

FEDERAL RESERVE BANK OF DALLAS

DALLAS, TEXAS 75222

Circular No. 72-227
October 12, 1972

AMENDMENT TO REGULATIONS T, U AND
SUPPLEMENT TO REGULATION U
(Special Insurance Premium Funding Account
and Exemption from Margin Requirements
on Certain Credit Extended to So-Called
Block Positioners and Third-
Market Makers)

To All Member Banks and Others Concerned
in the Eleventh Federal Reserve District:

On September 5, 1972, the Board of Governors of the Federal Reserve System adopted amendments to Regulation T, Section 220.4. This amendment is concerned with the special insurance premium funding account.

To be effective October 16, 1972, the Board has adopted amendments to Regulation T, Regulation U and Supplement to Regulation U. These amendments will exempt from margin requirements certain credit extended to so-called "block positioners" and third-market makers.

The Board's amendments, which also apply new reporting requirements to exchange specialists, were adopted simultaneously with registration and reporting requirements imposed by the Securities and Exchange Commission in this field.

Block positioners are securities firms that stand ready to hold amounts of stock for their own account sufficient to facilitate the sale or purchase by their customers--primarily institutions--of quantities too large to be absorbed by normal exchange transactions.

The minimum block of stock that could qualify for the exemption from margin requirements would have a market value of \$200,000. A block would also have to be sold by the block positioner within 20 business days although limited extensions of 5 days at a time could be allowed by the stock exchanges or the National Association of Securities Dealers.

Third-market makers are firms that make a market off the exchanges in stocks that are listed for exchange trading.

Under the new amendments to Regulations T and U stock exchange specialists will be required to report block transactions acquired on exempt credit to the Board.

Regulations T and U pertain to security credit by brokers and dealers and banks, respectively.

A copy of the Board's amendments is attached.

Yours very truly,

P. E. Coldwell,

President

Attachment

BOARD OF GOVERNORS OF THE FEDERAL RESERVE BANK

AMENDMENTS

REGULATION T †

Effective September 5, 1972, section 220.4 (k) is amended to read as follows:

Effective October 16, 1972, paragraph (g) of section 220.4 is amended as follows:

SECTION 220.4—SPECIAL ACCOUNTS

SECTION 220.4—SPECIAL ACCOUNTS

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(k) **Special insurance premium funding account.** In a special insurance premium funding account a creditor may arrange for the extension or maintenance of credit, not in excess of the premiums on the insurance policy (plus any applicable interest), on a security issued by an investment company registered pursuant to section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8) that serves as collateral under a plan, program, or investment contract registered with the Securities and Exchange Commission under the Securities Act of 1933 (15 U.S.C. 77), that provides for the acquisition both of a security issued by such investment company and of insurance: *Provided*, That such credit is extended or maintained by a lender subject to Part 207 of this Chapter (Regulation G) or a bank subject to Part 221 of this Chapter (Regulation U). A creditor arranging credit in a special insurance premium funding account shall not extend, arrange, or maintain credit in the general account or any other special account in §220.3 and this section, except for transactions involving the purchase of shares, in the special cash account described in paragraph (c) of this section, in investment companies which are so registered.

(g) **Specialist's account.** (1) In a special account designated as a specialist's account, a creditor may effect and finance, for any member of a national securities exchange who is registered and acts as a specialist in securities on the exchange, such member's transactions as a specialist in such securities, or effect and finance, for any joint venture in which the creditor participates, any transactions in any securities of an issue with respect to which all participants, or all participants other than the creditor, are registered and act on a national securities exchange as specialists.

(2) Such specialist's account shall be subject to the same conditions to which it would be subject if it were a general account except that if the specialist's exchange is a national securities exchange which requires and submits to the Board of Governors of the Federal Reserve System reports suitable for supplying current information regarding specialist's use of credit pursuant to this paragraph (g), the requirements of § 220.6(b) regarding joint ventures shall not apply to such accounts and the maximum loan value of a registered security in such account (except a security 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 as determined by the creditor in good faith.

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† For this Regulation to be complete as amended effective October 16, 1972, retain:

- 1) Printed Regulation Pamphlet containing Regulations G, T, U and X dated November 1971.
- 2) Amendment effective May 15, 1972.
- 3) Amendment effective September 18, 1972.
- 4) Supplement effective September 18, 1972.
- 5) This Slip Sheet.

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BOARD OF GOVERNORS OF THE FEDERAL RESERVE BANK

AMENDMENTS

REGULATION U †

Effective October 16, 1972, paragraph (a), (o), (w), (y) and (z) of section 221.3 is amended as follows:

SECTION 221.3—MISCELLANEOUS PROVISIONS

(a) **Required statement as to stock-secured credit.** 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 3 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 paragraphs (o), (w), (y), or (z) 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 of this section 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.

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(o) **Specialist.** In the case of 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 (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 as determined by the bank in good faith: *Provided*, That the specialist's exchange is a national securities exchange which re-

quires and submits to the Board of Governors of the Federal Reserve System reports suitable for supplying current information regarding specialists' use of credit pursuant to this section.

