

FEDERAL RESERVE BANK OF DALLAS

DALLAS, TEXAS 75222

Circular No. 83-73
June 9, 1983

REGULATION T
CREDIT BY BROKERS AND DEALERS

(Revised Regulation)

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

The Board of Governors of the Federal Reserve System has adopted a completely revised and simplified version of its Regulation T, Credit by Brokers and Dealers. The new regulation will go into effect on November 21, 1983. However, creditors may begin to operate under its terms as early as June 20, 1983.

Enclosed is a copy of the Board's press release and the regulation as published in the Federal Register. Questions regarding the material contained in this circular should be directed to the Legal Department, Extension 6171.

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

Enclosure

permitted to maintain separate margin accounts for a single person who is introduced by different brokers. Introducing brokers will also be permitted to maintain separate accounts for the same person if the accounts are cleared by different clearing brokers. A separate margin account may also be established for the same person if it is controlled by an investment adviser with discretionary authority.

The new regulation establishes a separate account for arbitrage transactions. This differs in form from the proposed revision, under which arbitrage transactions were to be recorded in the Market Functions Account.

Another difference between the proposed revision and the regulation adopted today is the elimination of the requirement in the Specialists' provision (§ 220.12) that exchanges file monthly reports with the Board disclosing the use of specialist credit. Regulation T currently requires a 25% margin on long and short positions in underlying stock serving as permitted offsets. The new regulation provides for a "good faith" margin in those situations. Specialists will have 7 days to deposit margin instead of the present 5 days in an effort to provide specialists with treatment parallel to that given public customers.

The regulation also takes cognizance of new instruments—securities-exchange-traded options on foreign currency, and options on certificates of deposit and equity stock indices—which were defined to be "securities" for purposes of the Securities Exchange Act of 1934 by Pub. L. 97-303. As has been previously announced (47 FR 47464 Oct. 26, 1982), Board staff is in the process of conducting a special study of the effectiveness, scope and structure of federal regulation of margin requirements. Accordingly, for the present time, the Board has set the margin level of these instruments as the amount specified by the rules of the national securities exchange on which the option is traded, provided that all such rules have been approved by the SEC. This is comparable to action taken in 1981 by the Board with respect to options on exempted debt securities (46 FR 49827 Oct. 8, 1981).

Other changes adopted today that are different from the proposed revision are as follows: (1) Permission to use a convertible or exchangeable security instead of the present 50% margin when the underlying security is sold short in a margin account; (2) permission for the use of convertible or exchangeable securities as proxies for the related security when call options are written in the cash account; (3) in connection with

the writing of put options, permission to use the following instruments as substitutes for cash, provided their current market value at the time the put is written equals or exceeds the exercise price of the option and provided further that they mature in one year or less: securities issued or guaranteed by the United States or its agencies, negotiable bank certificates of deposit, or bankers acceptances issued by banking institutions in the United States and payable in the United States; (4) one of the conditions under which an over-the-counter margin bond will be marginable has been changed to make the \$25 million size criterion applicable only at time of issuance, rather than at the time of the extension of credit, as was formerly the case and (5) minor refining language changes to the definitional section which will have no substantive effect on the regulation, but which were made to conform to industry usage.

EFFECTIVE DATE: November 21, 1983 but may be implemented after June 20, 1983, at the option of the creditor.

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:

I. History of the Proposed Revision of Regulation T

As part of its Regulatory Improvement Project, and after an extensive study conducted by the Federal Reserve Bank of New York on the margin regulations, the Board, on March 30, 1982 published for public comment a completely revised and simplified Regulation T, which governs credit extended by securities brokers and dealers. (FR 13376). The proposed simplification incorporated amendments to Regulation T adopted by the Board earlier in the year, as well as two proposed amendments issued for public comment prior to publication of the proposed simplification. The amendments already adopted by the Board and incorporated into the proposed complete revision expanded the permissible arranging activities of brokers and dealers and removed the automatic equity building features in the Regulation. (47 FR 2981, Jan. 21, 1982). The two amendments that were still in the proposal stage at the time of publication of the complete revision were adopted, with certain

FEDERAL RESERVE SYSTEM

12 CFR Part 220

[Docket No. R-0389]

Credit by Brokers and Dealers; Complete Revision and Simplification of Regulation T

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule.

SUMMARY: The Board is adopting a completely revised and simplified Regulation T, credit by brokers and dealers. The new Regulation incorporates changes made in response to comments received on the complete revision of Regulation T as well as proposals previously published and adopted. The 11 accounts currently required to be maintained by brokers and dealers will be consolidated into 7 accounts along functional lines. In addition, the new regulation will facilitate options writing by institutions and permit options clearing agencies to accept, under specified conditions, any underlying security as the required Regulation T deposit. Terminology throughout the new regulation has been conformed to that of modern-day industry usage so that the regulation will henceforth refer to "equity/margin requirement" instead of "maximum loan value/adjusted debit balance."

In response to comments received, the revised Regulation T will permit brokers to maintain more than one account for a customer in two situations. Under the old regulation, a customer's transactions had to be consolidated into a single margin account. Under the new regulation, a clearing broker will be

modifications, as final rules in May, 1982. They amended Regulation T (1) to permit letters of credit, CD's government securities and banker's acceptances to be used, in addition to cash, as collateral in broker/dealer securities borrowing and lending transactions (47 FR 21238, May 18, 1982), and (2) to specify new criteria for eligibility on the Board's List of OTC Margin Stocks (47 FR 21756, May 20, 1982).

Another amendment to Regulation T, proposed and adopted by the Board after publication of the complete revision, has been incorporated into the final rule. The amendment permits brokers and dealers to extend credit on the collateral of private mortgage pass-through securities meeting specified issue-size and reporting requirements (47 FR 55912, December 14, 1982).

A proposal to amend Regulation T by providing a framework for the regulation of credit extended in connection with transactions in stock index futures contracts has not been incorporated into the final rule adopted today. (47 FR 8788, March 2, 1982). This proposal is still under consideration by the Board.

II. Summary of Comments

There were thirty-eight (38) respondents to the Board's proposal to revise Regulation T. The respondents consisted of nine Federal Reserve Banks, sixteen broker/dealers, four self-regulatory organizations and exchanges, three trade associations, one clearing corporation, two law firms, two individuals and one State agency (North Carolina State Treasurer).

The majority of respondents supported the Board's efforts to simplify and reduce the language of Regulation T and to facilitate compliance with it. While the majority of the respondents requested both technical and language modifications, most felt that the proposed simplification would greatly reduce the burdens of recordkeeping and margin calculations for broker/dealers while not interfering with the Board's ability to regulate the extension of credit for the purchase of securities. Respondents such as the National Association of Securities Dealers, Merrill Lynch Pierce Fenner & Smith, and the Credit Division of the Securities Industry Association stated that the proposed regulation was responsive to changes taking place within the securities industry.

Several respondents, however, including the New York Stock Exchange (NYSE), repeated earlier positions that they have expressed to the Board and its staff that Regulation T should be eliminated and replaced by uniform margin regulations established by the

self-regulatory organizations with or without oversight authority by the Federal Reserve Board. Seven of the thirty-eight respondents argued in support of this position. Most of these respondents suggested technical and language changes to the proposed revised regulation in the event Regulation T was not eliminated. The NYSE acknowledged that some of its proposals to amend Regulation T may first require amendments to the Securities Exchange Act of 1934.

