FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 5182
April 19, 1962]

MARGIN REGULATIONS

Amendment to Regulation U

To All Banks, Members of National Securities Exchanges, and Others Interested, in the Second Federal Reserve District:

Effective May 1, 1962, the Board of Governors of the Federal Reserve System has amended paragraphs (f), (g), and (h) of section 221.2 of its Regulation U. These paragraphs exempt specified classes of bank loans from the margin requirements and other requirements of section 221.1.

The effect of the amendment is to prevent banks from extending credit under these exemptions to (1) any person who is not subject to Regulation T or U but who is engaged principally, or as one of the person's important activities, in the business of making loans for the purpose of purchasing or carrying stocks registered on a national securities exchange, or (2) any others for the purpose of financing transactions, commonly referred to as "clearances" or "free rides," in special cash accounts subject to section 220.4(c) of Regulation T.

Enclosed is a copy of Regulation U, revised to include this amendment; additional copies will be furnished upon request.

ALFRED HAYES,
President.

BOARD OF GOVERNORS

of the

FEDERAL RESERVE SYSTEM

LOANS BY BANKS FOR THE PURPOSE OF PURCHASING OR CARRYING REGISTERED STOCKS

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REGULATION U

(12 CFR 221)

As Amended effective May 1, 1962

INQUIRIES REGARDING THIS REGULATION

Any inquiry relating to this regulation should be addressed to the Federal Reserve Bank of the district in which the inquiry arises.

EXPLANATORY FOREWORD

(Not a part of the regulation)

This regulation is issued pursuant to the provisions of section 7 of the Securities Exchange Act of 1934.

This regulation does not prevent a bank from taking for any loan collateral in addition to that required by the regulation. Except as provided in § 221.3(*r*) with respect to convertible securities, it does not require a bank to reduce any loan, to obtain collateral for any outstanding loan, or to call any outstanding loan because of insufficient collateral.

NOTE.—The reporting and record-keeping requirements contained herein have been approved by the Bureau of the Budget in accordance with the Federal Reports Act of 1942.

REGULATION U

(12 CFR 221)

As Amended effective May 1, 1962

LOANS BY BANKS FOR THE PURPOSE OF PURCHASING OR CARRYING REGISTERED STOCKS*

SECTION 221.1—GENERAL RULE

(*a*) No bank shall make any loan secured directly or indirectly by any stock for the purpose of purchasing or carrying any stock registered on a national securities exchange (and no bank shall make any loan described in § 221.3(*q*) regardless of whether or not such loan is secured by any stock) in an amount exceeding the maximum loan value of the collateral, as prescribed from time to time for stocks in § 221.4 (the Supplement to Regulation U) and as determined by the bank in good faith for any collateral other than stocks.

(*b*) For the purpose of this part, the entire indebtedness of any borrower to any bank incurred at any time for the purpose of purchasing or carrying stocks registered on a national securities exchange shall be considered a single loan; and all the collateral securing such indebtedness shall be considered in determining whether or not the loan complies with this part.

(*c*) While a bank maintains any such loan, whenever made, the bank shall not at any time permit any withdrawal or substitution of collateral unless either (1) the loan would not exceed the maximum loan value of the collateral after such withdrawal or substitution, or (2) the loan is reduced by at least the amount by which the maximum loan value of any collateral deposited is less than the "retention requirement" of any collateral withdrawn. The "retention requirement" of nonstock collateral is the same as its maximum loan value, and the "retention requirement" of stock collateral is prescribed from time to time in § 221.4 (the Supplement to Regulation U). If the maximum loan value of the collateral securing the loan has become less than the amount of the loan, the amount of the loan may nevertheless be increased if there is provided additional collateral having maximum loan value at least equal to the amount of the increase.

