

FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 6258]
December 13, 1968]

PROPOSED AMENDMENTS TO MARGIN REGULATIONS G AND U

— “Equity Funding” Programs

— Loans on Mutual Fund Shares

*To All Banking Institutions, and Others Concerned,
in the Second Federal Reserve District:*

The following statement was made public December 10 by the Board of Governors of the Federal Reserve System:

The Board of Governors of the Federal Reserve System announced today proposals to broaden the coverage of margin Regulations G and U, especially as they apply to loans on mutual fund shares.

The proposals, on which the Board invited comment through the Federal Reserve Banks from interested persons by January 13, 1969, would bring “equity funding” plans or programs under both regulations.

Regulation G applies to “Credit By Persons Other Than Banks, Brokers, or Dealers for Purpose of Purchasing or Carrying Registered Equity Securities” while Regulation U covers “Credit By Banks for the Purpose of Purchasing or Carrying Registered Stocks.” Broker-dealer firms subject to Regulation T — “Credit By Brokers, Dealers, and Members of National Securities Exchanges” — are not permitted to make loans on mutual fund shares.

“Equity funding” programs are investment contracts for the coordinated acquisition of mutual fund shares and insurance or other goods, services, or investments, the shares being pledged to secure loans to pay for the other items specified. Credit extended in connection with such programs offered or sold after January 31, 1969, would be subject to the margin and other requirements of the regulations. Credit extended in connection with programs sold prior to that date would not be affected.

Under the margin requirement currently in effect, the maximum loan value of stock collateral is 20% which means that anyone seeking an extension of credit on \$100 of securities could receive a maximum credit of \$20.

The use of credit in connection with the sale of equity funding programs, which principally involve the purchase of mutual fund shares, represents an avenue for the circumvention of margin rules.

The proposed amendments would also make certain technical changes in the regulations designed to make it easier to determine whether a loan on mutual fund shares is subject to margin requirements. Loans are presently subject to Regulations G and U if the purpose of the loan is to purchase or carry exchange-registered stocks, or bonds convertible into such stocks. Loans to purchase or carry shares in a mutual fund are deemed to be for the purpose of purchasing or carrying such securities, and therefore, subject to margin regulation, if the assets of the fund “customarily include” such stocks or convertible bonds.

To facilitate such determinations, the Board has for some years published a “List of Stocks Registered on a National Securities Exchange and of Securities of Certain Investment Companies,” the investment companies on the list being those whose portfolios fall within the regulatory definition. It has become apparent that there are very few mutual funds whose shares would not be subject to margin regulation. Accordingly, the proposed amendment would provide that all investment company shares are subject to Regulations G and U unless 95 per cent of the fund’s portfolio is invested continuously in “exempted” (chiefly government) securities. This would eliminate the need for publication of the investment company list and it would be discontinued as would also the list of registered stocks.

Printed below are the texts of the proposed amendments to Regulations G and U, together with explanations of the effects of the proposed amendments, in the form in which they were submitted for publication in the *Federal Register*. Comments thereon may be submitted by January 13, 1969 and should be sent to our Bank Examinations Department.

Additional copies of this circular will be furnished upon request.

ALFRED HAYES,
President.

FEDERAL RESERVE SYSTEM

[12 CFR Part 207
Reg. G]

CREDIT BY PERSONS OTHER THAN BANKS, BROKERS, OR DEALERS FOR THE PURPOSE OF PURCHASING OR CARRYING REGISTERED EQUITY SECURITIES

Notice of Proposed Rule Making

Pursuant to the authority contained in the Securities Exchange Act of 1934 (15 U.S.C. 78g), the Board of Governors of the Federal Reserve System is considering amending Part 207 in the following respects:

1. In section 207.2, paragraph (d)(2) would be amended to read as follows:

§ 207.2 Definitions.

* * *

(d) Registered equity security. * * *

(2) Credit for the purpose of purchasing or carrying (i) any security convertible with or without consideration into a registered equity security or carrying any warrant or right to subscribe to or purchase a registered equity security or any such warrant or right, (ii) any security issued by an investment company registered pursuant to section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8), unless at least 95 per cent of the assets of such company are continuously invested in exempted securities (as defined in 15 U.S.C. 78c(a)(12)), or (iii) credit extended in furtherance of any plan, program, or investment contract offered or sold after January 31, 1969, which provides for the acquisition both of securities described in this paragraph (d) and of goods, services, other securities, or investments, is for the purpose of purchasing or carrying registered equity securities, and such security, warrant or right, or such plan,

program, or investment contract, shall for purposes of this Part be treated as if it were a registered equity security.