The continued role of the Board in the area of margin regulation is now being reviewed by Board staff in cooperation with the staffs of the Securities and Exchange Commission and the Commodity Futures Trading Commission (47 FR 47464, October 26, 1982). The study will consider possible recommendations for legislative change.

Many of the commenters requested that the Board provide an adequate implementation period to give firms time to adapt existing computer programs to changes required by the proposed revision. The implementation period requested ranged from two to six months. Several commenters also requested that the Board allow an additional comment period before the proposed regulation changes become mandatory. In view of the nature of the comments received, the Board does not believe that an additional comment period is necessary and that implementation of the revised regulation at an early date outweighs any further technical changes that may be necessary. The new regulation will go into effect on November 21, 1983, but creditors may at their option, begin to operate under its terms as early as June 20, 1983.

Many commenters requested that specific requirements, the imposition of which is currently left up to exchanges of firms, be mandated by the Board. For example, a request was made that the Board establish mandatory procedures for transferring accounts between brokers and fixed time periods for completion. The commenter making this request believes that such Board-imposed requirements would better serve the public than the system where each self-regulator designs its own requirements. The Board believes that granting such a request would be inconsistent with its efforts to simplify the Regulation and, therefore, has not adopted such requirements.

III. Detailed Explanation of Changes

1. General Applicability

(a) The titles of the accounts have been changed to titles that are more

descriptive of the contents of each account or simply to remove the term "special."

(b) The change in terminology from "adjusted debit balance/maximum loan value" to "margin/equity" is reflected in three sections of the regulation: Definitions (§ 220.2(a), (d), (f), (1), (m), and (n)), Margin Account (§ 220.4), and the Supplement (section 220.18).

2. Definitions, § 220.2

(a) The definition of "creditor" has been changed to conform the language to section 7 of the Securities Exchange Act of 1934 ("the Act") (15 U.S.C. section 78g) and to identify specific categories of persons coming within the definition.

(b) Language that is presently contained in paragraph (3) of the definition of "registered security" has been eliminated from the definition. That language is not necessary in light of the Board's authority, since 1968, to designate any security as marginable, *i.e.*, as having loan value in a margin account.

(c) The definition of "exempted security" has been removed from the regulation. The definition in section 3(a)(12) of the Act is sufficient because the only additional language presently in the regulatory definition is no longer necessary for the reason described in paragraph (b) above.

(d) In the definition of "OTC Margin Stock", the word "stock" has been replaced with the words "equity security" to clarify that the term includes convertible bonds and other instruments that are often not considered "stock." The criteria for inclusion on the list of OTC margin stocks has been moved from the Supplement to the body of the regulation, because it is not the type of requirement that the Board may need to change quickly, as are the margin levels.

(e) In response to several comments, the terms "equity deficiency" and "equity excess" have been changed to "margin deficiency" and "margin excess" in the definition section and throughout the regulation, as the terms in the proposal had a different meaning in the industry.

(f) A definition of "good faith margin" has been added because such a definition was added to the proposed revisions of Regulations G and U and is useful in simplifying language.

(g) A more descriptive definition of "short call or short put" (§ 220.2(w)) has been substituted for the definition contained in the original proposed revision. The new definitions will also refer to securities exchange-traded options on foreign currency, and options

on certificates of deposit and stock indices as these new instruments came within the Board's margin setting authority as a result of a legislative amendment (Pub. L. 97-303, amending 15 U.S.C. 78c(a)(10)) defining them as "securities" for purposes of the Securities Exchange Act of 1934.

(h) The definition of "OTC margin bond" has been changed to make the issue-size criterion applicable at time of issuance only. This will make the circumstances under which an OTC margin bond may be marginable consistent with the marginability of private mortgage pass-through securities (adopted by the Board in December 1982, 47 FR 55912, December 14, 1982).

3. General Provisions, § 220.3

(a) Separation of accounts, § 220.3(b).

(i) The term "segregation" has been replaced with "separation." A statement has been added to require written entries to be made when cash or securities are used to meet requirements in another account, if withdrawals of cash or securities are permitted under the regulation.

(b) Receipt of Funds or Securities, § 220.3(e). (i) The language that a creditor may "at his option" treat the various types of noncash payment as receipt of payment was removed as unnecessary.

(ii) Certain language was removed from the existing regulation describing a check, draft or order as drawn on a bank or a savings bank, which in the ordinary course of business is payable on presentation, as unnecessary. As long as the instrument is, by its terms or usage, payable on presentation and is accepted by the creditor in good faith, it may be considered receipt of payment, whether it is drawn on a "bank" or on one of the other types of depository institutions that may issue such payment instruments.

(iii) The reference to "telegraphic" notice was also removed; since the creditor has the right to obtain hard copy of a telegraphic notice, it may be considered to be included in the term "written notice."

(c) Exchange of Securities, § 220.3(f). The subsection entitled "Reorganizations" and certain language of that section was changed. Staff has received inquiries from time to time on the meaning of "reorganization" and "recapitalization," and there has not been a clear understanding of the scope of the section. The new language is intended to clarify that the section covers any exchange offer that is made to all holders of an issue of securities. The new language also clarifies the requirement that the consideration

received in the exchange must be deposited in the account.

(d) Variable Annuity Contracts Issued by Insurance Companies, § 220.3(i). Most of the language from the present § 220.7(f) was eliminated as unnecessary.

(e) Valuing Securities, § 220.3(g)(1). Language has been added specifying that the computation of the total cost of a purchase or the net proceeds of a sale must include any commission charged. This is a formal statement of the accepted practice of including the cost of a commission when determining the cost of a transaction. Because the treatment of commissions has been addressed in this section, the reference to commissions in the section on service charges (present § 220.6(g)) has been deleted. (See new § 220.4(f).)

(f) Innocent mistakes, § 220.3(h). In response to comments the word "mechanical" was deleted so as to avoid any inference that violations may be excused for only "non-human" errors.

4. Margin Account, § 220.4(a)

In contrast to the proposed revision, this section permits separate margin accounts to be established for the same person by creditors that: (1) Clear transactions for other creditors where the transactions are introduced to the clearing creditor by separate creditors or (2) clear transactions through other creditors if the transactions are effected by separate creditors. Separate accounts may also be established for the same person by a creditor to provide one or more accounts over which the creditor or a third party investment advisor has investment discretion.

5. Transfer of Account, § 220.5(f)

(a) The description of the statement to be obtained by the transferee in present § 220.6(d) was rephrased to state simply that any margin call issued under Regulation T has been satisfied.

(b) In subsection (2), the term "bona fide" was removed as unnecessary. Since the transaction must be one that is not undertaken to avoid Regulation T and the creditor is required to accept in good faith the statement describing the circumstances giving rise to the transfer, the creditor may not accept a statement that indicates that the transfer was not a legitimate incident to the transaction.

6. Cash Account, § 220.8

(a) The statement that *bona fide* cash transactions may be effected in the cash account has been removed as unnecessary. The description of permissible transactions includes only those that are *bona fide* cash transactions. Use of the term "*bona*

fide" is redundant since permissible transactions must be done in good faith. The reference in the present § 220.4(c)(6) to "*bona fide* cash transactions" was removed for the same reason.

