation X). When the term "broker/dealer" is used in this part (Regulation X), it means a person who is a broker or dealer, including every member of a national securities exchange, and includes a foreign branch or subsidiary of a broker/dealer.

(3) Credit obtained from a bank shall conform to the provisions of Part 221 of this chapter (Regulation U), except for § 221.2(i). Except for such section, Part 221 of this chapter (Regulation U) is hereby incorporated in this part (Regulation X). When the term "bank" is used in this part (Regulation X), it means a bank that is subject to Part 221 of this chapter (Regulation U).<sup>5</sup>

(b) *Credit obtained from outside the United States.* (1) A U.S. person or foreign person controlled by a U.S. person or acting on behalf of or in conjunction with such a person shall not obtain any purpose credit<sup>6</sup> from outside the United States except in compliance with the following conditions:

(i) Credit obtained from a foreign branch of a G-lender shall conform to the provisions of Part 207 of this chapter (Regulation G), except that the requirement of § 207.1(e) of this chapter as to obtaining a statement of the purpose of the credit shall not apply.

(ii) Credit obtained from a foreign branch or subsidiary of a broker/dealer shall conform to the provisions of Part 220 of this chapter (Regulation T).

(iii) Credit obtained from a foreign branch of a bank shall conform to the provisions of Part 221 of this chapter (Regulation U) which would apply if the credit were obtained from the head office of the bank in the United States, except that the requirement of § 221.3(a) of this chapter (Regulation U) as to obtaining a statement of the purpose of the credit shall not apply.

(iv) Credit obtained from a foreign lender shall conform to the provisions of Part 207 of this chapter (Regulation G) which would apply if the person extending, arranging, or maintaining the credit were a G-lender, except that the requirement of § 207.1(e) of this chapter (Regulation G) as to obtaining a statement of the purpose of the credit shall not apply. When the term "foreign

lender" is used in this part (Regulation X) it means any person, other than a U.S. person, who in the ordinary course of his business extends, maintains, or arranges purpose credit outside the United States and who is not a foreign branch or subsidiary of a broker/dealer, a foreign branch of a bank, or a foreign branch of a G-lender.

(2) The provisions of subparagraph (1) of this paragraph shall not apply to credit extended before November 1, 1971, except that as to credit extended after October 26, 1970, the requirements as to withdrawals and substitutions of collateral shall apply after May 1, 1972, as follows: The requirements in § 207.1(j) of this chapter (Regulation G) shall apply to credit obtained from a foreign branch of a G-lender or from a foreign lender; the requirements in § 220.3(b) of this chapter (Regulation T) shall apply to credit obtained from a foreign branch or subsidiary of a broker/dealer; and the requirements in § 221.1(b) of this chapter (Regulation U) shall apply to credit obtained from a foreign branch of a bank.

(3) *Record of credit.* Every borrower subject to this Part 224 (Regulation X) who obtains any credit from a lender described in subdivision (i), (iii), or (iv) of subparagraph (1) of this paragraph if such credit is secured directly or indirectly, in whole or in part, by collateral that includes any security, shall prepare and retain in his records, for at least 6 years after such credit is extinguished, a record substantially in conformity with the requirements of Federal Reserve Form X-1.

### § 224.3 Exemptions.

The following classes of persons shall be exempted from the provisions of section 7(f) of the Act and this part (Regulation X) to the extent described below:

(a) A U.S. person whose permanent residence is outside the United States, and who does not during any calendar year obtain a total of more than \$5,000 or have outstanding at any time during any calendar year a total of more than \$5,000 in credit obtained outside the United States to purchase or carry margin securities.

(b) A borrower who is not a U.S. person, but is controlled by or acting on behalf of or in conjunction with such person, who obtains credit for the purpose of bona fide clearing, market-making, or arbitrage transactions in offshore debt securities that are convertible into margin securities, except that any credit outstanding against collateral consisting of such securities shall be brought into conformity with the other provisions of this part (Regulation X)<sup>7</sup> upon the conversion of such securities into margin securities.

(c) A borrower who is not a U.S. person, but is controlled by or acting on behalf of or in conjunction with such person, who obtains credit from outside

<sup>1</sup> 15 U.S.C. 78g.

<sup>2</sup> For definition of the term "United States person," see Statutory Appendix, sec. 7(f)(2)(A).

<sup>3</sup> For definition of the term "foreign persons controlled by a United States person," see Statutory Appendix, sec. 7(f)(2)(C).

<sup>4</sup> For definition of the term "acting on behalf of or in conjunction with," see § 224.5(a) (Regulation X).

<sup>5</sup> For a definition of the term "bank" meaning "bank that is subject to Regulation U", see § 224.5(b) (Regulation X) and Statutory Appendix, sec. 3(a)(6).

<sup>6</sup> For a definition of the term "purpose credit" see § 224.5(j) (Regulation X).

<sup>7</sup> Including Parts 207, 220, or 221 of this chapter (Regulations G, T, and U) where applicable.



the United States, which borrower has been exempted by the Board of Governors of the Federal Reserve System, by order, from the requirements of this part (Regulation X), either unconditionally or upon specified terms and conditions or for stated periods, upon a finding that exceptional circumstances warrant the granting of such an exemption, and that the exemption is consonant with the purposes of section 7(f) of the Act and the provisions of this part (Regulation X).

#### § 224.4 Reports and records.

Every borrower described in § 224.1 who obtains any credit that is secured directly or indirectly, in whole or in part, by collateral that includes any securities, shall maintain such records and file such reports as may be prescribed by the Board of Governors of the Federal Reserve System to enable it to perform the functions conferred upon it by the Act.