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(w) **OTC market maker exemption.** (1) 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 the OTC market maker 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 stock pursuant to a rule of the Commission (Rule 17a-12(17 CFR 240.17a-12)), shall not have ceased to engage in such market-making activity, and shall have a reasonable average rate of inventory turnover in such stock: *And provided further*, That the bank shall obtain and retain in its records for at least 3 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 faith⁹ by a duly authorized officer of the bank prior to such extension. In determining whether or not an extension of credit is for the purpose of conducting such market-making activity, a bank may rely on such a statement if executed and accepted in accordance with the requirements of this paragraph (w) and paragraph (a) of this section.

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(y) **Third-market maker exemption.** (1) In the case of credit extended to a third-market maker, as defined in subparagraph (2) of this paragraph

⁹ As described in paragraph (a) of this section.

(y), for the purpose of purchasing or carrying a stock that is registered on a national securities exchange (other than a convertible debt security described in paragraph (t) (1) of this section) in order to conduct the market-making activity of such a market maker, the maximum loan value of any stock (except (i) a convertible debt security described in paragraph (t) (1) of this section, and (ii) 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, at least five full business days prior to such extension of credit, have filed with the Securities and Exchange Commission a notice of his intent to begin or continue such market-making activity, and thereafter all other reports required to be filed by third-market makers pursuant to a rule of the Securities and Exchange Commission and, except when such activity is unlawful, 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 3 years after such credit is extinguished a statement in conformity with the requirements of Federal Reserve Form U-3, executed by the third-market maker who is the recipient of such credit and executed and accepted in good faith¹⁰ by a duly authorized officer of the bank prior to such extension. In determining whether or not an extension of credit is for the purpose of conducting such market-making activity, a bank may rely on such a statement, if executed and accepted in accordance with the requirements of this paragraph (y) and paragraph (a) of this section.

(2) A third-market maker with respect to a stock that is registered on a national securities exchange is a dealer who has and maintains net capital, as defined in a rule of the Securities and Exchange Commission (Rule 15c3-1 (17 CFR 240.15c3-1)), or in the capital rules of an exchange of which he 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)), of \$100,000 plus \$20,000 for each stock in excess of five in respect of which he has filed and not withdrawn a notice with the Securities and Exchange Commission (but in no case does this subparagraph (2) require net capital of more than \$500,000) who is in compliance with such rule of the Commission and who, except when such activity is unlawful, meets all the following conditions with respect to such stock: (i) He furnishes bona fide, competitive bid and offer

¹⁰ As described in paragraph (a) of this section.

quotations to other brokers and dealers, in the stocks for which he makes a market, at all times on request, (ii) he is ready, willing, and able to effect transactions for his own account in reasonable amounts, and at his quoted prices, with other brokers and dealers, and (iii) he has a reasonable average rate of inventory turnover in the stock.

(3) If all or a portion of the credit extended pursuant to this paragraph (y) ceases to be for the purpose specified in subparagraph (1) of this paragraph or the dealer to whom the credit is extended ceases to be a third-market maker as defined in subparagraph (2) of this paragraph, the credit or such portion thereof shall thereupon be treated as "a credit subject to § 221.1".

(z) **Block positioner exemption.** (1) In the case of credit extended to a block positioner, as defined in subparagraph (2) of this paragraph (z), for the purpose of financing the activity of block positioning, the maximum loan value of any margin stock obtained in the ordinary course of the activity of block positioning as described in subparagraph (2) of this paragraph (z) (except (i) a convertible debt security described in paragraph (t) (1) of this section and (ii) 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 such activity he shall have filed with the Securities and Exchange Commission a notice of undertaking such activity as prescribed by the Commission, and all reports required to be filed by block-positioners: *And provided further*, That the bank shall obtain and retain in its records for at least 3 years after such credit is extinguished a statement in conformity with the requirements of Federal Reserve Form U-5 and paragraph (a) of this section, executed by the block positioner who is the recipient of such credit and executed and accepted in good faith¹¹ by a duly authorized officer of the bank prior to such extension. In determining whether or not an extension of credit is for the purpose of conducting such block positioning activity, a bank may rely on such a statement if executed and accepted in accordance with the requirements of this paragraph (z) and paragraph (a) of this section. In determining whether or not an extension of time has been granted pursuant to subparagraph (4) of this paragraph (z) and whether or not such extension of time is commensurate with the circumstances the bank may rely on a statement executed by an officer of the exchange or association on behalf of the committee in conformity

¹¹ As described in paragraph (a) of this section.

with the requirements of Federal Reserve Form U-6 and paragraph (a) of this section.

