

FEDERAL RESERVE BANK OF DALLAS

DALLAS, TEXAS 75222

Circular No. 83-37
March 11, 1983

REGULATION U

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

REGULATION G

SECURITIES CREDIT BY PERSONS
OTHER THAN BANKS, BROKERS, OR DEALERS

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

The Board of Governors of the Federal Reserve System has published for comment proposals to revise and simplify Regulation U (Credit by Banks for the Purpose of Purchasing or Carrying Margin Stocks) and Regulation G (Securities Credit by Persons Other than Banks, Brokers, or Dealers). The proposals are a result of the Board's Regulatory Improvement Project in which the Board is reviewing and revising its regulations in order to update them, simplify their language, eliminate obsolete or unneeded language or provisions, and lighten the burden of compliance.

Interested parties are invited to submit comments concerning the proposed regulation revisions to the Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, D.C., 20551. Comments should refer to Docket Number R-0458 (Regulation U) or Docket Number R-0457 (Regulation G) and must be received by April 22, 1983.

Attached are copies of the Board's press release and the material as submitted for publication in the Federal Register. Questions regarding the material contained in the circular should be directed to the Legal Department, Extension 6228.

Additional copies of this circular will be furnished upon request to the Public Affairs Department, Extension 6289.

Sincerely yours,



William H. Wallace
First Vice President

Banks and others are encouraged to use the following incoming WATS numbers in contacting this Bank: 1-800-442-7140 (intrastate) and 1-800-527-9200 (interstate). For calls placed locally, please use 651 plus the extension referred to above.

FEDERAL RESERVE press release



For immediate release

February 25, 1983

The Federal Reserve Board today published for comment proposals to revise in their entirety Regulation U -- margin credit extended by banks -- and Regulation G -- margin credit extended by persons other than banks, brokers, and dealers. The Board asked for comment on its proposals by April 22, 1983.

The proposed revision of Regulations U and G, two of the Board's four regulations concerning margin requirements, is part of the Board's Regulatory Improvement Project in which the Board is reviewing and revising all its regulations to update them, simplify their language, eliminate obsolete or unneeded language or provisions and lighten the burden of compliance.

The proposed revisions to Regulation U encompass amendments adopted in January 1982, and in addition, would:

- permit banks to lend on margin stock to Employee Stock Ownership Plans (ESOPs) on a "good faith" basis;
- eliminate a restriction on unsecured loans to lenders other than banks and broker-dealers, including collateral lenders, as Regulation G directly applies to these lenders; and
- delete requirements for reports presently required of OTC market-makers, third market-makers and block positioners.

The proposed revisions to Regulation G also incorporate amendments made to the regulation in January 1982. In addition, the proposals would:

- raise the registration threshold for G-lenders from \$100,000 to \$200,000 and eliminate the registration requirements for those who arrange but do not extend credit secured by margin securities;

- allow G-lenders to extend unsecured credit to a broker or dealer; and
- permit companies and their affiliates to finance employee purchases of company stock without a specific scheduled paydown of the loan or a three-year lockup of the stock, as is presently required.

The Board is also seeking specific public comment on whether Regulations U and G should be combined to form a new comprehensive regulation with various subchapters or whether the two regulations should be maintained separately in their simplified forms.

The Board's summary notices are attached. The full text of the Federal Register notices may be obtained upon request from the Federal Reserve Banks or from the Federal Reserve Board.

Attachments

Proposed Rules

Federal Register

Vol. 48, No. 41

Tuesday, March 1, 1983

This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

FEDERAL RESERVE SYSTEM

12 CFR Part 207

[Docket No. R-0457]

Securities Credit by Persons Other Than Banks, Brokers or Dealers; Complete Revision and Simplification of Regulation G

AGENCY: Federal Reserve System.

ACTION: Proposed rule.

SUMMARY: The Board proposes to revise Regulation G in its entirety. The proposed Regulation G is written in simplified language and organized in a more logical fashion. Obsolete provisions have been removed. This proposed revision incorporates amendments made to Regulation G in January 1982 which: (1) Removed existing provisions that prohibited lenders subject to the rule from extending both regulated and non-regulated credit to the same borrower and prohibited mixed collateral loans and (2) clarified the definition of the term "indirectly secured" (47 FR 2981, January 21, 1982).

The proposed revision raises the registration threshold for G-lenders to \$200,000 and eliminates the registration requirements for those who arrange but do not extend credit secured by margin securities.

In addition, the existing provision prohibiting unsecured loans to a broker or dealer by a G-lender is removed. The prohibition in section 8 of the Securities Exchange Act of 1934 ("1934 Act") which prevents anyone except a bank from lending to a broker or dealer on the collateral of registered securities is retained in the regulation.

A further reduction in regulatory burden will be achieved by the liberalization of the "Plan-lender" provision, which covers extensions of credit under employee option and stock purchase plans. The proposed revision will permit companies and their affiliates to finance employee purchases of company stock without a specific

scheduled paydown of the loan or a three-year lockup of the stock as is the present rule. The proposal will continue to permit a company to extend credit in excess of the current maximum loan value of the securities.

The Board is seeking specific public comment on the question whether Regulation G and U should be combined to form a new comprehensive regulation with various subchapters or whether the two regulations should be maintained separately in their simplified forms.

DATE: Comments should be received on or before April 22, 1983.

ADDRESS: Comments, which should refer to Docket No. R-0457, 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.

FOR FURTHER INFORMATION CONTACT:

At the Board of Governors of the Federal Reserve System, Washington, D.C. 20551, contact: Laura Homer, Securities Credit Officer, or Robert Lord, Attorney, Division of Banking Supervision and Regulation (202) 452-2781. At the Federal Reserve Bank of New York, contact: Mindy Silverman, Assistant Counsel, (212) 791-5032.

SUPPLEMENTARY INFORMATION: The Board proposes to revise Regulation G by: (1) Simplifying the language in all provisions, (2) removing obsolete provisions and (3) reordering provisions in a more logical manner.

Explanation of Changes

The proposed Regulation G is divided into seven sections which, in the following order: (1) State the legal basis and scope of the regulation, (2) define the terms used throughout the regulation, (3) state the general rule, (4) separately treat loans made to brokers or dealers for specified purposes, (5) provide special treatment for loans to employee stock option and stock purchase plans meeting certain qualifications, (6) set forth the criteria for inclusion on the list of OTC Margin Securities, and (7) establish the maximum loan value of different types of collateral.

Unless otherwise noted, no substantive changes have been made to the regulation. The regulation has been

reorganized in a more logical fashion and the language has been simplified for easier understanding. In addition, obsolete terms and provisions have been removed, and parts of the regulation incorporate Board and staff interpretations issued during the course of administration of the rule.

The revised definition of "indirectly secured" adopted by the Board in January 1982 did not contain a specific exception (contained in an earlier definition) that a loan will not be considered "indirectly secured" if a lender in good faith has not relied upon margin securities as collateral. It was not the intent of the Board, however, to remove this exception, and interpretations have been issued making this point clear. To avoid misunderstanding, language has been added to the definition in the proposed revision to clarify this point.

A section by section analysis of the proposed Regulation G follows.

1. *Authority, Purpose and Scope.* This section states the Board's legal authority to promulgate Regulation G, the purpose of the rule, and the fact that its coverage is limited to lenders other than banks, brokers, or dealers.

