



FEDERAL RESERVE BANK
OF DALLAS

WILLIAM H. WALLACE
FIRST VICE PRESIDENT
AND CHIEF OPERATING OFFICER

DALLAS, TEXAS 75222

August 22, 1988

Circular 88-56

TO: The Chief Executive Officer of all
member banks and others concerned in
the Eleventh Federal Reserve District

SUBJECT

Amendment to Regulation T (Credit by Brokers and Dealers)

DETAILS

The Federal Reserve Board has approved an amendment to its Regulation T to make certain foreign sovereign debt securities marginable.

The amendment was proposed earlier this year and is designed to provide equal treatment for U.S. broker-dealers who were previously prohibited from extending purpose credit on these securities.

The amendment permits brokers and dealers to extend "good faith" loan value on long-term debt securities issued or guaranteed by a foreign sovereign, its provinces, cities or states, or a supranational entity if the entity is rated in one of the two highest rating categories by a nationally recognized statistical rating organization.

ATTACHMENTS

The Board's press release and text of changes are attached.

MORE INFORMATION

For further information regarding this circular, please contact Dean A. Pankonien at (214) 651-6228. For additional copies of this circular, please contact the Public Affairs Department at (214) 651-6289.

Sincerely yours,

William H. Wallace

FEDERAL RESERVE press release



For immediate release

August 10, 1988

The Federal Reserve Board today approved an amendment to Regulation T (Credit by Brokers and Dealers) to make certain foreign sovereign debt securities marginable. The amendment is effective September 15, 1988.

The amendment to Regulation T will permit brokers and dealers to extend "good faith" loan value on long-term debt securities issued or guaranteed as a general obligation by a foreign sovereign, its provinces, states, or cities, or a supranational entity if there is available an explicit or implicit rating of the entity in one of the two highest rating categories by a nationally recognized statistical rating organization.

The Board's notice is attached.

-0-

Attachment

FEDERAL RESERVE SYSTEM

12 CFR Part 220

Regulation T

[Docket No. R-0633]

CREDIT BY BROKERS AND DEALERS

Foreign Sovereign Debt Securities

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final Rule.

SUMMARY: The Board is adopting an amendment to Regulation T that will permit broker-dealers to extend "good faith" loan value on long-term debt securities issued or guaranteed as a general obligation by a foreign sovereign, its provinces, cities or states, or a supranational entity if there is available an explicit or implicit rating of the entity in one of the two highest rating categories by a nationally recognized statistical rating organization. The amendment will provide equitable treatment for U.S. broker-dealers who, unlike banks and foreign broker-dealers, were previously prohibited from extending purpose credit on these securities.

EFFECTIVE DATE: September 15, 1988.

FOR FURTHER INFORMATION CONTACT: Laura Homer, Securities Credit Officer, or Scott Holz, Attorney, Division of Banking Supervision and Regulation, (202) 452-2781. For the hearing impaired only, Telecommunications Service for the Deaf, Earnestine Hill or Dorothea Thompson, (202) 452-3544.

SUPPLEMENTARY INFORMATION: The proposal for this amendment to Regulation T was published in the Federal Register on April 26, 1988 (53 Fed. Reg. 14812). Eighteen comments were received on the proposal. All supported the general principle of permitting broker-dealers to extend credit on highly rated foreign sovereign debt securities. Some commenters asked for clarification of the coverage or suggested changing the eligibility boundaries. The following is a more detailed discussion of those comments.

One commenter suggested that the definition be narrowed to eliminate basing marginability on the rating obtained for a prior issue. The Board believes that the nature of margin account practices under Regulation T, the flexibility afforded broker-dealers in determining "good faith" credit, and the relatively high rating required are sufficient to ensure the availability of a market for the securities, information on the issuer, and current prices. This commenter also noted the additional risk associated with bonds denominated in foreign currency and suggested that perhaps only dollar-denominated bonds should be permitted. This would sharply narrow the range of bonds eligible from that first proposed by the Board. Because timely information on exchange rates is readily available, no problem is foreseen in establishing bond prices in dollars (as is required for all securities held in a margin account). It is also expected that both customers and broker-dealers will appreciate that the purchase of these securities carries an element of exchange-rate risk.

A comment from a rating service suggesting the use of two ratings instead of one was not followed because it was believed that the proposed rating criterion, which was patterned after the one used by Congress for "mortgage related securities," is appropriate for foreign sovereign debt securities. In many instances, foreign sovereign debt ratings are available from two agencies, although in others only one rating is available. Under Regulation T, lenders are always free to impose more stringent standards than the rule requires and could require two ratings as a condition of making credit available.

In response to a comment asking for specific inclusion of language covering municipalities and other subdivisions, the word "cities," used in its generic sense, has been added to the entities covered by the rule. This same commenter suggested additional language to define the term guaranty to cover situations where an instrumentality acts as agent for its sovereign or where the related sovereign is under some other obligation to provide funds for the instrumentality and meet its obligations. Cases where the issuing instrumentality acts as agent for the sovereign are believed to be covered by this amendment. Other types of guarantees will be reviewed by Board staff on a case-by-case basis.

Regulatory Flexibility Act

The Board believes there will be no significant economic impact on a substantial number of small entities.

Paperwork Reduction Act

No additional reporting requirements or modification to existing reporting requirements are proposed.

List of Subjects in 12 CFR Part 220

Banks, Banking, Brokers, Credit, Federal Reserve System, Margin, Margin Requirements, Investments, Reporting and recordkeeping requirements, Securities.

For the reasons set out in this notice, and pursuant to the Board's authority under sections 3, 7, 8, 17, and 23 of the Securities Exchange Act of 1934, as amended, (15 U.S.C. §§ 78c, 78g, 78h, 78q and 78w), 12 CFR Part 220 is amended to read as follows:

1. The authority citation for Part 220 continues to read as follows:

Authority: 15 U.S.C. §§ 78c, 78g, 78h, 78q, and 78w.

2. Section 220.2 is amended by adding a new paragraph (r)(4) to read:

220.2 Definitions

* * * * *
(r) "OTC margin bond" means: * * *

(4) A debt security issued or guaranteed as a general obligation by the government of a foreign country, its provinces, states, or cities, or a supranational entity, if at the time of the extension of credit one of the following is rated in one of the two highest rating categories by a nationally recognized statistical rating organization:

- (i) the issue,
- (ii) the issuer or guarantor (implicitly), or
- (iii) other outstanding unsecured long-term debt securities issued or guaranteed by the government or entity.

By order of the Board of Governors of the Federal Reserve System, August 10, 1988.

(signed) William W. Wiles

William W. Wiles
Secretary of the Board