SECTION 221.2—EXCEPTIONS TO GENERAL RULE

Notwithstanding the provisions of § 221.1, a bank may make and may maintain any loan for the purpose specified in § 221.1, without

* This text corresponds to the Code of Federal Regulations, Title 12, Chapter II, Part 221; cited as 12 CFR 221.

regard to the limitations prescribed therein, if the loan comes within any of the following descriptions:

(*a*) Any loan to a bank or to a foreign banking institution;

(*b*) Any loan made prior to July 16, 1945, to any person whose total indebtedness to the bank at the date of and including such loan does not exceed $1,000;

(*c*) Any loan to a dealer, or to two or more dealers, to aid in the financing of the distribution of securities to customers not through the medium of a national securities exchange;

(*d*) Any loan to a broker or dealer that is made in exceptional circumstances in good faith to meet his emergency needs;

(*e*) Any loan to a broker or dealer secured by any securities which, according to written notice received by the bank from the broker or dealer pursuant to a rule of the Securities and Exchange Commission concerning the hypothecation of customers' securities (Rule X-8C-1 or Rule X-15C2-1), are securities carried for the account of one or more customers, *Provided*, The bank accepts in good faith from the broker or dealer a signed statement to the effect that he is subject to the provisions of Part 220 of this chapter (Regulation T) (or that he does not extend or maintain credit to or for customers except in accordance therewith as if he were subject thereto);

(*f*) Any temporary advance to finance the purchase or sale of securities for prompt delivery which is to be repaid in the ordinary course of business upon completion of the transaction: *Provided*, That the advance is not made to a person described in § 221.3(*q*): *And provided further*, That it is either (1) made to a broker or dealer, or (2) made for a purpose other than to enable the borrower to pay for securities purchased in a special cash account subject to § 220.4(*c*) of this chapter;

(*g*) Any loan against securities in transit, or surrendered for transfer, which is payable in the ordinary course of business upon arrival of the securities or upon completion of the transfer: *Provided*, That the loan is not made to a person described in § 221.3(*q*): *And provided further*, That it is either (1) made to a broker or dealer, or (2) made for a purpose other than to enable the borrower to pay for securities purchased in a special cash account subject to § 220.4(*c*) of this chapter;

(*h*) Any loan which is to be repaid on the calendar day on which it is made: *Provided*, That the loan is not made to a person described in § 221.3(*q*): *And provided further*, That it is either (1) made to a broker or dealer, or (2) made for a purpose other than to enable the borrower to pay for securities purchased in a special cash account subject to § 220.4(*c*) of this chapter;

(*i*) Any loan made outside the States of the United States and the District of Columbia;

(*j*) Any loan to a member of a national securities exchange for the purpose of financing his or his customers' bona fide arbitrage transactions in securities. For the purposes of this paragraph, the term "arbitrage" means (1) a purchase or sale of a security in one market together with an offsetting sale or purchase of the same security in a different market at as nearly the same time as practicable, for the purpose of taking advantage of a difference in prices in the two markets, or (2) a purchase of a security which is, without restriction other than the payment of money, exchangeable or convertible within 90 calendar days following the date of its purchase into a second security together with an offsetting sale at or about the same time of such second security, for the purpose of taking advantage of a disparity in the prices of the two securities;

(*k*) Any loan to a member of a national securities exchange for the purpose of financing such member's transaction as an odd-lot dealer in securities with respect to which he is registered on such national securities exchange as an odd-lot dealer.

SECTION 221.3—MISCELLANEOUS PROVISIONS

(*a*) In determining whether or not a loan is for the purpose specified in § 221.1 or for any of the purposes specified in § 221.2, a bank may rely upon a statement with respect thereto only if such statement (1) is signed by the borrower; (2) is accepted in good faith and signed by an officer of the bank as having been so accepted; and (3) if it merely states what is not the purpose of the loan, is supported by a memorandum or notation of the lending officer describing the purpose of the loan. To accept the statement in good faith, the officer must be alert to the circumstances surrounding the loan and the borrower and must have no information which would put a prudent man upon inquiry and if investigated with reasonable diligence would lead to the discovery of the falsity of the statement.

(*b*) (1) No loan, however it may be secured, need be treated as a loan for the purpose of "carrying" a stock registered on a national securities exchange unless the loan is as described in subparagraph (2) of this paragraph or the purpose of the loan is to enable the borrower to reduce or retire indebtedness which was originally incurred to purchase such a stock, or, if he be a broker or a dealer, to carry such stocks for customers.

