FEDERAL RESERVE BANK
OF DALLAS

ROBERT D. McTEER, JR.
PRESIDENT
AND CHIEF EXECUTIVE OFFICER

DALLAS, TEXAS
75265-5906

June 6, 1996

Notice 96-48

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

SUBJECT

Final Amendments to Regulation T and Request for Public Comment on Additional Amendments to the Margin Regulations

DETAILS

The Board of Governors of the Federal Reserve System is adopting amendments to Regulation T. Major amendments include eliminating restrictions on the ability of broker-dealers to arrange for credit; increasing the type and number of domestic and foreign securities that may be bought on margin and increasing the loan value of some securities that are already marginable; deleting Board rules regarding options transactions in favor of the rules of the options exchanges; and reducing restrictions on transactions involving foreign persons, foreign securities, and foreign currency. Technical changes are being adopted to provide clarification, update references, or restore language inadvertently deleted. These amendments become effective July 1, 1996.

The Board is considering further amendments to its margin regulations, Regulations G, T, and U and is seeking comment on whether it should expand the number of equity securities eligible for loan value under Regulation T, and on whether it should amend Regulations G and U to modify their method for determining which equity securities are eligible for loan value.

The Board must receive comments by July 1, 1996. Please address comments to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, D.C. 20551. All comments should refer to Docket No. R-0923.

For additional copies, bankers and others are encouraged to use one of the following toll-free numbers in contacting the Federal Reserve Bank of Dallas: Dallas Office (800) 333-4460; El Paso Branch *Intrastate* (800) 592-1631, *Interstate* (800) 351-1012; Houston Branch *Intrastate* (800) 392-4162, *Interstate* (800) 221-0363; San Antonio Branch *Intrastate* (800) 292-5810.

ATTACHMENT

A copy of the Board's notice as it appears on pages 20386-404, Vol. 61, No. 88, of the *Federal Register* dated May 6, 1996, is attached.

MORE INFORMATION

For more information, please contact Eugene Coy at (214) 922-6201. For additional copies of this Bank's notice, please contact the Public Affairs Department at (214) 922-5254.

Sincerely yours,

Robert D. McTeer, Jr.

F E D E R A L R E G I S T E R

May 6, 1996

Pages 20386-404

Final Amendments to Regulation T (Docket No. R-0772)

and

Request for Comments on Additional Amendments to the Margin Regulations (G, T, and U) (Docket No. R-0923)

FEDERAL RESERVE SYSTEM

12 CFR Part 220

[Regulation T; Docket No. R–0772]

RIN 7100–AB28

Securities Credit Transactions; Review of Regulation T, "Credit by Brokers and Dealers"

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule.

SUMMARY: The Board is adopting amendments to Regulation T, the regulation that covers extensions of credit by and to broker and dealers. These amendments reflect consideration of the comments submitted in response to the proposed rule issued by the Board for public comment on June 29, 1995.

Major amendments include eliminating restrictions on the ability of broker-dealers to arrange for credit; increasing the type and number of domestic and foreign securities that may be bought on margin and increasing the loan value of some securities that are already marginable; deleting Board rules regarding options transactions in favor of the rules of the options exchanges; and reducing restrictions on transactions involving foreign persons, foreign securities, and foreign currency. In addition, technical changes are being adopted to provide clarification, update references, or restore language inadvertently deleted. The Board is also soliciting comments on the possibility of additional Regulation T amendments in a separate document published elsewhere in today's **Federal Register**.

EFFECTIVE DATE: July 1, 1996.

FOR FURTHER INFORMATION CONTACT: Scott Holz, Senior Attorney, or Angela Desmond, Senior Counsel, Division of Banking Supervision and Regulation (202) 452–2781; for the hearing impaired *only*, Telecommunications Device for the Deaf (TDD), Dorothea Thompson (202) 452–3544.

SUPPLEMENTARY INFORMATION: In 1992, the Board issued an Advance Notice of Proposed Rulemaking and Request for Comment to aid in its periodic review of Regulation T.[1] In 1994, the Board proposed and adopted amendments exempting transactions involving government securities and shortening the time period within which customers must deposit margin requirements or make payment for securities in light of the industry's move to a three-day settlement period.[2] In June 1995, the Board published proposed amendments covering additional areas of Regulation T.[3] Forty-six comment letters were received in response to the 1995 proposal. The review of Regulation T predates but is now encompassed within the Board's regulatory review under section 303 of the Riegle Community Redevelopment and Regulatory Improvement Act of 1994.

The Board is now adopting a final rule which covers four major areas: arranging for credit, loan value of securities, options transactions, and international transactions.

In the arranging area, the Board is eliminating all restrictions on the ability of broker-dealers to arrange for credit that does not otherwise violate the lending provisions of the Board's margin regulations.

Amendments regarding the loan value of securities include changing the loan value of money market and exempted securities mutual funds from 50 percent to "good faith" loan value. The Board is adopting additional, alternate criteria for unlisted debt securities so that any debt security with an investment grade rating will be entitled to "good faith" loan value. The Board is also adopting an additional method for foreign stocks to qualify for margin treatment that will result in an increase in the number of foreign margin stocks from approximately 700 to approximately 1800 stocks. The Board is extending loan value to convertible bonds that do not meet the existing margin criteria if the underlying security is already marginable. Finally, the Board is extending loan value to exchange-traded options, which will be entitled to the loan value deemed appropriate by the exchange that trades the option, subject to the approval of the Securities and Exchange Commission (SEC).

In addition to giving loan value to exchange-traded options, other amendments in the options area will increase Regulation T's reliance on the margin rules of the exchange where the option is traded for customer and specialist transactions. This will allow increased flexibility in recognizing the offsetting nature of certain transactions and assets, such as financial futures. The Board is retaining the current provisions until June 1, 1997 in response to requests from options exchanges for extra time to develop exchange rules and have them approved by the SEC.

The Board is reducing Regulation T restrictions on international transactions involving the borrowing and lending of foreign securities that are not publicly traded in the United States and giving broker-dealers greater flexibility to accept foreign currencies, compute margin requirements using foreign currencies, and deal with foreign broker-dealers on the same basis as domestic broker-dealers. These changes are discussed more fully below. The amendments are discussed in the order they appear in the regulation.

Section 220.2 Definitions

The following new definitions or amended definitions are being adopted as proposed: *cash equivalent, exempted securities mutual fund, foreign person, in the money, margin security, money market mutual fund, non-U.S. traded foreign security*, and *OTC margin stock*. As proposed, the Board will delete the definition of *in or at the money*, but this will be delayed until June 1, 1997, when the other option-specific rules of Regulation T are deleted.[4] The effect of the definitions is described below under the section in which the defined term is used. Definitional changes that have the effect of increasing the types and number of securities that are marginable are discussed below under section 220.18, Supplement: *Margin requirements*.

The following definitions are being amended based on comments: *covered option transaction, escrow agreement, OTC margin bond, permitted offset position, short call or short put*, and *underlying security*. The modifications are technical in nature, with the exception of those discussed in the following two paragraphs.

The Board proposed to add the word "sold" to the definition *of short call or short put* and the list of permissible transactions in the cash account to mimic rules of the self-regulatory organizations (SROs). The word is not being added in light of comments pointing out that the Board's proposal would cover transactions that are not covered by SRO rules, which was not the Board's intent.

[1] 57 *FR* 37109 (August 18, 1992).

[2] The proposed amendments were published at 59 *FR* 33923 (July 1, 1994) and the final rule was published at 59 *FR* 53565 (October 25, 1994).

[3] 60 *FR* 33763 (June 29, 1995). The comment period was subsequently extended at the request of commenters (60 *FR* 43726, August 23, 1995).

[4] See also the definition of *permitted offset position* in section 220.2, section 220.4(b)(8), section 220.12(b)(6), and section 220.18(f). Several options exchanges requested a delay in effectiveness of Regulation T provisions which replace Board-specified options rules with reference to exchange rules. In order to allow the exchanges to develop rules in these areas and have them approved by the SEC, the Board is delaying the effectiveness of the new options provisions in Regulation T until June 1, 1997.

The definition of *underlying security* is being changed to *underlying asset* to account for the fact that not every asset underlying a securities option is a security. A conforming change has also been made to the definition of *in the money*. The definition is also being changed from the proposal so that customers and specialists may hold less than all of the securities in an index as cover for a short option position if SEC-approved rules of the SRO where the option is traded allow partial baskets. The language that was proposed required that all securities that comprise an index be held in the same proportion as the index.

Section 220.3 General Provisions

The Board is amending section 220.3(e)(4), which permits what the industry refers to as "cashless exercise" of employee stock options, to cover additional types of securities received by customers pursuant to an employee benefit plan and to conform with SEC rules that determine who is covered under these plans and therefore who may take advantage of the "cashless exercise" procedure. The Board is modifying the language that was proposed to accommodate employee stock award plans.

The Board is also adding a new paragraph to the general provisions in section 220.3 to make clear that freely convertible currency can be accepted by creditors and treated at its U.S. dollar equivalent on a marked-to-market basis for all purposes under Regulation T. Marking to market should minimize currency risk.