2. *Definitions.* This section contains eleven definitions of terms used throughout the regulation. All terms of art not defined in the 1934 Act itself are defined in this section. Other terms which have, over the past five decades, achieved "common usage" status in margin regulation parlance have been incorporated into the regulation and are, therefore, defined in this section. Some definitions are scattered throughout the current regulation. All such definitions have been brought within a single definitional section.

3. *General Requirements.* This section contains the general rules which lenders other than banks, brokers and dealers ("G-lenders") must follow when extending, maintaining or arranging credit on the collateral of margin securities. It places limits on the amount of credit G-lenders can extend when the purpose is to purchase or carry securities and the loan is secured by margin securities.

The registration threshold has been raised from \$100,000 to \$200,000 and the registration requirement for G-lenders who merely arrange credit has been eliminated. Registered G-lenders will

continue to be subject to restrictions on securities credit that they arrange.

The "general requirements" section also contains the "single credit" rule, which directs G-lenders to aggregate the amount of purpose credit extended to a single customer in order to prevent evasion of the rule. This section also specifically permits the use of other collateral with margin securities to support a purpose credit. Under the present rule, as written, there is some ambiguity as to whether such "mixed collateral" loans are permissible.

This section also requires G-lenders who extend credit on margin securities to obtain a Form G-3, which requires the borrower to state the purpose and amount of the loan and list the margin securities used as collateral for the loan. In the case of revolving credit agreements, this section permits the filing of a G-3 form at the time of the initial extension of credit and does not require a new form G-3 to be executed each time a disbursement is made.

Withdrawals and substitutions of collateral for an existing loan are permitted by this section: (1) As long as such action would not result in an increase in the amount by which the credit exceeds the maximum loan value of the collateral, or (2) at any time that the collateral has loan value in excess of that required by the regulation. In addition, withdrawals of collateral are permitted to enable a customer to participate in an exchange offer, provided the securities received in exchange are substituted for the securities withdrawn and treated as margin securities for a period of sixty days following the exchange.

Provisions regarding extensions and maturities of credit, transfers of credit, mistakes made in good faith, and action which a G-lender may take for its own protection have been consolidated in this section. These provisions are scattered throughout the current regulation.

Finally, this section requires a G-lender to file an annual report form (Form FR G-4) with its local Federal Reserve Bank.

4. Credit to Brokers and Dealers. In conformity with section 8 of the 1934 Act, this section prohibits G-lenders from lending on a secured basis to brokers and dealers except in emergencies or when the public interest so demands. The current prohibition against unsecured loans by G-lenders to brokers and dealers has been removed.

5. Credit to Finance Employee Stock Plans. This section would liberalize current rules with respect to credit extended by a corporation to its own employees and officers for the purpose

of purchasing the company's stock. The proposed revision will permit companies and their affiliates to finance employee purchases of company stock without a specific loan reduction schedule or a restriction on the disposition of the stock, as required under the present rule. Plan lenders that otherwise meet the registration requirements of the regulation will continue to be required to register and to file annual reports (Form FR G-4) required by the regulation. The registration and reporting requirements will provide a mechanism by which the Board can monitor future developments with respect to plan-lender credit.

6. List of OTC Margin Securities. This section contains the criteria for initial and continued inclusion on the Board's List of OTC Margin Securities. These criteria were recently amended to conform more closely with the listing requirements of major securities exchanges (47 FR 21,756) (May 20, 1982).

7. Supplement. This final section assigns value to various types of collateral for purposes of the regulation. Three specific types of collateral are given loan value: (1) Margin securities have a maximum loan value of fifty percent of their current market value; (2) all other collateral, other than puts or calls or combinations thereof, are assigned a "good faith" loan value; and (3) puts, calls and combinations are given no loan value.

8. Specific Comment Requested. The Board is seeking specific public comment on the question whether Regulations G and U should be combined to form a new comprehensive regulation with various subchapters or whether the two regulations should be maintained separately in their simplified forms.

Initial Regulatory Flexibility Analysis

The Board of Governors of the Federal Reserve System is requesting comment on a proposed to completely revise its margin regulation governing lenders other than banks and brokers or dealers.

These changes are part of a program to simplify all of the Board's margin regulations and to reduce specific administrative and regulatory burdens imposed upon lenders. The simplification of Regulation G that is being proposed at this time will provide benefits in the form of overall clarity and consistency of treatment of banks and other lenders. The Board, therefore, certifies for the purposes of 5 U.S.C. 605(b) that the changes proposed are not expected to have an adverse impact on a substantial number of small businesses.

List of Subjects in 12 CFR Part 207

Banks, banking, Credit, Federal Reserve System, Reporting and recordkeeping requirements, Securities.

Accordingly, pursuant to sections 3, 7, 8 and 23 of the Securities Exchange Act of 1934, as amended (15 U.S.C. 78c, 78g, 78h, and 78w) the Board proposes to completely revise Regulation G (Part 207) to read as follows:

PART 207—CREDIT EXTENDED BY PERSONS OTHER THAN BANKS, BROKERS, OR DEALERS

Sec.

- 207.1 Authority, purpose and scope.
- 207.2 Definitions.
- 207.3 General requirements.
- 207.4 Credit to Broker-Dealers.
- 207.5 Employee stock option and stock purchase plans.
- 207.6 Requirements for the list of OTC margin securities.
- 207.7 Supplement.

Authority: Secs. 3, 7, 8, and 23 of the Securities Exchange Act of 1934, as amended (15 U.S.C. 78c, 78g, 78h, 78w).

§ 207.1 Authority, purpose and scope.

(a) **Authority and Purpose.** Regulation G (this part) is issued by the Board of Governors of the Federal Reserve System (the "Board") pursuant to the Securities Exchange Act of 1934 (the "Act") (15 U.S.C. 78a et. seq.). Its principal purpose is to regulate extensions of credit by persons, other than banks, brokers and dealers, who extend or maintain credit for the purpose of purchasing or carrying margin securities.

(b) **Scope.** This part requires registration by persons who extend credit that is secured directly or indirectly by margin securities. Credit extended by such persons is regulated by limiting the loan value of the collateral securing the credit if the purpose of the credit is to purchase or carry margin securities.

§ 207.2 Definitions.

The terms used in this part have the meanings given them in section 3(a) of the Act (15 U.S.C. 78c(a)) or as defined in this section.

(a) **Affiliate.** A person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with the lender.

(b) **Carrying credit.** Credit that enables a customer to maintain a position in a margin security or reduce or retire indebtedness originally incurred to purchase a security that is currently a margin security.

(c) *Current market value.* (1) For a security, the closing sale price of the security on the preceding business day, as shown by any regularly published reporting or quotation service or, if the credit is used to finance the purchase of the security, the security's total cost of purchase. If there is no closing sale price, any reasonable estimate of the market value of the security as of the close of business on the preceding business day. Computation of total cost may include any commissions charged.

(2) Any other collateral shall be valued by any reasonable method in accordance with generally accepted accounting principles.

(d) *Customer.* Includes any person or group of persons acting jointly, to or for whom a person subject to this part is extending or maintaining credit.

(e) *Good faith.* (1) With respect to the acceptance of or notice from or on behalf of a customer that the lender or its duly authorized representative is alert to the circumstances surrounding the credit, and if in possession of information that would cause a prudent person not to accept the statement or notice without inquiry, investigates and is satisfied that the statement or notice is truthful;

(2) With respect to the loan value of collateral means that amount which a lender, exercising sound credit judgment, would lend on particular collateral, without regard to other assets of the customer or other collateral held in connection with separate transactions. Good faith loan value may not exceed 100 percent of the current market value of the collateral.

