

FEDERAL RESERVE BANK OF DALLAS

DALLAS, TEXAS 75222

Circular No. 81-141
July 13, 1981

REGULATIONS T AND U

Proposed Amendments

TO ALL MEMBER BANKS,
OTHER CREDITORS,
AND OTHERS CONCERNED IN THE
ELEVENTH FEDERAL RESERVE DISTRICT:

The Board of Governors of the Federal Reserve System has published for comment amendments to Regulation T (Credit by Brokers and Dealers) and Regulation U (Credit by Banks for the Purpose of Purchasing or Carrying Margin Stocks).

Enclosed are copies of the Board's press release dated June 18, 1981, and the material submitted for publication in the Federal Register. Interested persons are invited to submit comments to the Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551, to be received no later than September 15, 1981. When submitting comments, please refer to Docket No. R-0362.

Any questions concerning the proposed amendments should be directed to this Bank's Legal Department, Ext. 6662.

Sincerely yours,



William H. Wallace
First Vice President

Enclosure

FEDERAL RESERVE press release



For immediate release

June 18, 1981

The Federal Reserve Board today proposed for comment amendments to two of its regulations concerning margin requirements.

The Board requested comment by September 15, 1981.

The proposed amendments to Regulation T (Credit by Brokers and Dealers) and Regulation U (Credit by Banks for the Purpose of Purchasing or Carrying Margin Stocks) are the first steps in a review by the Board of its margin regulations. The review is intended to simplify and modernize all Federal Reserve margin regulations. This review is part of the Board's Regulatory Improvement Project established in 1978 in which the Board is examining all of its regulations to simplify them and reduce the burden of regulatory compliance wherever possible.

In its first group of proposed amendments to its margin regulations, the Board proposed, for Regulation T, to

1. Eliminate "equity building" devices; consolidate bond accounts with the General Account, and require in certain circumstances, an off-setting adjustment to any highly leveraged General Account by transfers from the customer's Special Miscellaneous Account.
2. Relax the restriction on the arranging of credit by customers by investment bankers to permit investment banking services that may be otherwise prohibited.

For Regulation U, the Board proposed to change the collateral test so as to exempt from quantitative limitation all bank credit not secured by margin equity securities. At the present time a purpose loan that is collateralized by any stock is subject to the margin regulation.

The Board's notice of its proposals is attached.

Attachment

Title 12 - Banks and Banking

CHAPTER II - FEDERAL RESERVE SYSTEM

SUBCHAPTER A -- BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

[Docket No. R - 0362]

Part 220 -- Credit By Brokers and Dealers

Part 221 -- Credit By Banks For the Purpose of
Purchasing or Carrying Margin Stocks

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Proposed Amendments.

SUMMARY: After a comprehensive review of the margin regulations, the Board has decided to proceed with a major simplification through a series of amendments to the regulations. In the first group of amendments the following changes are proposed for Regulation T:

1. Eliminate the "equity building" devices; consolidate the bond accounts with the General Account; and require an offsetting adjustment to any highly leveraged General Account from the Special Miscellaneous Account
2. Relax the restriction on the arranging of credit by investment bankers.

In Regulation U the Board proposes to change the collateral test so as to exempt from quantitative limitation all bank credit not secured by margin equity securities.

DATE: Comments should be received on or before September 15, 1981.

ADDRESS: Comments, which should refer to Docket No. R-0362, may be mailed to the Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, D.C. 20551 or delivered to Room B-2223 between 8:45 a.m. and 5:15 p.m. Comments received may also be inspected at Room B-1122 between 8:45 a.m. and 5:15 p.m, except as provided in section 261.6(a) of the Board's Rule Regarding Availability of Information (12 CFR § 261.6(a)).

FOR FURTHER INFORMATION CONTACT: Laura Homer, Securities Credit Officer, Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System, Washington, D.C. 20551 (202) 452-2786) or Mindy R. Silverman or James N. McNeil, Federal Reserve Bank of New York (212) 791-5000.

SUPPLEMENTARY INFORMATION:

The Board proposes to amend certain parts of Regulations T and U (12 CFR 220 and 221) in the first phase of the regulatory simplification of the margin rules. The changes in Regulation T will eliminate the so-called "equity building" devices by (a) deleting the retention requirement and permitting withdrawals from transactions equal to the current maximum loan value of securities in the account and (b) eliminating the suspension of the same-day substitution privilege in "super-restricted" accounts. It is the Board's intention to effect the same results in Regulations U and G if these "equity building" devices are eliminated from Regulation T. The consolidation of Accounts will simplify Regulation T and permit customers greater flexibility in changing the makeup of their portfolios.