(2) A loan for the purpose of purchasing or carrying a "redeemable security" (i.e., a redeemable proportionate interest in the issuer's assets) issued by an "open-end company," as defined in the Investment Company Act of 1940, whose assets customarily include stocks registered on

a national securities exchange, shall be deemed to be for the purpose of purchasing or carrying a stock so registered.

(*c*) In determining whether or not a security is a "stock registered on a national securities exchange" or a "redeemable security" described in paragraph (*b*) (2) of this section, a bank may rely upon any reasonably current record of such securities that is published or specified in a publication of the Board of Governors of the Federal Reserve System.

(*d*) Except as provided in paragraph (*r*) of this section, the renewal or extension of maturity of a loan need not be treated as the making of a loan if the amount of the loan is not increased except by the addition of interest or service charges on the loan or of taxes on transactions in connection with the loan.

(*e*) A bank, without following the requirements of this part as to the making of a loan, may:

(1) accept the transfer of a loan from another bank, or

(2) permit the transfer of a loan from one borrower to another, or to others, as a bona fide incident to a transaction that is not undertaken for the purpose of avoiding the requirements of this part, provided that a statement signed by the transferor, describing the circumstances giving rise to the transfer, is accepted in good faith by an officer of the bank and is kept with each transferee loan account;

Provided, The loan is not increased and the collateral for the loan is not changed; and, after such transfer, a bank may permit such withdrawals and substitutions of collateral as the bank might have permitted if it had been the original maker of the loan or had originally made the loan to the new borrower.

(*f*) A loan need not be treated as collateralled by securities which are held by the bank only in the capacity of custodian, depositary or trustee, or under similar circumstances, if the bank in good faith has not relied upon such securities as collateral in the making or maintenance of the particular loan.

(*g*) Nothing in this part shall be construed to prevent a bank from permitting withdrawals or substitutions of securities to enable a borrower to participate in a reorganization.

(*h*) No mistake made in good faith in connection with the making or maintenance of a loan shall be deemed to be a violation of this part.

(*i*) Nothing in this part shall be construed as preventing a bank from taking such action as it shall deem necessary in good faith for its own protection.

(*j*) Every bank, and every person engaged in the business of extending credit who, in the ordinary course of business, extends credit for the purpose of purchasing or carrying securities registered on a national securities exchange, shall make such reports as the Board of Governors of the Federal Reserve System may require to enable it to perform the functions conferred upon it by the Securities Exchange Act of 1934 (48 Stat. 881; 15 U.S.C. Chapter 2B).

(*k*) Terms used in this part have the meanings assigned to them in a portion of section 3(a) of the Securities Exchange Act of 1934 (48 Stat. 882; 15 U.S.C. 78c(a)), except that the term "bank" does not include a bank which is a member of a national securities exchange.

(*l*) The term "stock" includes any security commonly known as a stock, any voting trust certificate or other instrument representing such a security, and any warrant or right to subscribe to or purchase such a security.

(*m*) Indebtedness "subject to § 221.1" is indebtedness which is secured directly or indirectly by any stock (or made to a person described in paragraph (*q*) of this section), is for the purpose of purchasing or carrying any stock registered on a national securities exchange, and is not excepted by § 221.2.

(*n*) (1) The bank shall identify all the collateral used to meet the collateral requirements of § 221.1 (entire indebtedness being considered a single loan and collateral being similarly considered, as required by § 221.1) and shall not cancel the identification of any portion thereof except in circumstances that would permit the withdrawal of that portion. Such identification may be made by any reasonable method, and in the case of indebtedness outstanding at the opening of business on June 15, 1959 need not be made until immediately before some change in that or other indebtedness of the borrower or in collateral therefor.