(2) A block positioner is a dealer who (i) is registered with the Securities and Exchange Commission under section 15 of the Securities Exchange Act of 1934 (15 U.S.C. 78o) and has a minimum net capital, as defined in a rule of the Securities and Exchange Commission (Rule 15c3-1 (17 CFR 240.15c3-1)) or in the capital rules of an exchange of which he 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)), of \$1 million, (ii) engages in the activity of purchasing long or selling short as principal, from time to time, from or to a customer (other than a partner or a joint venture or other entity in which a partner of the dealer, or the dealer itself, participates or a person "associated with" such dealer as defined in section 3(a)(18) of the Securities Exchange Act of 1934) a block of stock (other than a convertible debt security as described in paragraph (t)(1) of this section) with a current market value of \$200,000 or more in a single transaction or in several transactions at approximately the same time from a single source to facilitate a sale or purchase by such customer, (iii) certifies to the lending bank that he has determined in the exercise of reasonable diligence that the block could not be sold to or purchased from others on equivalent or better terms, and (iv) sells the shares comprising such block as rapidly as possible commensurate with the circumstances. In the case where a block positioner acquires a block from a broker who acts as agent for several sellers, such acquisition shall be deemed for purposes

of this section to be an acquisition from a single source.

(3) No credit shall be extended or maintained pursuant to this paragraph (z) in respect of any such block of stock or portion thereof which the block positioner has held continuously for more than 20 business days, and any credit extended pursuant to this paragraph (z) shall be extinguished or brought into conformity with the initial margin requirements of §§ 221.1 and 221.4 before the expiration of such 20-day period. For the purposes of this subparagraph, a block or portion thereof shall be treated as not having been held continuously only to the extent that there has been a net sale (or in the case of short positions, net purchase) of such securities (whether or not represented by the same certificate) during such 20-day period.

(4) In exceptional cases the 20-day period specified in subparagraph (3) of this paragraph (z) may on the application of the block-positioner, be extended for one or more periods limited to 5 business days each commensurate with the circumstances by any regularly constituted committee of a national securities exchange having jurisdiction over the business conduct of its members, of which the block positioner is a member or through which his block transaction was effected, or by a committee of a national securities association, if effected in the over-the-counter market: *Provided*, That such committee is satisfied that the block-positioner is acting in good faith in making the application and that the circumstances in fact warrant such treatment.

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† For this Regulation to be complete as amended effective October 16, 1972, Retain:

- 1) Printed Regulation Pamphlet containing Regulations G, T, U, and X dated November 1971.
- 2) Amendment effective May 15, 1972.
- 3) Amendment effective September 18, 1972.
- 4) Supplement effective October 16, 1972.
- 5) This Slip Sheet.

*See Revised Supplement
effective 11-24-72, attached to
Circular No. 72-279, dated
11-28-72*

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

SUPPLEMENT TO REGULATION U

Effective October 16, 1972*

SECTION 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 45 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 50 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 credit 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.

(d) **Requirements for inclusion on list of OTC margin stock.** Except as provided in subparagraph (4) of § 221.3(d), OTC margin stock shall meet the requirements that:

(1) The stock is subject to registration under § 12(g) (1) of the Securities Exchange Act of 1934 (15 U.S.C. 78l(g) (1)), or if issued by an insurance company subject to § 12(g) (2) (G) (15 U.S.C. 78l(g) (2) (G)) the issuer had at least \$1 million of capital and surplus,

(2) 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 § 5 of the Act (15 U.S.C. 78e),

(3) There are 1,500 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,

(4) The issuer is organized under the laws of the United States or a State¹² and it, or a predecessor in interest, has been in existence for at least 3 years,

(5) The stock has been publicly traded for at least 6 months, and

(6) Daily quotations for both bid and asked prices for the stock are continuously available to the general public; and shall meet 3 of the 4 additional requirements that:

(7) 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,

(8) The shares described in subparagraph (7) of this paragraph have a market value in the aggregate of at least \$10 million,

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

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

(e) **Requirements for continued inclusion on list of OTC margin stock.**

(1) The stock continues to be subject to registration under § 12(g) (1) of the Securities Exchange Act of 1934 (15 U.S.C. 78l(g) (1)), or if issued by an insurance company such issuer continues to be subject to § 12(g) (2) (G) (15 U.S.C. 78l(g) (2) (G)) and has at least \$1 million of capital and surplus.

(2) Four or more dealers stand willing to, and do in fact, make a market in such stock including

¹² As defined in 15 U.S.C. 78c(a) (16).

*Effective date of addition of Paragraph (e). There have been no changes in maximum loan values or retention requirement since December 6, 1971.

(OVER)

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 § 5 of the Securities Exchange Act of 1934 (15 U.S.C. 78e),

(3) There continue to be 1,000 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,

(4) The issuer continues to be a U.S. corporation,

(5) Daily quotations for both bid and asked prices for the stock are continuously available to

the general public; and shall meet 3 of the 4 additional requirements that:

(6) 400,000 or more shares of such stock remain outstanding in addition to shares held beneficially by officers, directors, or beneficial owners of more than 10 per cent of the stock,

(7) The shares described in subparagraph (6) of this paragraph continue to have a market value in the aggregate of at least \$5 million,

(8) The minimum average bid price of such stock, as determined by the Board, is at least \$5 per share, and

(9) The issuer continues to have at least \$2.5 million of capital, surplus, and undivided profits.