The Board has long been concerned with the existence of large credit balances in Special Miscellaneous Accounts of customers with highly-leveraged General Accounts. The proposed changes to eliminate "equity building" devices and the consolidation of the Special Bond Account and the Special Convertible Debt Security Account into the General Account could result in an even greater increase in credit balances in the Special Miscellaneous Account. Accordingly, a provision is also being added to require transfers from the Special Miscellaneous Account whenever the customer's equity in the General Account falls below 25 percent. This proposed change would not require that the customer be called to deposit additional cash or securities with the broker; it would require only the draining of Special Miscellaneous Account balances into the General Account when the General Account equity fell below 25 percent.

In publishing the SMA adjustment proposal for comment, the Board expressed concern that it might have little or no effect since there may be alternate ways to preserve buying power for customers' accounts without the use of the Special Miscellaneous Account. In particular, it has been suggested that the goal of the Board's proposal could be circumvented by daily payment to the customer or the customer's cash account of an amount representing the excess loan value in the customer's General Account. Commenters are specifically invited to comment as to whether this is likely to occur and, if so, what the effects would be. Commenters are also asked to address the question as to whether there are alternative ways of addressing the Board's concern with respect to large credit balances in Special Miscellaneous Accounts of highly leveraged customers. If so, could these alternative methods be effected with less cost than the method proposed by the Board? Estimated cost projections associated with implementing the SMA adjustment feature of the Board's proposal are also requested.

Section 220.7(a) which restricts a broker or dealer in arranging credit will be relaxed to permit investment banking services which involve arranging credit. Arranging credit which the broker or dealer cannot itself extend would continue to be prohibited in other circumstances.

The collateral test in Regulation U will be changed so that only purpose loans secured by any margin stock will be subject to the margin restrictions and only loans secured by margin stock will require the execution of a Form U-1.

Accordingly, pursuant to §§ 7 and 23 of the Securities Exchange Act of 1934, as amended (15 U.S.C. §§ 78g, 78w), the Board proposes to amend Regulations T and U (Parts 220 and 221, respectively) as follows:

A. Section 220.3 of Regulation T is revised in the following manner:

1. Existing paragraphs (a) and (b) are deleted and replaced with the following paragraphs (a) through (e):

(a) Contents of general account

All financial relations between a customer and a creditor, whether recorded in one record or more than one record shall be included in and be deemed part of the customer's general account with the creditor except that:

- (1) relations which section 220.4 permits to be included in any special account provided for by the section may be included in the appropriate special account; and
- (2) all transactions in commodities shall be included in the special account provided by section 220.4(e).

(b) Initial margin

Whenever a creditor effects in a general account any transaction which, combined with other transactions effected in the account on the same day, creates or increases an excess of the adjusted debit balance of the account over the maximum loan value of the securities in the account, the creditor shall obtain, as promptly as possible, but no later than the end of seven full business days following the date of such transaction, the deposit into the account of cash or securities in such amount that the cash deposited plus the loan value of the securities deposited at least equals the excess so created or the increase so caused.

(c) Withdrawals

A creditor may permit the withdrawal of cash or securities from a general account unless:

- (1) cash or securities are required to be deposited in connection with a transaction on the current or a previous day, or
- (2) such withdrawal would, combined with other transactions, deposits and withdrawals on the same day, create or increase an excess of the adjusted debit balance over the maximum loan value of the account.

(d) Minimum Level Adjustment

Whenever the adjusted debit balance of the account exceeds 150% of the maximum loan value of the account, after treating all calls for

margin issued under section 220.3(b) as if they had been satisfied, the creditor shall transfer from the Special Miscellaneous Account to the General Account credit balances sufficient to decrease the adjusted debit balance of the account to 150% of the maximum loan value of the account or exhaust the credit balance of the Special Miscellaneous Account, whichever occurs first.

(e) Modifications and exceptions

Modifications of and exceptions to the provisions stated in this section are provided in the subsequent paragraphs of this section and in section 220.6.

2. Existing paragraphs (c) through (i) are redesignated as new paragraphs (f) through (l).

3. References throughout section 220.3 to the special convertible security account and the special bond account are deleted.

4. Subparagraph (2) of existing paragraph (c) is revised to read as follows:

(f) * * * * *

(2) The maximum loan value of a security in a general account shall be such maximum loan value as the Board shall prescribe from time to time in section 220.8 (the supplement to Regulation T). No collateral other than an exempted security or a margin security shall have any loan value in a general account.