(b) A substantive change has been added in paragraph (a)(3)(i) concerning the issuance of a call option before payment is made for the purchase of a security. This will permit customers who cannot or do not maintain a margin account to take advantage of the investment strategy of taking a position in an option at the same time that they take a position in the underlying security or a security immediately convertible into the underlying security without the payment of money. It is anticipated that creditors permitting customers to write options on an underlying security using a convertible or exchangeable security as the proxy will require the customer to give written authorization for the conversion in the event an option exercise notice is received. Banks issuing escrow agreements against convertible securities should also have such written authorization.

(c) In response to comments received, securities issued by the United States or its agencies, negotiable certificates of deposit and bankers acceptances will be permitted as substitutes for cash in connection with the writing of put options, provided these instruments have a maturity of one year or less and their current market value at the time the put is written is equal to or greater than the put exercise price.

(d) Language has been added in § 220.8(b)(2) to clarify that the extension of time in a delivery against payment transaction is permitted if delivery of the security is delayed due to market conditions. See ¶ 5-501 in Securities Credit Transactions Handbook. The phrase "delivery against payment" is defined in the Definitions Section (see § 220.2(e)) rather than in the Cash Account Section.

(e) The 90-day freeze provision has been modified, as a clarifying measure, to apply only to transactions in *non-exempted* securities.

7. The Special Memorandum Account, § 220.6

As described in the proposal (46 FR 37517), the account is a renamed version of section 6 of the Special Miscellaneous Account. The types of deposit permitted in the Special Memorandum Account are now listed in the regulation.

8. Broker Dealer Credit Account, § 220.11

(a) As noted in the proposal (46 FR 37517 (1981)), this account contains the provisions that are presently in sections 1, 2 and 3 of the Special Miscellaneous Account and adds a provision to cover jointly owned clearing firms.

(b) There is new language that approval for emergency credit, credit for capital contributions and subordinated credit for capital purposes should be obtained from the appropriate Examining Authority, rather than from a committee of a national securities exchange. This reflects the fact that all creditors may not be members of a national securities exchange; it does not change the requirement for members of exchanges for whom the appropriate Examining Authority would be the exchange.

9. The Non-Securities Credit Account, § 220.9

(a) As described in the proposal (46 FR 37517 (1981)), this account contains provisions that are presently in the Special Commodity Account and sections 7 and 8 of the Special Miscellaneous Account.

(b) In the language comparable to present § 220.7(c) the phrase "on a margin security (other than an exempted security)" has been removed. The revised language will clarify that the required nonpurpose statement applies to unsecured credit as well as secured credit.

(c) Specific reference to form F.R. T-4 has been deleted from the Nonsecurities Credit Account (§ 220.9), but creditors must obtain such forms when extending nonpurpose credit.

10. The Market Functions Account, § 220.12

This account combines the Specialist Account and two sections of the Special Miscellaneous Account for credit to odd-lot dealers and to finance the underwriting or distribution of securities. There is a substantive addition, which provides for credit to OTC marketmakers and third-marketmakers similar to the provisions for bank loans to such marketmakers in present § 221.3(w) and (y) of Regulation U. Under the new regulation, exchanges will no longer have to file monthly reports (Form 2020) on the use of specialist credit. The required margin on long and short positions in underlying stock that serve as permitted offsets has been changed from a proposed 25% requirement to a "good faith" requirement. In addition, like public customers, specialists will have 7 days

in which to deposit margin. The original proposal would have imposed a 5 day requirement.

11. The Arbitrage Account, § 220.7

Under the Board's March 30, 1982 proposal (47 FR 13376) this account would have been folded into the Market Functions Account. Due to comments received, a separate account for arbitrage transactions has been established.

12. Arranging for Loans by Others, § 220.13

The arranging provision has been clarified to indicate that sales of all non-margin securities (not just non-margin securities with installment or other deferred payment provisions) are excluded from the arranging prohibitions if such sales are exempt from registration under sections 4(2) or 4(6) of the Securities Act of 1933 (§ 220.13(b)).

13. Borrowing By Creditors, § 220.15

(a) The statutory prohibition in section 8 of the Act was rephrased to make it clear that borrowing "on" a security means using that security as collateral for a loan.

(b) The last sentence of present § 220.5(b) was removed as unnecessary. Blank forms and information regarding filing or termination of agreements are available at any Federal Reserve Bank.

(c) The provisions for loans from other creditors has been shortened considerably. The substance of present §§ 220.15(a)(3) and (c) are contained in § 220.5(a)(3) of the revised version. The revised version does not specifically refer to loans from other creditors to meet emergency needs or to the fact that credit from another creditor would be subject to any other applicable provisions of law. The former provision is included in the list of permissible loans by creditors under a provision of the Broker Dealer Credit Account (§ 220.11(a)); the latter provision applies to all activities of a creditor, *i.e.*, a creditor is always subject to any other applicable provisions of law in addition to those provisions contained in Regulation T.

14. Credit for Clearance of Securities, § 220.14

(a) The terminology was changed from a "fraction of a day" to "not for more than one day" because it is simpler and does not actually expand the permissible time period from that defined in present § 220.6(i). Since § 220.6(i) places no limit on the fraction of a day during which the credit may be extended, it could apply to credit

outstanding for an entire day (minus one minute, for example). Recognizing that that is the case, it is less confusing to simply permit the credit for no more than one day. Also, the term "association" (referring to a national securities association) was added in recognition of the fact that creditors may be members of a national securities exchange or association.

(b) A provision was added to permit a clearing broker to acquire an option position from an option clearing agency, such as the Options Clearing Corporation, by depositing securities other than the particular securities underlying the option. Under the present provisions, only cash, government securities, letters of credit or the particular securities may be used for the required deposit.

15. Supplement, § 220.18

In view of a pending SEC rule change (Release No. 34-19162 October 20, 1982), the language of the section describing margin required for OTC options on exempted debt securities has been modified to exclude any options on exempt securities that the SEC determines are themselves exempt securities.

16. Reports

The subsection entitled "Reports" (§ 220.7(d)) in the present Regulation was removed as unnecessary; section 17 of the Securities Exchange Act of 1934 (15 U.S.C. § 78q) requires persons subject to the margin regulations to file reports required by the Board.

17. Miscellaneous

(a) As under the present regulation, convertible or exchangeable securities may be used instead of the present 50% margin when the related security is sold short.

(b) Other requests for modification of the proposed revision have not been adopted because of insufficient supporting data or because they are inappropriate in light of the Board's statutory responsibilities.

Final Regulatory Flexibility Analysis

The *Federal Register* documents published in June and July of 1981 (46 FR 32592 and 46 FR 37516) by the Board contained an Initial Regulatory Flexibility Analysis for the complete revision of Regulation T. Comments received on the proposal appear to agree with the Board's analysis.

List of Subjects 12 CFR Part 220

Banks, banking, Brokers, Credit, Federal Reserve System, Margin, Margin

requirements, Investments, Reporting 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, g, h and w) the Board completely revises Regulation T as follows:

PART 220—CREDIT BY BROKERS AND DEALERS

Sec.