(f) *Indirectly secured.* Includes any arrangement with the customer under which the customer's right or ability to sell, pledge, or otherwise dispose of margin securities owned by the customer is in any way restricted as long as the credit remains outstanding or under which the exercise of such right is or may be cause for acceleration of the maturity of the credit.

The foregoing shall not apply:

(1) If, following application of the proceeds of the credit, not more than twenty-five percent of the value of the assets subject to the arrangement, as determined by any reasonable method, are margin securities;

(2) To a lending arrangement that permits acceleration of the maturity of the credit as a result of a default under, or the renegotiation of the terms of, another credit to the same customer by another creditor that is not an affiliate of the lender;

(3) If the margin security is held by the lender only in the capacity of custodian, depository, or trustee, or under similar

circumstances and the lender has not relied upon the margin security as collateral in extending or maintaining the particular credit; or

(4) If the lender in good faith has not relied upon the margin security as collateral in the extension or maintenance of the particular credit.

(g) *In the ordinary course of business.* Occurring or reasonably expected to occur from time to time in the course of any activity of a person for profit or the management or preservation of property, or in the case of a person other than an individual, carrying out or in furtherance of any business purpose.

(h) *Lender.* Any person subject to the registration requirements of this part.

(i) *Margin security.* (1) Any equity security registered on a national securities exchange or having unlisted trading privileges;

(2) An OTC margin security;

(3) A debt security which is convertible into a margin security or carrying any warrant or right to subscribe to or purchase a margin security;

(4) Any warrant or right to subscribe to or purchase a margin security; and

(5) Any security issued by an investment company, other than a company licensed under the Small Business Investment Company Act of 1958, as amended (15 U.S.C. 661), registered under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8).

(j) *Maximum loan value.* The percentage of current market value assigned by the Board under § 207.7 of this part to specified types of collateral.

(k) *OTC margin security.* Any equity security not traded on a national securities exchange that the Board has determined has the degree of national investor interest, the depth and breadth of market, the availability of information respecting the security and its issuer, and the character and permanence of the issuer to warrant being treated like an equity security traded on a national securities exchange. The Board will from time to time publish a list of the OTC margin securities that the Board has determined meet the criteria set forth in § 207.7 of this part.

(l) *Purpose credit.* Credit for the purpose, whether immediate, incidental, or ultimate, of purchasing or carrying a margin security.

§ 207.3 General requirements.

(a) *Registration; termination of registration.* (1) Every person who, in the ordinary course of business, extends or maintains credit secured, directly or indirectly, by any margin security shall register on Federal Reserve Form FR G-

1 (OMB No. 055-R0267) within 30 days after the end of any calendar quarter during which (i) the amount of credit extended equals \$200,000 or more, or (ii) the amount of credit outstanding at any time during that calendar quarter equals \$500,000 or more;

(2) A registered lender may apply to terminate its registration, by filing Federal Reserve Form FR G-2 (OMB No. 055-R0267), if the lender has not, during the preceding six calendar months, extended credit secured, directly or indirectly, by any margin security and has not had more than \$200,000 of such credit outstanding during that period. Registration shall be deemed terminated when the application is approved by the Board.

(b) *General Rule.* No lender, except a plan-lender, as defined in § 207.5(a)(1), shall extend any purpose credit, secured directly or indirectly by margin securities in an amount that exceeds the maximum loan value of the collateral securing the credit, as set forth in § 207.7 of this part.

(c) *Maintaining credit.* A lender may maintain any credit that it initially extended without violating this part, regardless of:

(1) Reduction in the customer's equity resulting from change in market prices;

(2) Change in the maximum loan value prescribed by this part; and

(3) Change in the status of the security (from non-margin to margin) securing an existing purpose credit.

(d) *Arranging credit.* No lender may arrange for the extension or maintenance of any credit for the purpose of purchasing or carrying any margin security, except upon the same terms and conditions under which the lender itself may extend or maintain such credit under the provisions of this part.

(e) *Purpose statement.* (1) Whenever a lender extends credit secured directly or indirectly by a margin security, the lender shall require its customer to execute Federal Reserve Form FR G-3 (OMB No. 055-R0274), which shall be signed and accepted by a duly authorized representative of the lender acting in good faith;

(2) If a lender extends such credit under a revolving credit agreement, Form FR G-3 need not be executed each time a disbursement is made under the agreement if:

(i) Form FR G-3 is executed at the time the credit arrangement is originally established;

(ii) the customer at that time states that the purpose or any extension under the agreement is to purchase or carry a margin security; and

(iii) either the collateral is sufficient for a purpose credit for the total amount covered by the agreement, or is sufficient for the amount of credit actually disbursed and a current list of collateral is appended to the executed Form FR G-3 each time credit is disbursed under the agreement.

(f) *Single credit rule.* (1) A lender that has extended purpose credit secured by a margin security may not subsequently extend unsecured purpose credit to the same customer unless the combined credit does not exceed the maximum loan value of the security securing the prior credit;

(2) If a lender extended unsecured purpose credit to a customer prior to the extension of purpose credit secured by a margin security, the credits shall be combined and treated as a single credit solely for the purpose of the withdrawal and substitution provision of paragraph (h) of this section.

(g) *Mixed collateral loans.* A purpose credit secured in part by a margin security, and in part by other collateral shall be treated as two separate loans, one secured by the margin security and one by all other collateral. A lender may use a single credit agreement, but it shall maintain its records so that each portion of the credit and its collateral are identified for the purpose of evidencing compliance with this part.

(h) *Withdrawals and Substitutions.* (1) A lender may permit any withdrawal or substitution of cash or collateral by the customer if, after the transaction, the withdrawal or substitution would not:

(i) Cause the credit to exceed the maximum loan value of the collateral; or
(ii) Increase the amount by which the credit exceeds the maximum loan value of the collateral.

(2) For purposes of this section, the maximum loan value of the collateral on the day the withdrawal or substitution shall be used.

(i) *Exchange offers.* To enable a customer to participate in an exchange offer that is made to all holders of an issue of margin securities, a lender may permit substitution of the securities received for the securities exchanged. A nonmargin nonexempted security acquired in exchange for a margin security shall be treated as if it is a margin security for a period of 60 days following the exchange.

(j) *Renewals and extensions of maturity.* A renewal or extension of maturity of a credit need not be considered a new extension of credit if the amount of the credit is increased only by the addition of interest, service charges or taxes with respect to the credit.

(k) *Transfers of credit.* (1) A transfer of a credit between customers or lenders shall not be considered a new extension of credit if:

(i) The original credit was in conformity with this part;
(ii) The transfer is not made to evade this part;
(iii) The amount of credit is not increased; and
(iv) The collateral for the credit is not changed.

(2) Any transfer between customers at the same lender shall be accompanied by a statement by the transferor customer describing the circumstances giving rise to the transfer and accepted in good faith and signed by an officer of the lender as having been so accepted. The lender shall keep such statement with its records of the transferee account.

(3) When a transfer is made between lenders, the transferee lender shall obtain a copy of the Form FR G-3 originally filed with the transferor lender and retain the copy with its records of the transferee account.