5. Existing paragraph (e) is revised to read as follows:

(h) Liquidation in lieu of deposit. ^{3/} In any case in which the deposit required by this section, or any portion thereof, is not obtained by the creditor within the seven-day period specified therein, the creditor shall promptly sell securities or effect other liquidating transactions in the account in such amount that the resulting decrease in the adjusted debit balance of such account equals or exceeds the required deposit or the undeposited portion thereof: Provided, that a creditor is not required to sell securities or to effect other liquidating transactions specified by this paragraph in an amount greater than necessary to eliminate the excess of the adjusted debit balance of such account over the maximum loan value of the securities remaining in such account after such liquidation.

6. Existing paragraph (g) is revised to read as follows:

^{3/} This requirement relates to the action to be taken when a customer fails to make the deposit required by section 220.3(b), and it is not intended to countenance on the part of customers the practice commonly known as "free-riding," to prevent which the principal national securities exchanges have adopted certain rules. See the rules of such exchanges and section 220.7(e).

(g) Transactions on given day (1) For the purpose of this section, the question of whether or not an excess of the adjusted debit balance of a general account over the maximum loan value of the securities in the account is created or increased on a given day shall be determined on the basis of all the transactions in the account on such day exclusive of any deposit of cash, deposit of securities, covering transactions, or other liquidation that has been effected on such day in connection with a transaction on a previous day.

(2) In any case in which an excess so created, or increase so caused, by transactions on a given day does not exceed \$500, the creditor need not obtain the deposit specified therefor in this section.

(3) Any transaction which serves to meet the requirements of this section or otherwise serves to permit any offsetting transaction in an account shall, to that extent, be unavailable to permit any other transaction in such account.

(4) For the purposes of this part (Regulation T), if a security has maximum loan value under of this section in a general account a sale of the same security (even though not the same certificate) in such account shall be deemed to be a long sale and shall not be deemed to be or treated as a short sale.

7. References to existing specific paragraph numbers throughout this Part will be changed to conform to these revisions.

B. Section 220.7(a) of Regulation T is revised to read as follows:

(a) - Arranging for loans by others. A creditor may not arrange for the extension or maintenance of credit to or for any customer by any person upon terms and conditions other than those upon which the creditor may himself extend or maintain under the provisions of this Part, except that this limitation shall not apply to credit arranged for a customer which does not violate Parts 207 and 221 of this Chapter and results solely from:

- (1) such investment banking services, provided by the creditor to the customer, as underwritings, private placements, and advice and other services in connection with exchange offers, mergers and acquisitions, except for underwritings that involve the public distribution of an equity security with installment or other deferred payment provisions; or
- (2) the sale of non-margin securities with installment or other deferred payment provisions if the sale is exempted from the registration requirements of the Securities Act of 1933 under section 4(2) or section 4(6) of the Act (15 U.S.C. §§ 77(d)(2) and (6)).

C. Part 221, Credit by Banks for the Purpose of Purchasing or Carrying Margin Stocks, would be amended as follows:

1. All references to "stock" throughout Regulation U (when the term refers to collateral and is not part of a definition) will be changed to "margin stock."

INITIAL REGULATORY FLEXIBILITY ANALYSIS: The Board of Governors of the Federal Reserve System is requesting comment on changes to its margin regulations. These changes are the first part of a planned series of amendments intended to simplify margin regulations, generally, and to reduce specific administrative and recordkeeping requirements imposed upon lenders by Regulation T (broker lending), Regulation U (bank lending), and Regulation G (lending by other than brokers or banks).

In addition to the widespread benefits associated with the simplification, the proposed changes would relax regulatory treatment of individual and business borrowers in a number of instances. For example, most of the changes to Regulation T will reduce restrictions applied to portfolio realignment for all margin customers -- benefiting customers with small as well as large margin account holdings to the same degree. Also, the modification of the credit arranging provision in Regulation T will permit brokers to provide additional investment banking services -- including the arranging of unsecured loans -- for business customers. Competition between brokers will be dependent upon investment banking expertise and not upon financial lending capacity -- thereby, providing an opportunity for small brokers to compete effectively with large brokers for this business. Furthermore, when seeking capital, business firms of all sizes should derive some benefit from the effects of augmented competition that will result from increased direct broker participation in investment banking activities. Finally, the amendment to the collateral test in Regulation U will allow nonmargin stock (typically, stock issued by small or privately-held corporations) to be used as collateral for bank loans without, any longer, a regulatory requirement that the borrower state the purpose for which the loan proceeds are to be used. The effect thereby, would be to exempt nonmargin equity security loans from the margin limitations and to reduce the overall reporting burden imposed by the current regulatory provisions.

By order of the Board of Governors of the Federal Reserve System,
June 17, 1981.

(signed) James McAfee

James McAfee
Assistant Secretary of the Board

[SEAL]