(2) Only the collateral required to be so identified shall have loan value for purposes of § 221.1 or be subject to the restrictions therein specified with respect to withdrawals and substitutions; and

(3) For any indebtedness of the same borrower that is not subject to § 221.1 (other than a loan described in § 221.2 (*d*), (*f*), (*g*) or (*h*)), the bank shall in good faith require as much collateral not so identified as the bank would require (if any) if it held neither the indebtedness subject to § 221.1 nor the identified collateral. This shall not be construed, however, to require the bank, after it has made any loan, to obtain any collateral therefor because of any deficiency in collateral already existing at the opening of business on June 15, 1959, or any decline in the value or quality of the collateral or in the credit rating of the borrower. It also does not require a bank to waive or forego any lien. In addition, it shall

not apply to a loan to enable the borrower to meet emergency expenses not reasonably foreseeable, provided the loan is supported by a statement of the borrower describing the circumstances, accepted in good faith and signed by an officer of the bank as having been so accepted.

(*o*) In the case of a loan to a member of a national securities exchange who is registered and acts as a specialist in securities on the exchange for the purpose of financing such member's transactions as a specialist in such securities, the maximum loan value of any stock shall be as determined by the bank in good faith provided that the specialist's exchange, in addition to other requirements applicable to specialists, is designated by the Board of Governors of the Federal Reserve System as requiring reports suitable for supplying current information regarding specialists' use of credit pursuant to this section.

(*p*) A loan need not comply with the other requirements of this part if it is to enable the borrower to acquire a stock by exercising a right to acquire such stock which is evidenced by a warrant or certificate issued to stockholders and expiring within 90 days of issuance: *Provided*, That (1) each such acquisition under this paragraph shall be treated separately, and the loan when made shall not exceed 75 per cent of the current market value of the stock so acquired as determined by any reasonable method, (2) while the borrower has any loan outstanding at the bank under this paragraph no withdrawal or substitution of stock used to make such loan shall be permissible, except that when the loan has become equal to or less than the maximum loan value of the stock as prescribed for § 221.1 in § 221.4 the stock and indebtedness may thereafter be treated as subject to § 221.1 instead of this paragraph, and (3) no loan shall be made under this paragraph at any time when the borrower has any such loan at the bank which has been outstanding more than 9 months without becoming eligible to be treated as subject to § 221.1. In order to facilitate the exercise of a right under this paragraph, a bank may permit the right to be withdrawn from a loan subject to § 221.1 without regard to any other requirement of this part.

(*q*) Any loan to a person not subject to this part (Regulation U) or to Part 220 of this chapter (Regulation T) engaged principally, or as one of the person's important activities, in the business of making loans for the purpose of purchasing or carrying stocks registered on a national securities exchange, is a loan for the purpose of purchasing or carrying stocks so registered unless the loan and its purposes are effectively and unmistakably separated and disassociated from any financing or refinancing, for the borrower or others, of any purchasing or carrying of stocks so registered. Any loan to any such borrower, unless the loan is so separated and disassociated or is excepted by § 221.2, is a loan "subject to § 221.1" regardless of whether or not the loan is secured by any stock;

and no bank shall make any such loan subject to § 221.1 to any such borrower on or after June 15, 1959, without collateral or without the loan being secured as would be required by this Part if it were secured by any stock. Any such loan subject to § 221.1 to any such borrower, whether or not made after June 15, 1959, shall be subject to the other provisions of this Part applicable to loans subject to § 221.1, including provisions regarding withdrawal and substitution of collateral.

(*r*) If, on or after June 15, 1959, a loan is made for the purpose of purchasing or carrying a security other than a stock registered on a national securities exchange and the loan is secured by the security, but subsequently there is substituted as direct or indirect collateral for the loan a stock so registered which is acquired by the borrower through the conversion or exchange of the security pursuant to its terms, the loan shall thereupon be deemed to be for the purpose of purchasing or carrying a stock so registered. In any such case, the amount of the outstanding loan, or such amount plus any increase therein to enable the borrower to acquire the stock so registered, shall not be permitted on the date such stock is substituted as collateral to exceed the maximum loan value of the collateral for the loan on such date, and thereafter such indebtedness shall be treated as subject to § 221.1: *Provided, however*, That any reduction in the loan or deposit of collateral required on that date to meet this requirement may be brought about within 30 days of such substitution.

(Section 221.4, Supplement, containing maximum loan values and retention requirements, which are changed from time to time, is printed separately.)

APPENDIX

There are printed below certain provisions of the Securities Exchange Act of 1934: (U. S. C., Title 15, sec. 78).