(1) *Action for lender's own protection.* Nothing in this part shall require a lender to waive or forego any lien or prevent a lender from taking any action that it deems necessary in good faith for its own protection.

(m) *Mistakes in good faith.* A mistake in good faith in connection with the extension or maintenance of credit shall not be a violation of this part.

(n) *Annual Report.* Every registered lender shall, within 30 days following June 30 of every year, file Form FR G-4 (OMB No. 055-R0267).

(o) *Where to register and file applications and reports.* Registration statements, applications to terminate registration, and annual reports shall be filed with the Federal Reserve Bank of the district in which the principal office of the lender is located.

§ 207.4 Credit to broker-dealers.

No lender shall extend or maintain credit secured, directly or indirectly, by any margin security to a customer who is subject to Part 220, except in the following circumstances:

(a) *Emergency Loans.* Credit extended in good faith reliance upon a certification from the customer that the credit is essential to meet emergency needs arising from exceptional circumstances. Any collateral for such credit shall have good faith loan value.

(b) *Capital Contribution Loans.* Credit that the Board has exempted by order upon a finding that the exemption is necessary or appropriate in the public interest or for the protection of investors, provided the Securities

Investor Protection Corporation certifies to the Board that the exemption is appropriate.

§ 207.5 Employee stock option and stock purchase plans.

(a) *Plan lender; Eligible Plan.* (1) Plan Lender. A corporation, a lender wholly owned by that corporation, or a lender which is a membership thrift organization whose membership is limited to employees and former employees of that corporation, its subsidiaries and affiliates, that extends or maintains credit to finance the acquisition of securities pursuant to an eligible plan;

(2) *Eligible Plan.* An employee stock option or purchase plan adopted by a corporation and approved by its stockholders that provides for the extension of credit to officers or employees to finance their purchase of margin securities of the corporation, its subsidiaries or affiliates.

(b) *Credit to exercise right under eligible plans.* (1) If a plan-lender extends or maintains credit to its officers and employees, or those of its subsidiaries or affiliates, to finance the exercise of rights granted under an eligible plan of the corporation, a margin security that directly or indirectly secures that credit shall have good faith loan value.

(2) Credit extended under this section shall be treated separately from credit extended under any other section in this part.

§ 207.6 Requirements for the List of OTC Margin Securities.

(a) *Requirements for inclusion on the list of OTC margin securities.* Except as provided in paragraph (d) of this section, OTC margin security shall meet the requirements that:

(1) The security is registered under section 12 of the Act (15 U.S.C. 781), is issued by an insurance company subject to section 12(g)(2)(G) (15 U.S.C. 781(g)(2)(G)), is issued by a closed end investment management company subject to registration pursuant to section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8), is an American Depository Receipt ("ADR") of a foreign issuer whose securities are registered under section 12 of the Act, or is a security of an issuer required to file reports under section 15(d) of the Act (15 U.S.C. 780(d));

(2) Four or more dealers make a market in the security and regularly submit bona fide bids and offers to an automated quotations system for their own accounts;

(3) There are 1,200 or more holders of record, as defined in SEC Rule 12g5-1 (17 CFR 240.12g5-1), of the security who are not officers, directors or beneficial owners of 10 percent or more of the security, or the average daily trading volume of such security as determined by the Board, is at least 500 shares;

(4) The issuer or a predecessor in interest has been in existence for at least three years;

(5) The security has been publicly traded for at least six months;

(6) Daily quotations for both bid and asked prices for the security are continuously available to the general public;

(7) There are 400,000 or more shares of such security outstanding in addition to shares held beneficially by officers, directors or beneficial owners of more than 10 percent of the security;

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

(9) The issuer had at least \$4 million of capital, surplus, and undivided profits.

(b) *Requirements for continued inclusion on the list of OTC margin securities.* Except as provided in paragraph (d) of this section, an OTC margin security shall meet the following requirements:

(1) The security is registered or issued under the conditions specified in paragraph (a)(1) of this section;

(2) Three or more dealers make a market in the security and regularly submit bona fide bids and offers to an automated quotations system for their own accounts;

(3) There continue to be 800 or more holders of record, as defined in SEC Rule 12g5-1 (17 CFR 240.12g5-1), of the security who are not officers, directors, or beneficial owners of 10 percent or more of the security, or the average daily trading volume of such security, as determined by the Board, is at least 300 shares;

(4) Daily quotations for both bid and asked prices for the security are continuously available to the general public;

(5) There are 300,000 or more shares of such security outstanding in addition to shares held beneficially by officers, directors, or beneficial owners of more than 10 percent of the security;

(6) The minimum average bid price of the security, as determined by the Board, is at least \$2 per share; and

(7) The issuer has at least \$2 million of capital, surplus, and undivided profits.

(c) *Removal from the list of OTC margin securities.* The Board shall from time to time remove from the OTC

margin security list securities that cease to:

(1) Exist or of which the issuer ceases to exist, or

(2) Meet substantially the provisions of paragraph (b) of this section.

(d) *Discretionary authority of Board.* The foregoing notwithstanding, the Board may omit or remove any security that is not traded on a national securities exchange from or add any such security to such list of OTC margin securities, if in the judgment of the Board, such action is necessary or appropriate in the public interest.

(e) *Unlawful Representations.* It shall be unlawful for any creditor to make, or cause to be made, any representation to the effect that the inclusion of a security on the list of OTC margin securities is evidence that the Board or the SEC has in any way passed upon the merits of, or given approval to, such security or any transactions therein. Any statement in an advertisement or other similar communication containing a reference to the Board in connection with the list or securities on that list shall be an unlawful representation.

§ 207.7 Supplement.

(a) *Maximum loan value of a margin security.* The maximum loan value of a margin security shall be fifty percent of its current market value.

(b) *Maximum loan value of nonmargin securities and all other collateral.* The maximum loan value of a nonmargin security and all other collateral except puts, calls, or combinations thereof shall be their good faith loan value.

(c) *Maximum loan value of options.* Puts, calls and combinations thereof shall have no loan value.

By order of the Board of Governors of the Federal Reserve System, February 23, 1983.

William W. Wiles,
Secretary of the Board.

[FR Doc. 83-5155 Filed 2-28-83; 8:45 am]

BILLING CODE 6210-01-M

12 CFR Part 221

[Docket No. R-0458]

Credit by Banks; Complete Revision and Simplification of Regulation U

AGENCY: Federal Reserve System.

ACTION: Proposed rule.

SUMMARY: The Board proposes to revise Regulation U in its entirety. The proposed Regulation U is written in simplified language and organized in a more logical fashion. Obsolete provisions have been removed. This proposed revision incorporates amendments made to Regulation U in

January 1982 which exempted bank credit not secured by margin securities from the regulation and clarified the definition of the term "indirectly secured" (47 FR 2981) (January 21, 1982).

Certain filing requirements have been removed from the proposed regulation. The related forms, F.R. U-2, U-3, U-5 and U-6, will, therefore, be eliminated. Also, in cooperation with the Securities and Exchange Commission ("SEC"), references to SEC forms X-17A-12 (1) and (2), X-17A-16 (1) and (2), and X-17A-17 are being deleted so that the SEC may proceed with its proposal to eliminate these forms.