- 220.1 Authority, purpose, and scope.
- 220.2 Definitions.
- 220.3 General provisions.
- 220.4 Margin account.
- 220.5 Margin account exceptions and special provisions.
- 220.6 Special memorandum account.
- 220.7 Arbitrage account.
- 220.8 Cash account.
- 220.9 Nonsecurities credit account.
- 220.10 Omnibus account.
- 220.11 Broker-dealer credit account.
- 220.12 Market functions account.
- 220.13 Arranging for loans by others.
- 220.14 Clearance of securities.
- 220.15 Borrowing by creditors.
- 220.16 Borrowing and lending securities.
- 220.17 Requirements for list of OTC margin stocks.
- 220.18 Supplement to Regulation T.

§ 220.1 Authority, purpose, and scope.

(a) *Authority and purpose.* Regulation T (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 and to brokers and dealers; it also covers related transactions within the Board's authority under the Act. It imposes, among other obligations, initial margin requirements and payment rules on securities transactions.

(b) *Scope.* (1) This part provides a margin account and seven special purpose accounts in which to record all financial relations between a customer and a creditor. Any transaction not specifically permitted in a special account shall be recorded in a margin account.

(2) This part does not preclude any exchange, national securities association, or creditor from imposing additional requirements or taking action for its own protection.

§ 220.2 Definitions.

The terms used in this part have the meanings given them in section 3(a) of the Act or as defined in this section.

(a) "Credit balance" means the cash amount due the customer in a margin account after debiting amounts transferred to the special memorandum account.

(b) "Creditor" means any broker or dealer (as defined in sections 3(a)(4) and

3(a)(5) of the Act), any member of a national securities exchange, or any person associated with a broker or dealer (as defined in section 3(a)(18) of the Act), except for business entities controlling or under common control with the creditor.

(c) "Customer" includes: (1) Any person or persons acting jointly: (i) to or for whom a creditor extends, arranges, or maintains any credit; or (ii) who would be considered a customer of the creditor according to the ordinary usage of the trade;

(2) any partner in a firm who would be considered a customer of the firm absent the partnership relationship; and

(3) any joint venture in which a creditor participates and which would be considered a customer of the creditor if the creditor were not a participant.

(d) "Debit balance" means the cash amount owed to the creditor in a margin account after debiting amounts transferred to the special memorandum account.

(e) "Delivery against payment," "Payment against delivery," or a "C.O.D. transaction" refers to an arrangement under which a creditor and a customer agree that the creditor will deliver to, or accept from, the customer, or the customer's agent, a security against full payment of the purchase price.

(f) "Equity" means the total current market value of security positions held in the margin account plus any credit balance less the debit balance in the margin account.

(g) "Escrow agreement" means any agreement issued in connection with a call or put option under which a bank, holding the underlying security, foreign currency, certificate of deposit, or required cash, is obligated to deliver to the creditor (in the case of a call option) or accept from the creditor (in the case of a put option) the underlying security, foreign currency, or certificate of deposit against payment of the exercise price upon exercise of the call or put.

(h) "Examining authority" means: (1) The national securities exchange or other self-regulatory organization of which a creditor is a member; or

(2) if not a member of any such self-regulatory organization, the Regional Office of the Securities and Exchange Commission (SEC) where the creditor has its principal place of business; or

(3) if a member of more than one self-regulatory organization, the organization designated by the SEC as the examining authority for the creditor.

(i) "Good faith margin" means the amount of margin which a creditor, exercising sound credit judgment, would customarily require for a specified

security position and which is established without regard to the customer's other assets or securities positions held in connection with unrelated transactions.

(j) "In or at the money" means the current market price of the underlying security is not more than one standard exercise interval below (with respect to a call option) or above (with respect to a put option) the exercise price of the option.

(k) "In the money" means the current market price of the underlying security is not below (with respect to a call option) or above (with respect to a put option) the exercise price of the option.

(l) "Margin call" means a demand by a creditor to a customer for a deposit of additional cash or securities to eliminate or reduce a margin deficiency as required under this part.

(m) "Margin deficiency" means the amount by which the required margin exceeds the equity in the margin account.

(n) "Margin excess" means the amount by which the equity in the margin account exceeds the required margin. When the margin excess is represented by securities, the current value of the securities is subject to the percentages set forth in § 220.18 (the Supplement).

(o) "Margin security" means any registered security, OTC margin stock, OTC margin bond, or any security issued by either an open-end investment company or unit investment trust which is registered under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8).

(p) "Nonexempted security" means any security other than an exempted security (as defined in section 3(a)(12) of the Act).

(q) "Nonmember bank" means a bank that is not a member of the Federal Reserve System.

(r) "OTC margin bond" means: (1) A debt security not traded on a national securities exchange which meets all of the following requirements:

(i) At the time of the original issue, a principal amount of not less than \$25,000,000 of the issue was outstanding;

(ii) The issue was registered under section 5 of the Securities Act of 1933 (15 U.S.C. 77e) and the issuer either files periodic reports pursuant to section 13(a) or 15(d) of the Act or is an insurance company which meets all of the conditions specified in section 12(g)(2)(G) of the Act; and

(iii) At the time of the extension of credit, the creditor has a reasonable basis for believing that the issuer is not

in default on interest or principal payments; or

(2) A private mortgage pass-through security (not guaranteed by an agency of the U.S. government) meeting all of the following requirements:

(i) An aggregate principal amount of not less than \$25,000,000 (which may be issued in series) was issued pursuant to a registration statement filed with the SEC under section 5 of the Securities Act of 1933;

(ii) Current reports relating to the issue have been filed with the SEC; and

(iii) At the time of the credit extension, the creditor has a reasonable basis for believing that mortgage interest, principal payments and other distributions are being passed through as required and that the servicing agent is meeting its material obligations under the terms of the offering.

(s) "OTC margin stock" means 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. An OTC stock is not considered to be an "OTC margin stock" until it appears on the Board's periodically published list of OTC margin stocks.

(t) "Overlying option" means: (1) A put option purchased or a call option written against a long position in an underlying security in the specialist record in § 220.12(b); or

(2) a call option purchased or a put option written against a short position in an underlying security in the specialist record in § 220.12(b).

(u) "Purpose credit" means credit for the purpose of: (1) Buying, carrying, or trading in securities; or

(2) buying or carrying any part of an investment contract security which shall be deemed credit for the purpose of buying or carrying the entire security.

(v) "Registered security" means any security that: (1) Is registered on a national securities exchange; or

(2) Has unlisted trading privileges on a national securities exchange.

(w) "Short call or short put" means a call option or a put option that is issued, endorsed, or guaranteed in or for an account.

(1) A short call obligates the customer to sell the underlying security, foreign currency, or certificate of deposit at the exercise price upon receipt of an exercise notice at any time prior to the expiration date of the option.

(2) A short put obligates the customer to purchase the underlying security, foreign currency, or certificate of deposit at the exercise price upon receipt of an exercise notice at any time prior to the expiration date of the option.

(3) A short call or a short put on stock index options obligates the customer to pay the holder of an "in the money" long put or call who has exercised the option the cash difference between the exercise price and the current assigned value of the index as established by the option contract.

(x) "Specialist joint account" means an account which, by written agreement, provides for the commingling of the security positions of the participants and a sharing of profits and losses from the account on some predetermined ratio.

(y) "Underlying security" means the security that will be delivered upon exercise of an option.

§ 220.3 General provisions.