Sec. 3.(a) * * *

(3) The term "member" when used with respect to an exchange means any person who is permitted either to effect transactions on the exchange without the services of another person acting as broker, or to make use of the facilities of an exchange for transactions thereon without payment of a commission or fee or with the payment of a commission or fee which is less than that charged the general public, and includes any firm transacting a business as broker or dealer of which a member is a partner, and any partner of any such firm.

(4) The term "broker" means any person engaged in the business of effecting transactions in securities for the account of others, but does not include a bank.

(5) The term "dealer" means any person engaged in the business of buying and selling securities for his own account, through a broker or otherwise, but does not include a bank, or any person insofar as he buys or sells securities for his own account, either individually or in some fiduciary capacity, but not as a part of a regular business.

(6) The term "bank" means (A) a banking institution organized under the laws of the United States, (B) a member bank of the Federal Reserve System, (C) any other banking institution, whether incorporated or not, doing business under the laws of any State or of the United States, a substantial portion of the business of which consists of receiving deposits or exercising fiduciary powers similar to those permitted to national banks under section 11 (k) of the Federal Reserve Act, as amended, and which is supervised and examined by State or Federal authority having supervision over banks, and which is not operated for the purpose of evading the provisions of this title, and (D) a receiver, conservator, or other liquidating agent of any institution or firm included in clauses (A), (B), or (C) of this paragraph.

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(9) The term "person" means an individual, a corporation, a partnership, an association, a joint-stock company, a business trust, or an unincorporated organization.

(10) The term "security" means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any

profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

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Sec. 7.(a) For the purpose of preventing the excessive use of credit for the purchase or carrying of securities, the Board of Governors of the Federal Reserve System shall, prior to the effective date of this section and from time to time thereafter, prescribe rules and regulations with respect to the amount of credit that may be initially extended and subsequently maintained on any security (other than an exempted security) registered on a national securities exchange. For the initial extension of credit, such rules and regulations shall be based upon the following standard: An amount not greater than whichever is the higher of—

(1) 55 per centum of the current market price of the security, or

(2) 100 per centum of the lowest market price of the security during the preceding thirty-six calendar months, but not more than 75 per centum of the current market price.

Such rules and regulations may make appropriate provision with respect to the carrying of undermargined accounts for limited periods and under specified conditions; the withdrawal of funds or securities; the substitution or additional purchases of securities; the transfer of accounts from one lender to another; special or different margin requirements for delayed deliveries, short sales, arbitrage transactions, and securities to which paragraph (2) of this subsection does not apply; the bases and the methods to be used in calculating loans, and margins and market prices; and similar administrative adjustments and details. For the purposes of paragraph (2) of this subsection, until July 1, 1936, the lowest price at which a security has sold on or after July 1, 1933, shall be considered as the lowest price at which such security has sold during the preceding thirty-six calendar months.

(b) Notwithstanding the provisions of subsection (a) of this section, the Board of Governors of the Federal Reserve System,

may, from time to time, with respect to all or specified securities or transactions, or classes of securities, or classes of transactions, by such rules and regulations (1) prescribe such lower margin requirements for the initial extension or maintenance of credit as it deems necessary or appropriate for the accommodation of commerce and industry, having due regard to the general credit situation of the country, and (2) prescribe such higher margin requirements for the initial extension or maintenance of credit as it may deem necessary or appropriate to prevent the excessive use of credit to finance transactions in securities.

(c) It shall be unlawful for any member of a national securities exchange or any broker or dealer who transacts a business in securities through the medium of any such member, directly or indirectly to extend or maintain credit or arrange for the extension or maintenance of credit to or for any customer—

(1) On any security (other than an exempted security) registered on a national securities exchange, in contravention of the rules and regulations which the Board of Governors of the Federal Reserve System shall prescribe under subsections (a) and (b) of this section.