Section 220.4 Margin Account

Consistent with the amendment to the general provisions in section 220.3 of Regulation T allowing freely convertible foreign currency to be accepted for all purposes under Regulation T, the Board is amending Regulation T to enhance the ability of broker-dealers to extend credit denominated in a foreign currency by eliminating the restriction in section 220.4(c) that prevents an increase in one foreign currency subaccount from offsetting a decrease in another foreign currency subaccount. The Board is also simplifying the language that was proposed for section 220.4(b)(8) to allow broker-dealers to extend credit in any freely convertible currency, whether or not a security denominated in that currency is (or was) held in the account.

As proposed, the Board is completing the process of deferring to SRO rules for options transactions by deleting specific provisions governing cover or positions in lieu of margin found in section 220.5(c) in favor of SRO rules. This change will become effective on June 1, 1997. The margin requirement for a customer who writes an over-the-counter (OTC) option that is purchased by its broker-dealer will be determined by the rules of the broker-dealer's examining authority.

As proposed, the margin account exceptions and special provisions in section 220.5 have been incorporated into section 220.4 so that each Regulation T account is described in a single section. The special memorandum account and the government securities account are being renumbered as section 220.5 and 220.6 respectively. No substantive change is intended by this renumbering.

Section 220.8 Cash Account

The Board is amending the cash account, as proposed, to recognize industry practice by specifically allowing the purchase of nonsecurities on a cash basis in the cash account. Because this change includes foreign currencies, foreign exchange transactions can be effected on a cash basis in the account.

The Board is adding money market mutual funds to the definition of *cash equivalent* as proposed to allow these mutual fund shares to be used to cover puts in the cash account. In response to commenters, the Board has added language to section 220.8(a)(4) to make clear that cash equivalents covering options transactions may be held in the account via an escrow agreement.

The specific option transactions formerly permitted in the cash account pursuant to section 220.8(a)(3) have been incorporated into a definition for *covered option transactions* along with new authority, effective June 1, 1997, for the SROs to permit additional transactions with finite risk in this account. The proposed language has been modified to permit greater flexibility for the SROs. This flexibility includes covering (1) transactions in which a customer's risk is not a fixed dollar amount but is effectively limited to the value of the assets securing it, (2) transactions in which early exercise of any aspect of the transaction results in contemporaneous exercise of all aspects, and (3) OTC options transactions. SROs may designate covered transactions by category if they choose to do so.

The Board is amending section 220.8(b)(1)(ii), the cash account provision covering the purchase of foreign securities with extended settlement periods, as proposed, so that a broker-dealer will not be required to sell a customer's securities for failure to make payment until one day beyond the foreign settlement date. Currently, a broker-dealer must receive its customer's payment by settlement date. The extra day will allow the broker-dealer to verify that its failure to receive the customer's payment is not due to time zone differences, error, or other exceptional circumstances.

Section 220.11 Broker-Dealer Credit Account

Two substantive changes proposed by the Board are being made to section 220.11(a), *Permissible transactions*. First, the Board is amending section 220.11(a) to permit foreign broker-dealers to use this account for delivery-versus-payment transactions with U.S. broker-dealers. Under this amendment foreign broker-dealers are referred to as "persons regulated by a foreign securities authority." Regulation T incorporates the definitions from section 3(a) of the Act, which defines a "foreign securities authority" to include entities "empowered by a foreign government to administer or enforce laws as they relate to securities matters." Several commenters stated that the Board's proposal may not encompass entities such as universal banks that are generally recognized as broker-dealers but are regulated by a banking regulator that is also responsible for securities regulation in that country. The Board believes that the phrase "person regulated by a foreign securities authority," is broad enough for purposes of Regulation T to cover universal banks.

The Board is also amending section 220.11(a) to include "prime broker" arrangements set up under SEC guidelines[5] in the list of permissible transactions. This will permit use of the broker-dealer credit account by executing broker-dealers so that a customer's transactions may be consolidated at the customer's prime broker.

In 1995, the Board proposed an amendment to clarify that the joint back office (JBO) arrangements established pursuant to section 220.11(a)(2), which allow participant broker-dealers to be treated as if they were self-clearing broker-dealers, require a reasonable relationship between the owners' equity interests and the amount of business transacted through the JBO. The Board's intention in 1983 in first permitting the formation of JBOs was to allow for economies of scale among registered broker-dealers, and the Board believed it was unnecessary to explicitly require a specific capital structure to ensure equitable treatment among participants.

[5] See, Fed. Sec. L. Rep. (CCH) ¶ 76,819.

Several commenters noted that the Board's 1995 proposal was ambiguous; others suggested that the current language could be interpreted to prevent unreasonable arrangements without the need for amendment; and several commenters, including some opposed to the Board's proposal, were in favor of involving SROs in this process. After considering the comments, the Board has decided not to incorporate its understanding into the regulation and believes it is appropriate to rely on the authority of the JBO's examining authority (SRO) to ensure the reasonableness of JBO arrangements under its supervision.

Section 220.12 Market Functions Account

The Board proposed two substantive amendments to this section and is adopting both of them. First, the Board is amending section 220.12(b), *Specialists*, to delete the specific "permitted offset positions" established by the Board in favor of SEC-approved rules of the SROs. Permitted offset positions are entitled to good faith margin, and allowing exchange rules to govern these transactions is consistent with the Board's intention to allow margin requirements for options transactions and margin requirements for specialists to be determined by the appropriate market, subject to SEC approval. This change will be effective June 1, 1997.

Second, the Board is revising the description of OTC marketmakers and third marketmakers to respond to questions raised about the coverage of this provision. The revision concerning third marketmakers mirrors the language in Regulation U, while the revision concerning OTC marketmakers ensures that the exempt credit available to OTC marketmakers, like the exempt credit for specialists, is in return for market-making obligations enforced by the regulatory authority for that market.

Section 220.13 Arranging for Loans by Others

The Board is amending section 220.13 to permit creditors to arrange for any credit transaction so long as they do not willfully arrange credit that otherwise violates the Board's margin regulations. Currently, broker-dealers cannot arrange for transactions they could not engage in themselves unless covered by one of the exceptions found in this section.

Section 7 of the Act requires broker-dealers to comply with Federal Reserve margin regulations when they "extend or maintain credit or arrange for the extension or maintenance of credit." Since 1938, Regulation T has contained a provision addressing the "arranging" of credit by broker-dealers. This provision remained unaltered until 1975, when the Board began to adopt exceptions to the general prohibition. Although the arranging prohibition was intended to prevent a broker-dealer from circumventing Regulation T by arranging for another lender to extend credit that the broker-dealer was prevented from extending itself, the Board's regulations now cover most U.S. margin lenders directly.[6]

One of the most basic and frequently raised trends noted in the comments received since the Board announced its review of Regulation T is the erosion of barriers between broker-dealers and other lenders, including globalization of the securities markets and the increasing overlap in the businesses of these various lenders. Several trade associations and broker-dealers responded favorably to the Board's request for comment on applying the arranging restriction only to credit that otherwise violates the Board's margin regulations.

The Board has concluded that broker-dealers should be permitted to arrange for any credit that is not directly prohibited by a Federal Reserve margin regulation. Because a broker-dealer may not know all of the credit terms agreed to between its customer and the actual lender, the amended language prohibits a broker-dealer from *willfully* arranging credit that violates one of the Board's margin regulations. The ability of broker-dealers to arrange for credit in connection with new issues of securities will still be constrained by section 11(d) of the Act and the rules of the SEC issued thereunder.[7]

Section 220.16 Borrowing and Lending Securities

The Board proposed two changes for this section, and is adopting both of them. First, the Board is expanding the types of permissible collateral for securities lending transactions to include marginable foreign sovereign debt securities and any other collateral that is acceptable to the SEC when a broker-dealer borrows securities from its customer.[8]

Second, the Board is adding a new subsection 220.16(b) to allow U.S. broker-dealers to lend foreign securities that are not publicly traded in the United States to a foreign person for any purpose, and against any collateral, legally permitted in the foreign country. Although several commenters stated their preference for also extending this liberalized treatment to foreign stocks that are publicly traded in the United States, other commenters, including U.S. securities exchanges, stressed the importance of equal treatment in this area for all securities that are publicly traded in the United States. The Board is confirming several clarifications in this area requested by the commenters: (1) a foreign security not listed on NASDAQ or a U.S. national securities exchange is not "U.S. traded" solely because American Depository Receipts (ADRs) on the foreign security are traded in the United States; (2) new section 220.16(b) is not mandatory and creditors may continue to borrow and lend foreign securities under the existing rule in section 220.16(a); and (3) coverage of the term "foreign lender" is determined by the status of the beneficial owner of an account and includes a non-U.S. person with a U.S. investment adviser or other fiduciary. The Board is also amending the language that was proposed to make clear that a creditor may borrow foreign securities pursuant to section 220.16(b) for the purpose of relending them to a foreign person (or relending them to a U.S. person as long as the ultimate borrower is a foreign person).

The Board is also amending section 220.16 to address questions regarding "pre-borrowing," that is the borrowing of securities in anticipation of a short sale. Currently, securities may be borrowed for a permitted purpose when the transaction has been effected "or is in immediate prospect".[9] The section will now provide that a creditor who reasonably anticipates a short sale may borrow securities up to one standard settlement cycle in advance of the trade date. The standard settlement cycle is contained in SEC Rule 15c6–1[10] and is currently three business days.