(a) *Records.* The creditor shall maintain a record for each account showing the full details of all transactions.

(b) *Separation of accounts.* Except as provided for in the margin account and the special memorandum account, the requirements of an account may not be met by considering items in any other account. If withdrawals of cash or securities are permitted under the regulation, written entries shall be made when cash or securities are used for purposes of meeting requirements in another account.

(c) *Maintenance of credit.* Except as prohibited by this part, any credit initially extended in compliance with this part may be maintained regardless of: (1) Reductions in the customer's equity resulting from changes in market prices;

(2) any security in an account ceasing to be margin or exempted; or

(3) any change in the margin requirements prescribed under this part.

(d) *Guarantee of accounts.* No guarantee of a customer's account shall be given any effect for purposes of this part.

(e) *Receipt of funds or securities.* (1) A creditor, acting in good faith, may accept as immediate payment:

(i) Cash or any check, draft, or order payable on presentation; or

(ii) Any security with sight draft attached.

(2) A creditor may treat a security, check or draft as received upon written notification from another creditor that the specified security, check, or draft has been sent.

(3) Upon notification that a check, draft, or order has been dishonored or when securities have not been received within a reasonable time, the creditor shall take the action required by this part when payment or securities are not received on time.

(f) *Exchange of securities.* (1) To enable a customer to participate in an offer to exchange securities which is made to all holders of an issue of securities, a creditor may submit for exchange any securities held in a margin account, without regard to the other provisions of this part, provided the consideration received is deposited into the account.

(2) If a nonmargin, nonexempted security is acquired in exchange for a margin security, its retention, withdrawal, or sale within 60 days following its acquisition shall be treated as if the security is a margin security.

(g) *Valuing securities.* The current market value of a security shall be determined as follows:

(1) Throughout the day of the purchase or sale of a security, the creditor shall use the security's total cost of purchase or the net proceeds of its sale including any commissions charged.

(2) At any other time, the creditor shall use the closing sale price of the security on the preceding business day, as shown by any regularly published reporting or quotation service. If there is no closing price, the creditor may use any reasonable estimate of the market value of the security as of the close of business on the preceding business day.

(h) *Innocent mistakes.* If any failure to comply with this part results from a mistake made in good faith in executing a transaction or calculating the amount of margin, the creditor shall not be deemed in violation of this part if, promptly after the discovery of the mistake, the creditor takes appropriate corrective action.

(i) *Variable annuity contracts issued by insurance companies.* Any insurance company that issues or sells variable annuity contracts or engages in a general securities business as a broker or dealer shall be subject to this part only for transactions in connection with those activities. Extensions of credit associated with conventional lending practices of insurance companies are subject to Part 207 of this Chapter.

§ 220.4 Margin account.

(a) *Margin transactions.* (1) All transactions not specifically authorized for inclusion in another account shall be recorded in the margin account.

(2) A creditor may establish separate margin accounts for the same person to:

(i) Clear transactions for other creditors where the transactions are introduced to the clearing creditor by separate creditors; or

(ii) Clear transactions through other creditors if the transactions are effected by separate creditors; or

(iii) Provided one or more accounts over which the creditor or a third party investment adviser has investment discretion.

(b) *Required margin.* The required margin for each position in securities is set forth in section 220.18 (the Supplement) and is subject to the exceptions and special provisions contained in section 220.5 (Margin Account Exceptions and Special Provisions).

(c) *When additional margin is required.* (1) *Computing deficiency.* All transactions on the same day shall be combined to determine whether additional margin is required by the creditor. For the purpose of computing equity in an account, security positions are established or eliminated and a credit or debit created on the trade date of a security transaction. Additional margin is required on any day when the day's transactions create or increase a margin deficiency in the account and shall be for the amount of the margin deficiency so created or increased.

(2) *Satisfaction of deficiency.* The additional required margin may be satisfied by a transfer from the special memorandum account or by a deposit of cash, margin securities, exempted securities, or any combination thereof.

(3) *Time limits.* (i) A margin call shall be satisfied within 7 business days after the margin deficiency was created or increased.

(ii) The 7 day period may be extended for one or more limited periods upon application by the creditor to a self-regulatory organization or national securities association unless the organization or association believes that the creditor is not acting in good faith or that the creditor has not sufficiently determined that exceptional circumstances warrant such action. Applications shall be filed and acted upon prior to the end of the 7 day period or the expiration of any subsequent extension. However, applications filed by firms having no direct electronic access to the organization or association may be accepted as timely filed if postmarked by midnight of the last day of the 7 day period or any subsequent extension.

(4) *Satisfaction restriction.* Any transaction, position, or deposit that is used to satisfy one requirement under

this part shall be unavailable to satisfy any other requirement.

(d) *Liquidation in lieu of deposit.* If any margin call is not met in full within the required time, the creditor shall liquidate securities sufficient to meet the margin call or to eliminate any margin deficiency existing on the day such liquidation is required, whichever is less. If the margin deficiency created or increased is \$500 or less, no action need be taken by the creditor.

(e) *Withdrawals of cash or securities.* (1) Cash or securities may be withdrawn from an account, except if:

(i) Additional cash or securities are required to be deposited into the account for a transaction on the same or a previous day; or

(ii) The withdrawal, together with other transactions, deposits, and withdrawals on the same day, would create or increase a margin deficiency.

(2) Margin excess may be withdrawn or may be transferred to the special memorandum account (§ 220.6) by making a single entry to that account which will represent a debit to the margin account and a credit to the special memorandum account.

(3) If a creditor does not receive a distribution of cash or securities which is payable with respect to any security in a margin account on the day it is payable and withdrawal would not be permitted under this paragraph, a withdrawal transaction shall be deemed to have occurred on the day the distribution is payable.

(f) *Interest, service charges, etc.* (1) Without regard to the other provisions of this section, the creditor, in its usual practice, may debit the following items to a margin account if they are considered in calculating the balance of such account:

(i) Interest charged on credit maintained in the margin account;

(ii) Premiums on securities borrowed in connection with short sales or to effect delivery;

(iii) Dividends, interest, or other distributions due on borrowed securities;

(iv) Communication or shipping charges with respect to transactions in the margin account; and

(v) Any other service charges which the creditor may impose.

(2) A creditor may permit interest, dividends, or other distributions credited to a margin account to be withdrawn from the account if:

(i) The withdrawal does not create or increase a margin deficiency in the account; or

(ii) The current market value of any securities withdrawn does not exceed 10 percent of the current market value of

the security with respect to which they were distributed.

§ 220.5 Margin account exceptions and special provisions.

(a) *Unissued securities.* (1) The required margin on a net long or net short commitment in an unissued security is the margin that would be required if the security were an issued margin security, plus any unrealized loss on the commitment or less any unrealized gain.

(2) Margin is not required on a net short commitment in unissued securities when the account contains the related issued securities, nor for any net short or net long position in unissued exempted securities.

(b) *Short Sales.* (1) The required margin for the short sale of a security shall be the amount set forth in § 220.18 (the Supplement).

(2) A short sale "against the box" shall be treated as a long sale for the purpose of computing the equity and the required margin.