A new section is proposed to be added to Regulation U to notify nonmember banks who propose to lend to brokers and dealers on registered securities that they are required by statute (15 U.S.C. 78h) to comply with securities credit laws and regulations applicable to member banks. Currently, notice of this requirement is contained in Regulation T (12 CFR Part 220), but not in Regulation U. The Board believes that notice of this requirement should also be contained in Regulation U since the statute places an affirmative duty of compliance upon banks as well as brokers and dealers. This addition to Regulation U will not place any new compliance responsibilities on banks.

Under this proposed revision of Regulation U, the Board would remove, in its entirety, current 221.3(q), which regulates loans to certain lenders. This section was added to Regulation U in 1959 to limit the amount of credit available to "collateral lenders," who were neither banks nor broker-dealers and, therefore, not subject to the Board's then existing margin regulations. A comprehensive regulation (Regulation G, 12 CFR 207.1 et seq.) was adopted by the Board in 1968 to cover all lenders other than banks and broker-dealers, including collateral lenders. Because of the adoption of Regulation G, the retention of § 221.3(q) is no longer considered necessary.

DATE: Comments should be received on or before April 22, 1983.

ADDRESS: Comments, which should refer to Docket No. R-0458, may be mailed to the Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW., 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.

FOR FURTHER INFORMATION CONTACT: At the Board of Governors of the Federal Reserve System, Washington,

D.C. 20551, contact: Laura Homer, Securities Credit Officer, or Robert Lord, Attorney, Division of Banking Supervision and Regulation (202) 452-2781. At the Federal Reserve Bank of New York, contact: Mindy Silverman, Assistant Counsel, (212) 791-5032.

SUPPLEMENTARY INFORMATION: The Board proposes to revise Regulation U by: (1) Simplifying the language in all provisions, (2) removing obsolete provisions, and (3) reordering provisions in a more logical manner.

Explanation of Changes

The proposed Regulation U is divided into eight sections which, in the following order: (1) State the legal basis and scope of the regulation, (2) define the terms used throughout the regulation, (3) state the general rule, (4) require non-member banks to file agreements with the Board before they engage in securities credit transactions with brokers or dealers, (5) separately treat loans made to brokers or dealers for market facilitating purposes, (6) specify transactions which are exempt from the requirements of the regulation, (7) set forth the criteria for inclusion on the List of OTC Margin Securities, and (8) establish the maximum loan value of different types of collateral.

Unless otherwise noted, no substantive changes have been made to the regulation. The regulation has been reorganized in a more logical fashion and the language has been simplified for easier understanding. In addition, obsolete terms and provisions have been removed, and parts of the regulation incorporate Board and staff interpretations issued during the course of administration of the rule.

The revised definition of "indirectly secured" adopted by the Board in January, 1982 did not contain a specific exception (contained in an earlier definition) that a loan will not be considered "indirectly secured" if a lender in good faith has not relied upon margin securities as collateral. It was not the intent of the Board, however, to remove this exception, and interpretations have been issued making this point clear. To avoid misunderstanding, language has been added to the definition in the proposed revision to clarify this point.

A section by section analysis of the proposed Regulation U follows.

1. *Authority, Purpose and Scope.* This section states the Board's legal authority to promulgate Regulation U, the purpose of the rule, and the fact that its coverage is limited to banks.

2. *Definitions.* This section contains eleven definitions of terms used

throughout the regulation. All terms of art not defined in the Securities Exchange Act of 1934 ("1934 Act") (15 U.S.C. 78a et seq.) itself are defined in this section. The term "bank", although defined in the 1934 Act, is defined more precisely in the proposed regulation. Other terms which have, over the past five decades, achieved "common usage" status in margin regulation parlance have been incorporated into the regulation and are, therefore, defined in this section. Some definitions are scattered throughout the current regulation. All such definitions have been brought within a single definitional section.

3. *General Requirements.* This section contains the general rules which banks must follow when extending, maintaining or arranging credit on the collateral of margin securities. It places limits on the amount of credit banks can extend when the purpose is to purchase or carry securities and the loan is secured by margin securities.

The "general requirements" section also contains the "single credit" rule, which directs banks to aggregate the amount of purpose credit extended to a single customer in order to prevent evasion of the rule. This section also specifically permits the use of other collateral with margin securities to support a purpose credit. Under the present rule, as written, there is some ambiguity as to whether such "mixed collateral" loans are permissible.

This section also requires banks who extend credit on margin securities to obtain a Form F.R. U-1, which requires a borrower to state the purpose and amount of a loan, and list the margin securities used as collateral.

Withdrawals and substitutions of collateral for an existing loan are permitted by this section: (1) As long as such action would not result in an increase in the amount by which the credit exceeds the maximum loan value of the collateral, or (2) at any time that the collateral has loan value in excess of that required by the regulation. In addition, withdrawals of collateral will be permitted to enable a customer to participate in an exchange offer, provided the securities received in exchange are substituted for the securities withdrawn and treated as margin securities for a period of sixty days following the exchange.

Provisions regarding extensions and maturities of credit, transfers of credit, mistakes made in good faith, and action which a bank may take for its own protection have been consolidated in this section. These provisions are scattered throughout the current regulation.

4. *Agreements of Non-Member Banks.* This is a new section of Regulation U. Section 8 of the 1934 Act (15 U.S.C. 78h) prohibits brokers and dealers from borrowing on registered securities unless they borrow from either a member bank or a nonmember bank that has filed an agreement with the Board agreeing to comply with all laws applicable to member banks in connection with securities credit transactions. This statutory requirement is currently embodied in Regulation T (12 CFR 220.1 et seq.), which is applicable to brokers and dealers. However, it is the nonmember bank which has the affirmative duty to file such agreements (F.R. T-1 and F.R. T-2) with the Board. In the interest of providing nonmember banks with more adequate notice of this statutory requirement, this subsection is being added to Regulation U.

5. *Special Purpose Loans to Brokers and Dealers.* Since the inception of Regulation U, the Board recognized that banks made certain specialized loans to brokers and dealers which were either short-term loans to facilitate settlement and clearance or loans regulated at another level. These loans have always been treated differently from regular margin loans. Provision is made in a separate section, therefore, by which banks may give a "good faith" valuation to any collateral furnished by brokers and dealers who borrow for any one or more of the thirteen specialized purposes listed in the regulation. Special treatment of such loans is conditioned upon receipt of certified statements from the broker or dealer as to the purpose of the loan. Comparable exceptions to the general credit limitations are in the current Regulation U, but the proposed rule consolidates all of these exceptions into one section and removes any limitations on the type of collateral securing the loans.

The provisions regarding credit extended to block positioners, OTC market makers, and third market makers will no longer refer to SEC Forms X-17A-12(1), X-17A-16(1), and X-17A-17. This will obviate the need for filing these forms with the SEC as a prerequisite to eligibility for special credit. It is the Board's understanding that the SEC is preparing to rescind its rules pursuant to which these forms are required.

6. *Exempted Transactions.* This section grants outright exemptions to nine specific kinds of non-broker-dealer bank loans. All but one of these exemptions are contained in various sections of the current regulation. The proposed rule consolidates the existing

exemptions into one section. A new exemption is provided for loans to employee stock ownership plans (ESOPs) qualified under section 401 of the Internal Revenue Code. The purpose of this new exemption is to provide banks with an opportunity to give the same kind of treatment for employee loans as is now provided for similar corporate lenders referred to as "plan lenders" under Regulation G.