[6] The Board adopted Regulation U in 1936 to cover securities credit extended by banks. In 1968 the Board adopted Regulation G to cover most other margin lenders in the United States, and in 1971 the Board adopted Regulation X to cover U.S. borrowers obtaining margin credit against U.S. securities abroad.

[7] Section 11(d) of the Act prohibits a broker-dealer from extending or maintaining or arranging for the extension or maintenance of credit on any newly issued security if the broker-dealer has been involved in the distribution of that security within the past thirty days. The section is aimed at preventing a broker-dealer from inducing its customer to buy on credit securities which it has undertaken to distribute to the public.

[8] The SEC requirements are found in Rule 15c3–3 (17 CFR 240.15c3–3).

[9] See 12 CFR 220.103, a Board Interpretation reprinted in the *Federal Reserve Regulatory Service* at 5–472.

[10] 17 CFR 240.15c6–1.

Section 220.17 Requirements for the List of Marginable OTC Stocks and the List of Foreign Margin Stocks

The Board is adopting additional, alternative criteria for determining which foreign stocks qualify as margin equity securities. The Board has published a *List of Foreign Margin Stock* (Foreign List) since 1990, using criteria modeled on those for OTC margin stocks. In the 1995 proposal, the Board asked for comment on whether foreign stocks should also be marginable if they meet two criteria: (1) the SEC or CFTC has approved trading in the United States of options, warrants, or futures on a foreign securities index that contains the foreign stock and (2) the stock is deemed to have a "ready market" for purposes of the SEC's net capital rule.[11] The SEC has issued a no-action letter that effectively treats all stocks on the Financial Times/Standard & Poor's World Actuaries Indices as having a "ready market" for capital purposes, and requested comment on adopting regulatory language to this effect.[12]

None of the commenters opposed the Board's proposal to enlarge the number of foreign margin stocks, but many suggested modification of the proposed criteria. Some commenters asked the Board to use the SEC's capital rule's "ready market" test as a criterion for determining the margin status of foreign securities. The Board has concluded that a determination that a foreign stock has a "ready market" for purposes of the SEC's net capital rule is a more particularized determination about the collateral value of the stock than SEC or CFTC approval for trading in the United States of an index product containing the stock. The Board is therefore adopting this test as an alternate method by which stocks will be included on the Foreign List. To implement this change, stocks on the Financial Times/Standard & Poor's Actuaries World Indices will be added to the Board's Foreign List as soon as practical.

Comments were few and contradictory concerning how a new test for foreign margin stocks should be integrated with the Board's Foreign List. The Board is requesting additional comment regarding the Foreign List in the proposed rule published elsewhere today in the **Federal Register**.

Section 220.18 Supplement: Margin Requirements

The Board is increasing the coverage of the definitions of *margin security* and *OTC margin bond* and is allowing loan value for exchange-traded options that are currently denied loan value.[13] The Board is also changing the loan value of mutual funds whose portfolios consist of exempted securities and money market mutual funds. These mutual funds were previously subject to the margin for margin equity securities (currently 50 percent) and today's amendments will instead allow good faith loan value.

The Board is amending the definition of *margin security* to cover a debt security convertible into a margin security. This mirrors the treatment of convertible bonds in Regulations G and U, as well as Regulation T's treatment of foreign convertible bonds.

The Board is also amending the definition of *OTC margin bond* to include any nonconvertible debt security with an investment grade rating. Although commenters suggested a variety of ways to expand the categories of unlisted debt securities entitled to good faith margin as "OTC margin bonds," at a minimum there was agreement that an investment grade rating (i.e. a rating in one of the top four rating categories by a nationally recognized statistical rating organization) should be sufficient to make a debt security marginable. The Board has successfully used rating criteria for unregistered mortgage-related securities[14] and foreign debt securities and believes it is now appropriate to enlarge the number of qualifying ratings and extend this treatment to other debt securities.

The Board is permitting loan value for exchange-traded options, but has modified its 1995 proposal that options be given the same fifty percent loan value if listed on a national securities exchange as other exchange-traded equity securities. Commenters, including some of the options exchanges, indicated that the time value of options may make it appropriate to have higher margin requirements for options approaching expiration and expressed support for use of SRO rules in this area generally. Rather than adopting a flat 50 percent margin requirement, the Board is incorporating into Regulation T the margin requirements established by the exchange that trades the option. This change will also respond to commenters seeking confirmation that the Board intends to allow loan value for options on non-equity securities. To ensure comparability with exchange-traded warrants on securities indexes and warrants on foreign currency, these products will also be subjected to exchange maintenance margin rules in lieu of specific Regulation T requirements. Margin requirements for short OTC options will continue to be subject to the rules of the examining authority of the broker-dealer involved.

Board Interpretations

The Board has begun to review its interpretations of Regulation T, and is deleting eleven interpretations as a first step. These interpretations have either been incorporated directly into the regulation or have become moot due to subsequent amendments. The Board will continue its review to cover the remaining interpretations.

Regulatory Flexibility Act

The amendments being adopted are intended to simplify regulatory requirements and eliminate restrictions currently imposed on broker-dealers and their customers. The Board is also increasing reliance on the rules of the SEC and SROs so that Regulation T will reflect market developments that are subsequently approved by regulators with primary responsibility for the securities markets. The Board believes that these benefits will be shared by all broker-dealers and the amendments will not have a substantial adverse effect on a significant number of small broker-dealers.

Paperwork Reduction Act

No collections of information pursuant to section 3504(h) of the Paperwork Reduction Act (44 U.S.C. 3501 *et seq.*) are contained in this rule.

List of Subjects in 12 CFR Part 220

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

For the reasons set out in the preamble, 12 CFR Part 220 is amended as follows:

PART 220—CREDIT BY BROKERS AND DEALERS (REGULATION T)

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

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

[11] See SEC Rule 15c3–1 (17 CFR 240.15c3–1).

[12] 58 *FR* 44310, August 20, 1993.

[13] Although most customers cannot purchase exchange-traded options on credit, specialists in these options and the underlying securities have been able to obtain good faith credit on options for some time.

[14] The Board first used a rating requirement when it fulfilled Congress' mandate under the Secondary Mortgage Market Enhancement Act of 1984 by making a "mortgage-related security" marginable. The Congressional definition of "mortgage-related security" included a requirement that the security be rated in one of the top two rating categories by a nationally recognized statistical rating organization.

2. Sections 220.1 through 220.18 are revised to read as follows:

§ 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 eight 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.

(3) This part does not apply to transactions between a customer and a broker or dealer registered only under section 15C of the Act.

§ 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.

Cash equivalent means securities issued or guaranteed by the United States or its agencies, negotiable bank certificates of deposit, bankers acceptances issued by banking institutions in the United States and payable in the United States, or money market mutual funds.

Covered option transaction means:

(1) In the case of a short call, the underlying asset (or a security immediately convertible into the underlying asset, 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 asset or convertible security is received; or

(2) In the case of a short put, the creditor obtains cash in an amount equal to the exercise price or holds in the account cash equivalents with a current market value at least equal to the exercise price and, except in the case of money market mutual funds, with one year or less to maturity; or

(3) In the case of a short put or short call, the creditor verifies that the appropriate escrow agreement will be delivered to the creditor promptly and the option premium is held in the account until such delivery is made; or

(4) Beginning June 1, 1997, any other transaction involving options or warrants in which the customer's risk is limited and all elements of the transaction are subject to contemporaneous exercise if:

(i) the amount at risk is held in the account in cash, cash equivalents, or via an escrow receipt; and

(ii) the transaction is eligible for the cash account by the rules of the registered national securities exchange authorized to trade the option or warrant or by the rules of the creditor's examining authority in the case of an unregistered option, provided that all such rules have been approved or amended by the SEC.

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

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.

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.

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

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.

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.

Escrow agreement means any agreement issued in connection with a call or put option under which a bank or any person designated as a control location under paragraph (c) of SEC Rule 15c3–3 (17 CFR 240.15c3–3(c)), holding the underlying asset or required cash or cash equivalents, 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 asset or required cash or cash equivalent against payment of the exercise price upon exercise of the call or put.

Examining authority means:

(1) The national securities exchange or national securities association of which a creditor is a member; or

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

Exempted securities mutual fund means any security issued by an investment company registered under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a–8), provided the company has at least 95 percent of its assets continuously invested in exempted securities (as defined in section 3(a)(12) of the Act).

Foreign margin stock means a foreign security that is an equity security and that appears on the Board's periodically published List of Foreign Margin Stocks.

Foreign person means a person other than a United States person as defined in section 7(f) of the Act.

Foreign security means a security issued in a jurisdiction other than the United States.

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.

In or at the money means, until June 1, 1997, 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.

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

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.

Margin deficiency means the amount by which the required margin exceeds the equity in the margin account.

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).

Margin security means:

(1) Any registered security;

(2) Any OTC margin stock;

(3) Any OTC margin bond;

(4) Any OTC security designated as qualified for trading in the National Market System under a designation plan approved by the Securities and Exchange Commission (NMS security);

(5) 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);

(6) Any foreign margin stock; or

(7) Any debt security convertible into a margin security.

Money market mutual fund means any security issued by an investment company registered under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a–8) that is considered a money market fund under SEC Rule 2a–-7 (17 CFR 270.2a–7).