(c) *Options.* (1) *Margin or cover for options on exempted debt securities, certificates of deposit, stock indices, or securities exchange traded options on foreign currencies.* The required margin for each transaction involving any short put or short call on an exempted debt security, certificate of deposit, stock index, or foreign currency (if the option is traded on a securities exchange), shall be the amount or positions in lieu of margin set forth in § 220.18 (the Supplement).

(2) *Margin for options on equity securities.* The required margin for each transaction involving any short put or short call on an equity security shall be the amount set forth in § 220.18 (the Supplement), plus any unrealized loss on the commitment or minus any unrealized gain. However, the required margin may not exceed the current market value of the underlying security in the case of a call, or the exercise price in the case of a put.

(3) *Cover or positions in lieu of margin.* No margin is required for an option written on an equity security position when the account holds any of the following:

(i) the underlying security in the case of a short call, or a short position in the underlying security in the case of a short put;

(ii) securities immediately convertible into or exchangeable for the underlying security without the payment of money in the case of a short call, if the right to convert or exchange does not expire on or before the expiration date of the short call;

(iii) an escrow agreement for the underlying security or foreign exchange (in the case of a short call) or cash (in the case of a short put);

(iv) a long call on the same number of shares of the same underlying security if the long call does not expire before the expiration date of the short call, and if the amount (if any), by which the exercise price of the long call exceeds the exercise price of the short call is deposited in the account;

(v) a long put on the same number of shares of the same underlying security if the long put does not expire before the expiration date of the short put, and if the amount (if any), by which the exercise price of the short put exceeds the exercise price of the long put is deposited in the account;

(vi) a warrant to purchase the underlying security, in the case of a short call, if the warrant does not expire on or before the expiration date of the short call, and if the amount (if any), by which the exercise price of the warrant exceeds the exercise price of the short call is deposited in the account. A warrant used in lieu of the required margin under this provision shall contribute no equity to the account.

(4) *Adjustments.* (i) When a short position held in the account serves in lieu of the required margin for a short put, the amount prescribed by paragraph (c)(2) of this section as the amount to be added to the required margin in respect of short sales shall be increased by any unrealized loss on the position.

(ii) When a security held in the account serves in lieu of the required margin for a short call, the security shall be valued at no greater than the exercise prices of the short call.

(5) *Straddles.* When both a short put and a short call are in a margin account on the same number of shares of the same underlying security, the required margin shall be the margin on either the short put or the short call, whichever is greater, plus any unrealized loss on the other option.

(6) *Exclusive designation.* The customer may designate at the time the option order is entered which security position held in the account is to serve in lieu of the required margin, if such service is offered by the creditor; or the customer may have a standing agreement with the creditor as to the method to be used for determining on any given day which security position will be used in lieu of the margin to support an option transaction. Only security held in the account which serves in lieu of the required margin for a short put or a short call shall be unavailable to support any other option transaction in the account.

(d) *Accounts of partners.* If a partner of the creditor has a margin account with the creditor, the creditor shall disregard the partner's financial relations with the firm (as shown in the partner's capital and ordinary drawing accounts) in calculating the margin or equity of the partner's margin account.

(e) *Contribution to joint venture.* If a margin account is the account of a joint venture in which the creditor participates, any interest of the creditor in the joint account in excess of the interest which the creditor would have on the basis of its right to share in the profits shall be treated as an extension of credit to the joint account and shall be margined as such.

(f) *Transfer of accounts.* (1) A margin account that is transferred from one creditor to another may be treated as if it had been maintained by the transferee from the date of its origin, if the transferee accepts, in good faith, a signed statement of the transferor (or, if that is not practicable, of the customer), that any margin call issued under this part has been satisfied.

(2) A margin account that is transferred from one customer to another as part of a transaction, not undertaken to avoid the requirements of this part, may be treated as if it had been maintained for the transferee from the date of its origin, if the creditor accepts in good faith and keeps with the transferee account a signed statement of the transferor describing the circumstances for the transfer.

§ 220.6 Special memorandum account.

(a) A special memorandum account (SMA) may be maintained in conjunction with a margin account. A single entry amount may be used to represent both a credit to the SMA and a debit to the margin account. A transfer between the two accounts may be effected by an increase or reduction in the entry. When computing the equity in a margin account, the single entry amount shall be considered as a debit in the margin account. A payment to the customer or on the customer's behalf or a transfer to any of the customer's other accounts from the SMA reduces the single entry amount.

(b) The SMA may contain the following entries:

(1) dividend and interest payments;

(2) Cash not required by this part, including cash deposited to meet a maintenance margin call or to meet any requirement of a self-regulatory organization that is not imposed by this part;

(3) Proceeds of a sale of securities or cash no longer required on any expired or liquidated security position that may

be withdrawn under § 220.4(e) of this part; and

(4) Margin excess transferred from the margin account under § 220.4(e)(2) of this part.

§ 220.7 Arbitrage account.

In an arbitrage account a creditor may effect and finance for any customer *bona fide* arbitrage transactions. For the purpose of this section, the term "*bona fide* arbitrage" means:

(1) A 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

(2) A purchase of a security which 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 offsetting sale of the second security at or about the same time, for the purpose of taking advantage of a concurrent disparity in the prices of the two securities.

§ 220.8 Cash account

(a) *Permissible transactions.* In a cash account, a creditor, may:

(1) Buy for or sell to any customer any security if: (i) There are sufficient funds in the accounts; or (ii) the creditor accepts in good faith the customer's agreement that the customer will promptly make full cash payment for the security before selling it and does not contemplate selling it prior to making such payment;

(2) Buy from or sell for any customer any security if: (i) The security is held in the account; or (ii) the creditor accepts in good faith the customer's statement that the security is owned by the customer or the customer's principal, and that it will be promptly deposited in the account;

(3) Issue, endorse, or guarantee an option for any customer if:

(i) In the case of a call option, the underlying security (or a security immediately convertible into the underlying security, without the payment of money) is held in or purchased for the account on the same day, and the option premium is held in the account until cash payment for the underlying or convertible security is received; or

(ii) In the case of a put option, the creditor obtains cash in an amount equal to the exercise price or holds in the account any of the following instruments with a current market value at least equal to the exercise price and

with one year or less to maturity; securities issued or guaranteed by the United States or its agencies, negotiable bank certificates of deposit, or bankers acceptances issued by banking institutions in the United States and payable in the United States.

(4) Use an escrow agreement in lieu of the cash or underlying security position if:

(i) In the case of a call or a put, the creditor is advised by the customer that the required securities or cash are held by a bank and the creditor independently verifies that an appropriate escrow agreement will be delivered by the bank promptly; or

(ii) In the case of a call issued, endorsed, or guaranteed on the same day the underlying security is purchased in the account and the underlying security is to be delivered to a bank, the creditor verifies that an appropriate escrow agreement will be delivered by the bank promptly.

(b) *Time periods for payment; cancellation or liquidation.* (1) *Full cash payment.* A creditor shall obtain full cash payment for customer purchases within 7 business days of the date:

(i) Any nonexempted security was purchased;

(ii) Any unissued security was made available by the issuer for delivery to purchasers;

(iii) Any "when distributed" security was distributed under a published plan;

(iv) A security owned by the customer has matured or has been redeemed and a new refunding security of the same issuer has been purchased by the customer, provided:

(A) The customer purchased the new security no more than 35 calendar days prior to the date of maturity or redemption of the old security;

(B) The customer is entitled to the proceeds of the redemption; and

(C) The delayed payment does not exceed 103 percent of the proceeds of the old security.