7. *List of OTC Margin Securities.* This section contains the criteria for initial and continued inclusion on the Board's List of OTC Margin Securities. These criteria were recently amended to conform more closely with the listing requirements of major exchanges (47 F.R. 21,756) (May 20, 1982).

8. *Supplement.* This final section assigns value to various types of collateral for purposes of the regulation. Three specific types of collateral are given loan value: (1) Margin securities have a maximum loan value of fifty per cent of their current market value; (2) all other collateral, other than puts, calls or combinations thereof, are assigned a "good faith" loan value; and (3) puts, calls and combinations are given no loan value.

9. *Specific Comments Requested.* The Board is seeking specific public comment on the question whether Regulations G and U should be combined to form a new comprehensive regulation with various subchapters or whether the two regulations should be maintained separately in their simplified forms.

Initial Regulatory Flexibility Analysis

The Board of Governors of the Federal Reserve System is requesting comment on a proposal to completely revise its margin regulation governing banks. These changes are part of a program to simplify all of the Board's margin regulations, generally, and to reduce specific administrative and regulatory burdens imposed upon lenders. The simplification of Regulation U that is being proposed at this time will provide benefits in the form of overall clarity and consistency of treatment among margin lenders. The Board, therefore, certifies for the purposes of 5 U.S.C. 605(b) that the changes proposed are not expected to have any adverse impact on a substantial number of small businesses.

List of Subjects in 12 CFR Part 221

Banks, banking, Credit, Federal Reserve System, Reporting and recordkeeping requirements, Securities.

Accordingly, pursuant to sections 3, 7, 8 and 23 of the Securities Exchange Act of 1934, as amended (15 U.S.C. 78c, 78g,

78h and 78w) the Board proposes to completely revise Regulation U (Part 221) to read as follows:

PART 221—CREDIT EXTENDED BY BANKS FOR THE PURPOSE OF PURCHASING OR CARRYING MARGIN SECURITIES

- Sec.
221.1 Authority, purpose and scope.
221.2 Definitions.
221.3 General requirements.
221.4 Agreements of nonmember banks.
221.5 Special purpose loans to brokers and dealers.
221.6 Exempted Transactions.
221.7 Requirements for the List of OTC Margin Securities.
221.8 Supplement.

Authority: Secs. 3, 7, 8, and 23 of the Securities Exchange Act of 1934, as amended (15 U.S.C. 78c, 78g, 78h, 78w).

§ 221.1 Authority, purpose and scope.

(a) *Authority and Purpose.* Regulation U ("this part"), is issued by the Board of Governors of the Federal Reserve System ("the Board") pursuant to the Securities Exchange Act of 1934 ("the Act") (15 U.S.C. 78a, et seq.). Its principal purpose is to regulate banks that extend or maintain credit for the purpose of purchasing or carrying securities.

(b) *Scope.* This part imposes credit restrictions upon "banks", as that term is defined in § 221.2(b) of this part, that extend credit for the purpose of purchasing or carrying margin securities if the credit is secured directly or indirectly by margin securities. Banks extending such credit may not extend more than the maximum loan value of the collateral securing the credit. The maximum loan value of a margin security, set by the Board, can be found in the Supplement to Regulation U (12 CFR 221.8) and is stated in terms of a percentage of the current market value of the collateral. All other collateral has "good faith" loan value, which is defined in § 221.2(f) of this part.

§ 221.2 Definitions.

The terms used in this part have the meanings given them in section 3(a) of the Act (15 U.S.C. 78c(a)) or as defined in this section.

(a) *"Affiliate"* (1) A bank holding company of which a bank is a subsidiary within the meaning of the Bank Holding Company Act of 1956, as amended, (12 U.S.C. 1841(d)); (2) any other subsidiary of such bank holding company; or (3) any other corporation, business trust, association, or other similar organization that is an affiliate as defined in section 2(b) of the Banking Act of 1933 (12 U.S.C. 221a).

(b) *"Bank"* has the meaning given to it in section 3(a)(6) of the Act (15 U.S.C. 78c(a)(6)) and includes a subsidiary of a bank, a corporation organized under section 25(a) of the Federal Reserve Act (12 U.S.C. 611) and an agency or branch of a foreign bank located within the United States. "Bank" does not include a savings and loan association, a credit union, any lending institution that is an instrumentality or agency of the United States, or any member of a national securities exchange.

(c) *"Carrying credit"* is credit that enables a customer to maintain a position in a margin security or reduce or retire indebtedness originally incurred to purchase a security that is currently a margin security.

(d) *"Current market value"* means: (1) For a security, the closing sale price of the security on the preceding business day, as shown by any regularly published reporting or quotation service. If the credit is used to finance the purchase of the security, the bank may use the security's total cost of purchase. Computation of total cost may include any commissions charged. If there is no closing sale price, the bank may use any reasonable estimate of the market value of the security as of the close of business on the preceding business day.

(2) Any other collateral shall be valued by any reasonable method in accordance with generally accepted accounting principles and sound banking practices.

(e) *"Customer"* includes any person or group of persons acting jointly, to or for whom a bank is extending or maintaining credit.

(f) *"Good faith"* (1) With respect to the acceptance of or notice or certification from or on behalf of a customer that the bank or its duly authorized representative is alert to the circumstances surrounding the credit, and if in possession of information that would cause a prudent person not to accept the statement or notice without inquiry, investigates and is satisfied that the statement or notice is truthful;

(2) With respect to the loan value of collateral means that amount which a bank, exercising sound banking judgment, would lend on particular collateral, without regard to other assets of the customer or other collateral held in connection with separate transactions. Good faith loan value may not exceed 100 percent of the current market value of the collateral.

(g) *"Indirectly secured"* includes any arrangement with the customer under which the customer's right or ability to sell, pledge, or otherwise dispose of margin security owned by the customer

is in any way restricted as long as the credit remains outstanding or under which the exercise of such right is or may be cause for acceleration of the maturity of the credit.

The foregoing shall not apply:

(1) If, following application of the proceeds of the credit, not more than twenty-five percent of the value of the assets subject to the arrangement, as determined by any reasonable method, consists of margin securities;

(2) To a lending arrangement that permits acceleration of the maturity of the credit as a result of a default under, or the renegotiation of the terms of, another credit to the same customer by another lender that is not an affiliate of the bank;

(3) If the margin security is held by the bank only in the capacity of custodian, depository, or trustee, or under similar circumstances; or

(4) If the bank in good faith has not relied upon the margin security as collateral in the extension or maintenance of the particular credit.

(h) "*Margin security*" (1) Any equity security registered on a national securities exchange or having unlisted trading privileges; (2) any OTC margin security; (3) any debt security which is convertible into a margin security, or carrying a warrant or right to subscribe to or purchase a margin security; (4) any warrant or right to subscribe to or purchase a margin security; (5) any security issued by an investment company, other than a company licensed under the Small Business Investment Company Act, as amended (15 U.S.C. 661), registered under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8).

(i) "*Maximum loan value*" is the percentage of current market value assigned by the Board under § 221.8 of this part to specified types of collateral.

(j) "*OTC margin security*" is any equity security not traded on a national securities exchange that the Board has determined has the degree of national investor interest, the depth and breadth of market, the availability of information respecting the security and its issuer, and the character and permanence of the issuer to warrant being treated like an equity security traded on a national securities exchange. The Board will from time to time publish a list of the OTC margin securities that it has determined meet the criteria set forth in § 221.7 of this part.