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

Nonmember bank means a bank that is not a member of the Federal Reserve System.

Non-U.S. traded foreign security means a foreign security that is neither a registered security nor one listed on NASDAQ.

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 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 (15 U.S.C. 77e);

(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; or

(3) A mortgage related security as defined in section 3(a)(41) of the Act; or

(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; or

(5) A foreign security that is a nonconvertible debt security that meets all of the following requirements:

(i) At the time of original issue, a principal amount of at least $100,000,000 was outstanding;

(ii) 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; and

(iii) At the time of the extension of credit, the issue is rated in one of the two highest rating categories by a nationally recognized statistical rating organization; or

(6) Any nonconvertible debt security that meets all of the following requirements:

(i) 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; and

(ii) At the time of the extension of credit, the issue is rated in one of the four highest rating categories by a nationally recognized statistical rating organization.

OTC margin stock means any equity security traded over-the-counter 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 unless it appears on the Board's periodically published list of OTC margin stocks.

Overlying option means:

(1) A put option purchased or a call option written against a long position in an underlying asset 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 asset in the specialist record in § 220.12(b).

Payment period means the number of business days in the standard securities settlement cycle in the United States, as defined in paragraph (a) of SEC Rule 15c6–1 (17 CFR 240.15c6–1(a)), plus two business days.

Permitted offset position means, in the case of an option in which a specialist makes a market, a position in the underlying asset or other related assets, and in the case of other securities in which a specialist makes a market, a position in options overlying the securities in which a specialist makes a market, provided the positions qualify as permitted offsets under the rules of the national securities exchange with which the specialist is registered, and further provided all such rules have been approved or amended by the SEC. Until June 1, 1997, permitted offsets are determined by reference to section 220.12(b)(6).

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.

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.

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 that is not cash-settled obligates the customer to sell the underlying asset at the exercise price upon receipt of a valid exercise notice or as otherwise required by the option contract.

(2) A short put that is not cash-settled obligates the customer to purchase the underlying asset at the exercise price upon receipt of a valid exercise notice

or as otherwise required by the option contract.

(3) A short call or a short put that is cash-settled obligates the customer to pay the holder of an in the money long put or long call who has, or has been deemed to have, exercised the option the cash difference between the exercise price and the current assigned value of the option as established by the option contract.

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.

Underlying asset means:

(1) the security or other asset that will be delivered upon exercise of an option; or

(2) In the case of a cash-settled option, the securities or other assets which comprise the index or other measure from which the option's value is derived.

§ 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.

(4) To temporarily finance a customer's receipt of securities pursuant to an employee benefit plan registered on SEC Form S–8 or the withholding taxes for an employee stock award plan, a creditor may accept, in lieu of the securities, a properly executed exercise notice, where applicable, and instructions to the issuer to deliver the stock to the creditor. Prior to acceptance, the creditor must verify that the issuer will deliver the securities promptly and the customer must designate the account into which the securities are to be deposited.

(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) *Foreign currency.* Freely convertible foreign currency may be treated at its U.S. dollar equivalent, provided the currency is marked-to-market daily.

§ 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 cleared by separate creditors; or

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

(b) *Required margin—(1) Applicability.* The required margin for each long or short position in securities is set forth in § 220.18 (the Supplement) and is subject to the following exceptions and special provisions.

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

(3) *When-issued securities.* The required margin on a net long or net short commitment in a when-issued 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.

(4) *Stock used as cover.* (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 (b)(1) 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 price of the short call.

(5) *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.

(6) *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.

(7) *Transfer of accounts.* (i) 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.

(ii) 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.

(8) *Credit denominated in foreign currency.* A creditor may extend credit denominated in any freely convertible foreign currency.

(9) *Options.* The following provisions are in force until June 1, 1997:

(i) *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 position in lieu of margin set forth in § 220.18 (the Supplement).

(ii) *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).

(iii) *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:

(A) The underlying asset in the case of a short call, or a short position in the underlying asset in the case of a short put;

(B) Securities immediately convertible into or exchangeable for the underlying asset 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;

(C) 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);

(D) A long call on the same number of shares of the same underlying asset 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;

(E) A long put on the same number of shares of the same underlying asset 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;

(F) A warrant to purchase the underlying asset, 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 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.

(iv) *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 of the short call, whichever is greater, plus any unrealized loss on the other option.

(v) *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. Any 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.

(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 one payment period after the margin deficiency was created or increased.

(ii) The payment period may be extended for one or more limited periods upon application by the creditor to its examining authority unless the examining authority 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 payment period or the expiration of 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 $1000 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 (§ 220.5) 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 paragraph (e) of this section, 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 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); and

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

§ 220.6 Government securities account.

In a government securities account, a creditor may effect and finance transactions involving government securities, provided the transaction is not prohibited by section 15C of the Act or any rule thereunder.

§ 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:

(a) 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

(b) A purchase of a security which is, without restriction other then 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 or other asset if:

(i) There are sufficient funds in the account; or

(ii) The creditor accepts in good faith the customer's agreement that the customer will promptly make full cash payment for the security or asset before selling it and does not contemplate selling it prior to making such payment;

(2) Buy from or sell for any customer any security or other asset 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, or sell an option for any customer as part of a covered option transaction; and

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

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

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

(b) *Time periods for payment; cancellation or liquidation*—(1) *Full cash payment.* A creditor shall obtain full cash payment for customer purchases—

(i) Within one payment period of the date:

(A) Any nonexempted security was purchased;

(B) Any when-issued security was made available by the issuer for delivery to purchasers;

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

(D) 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:

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

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

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

(ii) In the case of the purchase of a foreign security, within one payment period of the trade date or within one day after the date on which settlement is required to occur by the rules of the foreign securities market, provided this period does not exceed the maximum time permitted by this part for delivery against payment transactions.

(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 payment period by the number of days required for shipment, but not by more than one additional payment period.

(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 $1000.

(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 the period specified in paragraph (b)(1) of this section, 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 the creditor's examining authority 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 payment period, or in the case of the purchase of a foreign security within the period specified in paragraph (b)(1)(ii) of this section, or the expiration of any subsequent extension.

§ 220.9 Nonsecurities credit and employee stock ownership 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; and

(4) Extend and maintain credit to employee stock ownership plans without regard to the other sections of this part.

(b) Every extension of credit, except as provided in paragraphs (a)(1) and (a)(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) of this section 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 or person regulated by a foreign securities authority 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 would not be considered a customer of the lender apart from the subordinated loan; 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.

(5) Effect transactions for a customer as part of a "prime broker" arrangement in conformity with SEC guidelines.

(b) *Affiliated corporations.* For purposes of paragraphs (a)(3) and (a)(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 (e) 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 and permitted offset positions 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) *Required margin.* The required margin for a specialist's transactions shall be:

(i) Good faith margin for:

(A) Any long or short position in a security in which the specialist makes a market;

(B) Any wholly-owned margin security or exempted security; or

(C) Any permitted offset position.

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

(3) *Additional margin; restriction on "free-riding."* (i) Except as required by paragraph (b)(4) 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 one payment period to satisfy a margin call.

(ii) If a specialist fails to satisfy a margin call within the period specified in paragraph (b)(3) of this section (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.

(4) *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.

(5) *Withdrawals.* Withdrawals may be permitted to the extent that the equity exceeds the margin requirements specified in paragraph (b)(2) of this section.

(6) *Permitted offset positions.* Until June 1, 1997, 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.

(c) *Underwriters and distributors.* 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 a creditor who is a registered NASDAQ marketmaker or a qualified third marketmaker as defined in SEC Rule 3b–8 (17 CFR 240.3b-8).

(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 § 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 arrange for the extension or maintenance of credit to or for any customer by any person, provided the creditor does not willfully arrange credit that violates parts 207, 221, or 224 of this chapter.

§ 220.14 Clearance of securities, options, and futures.

(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 a clearing agency.* The provisions of this part shall not apply to the deposit of securities with an options or futures clearing agency for the purpose of meeting the deposit requirements of the agency if:

(1) The clearing agency:

(i) Issues, guarantees performance on, or clears transactions in, any security (including options on any security, certificate of deposit, securities index or foreign currency); or

(ii) Guarantees performance of contracts for the purchase or sale of a commodity for future delivery or options on such contracts;

(2) The clearing agency is registered with the Securities and Exchange Commission or is the clearing agency for a contract market regulated by the Commodity Futures Trading Commission; and

(3) The deposit consists of any margin security and complies with the rules of the clearing agency that have been approved by the Securities and Exchange Commission or the Commodity Futures Trading Commission.

§ 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 FR T–1, T–2).

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

§ 220.16 Borrowing and lending securities.

(a) 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, cash equivalents, foreign sovereign nonconvertible debt securities that are margin securities, collateral acceptable for borrowings of securities pursuant to SEC Rule 15c3–3 (17 CFR 240.15c3–3), 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 FR T–1, 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. If a creditor reasonably anticipates a short sale, such borrowing may be made up to one standard settlement cycle in advance of trade date.

(b) A creditor may lend non-U.S. traded foreign securities to a foreign person (or borrow such securities for the purpose of relending them to a foreign person) for any purpose lawful in the country in which they are to be used. Each borrowing shall be secured with collateral having 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 the list of marginable OTC stocks and the list of foreign margin stocks.