(2) *Delivery against payment.* If a creditor purchases for or sells to a customer a security in a delivery against payment transaction, the creditor shall have up to 35 calendar days to obtain payment if delivery of the security is delayed due to the mechanics of the transaction and is not related to the customer's willingness or ability to pay.

(3) *Shipment of securities, extension.* If any shipment of securities is incidental to consummation of a transaction, a creditor may extend the 7 business day period by the number of days required for shipment, but not by more than 7 business days.

(4) *Cancellation; liquidation; minimum amount.* A creditor shall

promptly cancel or otherwise liquidate a transaction or any part of a transaction for which the customer has not made full cash payment within the required time. A creditor may, at its option, disregard any sum due from the customer not exceeding \$500.

(c) *90 day freeze.* (1) If a nonexempted security in the account is sold or delivered to another broker or dealer without having been previously paid for in full by the customer, the privilege of delaying payment beyond the trade date shall be withdrawn for 90 calendar days following the date of sale of the security. Cancellation of the transaction other than to correct an error shall constitute a sale.

(2) The 90 day freeze shall not apply if: (i) Within 7 business days of the trade date, full payment is received or any check or draft in payment has cleared and the proceeds from the sale are not withdrawn prior to such payment or check clearance; or (ii) the purchased security was delivered to another broker or dealer for deposit in a cash account which holds sufficient funds to pay for the security. The creditor may rely on a written statement accepted in good faith from the other broker or dealer that sufficient funds are held in the other cash account.

(d) *Extension of time periods; transfers.* (1) Unless a self-regulatory organization or association believes that the creditor is not acting in good faith or that the creditor has not sufficiently determined that exceptional circumstances warrant such action, it may, upon application by the creditor:

(i) Extend any period specified in paragraph (b) of this section;

(ii) Authorize transfer to another account of any transaction involving the purchase of a margin or exempted security; or

(iii) Grant a waiver from the 90 day freeze.

(2) Applications shall be filed and acted upon prior to the end of the 7 day period or the expiration of any subsequent extension. However, an application filed from firms having no direct electronic access to the exchange or association may be accepted as timely filed if it is postmarked no later than midnight of the last day of the 7 day period or any subsequent extension.

§ 220.9 Nonsecurities credit account.

(a) In a nonsecurities credit account a creditor may:

(1) Effect and carry transactions in commodities;

(2) Effect and carry transactions in foreign exchange;

(3) Extend and maintain secured or unsecured nonpurpose credit, subject to

the requirements of paragraph (b) of this section.

(b) Every extension of credit, except as provided in paragraphs (a) (1) and (2) of this section, shall be deemed to be purpose credit unless, prior to extending the credit, the creditor accepts in good faith from the customer a written statement that it is not purpose credit. The statement shall conform to the requirements established by the Board. To accept the customer's statement in good faith, the creditor shall be aware of the circumstances surrounding the extension of credit and shall be satisfied that the statement is truthful.

§ 220.10 Omnibus account.

(a) In an omnibus account, a creditor may effect and finance transactions for a broker or dealer who is registered with the SEC under section 15 of the Act and who gives the creditor written notice that:

(1) all securities will be for the account of customers of the broker or dealer; and

(2) any short sales effected will be short sales made on behalf of the customers of the broker or dealer other than partners.

(b) The written notice required by paragraph (a) shall conform to any SEC rule on the hypothecation of customers' securities by brokers or dealers.

§ 220.11 Broker-dealer credit account.

(a) *Permissible transactions.* In a broker-dealer credit account, a creditor may:

(1) Purchase any security from or sell any security to another creditor under a good faith agreement to promptly deliver the security against full payment of the purchase price.

(2) Effect or finance transactions of any of its owners if the creditor is a clearing and servicing broker or dealer owned jointly or individually by other creditors.

(3) Extend and maintain credit to any partner or stockholder of the creditor for the purpose of making a capital contribution to, or purchasing stock of, the creditor, affiliated corporation or another creditor.

(4) Extend and maintain, with the approval of the appropriate examining authority:

(i) Credit to meet the emergency needs of any creditor; or

(ii) Subordinated credit to another creditor for capital purposes, if the other creditor:

(A) Is an affiliated corporation; or

(B) Will not use the proceeds of the loan to increase the amount of dealing in securities for the account of the creditor.

its firm or corporation or an affiliated corporation.

(b) For purposes of paragraphs (a) (3) and (4) of this section "affiliated corporation" means a corporation all the common stock of which is owned directly or indirectly by the firm or general partners and employees of the firm, or by the corporation or holders of the controlling stock and employees of the corporation and the affiliation has been approved by the creditor's examining authority.

§ 220.12 Market functions account.

(a) *Requirements.* In a market functions account, a creditor may effect or finance the transactions of market participants in accordance with the following provisions. A separate record shall be kept for the transactions specified for each category described in paragraphs (b) through (f) of this section. Any position in a separate record shall not be used to meet the requirements of any other category.

(b) *Specialists.* (1) *Applicability.* A creditor may clear or finance specialist transactions for any specialist, or any specialist joint account, in which all participants, or all participants other than the creditor, are registered as specialists on a national securities exchange that requires regular reports on the use of specialist credit from the registered specialists.

(2) *Permitted offset positions.* A specialist in options may establish, on a share-for-share basis, a long or short position in the securities underlying the options in which the specialist makes a market, and a specialist in securities other than options may purchase or write options overlying the securities in which the specialist makes a market, if the account holds the following permitted offset positions:

(i) A short option position which is "in or at the money" and is not offset by a long or short option position for an equal or greater number of shares of the same underlying security which is "in the money";

(ii) A long option position which is "in or at the money" and is not offset by a long or short option position for an equal or greater number of shares of the same underlying security which is "in the money";

(iii) A short option position against which an exercise notice was tendered;

(iv) A long option position which was exercised;

(v) A net long position in a security (other than an option) in which the specialist makes a market; or

(vi) A net short position in a security (other than an option) in which the specialist makes a market.

(3) *Required Margin.* The required margin for a specialist's transactions shall be:

(i) Good faith margin for any long or short position in a security in which the specialist makes a market;

(ii) Good faith margin for any wholly-owned margin security or exempted security;

(iii) The margin prescribed by section 220.18 (the Supplement) when a security purchased or sold short in the account does not qualify as a specialist or permitted offset position.

(4) *Additional margin; restriction on "free-riding."* (i) Except as required by paragraph (b)(6) of this section, the creditor shall issue a margin call on any day when additional margin is required as a result of specialist transactions. The creditor may allow the specialist a maximum of 7 business days to satisfy a margin call.

(ii) If a specialist fails to satisfy a margin call within the period specified in this paragraph (and the creditor is required to liquidate securities to satisfy the call), the creditor shall be prohibited for a 15 calendar day period from extending any further credit to the specialist to finance transactions in nonspecialty securities.

(iii) The restriction on "free-riding" shall not apply to:

(A) Any specialist on a national securities exchange that has an SEC-approved rule on "free-riding" by specialists; or (B) the acquisition or liquidation of a permitted offset position.