#### § 224.5 Definitions.

Unless the context otherwise requires, or it is otherwise specified herein, the terms used in and for the purposes of this part (Regulation X) have the meanings given them in this section, in sections 3(a) or 7(f) of the Act, or in Part 207, 220, or 221 of this chapter (Regulation G, T, or U). The relevant portions of sections 3(a) and 7(f) of the Act are set forth in the Statutory Appendix. In the case of inconsistency between definitions appearing in this section and those appearing in Part 207, 220, or 221 of this chapter (Regulation G, T, or U), the definition appearing in the regulation that applies to the particular credit involved, whether Part 207, 220, or 221 of this chapter (Regulation G, T, or U) shall prevail.

(a) The term "acting on behalf of or in conjunction with" in reference to a foreign person means obtaining credit for the purpose of purchasing or carrying a security in which, or in the income or gains or losses from which, a U.S. person or a foreign person controlled by a U.S. person has a substantial direct or indirect beneficial interest. Absent these factors the term does not include an interest derived solely from the ownership of less than 50 percent of the outstanding capital stock issued by such foreign person who is obtaining such credit.

(b) The term "bank" means a bank as defined in section 3(a)(6) of the Act, including a foreign branch of a bank, except that such term does not include a bank which is a member of a national securities exchange, a foreign affiliate of a bank, or a foreign bank.

(c) The term "broker/dealer" means any broker or dealer including every member of a national securities exchange, and includes a foreign branch or subsidiary of a broker/dealer.

(d) The term "foreign lender" means a person, other than a U.S. person, who in the ordinary course of his business extends, maintains, or arranges purpose credit outside the United States and who is not a foreign branch or subsidiary of a broker/dealer, a foreign branch of a bank, or a foreign branch of a G-lender.

(e) The term "G-lender" means a person who is not a broker/dealer or bank, who in the ordinary course of his business extends, maintains, or arranges credit that is secured, directly or indirectly, in whole or in part, by collateral that includes any margin securities, and who is subject to the registration requirement of § 207.1(a) of this chapter (Regulation G).

(f) The term "indirectly secured" includes any arrangement with the lender under which the right or ability to sell, pledge, or otherwise dispose of securities owned by the borrower (or by any other person who has made the use of such securities available to the borrower) is in any way restricted as 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 maturity of the credit. The foregoing shall not apply, however—

(1) If such restriction arises solely by virtue of an arrangement with the lender which pertains generally to the borrower's assets unless a substantial part of such assets consists of margin securities, or

(2) If the lender in good faith has not relied upon such securities as collateral in the extension or maintenance of the particular credit, or

(3) To securities held by the lender only in the capacity of custodian, depository, or trustee, or under similar circumstances, if the lender in good faith has not relied upon such securities as collateral in the extension or maintenance of the particular credit.

(g) The term "lender" means a person who in the ordinary course of his business extends, maintains, or arranges for credit, including a G-lender, a broker/dealer, a bank, and a foreign lender.

(h) The term "margin security" shall have the meaning of "margin security" as defined in § 207.2(d) of this chapter (Regulation G) if the borrower is obtaining credit from a G-lender or a foreign lender, the meaning of "margin security" as defined in § 220.2(f) of this chapter (Regulation T) if the borrower is obtaining credit from a broker/dealer, and the meaning of "margin stock" as defined in § 221.3(v) of this chapter (Regulation U) if the borrower is obtaining credit from a bank.

(i) The term "offshore debt security," as to this part (Regulation X) means a debt security offered only outside the United States, the purchase of which by a U.S. person would give rise to a liability under the Interest Equalization Tax (26 U.S.C. 4911 et seq.).

(j) The term "purpose credit" means credit for the purpose of purchasing or carrying securities. The purpose of a credit is determined by substance rather than form. The following are some examples of purpose credit.

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

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

(3) Credit that is secured directly or indirectly, in whole or in part, by collateral that includes any securities, is presumed to be for the purpose of purchasing or carrying securities, unless the borrower has complied with the requirements of Part 207 (Regulation G), Part 220 (Regulation T), and Part 221 of this chapter (Regulation U) as to the statement of the purpose of a credit, if such requirements are applicable, or in the case of credit obtained from a foreign lender, can furnish satisfactory evidence of the use of the credit for a purpose other than purchasing or carrying securities.

(4) An extension of credit provided for in a plan, program, or investment contract offered or sold or otherwise initiated after August 31, 1969, which provides for the acquisition both of any securities and of goods, services, property interests, or investments.

(k) The term "obtain credit" means to obtain, receive, or enjoy the beneficial use of credit.

(l) The term "United States" includes any State of the United States, the District of Columbia, Puerto Rico, the Canal Zone, the Virgin Islands, or any other possession of the United States.

#### § 221.6 Miscellaneous provisions.

(a) *Innocent mistake.* An innocent mistake made in good faith by a borrower in connection with the obtaining of a credit shall not be deemed to be a violation of this part (Regulation X) if promptly after discovery of the mistake the borrower takes whatever action is practicable to remedy the noncompliance.

(b) *Aiding or abetting.* Any person who willfully aids or abets the violation by any other person of any provision of this part (Regulation X) shall be deemed to be in violation of this part (Regulation X). For the purpose of this subsection the term "aids or abets" shall include, but not be limited to, counsels, commands, induces, or procures.

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