(a) *Requirements for inclusion on the list of marginable OTC stocks.* Except as provided in paragraph (f) 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, is issued by an insurance company subject to section 12(g)(2)(G) of the Act, 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 stock of an 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 or a predecessor in interest has been in existence for at least three years.

(b) *Requirements for continued inclusion on the list of marginable OTC stocks.* Except as provided in paragraph (f) 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) *Requirements for inclusion on the list of foreign margin stocks.* Except as provided in paragraph (f) of this section, a foreign margin stock shall be a foreign security deemed to have a "ready market" for purposes of SEC Rule 15c3–1 (17 CFR 240.15c3–1) or meet the following requirements:

(1) The security is listed for trading on or through the facilities of a foreign securities exchange or a recognized foreign securities market and has been trading on such exchange or market for at least six months;

(2) Daily quotations for both bid and asked or last sale prices for the security provided by the foreign securities exchange or foreign securities market on which the security is traded are continuously available to creditors in the United States pursuant to an electronic quotation system;

(3) The aggregate market value of shares, the ownership of which is unrestricted, is not less than $1 billion;

(4) The average weekly trading volume of such security during the preceding six months is either at least 200,000 shares or $1 million; and

(5) The issuer or a predecessor in interest has been in existence for at least five years.

(d) *Requirements for continued inclusion on the list of foreign margin stocks.* Except as provided in paragraph (f) of this section, a foreign margin stock shall be a foreign security deemed to have a "ready market" for purposes of SEC Rule 15c3–1 (17 CFR 240.15c3–1) or meet the following requirements:

(1) The security continues to meet the requirements specified in paragraphs (c)(1) and (2) of this section;

(2) The aggregate market value of shares, the ownership of which is unrestricted, is not less than $500 million; and

(3) The average weekly trading volume of such security during the preceding six months is either at least 100,000 shares or $500,000.

(e) *Removal from the lists.* The Board shall periodically remove from the lists 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) or (d) of this section or the definition of OTC margin stock.

(f) *Discretionary authority of Board.* Without regard to other paragraphs of this section, the Board may add to, or omit or remove from the list of marginable OTC stocks and the list of foreign margin stocks and equity security, if in the judgment of the Board, such action is necessary or appropriate in the public interest.

(g) *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 marginable OTC stocks or the list of foreign 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 lists or stocks on those lists shall be an unlawful representation.

§ 220.18 Supplement: Margin requirements.

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

(a) Margin equity security, except for an exempted security, money market mutual fund or exempted securities mutual fund, warrant on a securities index or foreign currency or a long position in an option: 50 percent of the current market value of the security or the percentage set by the regulatory authority where the trade occurs, whichever is greater.

(b) Exempted security, registered nonconvertible debt security, OTC margin bond, money market mutual fund or exempted securities mutual fund: The margin required by the creditor in good faith or the percentage set by the regulatory authority where the trade occurs, whichever is greater.

(c) Short sale of a nonexempted security, except for a registered nonconvertible debt security or OTC margin bond: 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.

(d) Short sale of an exempted security, registered nonconvertible debt security or OTC margin bond: 100 percent of the current market value of the security plus the margin required by the creditor in good faith.

(e) Nonmargin, nonexempted security: 100 percent of the current market value.

(f) Put or call on a security, certificate of deposit, securities index or foreign currency or a warrant on a securities index or foreign currency:

(1) In the case of puts and calls issued by a registered clearing corporation and listed or traded on a registered national securities exchange or a registered securities association and registered warrants on a securities index or foreign currency, the amount, or other position (except in the case of an option on an equity security until June 1, 1997), specified by the rules of the registered national securities exchange or the registered securities association authorized to trade the option or warrant, provided that all such rules have been approved or amended by the SEC; or

(2) In the case of all other puts and calls, the amount, or other position, specified by the maintenance rules of the creditor's examining authority.

§ 220.19 [Removed]

3. Section 220.19 is removed.

§§ 220.106, 220.107, 220.109, 220.112, 220.114–220.116, 220.120, 220.125, 220.129, 220.130 [Removed]

Interpretations

4. The following sections are removed and reserved: 220.106, 220.107, 220.109, 220.112, 220.114, 220.115, 220.116, 220.120, 220.125, 220.129, and 220.130.

By order of the Board of Governors of the Federal Reserve System, April 24, 1996.

William W. Wiles,

Secretary of the Board.

[FR Doc. 96–10607 Filed 5–3–96; 8:45 am]

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FEDERAL RESERVE SYSTEM

12 CFR Parts 207, 220, and 221

[Regulations G, T, and U; Docket No. R–0923]

Securities Credit Transactions

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Proposed rule.

SUMMARY: In conjunction with a final rule printed elsewhere in today's **Federal Register**, the Board is considering further amendments to its margin regulations, Regulations G, T, and U. Regulation T covers extensions of credit by and to brokers and dealers; Regulation U covers extensions of credit by banks; and Regulation G covers extensions of credit by all other U.S. lenders.

The Board is proposing to: allow a broker-dealer to extend "good faith" credit on any non-equity security rather than only those currently permitted by Board rules; allow lending on non-equity securities to occur in a new "non-equity" account, absent the restrictions currently imposed in the margin account; remove restrictions on the ability of broker-dealers to calculate required margin for non-equity securities on a "portfolio" basis; ease or eliminate the Board's collateral requirements for the borrowing and lending of securities; exempt lending to foreign persons on foreign securities by foreign branches of U.S. broker dealers; remove a Board interpretation that prevents options from serving as cover in lieu of margin for a short sale; and allow banks to lend against exchange-traded options to the extent permitted by the exchange listing the option.

The Board is also seeking comment on whether it should expand the number of equity securities eligible for loan value under Regulation T, and on whether it should amend Regulations G and U to modify their method for determining which equity securities are eligible for loan value.

DATES: Comments should be received on or before July 1, 1996.

ADDRESSES: Comments should refer to Docket No. R–0923, and may be mailed to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue NW., Washington, DC 20551. Comments also may be delivered to Room B–222 of the Eccles Building between 8:45 a.m. and 5:15 p.m. weekdays, or to the guard station in the Eccles Building courtyard on 20th Street NW. (between Constitution Avenue and C Street NW.) at any time. Comments received will be available for inspection in Room MP–500 of the Martin Building between 9:00 a.m. and 5:00 p.m. weekdays, except as provided in 12 CFR 261.8 of the Board's rules regarding availability of information.

FOR FURTHER INFORMATION CONTACT: Scott Holz, Senior Attorney, or Angela Desmond, Senior Counsel, Division of Banking Supervision and Regulation (202) 452–2781; Oliver Ireland, Associate General Counsel (202) 452–3625 or Gregory Baer, Managing Senior Counsel (202) 452–3236, Legal Division; for the hearing impaired only, Telecommunications Device for the Deaf (TDD), Dorothea Thompson (202) 452–3544.

SUPPLEMENTARY INFORMATION: Regulation T implements the Board's authority over securities credit extended by broker-dealers under section 7 of the Securities Exchange Act of 1934, 15 U.S.C. 78g (the Act). Section 7 requires the Board to regulate the amount of credit that may be extended on securities by a broker-dealer, requires that collateral for securities purchases consist of "exempted securities" (U.S. government and municipal securities) or securities assigned loan value by the Board, and prohibits a broker-dealer from extending unsecured credit for the purpose of purchasing securities. Regulation T establishes the margin that a customer of a broker-dealer must post when engaging in a securities transaction on credit. The "margin" for a security is the converse of the security's "loan value;" by definition, the two always add up to 100 percent.

Section 7 also authorizes the Board to regulate credit extended by banks and all other U.S. lenders. Regulation U limits credit extended by banks to finance the purchase or carrying by customers of margin equity securities when the credit is collateralized by such securities. 12 CFR Part 221. Regulation G limits credit extended by lenders other than broker-dealers and banks to finance the purchase or carrying of margin equity securities when the credit is collateralized by such securities. 12 CFR Part 207.[1]

In 1995, the Board published for comment a series of amendments to Regulation T that were intended to remove constraints that were hampering developing trends in the securities markets. 60 FR 33763, June 29, 1995. These trends included the erosion of barriers between broker-dealers and other lenders, the globalization of securities markets, the increasing overlap in the businesses of various lenders, and the constant development of new mechanisms for extending securities credit. The Board also solicited comment on broader changes that could be made to Regulation T. The recent effort to modernize Regulation T predated but is now encompassed within the Board's regulatory review under section 303 of the Riegle Community Development and Regulatory Improvement Act of 1994, Pub. L. 103–325.

Extensive comment was received on the Board's 1995 proposal, including voluminous responses from the major securities trade groups. Commenters generally supported the proposed amendments to Regulation T, but also emphasized the need for more wholesale reform.

Today, the Board is elsewhere adopting as a final rule many of the amendments it proposed in 1995. However, the Board is also proposing additional amendments to Regulation T, and seeking comment on provisions of Regulations G and U as well.[2] In addition, the Board seeks comment on any other steps it can take to reduce the burden imposed by Regulation T, including any steps to reduce the accounting and recordkeeping burdens of the regulation, that would be consistent with the purposes and requirements of the Act.