(5) *Deficit status.* On any day when a specialist's separate record would liquidate to a deficit, the creditor shall not extend any further specialist credit in the account and shall issue a margin call at least as large as the deficit. If the call is not met by noon of the following business day, the creditor shall liquidate positions in the specialist's account.

(6) *Withdrawals.* Withdrawals may be permitted to the extent that the equity exceeds the margin requirements specified in paragraph (b)(4) of this section.

(c) *Underwritings and distributions.* A creditor may effect or finance for any dealer or group of dealers transactions for the purpose of facilitating the underwriting or distribution of all or a part of an issue of securities with a good faith margin.

(d) *OTC Marketmakers and Third Marketmakers.* (1) A creditor may clear or finance with a good faith margin, marketmaking transactions for an OTC marketmaker or a third marketmaker who:

(i) Is in compliance with any applicable SEC rule, including minimum net capital rules;

(ii) Regularly submits *bona fide* competitive bid and offer quotations to a recognized inter-dealer quotation system;

(iii) Is ready, willing, and able to effect transactions in reasonable amounts with other brokers and dealers at the quoted prices; and

(iv) Has a reasonable average rate of inventory turnover.

(2) If the credit extended to a marketmaker ceases to be for the purpose of marketmaking, or the dealer ceases to be a marketmaker for an issue of securities for which credit was extended, the credit shall be subject to the margin specified in section 220.18 (the Supplement).

(e) *Odd-lot dealers.* A creditor may clear and finance odd-lot transactions for any creditor who is registered as an odd-lot dealer on a national securities exchange with a good faith margin.

§ 220.13 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 itself extend or maintain credit 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:

(a) Investment banking services, provided by the creditor to the customer, including, but not limited to, underwritings, private placements, and advice and other services in connection with exchange offers, mergers or acquisitions, except for underwritings that involve the public distribution of an equity security with installment or other deferred payment provisions; or

(b) The sale of nonmargin securities (including 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.

§ 220.14 Clearance of Securities.

(a) *Credit for clearance of securities.* The provisions of this part shall not apply to the extension or maintenance of any credit that is not for more than one day if it is incidental to the clearance of transactions in securities directly between members of a national securities exchange or association or through any clearing agency registered with the SEC.

(b) *Deposit of securities with options clearing agency.* The provisions of this part shall not apply to the deposit of securities with an options clearing agency for the purpose of meeting its deposit requirements if:

- (1) The clearing agency issues options on securities;
- (2) The clearing agency is registered with the SEC;
- (3) The deposit consists of any underlying securities for classes of option contracts outstanding at the time of the deposit; and
- (4) The deposit complies with the rules of the clearing agency which have been approved by the SEC.

§ 220.15 Borrowing by Creditors.

(a) *Restrictions on borrowing.* A creditor may not borrow in the ordinary course of business as a broker or dealer using as collateral any registered nonexempted security, except:

- (1) From or through a member bank of the Federal Reserve System; or
- (2) From any nonmember bank that has filed with the Board an agreement as prescribed in paragraph (b) of this section, which agreement is still in effect; or
- (3) From another creditor if the loan is permissible under this part.

(b) *Agreements of nonmember banks.*

(1) A nonmember bank shall file an agreement that conforms to the requirements of section 8(a) of the Act (See Form F.R. T-2) if:

- (i) Its principal place of business is in a territory or insular possession of the United States; or
- (ii) It has an office or agency in the United States and its principal place of business is outside the United States.

(2) Any other nonmember bank shall file an agreement that conforms to the requirements of section 8(a) of the Act (See Form F.R. T-1).

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

§ 220.16 Borrowing and Lending Securities.

Without regard to the other provisions of this part, a creditor may borrow or lend securities for the purpose of making delivery of the securities in the case of short sales, failure to receive securities required to be delivered, or other similar situations. Each borrowing shall be secured by a deposit of one or more of the following: cash, securities issued or guaranteed by the United States or its agencies, negotiable bank certificates of deposit and bankers acceptances issued by banking institutions in the United States and payable in the United States,

or irrevocable letters of credit issued by a bank insured by the Federal Deposit Insurance Corporation or a foreign bank that has filed an agreement with the Board on Form F.R. T-2. Such deposit made with the lender of the securities shall have at all times a value at least equal to 100 percent of the market value of the securities borrowed, computed as of the close of the preceding business day.

§ 220.17 Requirements for list of OTC margin stocks.

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

(1) Four or more dealers stand willing to, and do in fact, make a market in such stock and regularly submit bona fide bids and offers to an automated quotations system for their own accounts;

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

(3) The stock is registered under section 12 of the Act, or is an American Depository Receipt (ADR) of a foreign issuer whose securities are registered under section 12 of the Act, or is a stock of a foreign issuer required to file reports under section 15(d) of the Act;

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

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

(6) The issuer has at least \$4 million of capital, surplus, and undivided profits;

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

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

(9) The issuer has been in existence for at least three years.

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

(1) Three or more dealers stand willing to, and do in fact, make a market in such stock and regularly submit bona fide bids and offers to an automated

quotations system for their own accounts;

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

(3) The stock is registered as specified in paragraph (a)(3) of this section;

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

(5) The issuer has at least \$1 million of capital, surplus, and undivided profits;

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

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

(c) *Removal from the list.* The Board shall periodically remove from the list any stock that:

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

(2) No longer substantially meets the provisions of paragraph (b) of this section or § 220.2(s).

(d) *Discretionary authority of Board.* Without regard to the other paragraphs of this section, the Board may add to, or omit or remove from the OTC margin stock list, any equity security, 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 stocks 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 stocks on that list shall be an unlawful representation.

§ 220.18 Supplement to Regulation T.

Margin Requirements

The required margin for each security position held in a margin account shall be as follows:

(a) *Margin security except for (b) below:* 50 percent of the current market value of the security.

(b) *Exempted security, registered non-*

convertible debt security or OTC margin bond: the margin required by the creditor in good faith.

(c) *Short put or short call on an equity security:* 30 percent of the current market value of the underlying security, but not less than \$250, adjusted or waived in accordance with section 220.5(c).

(d) *Short sale of nonexempted security:* 150 percent of the current market value of the security or 100 percent of the current market value if a security exchangeable or convertible within 90 calendar days without restriction other than the payment of money into the security sold short is held in the account.

(e) *Short sale of an exempted security:* 100 percent of the current market value of the security plus the margin required by the creditor in good faith.

(f) *Nonmargin, nonexempted security or a long position in any option:* 100 percent of the current market value.

(g) *Short put or short call on an exempted debt security or certificate of deposit:* (1) The amount or other position specified by the rules of the national securities exchange on which the option is traded, provided that all such rules have been approved or amended by the SEC; or

(2) In the case of an over-the-counter option on an exempted debt security that the SEC has not determined to be an exempted security, an amount or other position which the creditor in good faith deems to be equivalent to the margin or cover on comparable exchange-traded options.

(h) *Short put or short call (securities exchange traded) on foreign currency:* The amount, other option position, or foreign currency position specified by the rules of the national securities exchange on which the option is traded, provided that all such rules have been approved or amended by the SEC.

(i) *Short put or short call on a stock index:* The amount or other security positions specified by the rules of the national securities exchange on which the option is traded, provided that all such rules have been approved or amended by the SEC.

By order of the Board of Governors of the Federal Reserve System, May 16, 1983.

William W. Wiles,
Secretary of the Board.