(2) Without collateral or on any collateral other than exempted securities and/or securities registered upon a national securities exchange, except in accordance with such rules and regulations as the Board of Governors of the Federal Reserve System may prescribe (A) to permit under specified conditions and for a limited period any such member, broker, or dealer to maintain a credit initially extended in conformity with the rules and regulations of the Board of Governors of the Federal Reserve System, and (B) to permit the extension or maintenance of credit in cases where the extension or maintenance of credit is not for the purpose of purchasing or carrying securities or of evading or circumventing the provisions of paragraph (1) of this subsection.

(d) It shall be unlawful for any person not subject to subsection (c) to extend or maintain credit or to arrange for the extension or maintenance of credit for the purpose of purchasing or carrying any security registered on a national securities exchange, in contravention of such rules and regulations as the Board of Governors of the Federal Reserve System shall prescribe to prevent the excessive use of credit for the purchasing or carrying of or trading in securities in circumvention of the other provisions of this section. Such rules and regulations may impose upon all loans made for the purpose of purchasing or carrying securities registered on national securities exchanges limitations similar to those imposed upon members,

brokers, or dealers by subsection (c) of this section and the rules and regulations thereunder. This subsection and the rules and regulations thereunder shall not apply (A) to a loan made by a person not in the ordinary course of his business, (B) to a loan on an exempted security, (C) to a loan to a dealer to aid in the financing of the distribution of securities to customers not through the medium of a national securities exchange, (D) to a loan by a bank on a security other than an equity security, or (E) to such other loans as the Board of Governors of the Federal Reserve System shall, by such rules and regulations as it may deem necessary or appropriate in the public interest or for the protection of investors, exempt, either unconditionally or upon specified terms and conditions or for stated periods, from the operation of this subsection and the rules and regulations thereunder.

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Sec. 17. (b) Any broker, dealer, or other person extending credit who is subject to the rules and regulations prescribed by the Board of Governors of the Federal Reserve System pursuant to this title shall make such reports to the Board as it may require as necessary or appropriate to enable it to perform the functions conferred upon it by this title. If any such broker, dealer, or other person shall fail to make any such report or fail to furnish full information therein, or, if in the judgment of the Board it is otherwise necessary, such broker, dealer, or other person shall permit such inspections to be made by the Board with respect to the business operations of such broker, dealer, or other person as the Board may deem necessary to enable it to obtain the required information.

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Sec. 29.(a) Any condition, stipulation, or provision binding any person to waive compliance with any provision of this title or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void.

(b) Every contract made in violation of any provision of this title or of any rule or regulation thereunder, and every contract (including any contract for listing a security on an exchange) heretofore or hereafter made the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this title or any rule or regulation thereunder, shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, or regulation, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual

knowledge of the facts by reason of which the making or performance of such contract was in violation of any such provision, rule or regulation. * * *

(c) Nothing in this title shall be construed (1) to affect the validity of any loan or extension of credit (or any extension or renewal thereof) made or of any lien created prior or subsequent to the enactment of this title, unless at the time of the making of such loan or extension of credit (or extension or renewal thereof) or the creating of such lien, the person making such loan or extension of credit (or extension or renewal thereof) or acquiring such lien shall have actual knowledge of facts by reason of which the making of such loan or extension of credit (or extension or renewal thereof) or the acquisition of such lien is a violation of the provisions of this title or any rule or regulation thereunder, or (2) to afford a defense to the collection of any debt or obligation or the enforcement of any lien by any person who shall have acquired such debt, obligation, or lien in good faith for value and without actual knowledge of the violation of any provision of this title or any rule or regulation thereunder affecting the legality of such debt, obligation, or lien.

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Sec. 32.(a) Any person who willfully violates any provision of this title, or any rule or regulation thereunder the violation of which is made unlawful or the observance of which is required under the terms of this title, or any person who willfully and knowingly makes, or causes to be made, any statement in any application, report, or document required to be filed under this title or any rule or regulation thereunder or any undertaking contained in a registration statement as provided in subsection (d) of section 15 of this title, which statement was false or misleading with respect to any material fact, shall upon conviction be fined not more than $10,000, or imprisoned not more than two years, or both, except that when such person is an exchange, a fine not exceeding $500,000 may be imposed; but no person shall be subject to imprisonment under this section for the violation of any rule or regulation if he proves that he had no knowledge of such rule or regulation.

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