* * *

2. In section 207.4, paragraph (b), relating to the Board of Governors' "List of Stocks Registered on a National Securities Exchange and of Securities of Certain Investment Companies," would be revoked.

The purpose of the change in paragraph (d)(2) of section 207.2 is to establish that credit to finance programs for the combined purchase of registered equity securities (including securities issued by most investment companies registered pursuant to the Investment Company Act of 1940) and goods, services, other securities, or investments ("equity funding") is subject to the regulation. An additional technical change would clarify that credit to purchase or carry securities issued by most investment companies is subject to the regulation. Paragraph (b) of section 207.4 would be revoked as unnecessary and reserved for subsequent use.

This notice is published pursuant to section 553(b) of Title 5, United States Code, and § 262.2(a) of the rules of procedure of the Board of Governors of the Federal Reserve System (12 CFR 262.2(a)).

To aid in the consideration of this matter by the Board, interested persons are invited to submit, in writing, relevant data, views, or arguments. Such material should be submitted to any Federal Reserve Bank, to be received not later than January 13, 1969. Under the Board's rules regarding availability of information (12 CFR 261), such materials will be made available for inspection and copying to any person upon request unless the person submitting the material requests that it be considered confidential.

Dated at Washington, D. C., this 10th day of December, 1968.

By order of the Board of Governors.

ROBERT P. FORRESTAL,
Assistant Secretary.

FEDERAL RESERVE SYSTEM

[12 CFR Part 221
Reg. U]

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

Notice of Proposed Rule Making

Pursuant to the authority contained in the Securities Exchange Act of 1934 (15 U.S.C. 78g), the Board of Governors is considering amending Part 221 in the following respects:

Section 221.3 would be amended as follows: Paragraph (b)(3) would be revised, paragraph (d) would be revoked, and paragraph (m) would be revised, as follows:

§ 221.3 Miscellaneous Provisions.

* * *

(b) Purpose of a credit. * * *

(3) Credit for the purpose of purchasing or carrying a security issued by an investment company registered pursuant to section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8), unless at least 95 per cent of the assets of such company are continuously invested in exempted securities (as defined in 15 U.S.C. 78c(a)(12)), and credit extended in furtherance of any plan, program, or investment contract offered or sold after January 31, 1969, which provides for the acquisition both of stock registered on a national securities exchange, any security convertible into such a stock, or any securities described in this paragraph (b)(3), and of goods, services, other securities, or investments, is "credit subject to § 221.1."

* * *

(d) [revoked]

* * *

(m) A "credit subject to § 221.1" is a credit which is (1) secured directly or indirectly by any stock (or made to a person described in paragraph (q) of this section), (2) extended for the purpose of purchasing or carrying any stock registered on a national securities

exchange, or any security convertible with or without consideration into such a stock, or carrying any warrant or right to subscribe to or purchase or carry such a stock, or any such warrant or right (such security, warrant, or right is sometimes referred to as a "security convertible into a stock registered on a national securities exchange"), or any security described in § 221.3(b)(3), and (3) not excepted by § 221.2.

* * *

The purpose of the change in paragraph (b)(3) is to establish that credit to finance programs for the combined purchase of registered equity securities (including securities issued by most investment companies registered pursuant to the Investment Company Act of 1940) and goods, services, other securities, or investments ("equity funding") is subject to the regulation. An additional technical change would clarify that credit to purchase or carry securities issued by most investment companies is subject to the regulation. Paragraph (d), relating to the Board of Governors' "List of Stocks Registered on a National Securities Exchange and of Securities of Certain Investment Companies," would be revoked as unnecessary and reserved for subsequent use. Paragraph (m) would be amended to conform to the change in paragraph (b)(3).

This notice is published pursuant to section 553(b) of Title 5, United States Code, and § 262.2(a) of the rules of procedure of the Board of Governors of the Federal Reserve System (12 CFR 262.2(a)).

To aid in the consideration of this matter by the Board, interested persons are invited to submit, in writing, relevant data, views, or arguments. Such material should be submitted to any Federal Reserve Bank, to be received not later than January 13, 1969. Under the Board's rules regarding availability of information (12 CFR 261), such materials will be made available for inspection and copying to any person upon request unless the person submitting the material requests that it be considered confidential.

Dated at Washington, D. C., this 10th day of December, 1968.

By order of the Board of Governors.

ROBERT P. FORRESTAL,
Assistant Secretary.