1. Good Faith Loan Value for all Non-Equity Securities

Regulation T gives "good faith" loan value to many but not all debt securities. Good faith loan value means that a broker-dealer may extend credit on a particular security in any amount consistent with sound credit judgment. 12 CFR 220.2. Those debt securities not eligible for good faith loan value receive no loan value and therefore have a margin requirement of 100 percent.

With the adoption of today's final rule, the Board currently assigns a debt security good faith loan value if it is: (1) listed on a U.S. securities exchange, (2) a government or municipal security, (3) an investment grade security; or (4) a less-than-investment grade security that is registered with the Securities and Exchange Commission (SEC) and has an original principal amount of not less than $25,000,000. 12 CFR 220.18(b).

[1] Regulation X covers U.S. borrowers obtaining credit outside the United States. Because Regulation X incorporates the requirements of Regulation T, U, or G (depending on the lender), any amendments to those regulations automatically pass through to Regulation X. Therefore, no amendments to Regulation X are being proposed.

[2] The Board is also continuing to review Regulations G and U as part of its ongoing effort to reduce regulatory burden, as mandated by section 303 of the Riegle Community Development and Regulatory Improvement Act of 1994.

Non-equity securities that are not registered, are not government or municipal securities, and are not investment grade generally will continue to receive no loan value under Regulation T.

In contrast, the Board's Regulations G and U do not impose any margin restrictions on non-broker-dealer lenders (such as banks) when they lend against non-equity securities, even securities that receive no loan value under Regulation T.[3] Foreign broker-dealers and other foreign lenders, with whom U.S. broker dealers increasingly compete worldwide, are generally also unconstrained. Thus, customers who wish to borrow against non-equity securities that receive no loan value under Regulation T, and investors who wish to engage in repo or forward transactions in such securities, may go to these other lenders.

The Board proposes to grant good faith loan value to all non-equity securities. To effectuate this change, the Board is proposing to amend revised section 220.13, discussed below, and section 220.18 (b), (c), and (d) to include all non-equity securities among those securities subject to good faith margin. A new definition of "non-equity security" would be added to section 220.2 to include any security that is not an "equity security" for purposes of section 3(a)(11) of the Act. This definition of non-equity security may include certain equity-linked securities. The Board seeks comment on whether it should modify the definition of non-equity security to exclude equity-linked securities and, if so, what securities should be excluded.

In a conforming change, the definition of "OTC margin bond" in section 220.2 would be deleted; since all non-equity securities would receive loan value, this definition would no longer be required. In another conforming change, the definition of "margin security" in section 220.2 would be revised to include any "non-equity security" instead of any "OTC margin bond."

Expanding the types of non-equity securities eligible for good faith loan value should expand broker-dealers' ability to lend and put them on a more equal footing with other lenders under Regulations G and U. Broker-dealers should be no less competent to determine the loan value of non-investment grade debt securities than a bank or other lender would be. Finally, any remaining regulatory concerns could be addressed by the self-regulatory organizations (SROs), which include the exchanges and the National Association of Securities Dealers, who still would be able to set their own margin requirements for these transactions.

[3] Section 7(d) of the Act prohibits the Board from establishing margin requirements on non-equity securities at banks. 15 U.S.C. 78g(d). When Regulation G was adopted in 1968, it was modeled on Regulation U.

2. Establishment of Non-Equity Account

Other restrictions beyond margin requirements are also currently placed on transactions involving non-equity securities. Currently, any credit extended by a broker-dealer on a non-equity security (other than a security eligible for the government securities account) must be recorded in the margin account. 12 CFR 220.4. These transactions are thus subject to the same restrictions as equity securities with respect to when payments must be made and when positions must be liquidated. On the other hand, because Regulations U and G restrict lending only on equity securities, banks and other lenders may lend on non-equity securities without such Board-imposed restrictions. 12 CFR 221.3(a); 12 CFR 207.3(b).

The Board proposes to allow any transaction involving a non-equity security to be effected in a new "non-equity" account. For example, a customer could effect in this account: (1) purchases of non-equity securities on credit; (2) repurchase and reverse repurchase agreements with broker-dealers on non-equity securities; and (3) the purchase or sale of options on non-equity securities. All transactions in the account would be subject to good faith margin. In order to ensure that unsecured credit would not be extended under the rubric of good faith margin, the proposed rule would prohibit any transaction or withdrawal that would cause the non-equity account to liquidate to a deficit—that is, cause the marked-to-market value of the securities held in the account to be less than the credit outstanding.

This account would be otherwise unregulated. The absence of restrictions on the terms of credit for non-equity securities would promote equality of treatment between broker-dealers and banks and other lenders, who face no Federal Reserve regulation when they lend on non-equity securities.

The Board seeks comment on whether the creation of a non-equity account would be beneficial and whether the account could be better named. The Board also seeks comment on whether this account could be merged with the government securities account (12 CFR 220.6) or the nonsecurities credit account (220.9) or both.

3. Portfolio Margining

A. Amendment to definition of good faith margin

As noted above, Regulation T currently allows good faith margin on some non-equity securities, and the Board is proposing to extend this treatment to all non-equity securities. "Good faith margin" is defined in Regulation T to mean "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*" (emphasis added). 12 CFR 220.2.

This definition limits so-called "portfolio margining"—allowing positions to be evaluated as a group and determining collateral requirements based upon estimated changes in the value of that portfolio. (It would continue to do so even if the proposed non-equity account were adopted, as the definition of good faith applies regardless of where the transaction is booked.) Regulation T has defined limited positions that can serve as offsets for each other, but any combination of positions not specifically permitted by the regulation may not offset one another. Commenters have for some time requested greater flexibility to engage in cross-margining (allowing positions in financial futures to offset the margin required for a given securities credit) and more broadly in "portfolio" or "risk-based" margining.

In order to remove an impediment to portfolio margining, the Board would amend the definition of "good faith margin" to eliminate the requirement that such margin be calculated "for a specified security position * * * without regard to the customer's other assets or securities positions held in connection with unrelated transactions." Instead, "good faith margin" would be defined to mean "the amount of margin the creditor would require in exercising sound credit judgment."

The Board is seeking comment on whether this definition should: (1) apply only in the proposed non-equity account, thereby continuing to limit portfolio margining of securities eligible for good faith margin in the margin account or market functions account; or (2) apply regardless of the account—margin, non-equity, or market functions—in which the transactions are booked. In addition, the Board seeks comment on the extent to which this change would allow SROs and broker-

dealers greater flexibility to develop portfolio margining systems. The Board also seeks comment from SROs and others on the potential benefits and burdens of adopting a portfolio margining system in addition to the existing position-based system, and whether changing the definition of good faith margin for any or all accounts is consistent with section 7(b) of the Act.

B. Separation of Accounts

Section 7 of the Act prohibits a broker-dealer from extending securities credit on any collateral other than a security. Accordingly, Regulation T requires that futures contracts and non-securities be accounted for in their own account, and section 220.3(b) of Regulation T generally prohibits using items in one account (including the nonsecurities account) from being used to meet the margin requirements for items in another account (including the margin account). However, with adoption of today's final rule, Regulation T will allow financial futures to serve in lieu of margin for securities options consistent with SRO rules. This treatment is consistent with Section 7 because the broker-dealer is not extending credit on the futures contract when it considers a futures contract in determining the amount of credit it can extend in good faith on a security.

The proposed rule would amend section 220.3(b) to allow explicitly commodities and foreign exchange positions in the nonsecurities account to be considered in calculating margin for *any* securities transaction in the proposed non-equity account or the margin account. The Board would expect that these positions would be valued in accordance with SRO rules, where applicable, or in any event not in excess of their marked-to market value. The proposed rule would also amend section 220.18 to remove a requirement that margin be held for "each security position."

The Board also seeks comment on whether further amendments to sections 220.3(b) should be adopted to facilitate portfolio margining—in particular, whether the Board should modify the general prohibition on separation of accounts in section 220.3(b). Doing so could allow any excess margin in one account to be used to meet a margin deficiency in another account. To the extent that such a change were adopted, the Board seeks comment on the continuing need for a Special Memorandum Account. As noted above, the Board is also seeking comment on whether the government securities account, nonsecurities account, and proposed non-equity account should be combined.

C. Implementation

The Board also seeks comment on any implementation problems that might arise with a partial or complete move to portfolio margining, including the need for delaying the effective date of any final rule in order to allow the SROs time to amend their rules.

4. Borrowing and Lending of Securities by Brokers-dealers

In order to facilitate short sales and the curing of failures to deliver a security (fails), Regulation T allows broker-dealers to borrow and lend securities outside of the normal margin requirements for securities purchases. To qualify for this treatment, borrowing and lending transactions must not only relate to a short sale or fail but also be secured by cash or similarly liquid collateral equal to 100 percent of the value of the securities lent.[4] Any borrowing and lending of securities that does not meet both the "purpose test" and the "collateral test" is usually a financing, is not considered a borrowing and lending of securities for Regulation T purposes, and therefore is conducted in a margin account, subject to the appropriate margin requirement for the underlying security.

Requiring 100 percent collateral (marked to market daily) to secure any stock loan reflects industry practice and is, the Board believes, consistent with prudent securities lending. The SEC imposes similar requirements on the types and amount of collateral a broker-dealer must post when it borrows securities from a customer, and the Department of Labor applies similar requirements to an ERISA pension plan when it lends securities.