(k) "*Purpose credit*" is any credit that is for the purpose, whether immediate, incidental, or ultimate, of purchasing or carrying margin securities.

§ 221.3 General requirements.

(a) *Extending, maintaining, and arranging credit.* (1) *Extending credit.* No bank shall extend any purpose credit, secured directly or indirectly by margin securities, in an amount that exceeds the maximum loan value of the collateral securing the credit. The maximum loan value of a margin security (set forth in § 221.8 of this part) is assigned by the Board in terms of a percentage of the current market value of the margin security. All other collateral has "good faith" loan value, as defined in § 221.2(f) of this part.

(2) *Maintaining credit.* A bank may maintain any credit that it initially extended without violating this part, regardless of: (i) Reduction in the customer's equity resulting from change in market prices; (ii) change in the margin requirements prescribed by this part; or (iii) change in the status of the security (from nonmargin to margin) securing an existing purpose credit.

(3) *Arranging credit.* No bank may arrange for the extension or maintenance of any credit for the purpose of purchasing or carrying any margin security, except upon the same terms and conditions under which the bank itself may extend or maintain such credit under the provisions of this part.

(b) *Purpose statement.* (1) Whenever a bank extends credit secured directly or indirectly by margin security, the bank shall require its customer to execute Form F.R. U-1 (OMB No. 7100-0115), which shall be signed and accepted by a duly authorized officer of the bank acting in good faith.

(2) If a bank extends such credit under a revolving credit agreement, Form F.R. U-1 need not be executed each time a disbursement is made under the agreement if:

(i) Form F.R. U-1 is executed at the time the credit arrangement is originally established;

(ii) The customer at that time states that the purpose of any extension under the agreement is to purchase or carry margin securities; and

(iii) Either the collateral is sufficient for a purpose credit for the total amount covered by the agreement, or is sufficient for the amount of credit actually disbursed and a current list of collateral is appended to the executed Form F.R. U-1 each time credit is disbursed under the agreement.

(c) *Single credit rule.* (1) A bank that has extended purpose credit secured by margin securities may not subsequently extend unsecured purpose credit to the same customer unless the combined credit does not exceed the maximum loan value of the security securing the prior credit.

(2) If a bank extended unsecured purpose credit to a customer prior to the extension of purpose credit secured by margin security, the credits shall be combined and treated as a single credit solely for the purposes of the withdrawal and substitution provision of paragraph (e) of this section.

(d) *Mixed collateral loans.* A purpose credit secured in part by margin security, and in part by other collateral shall be treated as two separate loans, one secured by margin security and one by all other collateral. A bank may use a single credit agreement, but it shall maintain its records so that each portion of the credit and its collateral are identified for the purpose of evidencing compliance with this part.

(e) *Withdrawals and Substitutions* (1) A bank may permit any withdrawals or substitution of cash collateral by the customer if, after the transaction, the withdrawal or substitution would not: (i) Cause the credit to exceed the maximum loan value of the collateral; or (ii) increase the amount by which the credit exceeds the maximum loan value of the collateral.

(2) For purposes of this section, the maximum loan value of the collateral on the day of the withdrawal or substitution shall be used.

(f) *Exchange offers.* To enable a customer to participate in an exchange offer that is made to all holders of an issue of margin securities, a bank may permit substitution of the securities received. A nonmargin, nonexempted security acquired in exchange for a margin security shall be treated as if it is a margin security for a period of 60 days following the exchange.

(g) *Renewals and extensions of maturity.* A renewal or extension of maturity of a credit need not be considered a new extension of credit if the amount of the credit is increased only by the addition of interest or service charges with respect to the credit.

(h) *Transfers of credit.* (1) A transfer of a credit between customers or banks shall not be considered a new extension of credit if: (i) The original credit was in conformity with this part; (ii) the transfer is not made to evade this part; (iii) the amount of credit is not increased; and (iv) the collateral for the credit is not changed.

(2) Any transfer between customers at the same bank shall be accompanied by a statement by the transferor customer describing the circumstances giving rise to the transfer and accepted in good faith and signed by an officer of the bank as having been so accepted. The

bank shall keep such statement with its records of the transferee account.

(3) When a transfer is made between banks, the transferee bank shall obtain a copy of the Form F.R. U-1 originally filed with the transferor bank and retain the copy with its records of the transferee account.

(i) *Mistakes in good faith.* A mistake in good faith in connection with the extension or maintenance of credit shall not be a violation of this part.

(j) *Action for bank's own protection.* Nothing in this part shall require a bank to waive or forego any lien or prevent a bank from taking any action that it deems necessary in good faith for its own protection.

§ 221.4 Agreement of nonmember banks.

(a) Banks not members of the Federal Reserve System shall execute a Form F.R. T-1 or F.R. T-2, prior to extending any credit secured by any non-exempt security registered on a national securities exchange to persons subject to Regulation T (12 CFR Part 220), as follows:

(1) Form F.R. T-1 shall be filed by any nonmember bank that has its principal place of business in the United States.

(2) Form F.R. T-2 shall be filed by all other nonmember banks.

(b) Any nonmember bank may terminate its agreement if it obtains the written consent of the Board.

§ 221.5 Special purpose loans to brokers and dealers.

(a) A member bank, and a nonmember bank that is in compliance with § 221.4 of this part may extend and maintain purpose credit on a good faith loan value basis to brokers and dealers without regard to the limitations set forth in section 221.3 of this part if the credit is for any of the specific purposes set forth in paragraph (c) of this section and meets the conditions set forth therein.

(b) Prior to extending any credit to a broker or dealer pursuant to this section, the bank shall in good faith obtain and accept a written notice or certification from the borrower as to the purposes of the loan. The written notice or certification shall be evidence of continued eligibility for the special credit provisions until the broker or dealer notifies the bank that it is no longer eligible or the bank has information that would cause a reasonable person to question whether the proceeds of the credit are being used for the purpose specified.

(c) The types of credit that may be extended and maintained on a good faith loan value basis are as follows:

(1) *Hypothecation loans.* Credit secured by hypothecated customer securities that, according to written notice received by the bank from the broker or dealer, are securities carried for the accounts of customers that the broker or dealer is permitted to hypothecate under Securities and Exchange Commission ("SEC") rules.

(2) *Temporary advances in payment-against-delivery transactions.* Credit extended to finance the purchase of sale of securities for prompt delivery, if the credit is to be repaid in full upon completion of the transaction.

(3) *Loans for securities in transit or transfer.* Credit extended to finance securities in transit or surrendered for transfer, if the credit is to be repaid upon completion of the transaction.

(4) *Intra-day loans.* Credit that is to be repaid on the same day it is extended for the purpose of enabling a broker or dealer to pay for securities purchased for customers.

(5) *Arbitrage loans.* Credit to finance proprietary or customer *bona fide* arbitrage transactions. For the purpose of this section *bona fide* arbitrage means:

(i) Purchase or sale of a security in one market, together with an offsetting sale or purchase of the same security in a different market, at as nearly the same time as practicable, for the purpose of taking advantage of a difference in prices in the two markets; or

(ii) Purchase of a security that is, without restriction other than the payment of money, exchangeable or convertible within 90 calendar days of the purchase into a second security, together with an off-setting sale of the second security, at or about the same time, for the purpose of taking advantage of a concurrent disparity in the price of the two securities.