Nonetheless, the Board is seeking comment on whether the Board's existing collateral requirements are necessary for Regulation T purposes. Commenters have sought an expansion of eligible collateral to include all securities marginable under Regulation T. Although the Board has expressed concern that Regulation T could be evaded by structuring a financing transaction as a borrowing and lending,[5] the purpose test may be adequate to prevent such an evasion. The purpose test limits the exception to transactions that have a clear market purpose that is verifiable (as any evasion becomes evident within a few days, when no short sale is consummated or the fail proves illusory). The collateral test addresses the evasion issue only indirectly by imposing collateral arrangements that conform to industry practice.

Accordingly, the Board is proposing to amend section 220.16 either to allow any security that qualifies for loan value to serve as collateral, valued at its regulatory loan value,[6] or to require a *bona fide* posting of collateral equal to 100 percent of the value of the securities borrowed, without requiring any specific type of collateral. The Board also seeks comment on whether the collateral requirement of section 220.16 could be eliminated altogether. The Board notes that even if the collateral/requirements were eliminated, other concerns might merit continued or further regulation by the SROs or the SEC.

5. Extensions of Credit by Foreign Branches of U.S. Broker-Dealers

Most U.S. broker-dealers conduct their overseas operations through separately incorporated subsidiaries of their holding companies. These subsidiaries are not subject to Regulation T or SEC regulations. However, a few firms maintain foreign branches that are subject to Regulation T. The Board is proposing to exclude these foreign branches from Regulation T when they extend credit to foreign persons on foreign securities. This would be analogous to the exclusion from Regulation U of foreign branches of U.S. banks when they extend securities credit.

6. Option as Cover for a Short Sale of an Equity Security

In a short sale, a customer generally sells securities it does not own and borrows those securities from a broker-dealer in order to meet its delivery obligation. The customer is then obligated to redeliver such securities to the broker-dealer at some time in the future, but hopes to obtain those securities for less than the sale price less financing costs. Regulation T currently

[4] With the adoption of today's final rule, permissible types of collateral include cash, securities issued or guaranteed by the United States or its agencies, certain negotiable bank certificates of deposit and bankers acceptances, and certain irrevocable letters of credit issued by banks, marginable foreign sovereign debt securities, and any collateral acceptable to the SEC when a broker-dealer borrows securities from a customer.

[5] For example, a broker-dealer prohibited by Regulation T from extending a customer 100 percent credit on a security could instead borrow the security from the customer and post 100 percent cash collateral; the customer could then withdraw the cash, evading the 50 percent initial or good faith margin requirement.

[6] If this option were adopted, "loan value" would be defined in Regulation T to mean an amount equal to "1 minus the margin requirement for the security under this part."

requires margin of 150 percent for a short sale of an equity security.[7] For example, if a customer sells short 100 shares of XYZ Corp, the broker-dealer retains 100 percent of the proceeds from the sale in the customer's account, and the customer is required to post an additional 50 percent of the sale price. (This parallels the 50 percent margin requirement for a purchase of the stock; in each case, the customer's stake in the transaction must be 50 percent of its price.) However, Regulation T requires margin of only 100 percent—in other words, allows retaining of the proceeds of the sale to suffice—if a "security exchangeable or convertible * * * into the security sold short" is held in the customer's account. The most common example of such a security is a convertible bond.

Although it can be argued that both stock warrants and call options qualify as a "security exchangeable or convertible into another security," the Board has only permitted the former to serve in lieu of the additional 50 percent margin for short sales in Regulation T. *See* Board Interpretation 12 CFR 220.126, reprinted in the *Federal Reserve Regulatory Service* at 5–488. Some commenters have criticized this inequality of treatment, and some have asked that a call option—in the above example, a call option for 100 shares of XYZ stock—be allowed to serve in lieu of the additional 50 percent margin requirement.

The Board is seeking comment on whether to allow the use of a call option to offset the short sale of a security and whether doing so would bias the market in favor of short selling. The Board has historically sought to ensure that traders on the short side of the market should not be in a position, with a given amount of funds, to exert greater influence on the market than they could with the same amount of funds if they were trading on the long side. However, under this proposal, a customer wishing to purchase 100 shares of XYZ would be required to come up with 50 percent of the purchase price, but a customer wishing to sell 100 shares of XYZ short would only be required to come up with the premium necessary to purchase a call option for 100 shares of XYZ, a far smaller amount. The Board seeks comment on whether this fact argues against adoption of the proposed change.

[7] If a marginable debt security is sold short, the margin required is 100 percent of the current market value of the security plus the margin required by the creditor in good faith.

7. Eligibility of Equity Securities for Credit Under Regulations G, T, and U

In order to qualify for credit under Regulation T, an equity security must be a mutual fund, a bond convertible into a qualifying equity security, or registered on a national securities exchange, trade in NASDAQ's National Market System, or appear on the Board's quarterly lists of "marginable OTC stocks" or "foreign margin stocks." Stocks qualify for inclusion on the Board's lists if they meet Regulation T's definition of "OTC margin stock" or "foreign margin stock."

A. Foreign Margin Stocks Under Regulation T

The Board is adopting as a final rule an amendment to Regulation T that includes as a foreign margin stock any foreign stock that has a "ready market" for purposes of the SEC's net capital rule. 17 CFR 240.15c3–1(c)(11)(i). SEC staff has stated that they will take no action against broker-dealers that treat any foreign stock listed on the Financial Times-Actuaries World Indices as having a ready market for purposes of computing a broker-dealer's net capital. Thus, these stocks will be added to the Board's foreign list.

Although there is considerable overlap between the stocks on the Financial Times Indices and the Board's list of foreign margin stocks, the Financial Times list contains substantially more foreign stocks than the Board's list, and there are also a significant number of foreign stocks that appear on the Board's list but not the Financial Times list. The Board did not receive comment on whether its current list of, and test for, foreign margin stocks would continue to be necessary if this new test were adopted. Accordingly, the Board seeks comment on whether it should rely on the ready market test exclusively and phase out the Board's own test and list.

B. Domestic Margin Stocks

The Board is also seeking comment on whether it should supplement or replace the current criteria for qualification as an OTC margin stock in section 220.17 of Regulation T by allowing a broker-dealer to extend credit on any stock traded on a national securities exchange, quoted on NASDAQ, or otherwise having a "ready market" for purposes of the SEC's net capital rule. In the domestic area, SEC staff has taken the position that a stock has a "ready market" if: (1) three or more market makers quote its prices through the so-called "pink sheets," and (2) the broker-dealer can show the existence of bona fide inter-dealer trades within five business days before or after the date of valuation that are of sufficient volume to justify a reasonable belief that the price used would support the liquidation of the entire position at or near that price.

This proposal would make 1700 NASDAQ stocks, as many as 5400 stocks quoted on the NASD's electronic bulletin board, and an unknown number of additional "pink sheet" stocks eligible for broker-dealer credit for the first time. Some of these stocks are thinly traded when compared to currently marginable stocks, including those that qualify as OTC margin stocks. The Board seeks comment on whether such stocks should be eligible to serve as collateral for securities credit.

The Board particularly seeks comment on whether an expansion in the number of OTC margin stocks should be made only for purposes of Regulation T, or for purposes of Regulations G and U as well. Although all the Board's margin regulations currently contain a common definition of "OTC margin stock," this common definition does *not* result in common treatment of all lenders. Under Regulation T, a broker-dealer is *prohibited* from lending on any domestic stock that does not qualify as an OTC margin stock; conversely, a bank or other lender is *unregulated* by Regulations U and G when it lends on any stock that does not qualify as an OTC margin stock. Thus, qualification of a stock as an OTC margin stock *increases* its loan value under Regulation T from zero to 50 percent, but subjects it for the first time to coverage by Regulations G and U and thereby *decreases* its loan value to the extent that banks and other lenders had previously been willing to give the stock loan value of greater than 50 percent. Conversely, disqualification of a stock as an OTC margin stock eliminates its loan value under Regulation T and thereby prevents broker-dealers from lending on it, but eliminates its coverage by Regulations G and U and allows banks and other lenders to lend as much as they deem appropriate.

Thus, using the ready market definition for purposes of Regulations G and U would impose burdens on banks and other lenders. Use of the definition would limit the amount of credit that banks could extend on thousands of additional stocks and would also require banks to obtain a "purpose statement" (FR U–1) whenever they lend more than $100,000 on those stocks. In addition, it would no longer be possible for the Board to publish a complete "List of Marginable OTC

Stocks" (OTC List), as the stocks that met the SEC's ready market test would be ever changing and outside the Board's control. Banks therefore would be responsible for determining on their own whether a given OTC equity security was subject to Regulation U. The burden imposed on Regulation G lenders would be similar.[8] In addition, the number of lenders potentially covered by Regulation G would expand to include as many as 6600 additional companies to the extent that those companies extended credit to their employees secured with company stock.[9] Although the Board currently alerts companies with OTC margin stock to the possibility of registration under Regulation G, elimination of the OTC list would prevent the Board from continuing this practice.