(6) *Distribution loans.* Credit to finance the distribution of securities to customers.

(7) *Odd-lot loans.* Credit to finance the odd-lot transaction of a person registered as an odd-lot dealer on a national securities exchange.

(8) *Emergency loans.* Credit extended in good faith reliance upon a certification from the broker or dealer that it is essential to meet emergency needs arising from exceptional circumstances.

(9) *Capital contribution loans.* (i) Credit that the Board has exempted by order upon a finding that the exemption is necessary or appropriate in the public interest or for the protection of investors provided, the Securities Investor Protection Corporation certifies to the Board that the exemption is appropriate; or

(ii) Credit to a customer for the purpose of making a subordinated loan or capital contribution to a broker or dealer in conformity with the SEC's net capital rules and the rules of the broker's or dealer's Examining Authority, provided:

(A) That the customer shall reduce the credit by the amount of any reduction in the loan or contribution to the broker or dealer; and

(B) The credit is not used to purchase securities issued by the broker or dealer in a public distribution.

(10) *Loans to specialists.* Credit extended to members of a national securities exchange who are registered and acting as specialists on the exchange for the purpose of financing the specialist transactions, provided the specialists' exchange requires, and submits to the Board, reports suitable for supplying current information regarding the specialist's use of credit.

(11) *OTC market maker credit.* Credit to a dealer who has given written notice to the bank that it is a "qualified OTC market maker" in an OTC margin security as defined in SEC Rule 3b-8 (17 CFR 240.3b-8) and that the credit will be used solely for the purpose of financing the market making activity.

(12) *Third market maker loans.* Credit to a dealer who has given written notice to the bank that it is a "qualified third market maker," as defined in SEC Rule 3b-8 (17 CFR 240.3b-8) and that the credit will be used solely for the purpose of financing positions in securities assumed as a "qualified third market maker."

(13) *Block positioner credit.* Credit to a dealer who has given written notice to the bank that it is a "qualified block positioner" for a block of securities, as defined in SEC Rule 3b-8 (17 CFR 240.3b-8) and that the credit will be used to finance a position in that block.

§ 221.6 Exempted transactions.

A bank may extend and maintain purpose credit without regard to the provisions of this part if such credit is extended:

(a) To any bank;

(b) To any foreign banking institution;

(c) Outside the United States; or

(d) To an employee security ownership plan ("ESOP") qualified under section 401 of the Internal Revenue Code (26 U.S.C. 401)

(e) To any "plan lender" as defined in Regulation G (12 CFR Part 207) to finance such a plan, provided the bank has no recourse to any securities purchased pursuant to the plan;

(f) To any customer, other than a broker or dealer, to temporarily finance

the purchase or sale of securities for prompt delivery, if the credit is to be repaid in the ordinary course of business upon completion of the transaction;

(g) Against securities in transit, if the credit is not extended to enable the customer to pay for securities purchased in an account subject to Regulation T (12 CFR Part 220); or

(h) To enable a customer to meet emergency expenses not reasonably foreseeable. The extension of credit shall be supported by a statement executed by the customer and accepted in good faith and signed by an officer of the bank as having been so accepted. For this purpose, such emergency expenses shall include expenses arising from circumstances such as the death or disability of the customer, or some other change in circumstances involving extreme hardship, not reasonably foreseeable at the time the credit was extended. The opportunity to realize monetary gain or to avoid loss is not a "change in circumstances" for this purpose.

§ 221.7 Requirements for the list of OTC Margin Securities.

(a) Requirements for inclusion on the list of OTC margin securities. Except as provided in paragraph (d) section, an OTC margin security shall meet the requirements that:

(1) The security is registered under section 12 of the Act (15 U.S.C. 781), is issued by an insurance company subject to section 12(g)(2)(G) (15 U.S.C. 781(g)(2)(G)), is issued by a closed end investment management company subject to registration pursuant to section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8), is an American Depository Receipt ("ADR") of a foreign issuer whose securities are registered under section 12 of the Act, or is a security of an issuer required to file reports under section 15(d) of the Act (15 U.S.C. 78o(d));

(2) Four or more dealers make a market in such a security and regularly submit bona fide bids and offers to an automated quotations system for their own accounts;

(3) There are 1,200 or more holders of record, as defined in SEC Rule 12g5-1 (17 CFR 240.12g5-1), of the security who are not officers, directors or beneficial owners of ten percent or more of the security, or the average daily trading volume of such a security as determined by the Board, is at least 500 shares;

(4) The issuer or a predecessor in interest has been in existence for at least three years;

(5) The security has been publicly traded for at least six months;

(6) Daily quotations for both bid and asked prices for the security are continuously available to the general public;

(7) There are 400,000 or more shares of such security outstanding in addition to shares held beneficially by officers, directors or beneficial owners of more than ten percent of the security;

(8) The minimum average bid price of such security, as determined by the Board, is at least five dollars per share; and

(9) The issuer had at least four million dollars of capital, surplus, and undivided profits.

(b) *Requirements for continued inclusion on the list of OTC margin securities.* Except as provided in paragraph (d) of this section, an OTC margin security shall meet the following requirements:

(1) The security is registered or issued under the conditions specified in paragraph (a)(1) of this section;

(2) Three or more dealers make a market in such security and regularly submit bona fide bids and offers to an automated quotations system for their own accounts;

(3) There continue to be 800 or more holders of record, as defined in SEC Rule 12g5-1 (17 CFR 240.12g5-1), of the security who are not officers, directors, or beneficial owners of ten percent or more of the security, or the average daily trading volume of such security, as determined by the Board, is at least 300 shares;

(4) Daily quotations for both bid and asked prices for the security are continuously available to the general public;

(5) There are 300,000 or more shares of such security outstanding in addition to shares held beneficially by officers, directors, or beneficial owners of more than ten percent of the security;

(6) The minimum average bid price of such security, as determined by the Board, is at least two dollars per share; and

(7) The issuer has at least two million dollars of capital, surplus, and undivided profits.

(c) *Removal from the list of OTC margin securities.* The Board shall from time to time remove from the OTC margin security list securities that cease to:

(1) Exist or of which the issuer ceases to exist, or

(2) Meet substantially the provisions of paragraph (b) of this section.

(d) *Discretionary authority of Board.* The foregoing notwithstanding, the Board may omit or remove any security that is not traded on a national securities exchange from or add any

such security to such list of OTC margin securities, if in the judgment of the Board, such action is necessary or appropriate in the public interest.

(e) *Unlawful Representations.* It shall be unlawful for any bank to make, or cause to be made, any representation to the effect that the inclusion of a security on the list of OTC margin securities is evidence that the Board or the SEC has in any way passed upon the merits of, or given approval to, such security or any transactions therein. Any statement in an advertisement or other similar communication containing a reference to the Board in connection with the list or securities on that list shall be an unlawful representation.

§ 221.8 Supplement.

(a) *Maximum loan value of margin securities.* The maximum loan value of any margin security is fifty percent of its current market value.

(b) *Maximum loan value of nonmargin securities and all other collateral.* The maximum loan value of nonmargin securities and all other collateral except puts, call, or combinations thereof is their good faith loan value.

(c) *Maximum loan value of options.* Puts, calls, and combinations thereof have no loan value.

By order of the Board of Governors of the Federal Reserve System, February 23, 1983.

William W. Wiles,
Secretary of the Board.

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