Accordingly, the Board is seeking comment on possible solutions to the disparate treatment of broker-dealers and other lenders, and the resulting increase in burden for one group whenever burden is reduced for the other. The Board seeks comment on whether it should establish separate regimes for determining coverage by Regulation T on the one hand, and Regulations G and U on the other; for example, any domestic stock that has a ready market for purposes of the SEC's net capital rule might receive loan value under Regulation T, while only domestic stocks that are listed on an exchange might be subject to Regulations G and U.

8. Options Under Regulation U

On December 12, 1995, the Board published proposed amendments to Regulation U, including one that concerned the treatment of exchange-traded options. The proposal mirrored the treatment proposed by the Board for broker-dealers under Regulation T. Specifically, the Board proposed to allow the same 50 percent loan value for long positions in exchange-traded options currently permitted for other exchange-traded equity securities. Because the final rule under Regulation T ties the loan value of these securities to the rules of the exchange authorized to trade the option, the Board is proposing, as a matter of parity between Regulations T and U, to amend Regulation U so that banks can lend against exchange-traded options to the extent permitted by the rules of the options exchanges. The Board seeks comment on the practicality of requiring banks to comply with rules of SROs of which they are not members.

9. Technical Amendments

The Board is also prescribing technical amendments to Regulation T that are intended to streamline and rationalize the regulation without altering its substance. The Board is proposing to add a definition of "margin equity security," a term currently used but not defined in the regulation. The Board is seeking comment on whether the definition of "covered option transaction" can be shortened to include "any transaction eligible for the cash account under the rules of the registered national securities exchange authorized to trade the option or warrant or the creditor's examining authority in the case of an unregistered option provided that all such rules have been approved or amended by the SEC." This change could not take effect until the provision in the final rule delegating authority over options to the SROs became effective.

Regulatory Flexibility Act

The Board has concluded after reviewing the proposed regulation that, if adopted, it would not impose a significant economic hardship on small institutions. The proposal does not necessitate the development of sophisticated recordkeeping or reporting systems by small institutions; nor will small institutions need to seek out the expertise of specialized accountants, lawyers, or managers in order to comply with the regulation. The proposal is designed to reduce the complexity and burden of Regulation T. The Board therefore certifies pursuant to section 605b of the Regulatory Flexibility Act (5 U.S.C. 605b) that the proposal, if adopted, will not have a significantly adverse economic impact on a substantial number of small entities within the meaning of the Regulatory Flexibility Act (5 U.S.C. 601 *et. seq.*).

Paperwork Reduction Act

In accordance with section 3506 of the Paperwork Reduction Act of 1995 (44 U.S.C. Ch. 35; 5 CFR 1320 Appendix A.1), the Board reviewed the proposed rule under the authority delegated to the Board by the Office of Management and Budget. Comments on the collections of information should be sent to the Office of Management and Budget, Paperwork Reduction Projects 7100–0001 (or 7100–0004), Washington, DC 20503, with copies of such comments to be sent to Mary M. McLaughlin, Federal Reserve Board Clearance Officer, Division of Research and Statistics, Mail Stop 97, Board of Governors of the Federal Reserve System, Washington, DC 20551.

The collection of information implications of the proposal to amend this regulation are found in 12 CFR part 220. This information is required to evidence compliance with the requirements of the Securities Exchange Act of 1934 (15 U.S.C. 78g). The respondents are for-profit financial institutions (7100–0001) and public corporations (7100–0004).

Implications for Reporting

The proposal to change the definition of "OTC margin stock by allowing a broker-dealer to extend credit on any stock traded on a national securities exchange, quoted on NASDAQ, or otherwise having a 'ready market' * * *" could lead to an increase in the number of respondents for the OTC Margin Stock Report (FR 2048; OMB No. 7100–0004) because of the increase in the number of firms whose stock would be marginable. The burden per response of 0.25 hours would not change. However, if it is decided that the stock of any firm listed on the NASD SmallCap market is automatically marginable, as currently is the case for the stocks of firms listed on the NASD National Market System, the FR 2048 could be eliminated. Currently, the FR 2048 is filed by approximately 75 respondents each quarter. The current annual burden of the FR 2048 is estimated to be 75 hours. Based on an hourly cost of $20, the annual cost to the public is estimated to be $1,500.

The Federal Reserve may not conduct or sponsor, and an organization is not required to respond to, an information collection unless it displays a currently valid OMB control number.

Comments are invited on: (a) whether the proposed amendments to this collection of information are necessary for the proper performance of the Federal Reserve's functions; including whether the information has practical utility; (b) the accuracy of the Federal Reserve's estimate of the burden of the proposed information collection, including the cost of compliance; (c) ways to enhance the quality, utility, and clarity of the information to be collected; and (d) ways to minimize the burden of information collection on respondents, including through the use of automated collection techniques or other forms of information technology.

[8] Regulation G does not contain a paperwork exemption for loans of $100,000 or less, so all loans secured by these new OTC margin stocks would require a "purpose statement" (Form FR G–3).

[9] Companies that extend credit to employers in connection with an employee benefit plan adopted by the company and approved by its stockholders are not subject to the 50 percent requirement normally imposed on loans secured by margin stock. 12 CFR 207.5. However, these companies must register with the Federal Reserve and provide annual reports of their securities credit activities.

List of Subjects

12 CFR Part 207

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

12 CFR Parts 220 and 221

Banks, banking, Bonds, Brokers, Credit, Federal Reserve System, Margin, Margin requirements, Investment companies, Investments, Reporting and recordkeeping requirements, Securities.

For the reasons set out in the preamble, the Board proposes to amend 12 CFR Part 220 as follows:

PART 220—CREDIT BY BROKERS AND DEALERS (REGULATION T)

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 as follows:

a. By adding a new definition of *Margin equity security* in alphabetical order;

b. By revising paragraph (3) in the definition of *Margin security*;

c. By adding a new definition of *Non-equity security* in alphabetical order;

d. By removing the definition of *OTC margin bond.*

The additions and revisions read as follows:

§ 220.2 Definitions.

* * * * *

Margin equity security means a margin security that is an equity security (as defined in section 3(a)(11) of the Act.).

* * * * *

Margin security * * *

(3) Any non-equity security;

* * * * *

Non-equity security means a security that is not an equity security (as defined in section 3(a)(11) of the Act).

* * * * *

3. Section 220.3(b) is revised to read as follows:

§ 220.3 General provisions.

* * * * *

(b) *Separation of accounts*—(1) *In general.* The requirements of one account may not be met by considering items in another 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.

(2) *Exceptions.* Notwithstanding paragraph (b) (1) of this section—

(i) For purposes of calculating the required margin for a security in the non-equity account or margin account, assets described in § 220.9(a) (1) or (2) may serve in lieu of margin;

(ii) Transfers may be effected between the margin account and the special memorandum account pursuant to §§ 220.4 and 220.5.

* * * * *

4. Section 220.4(b)(1) is revised to read as follows:

§ 220.4 Margin account.

* * * * *

(b) *Required margin*—(1) *Applicability.* The required margin for long or short positions in securities is set forth in § 220.18 (the Supplement) and is subject to the following exceptions and special provisions.

* * * * *

5. The text of § 220.13 is redesignated as paragraph (j) of § 220.3, the section heading of § 220.13 is redesignated as the heading of newly designated paragraph (j) of § 220.3, and § 220.13 is removed.

6. New section 220.13 is added to read as follows:

§ 220.13 Non-equity account.

(a) *Permissible transactions.* In a non-equity account, a creditor may effect and finance any transaction involving any non-equity security. No transaction or withdrawal shall be allowed if it would cause the account to liquidate to a deficit.

(b) *Required margin.* The required margin for transactions effected in the non-equity account is set forth in § 220.18 (the Supplement).

7. Section 220.16 is amended by revising the second sentence of paragraph (a) and the last sentence of paragraph (b) to read as follows:

§ 220.16 Borrowing and lending securities.

Option 1 for Paragraph (a)

(a) * * * Each borrowing shall be secured by a deposit of one or more of the following: cash, cash equivalents, foreign sovereign nonconvertible debt securities that are margin securities, collateral acceptable for borrowings of securities pursuant to SEC Rule 15c3–3 (17 CFR 240.15c3–3), 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 FR T–1, T–2, or any margin security, valued at its loan value.* * *

Option 2 for Paragraph (a)

(a) * * * Each borrowing shall be secured by a *bona fide* deposit of collateral equal to at least 100 percent of the market value of the securities borrowed.* * *

(b) * * * Each borrowing shall be secured by a *bona fide* deposit of collateral equal to at least 100 percent of the market value of the securities borrowed.

8. Section 220.18 is amended by revising the introductory text and paragraphs (b) through (d) to read as follows:

§ 220.18 Supplement: Margin requirements.

The required margin for positions held in a margin account shall be as follows:

* * * * *

(b) Exempted security, non-equity security, money market mutual fund, or exempted securities mutual fund: the margin required by the creditor in good faith or the percentage set by the regulatory authority where the trade occurs, whichever is greater.

(c) Short sale of a nonexempted security, except for a non-equity 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.

(d) Short sale of an exempted security or non-equity security: 100 percent of the current market value of the security plus the margin required by the creditor in good faith.

* * * * *

By order of the Board of Governors of the Federal Reserve System, April 24, 1996.

William W. Wiles,

Secretary of the Board.

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