

FEDERAL RESERVE BANK  
OF NEW YORK

[ Circular No. 6335 ]  
May 19, 1969 ]

PROPOSED AMENDMENT TO MARGIN REGULATION U  
Exemption for Loans to "Third Market Makers"

*To All Banking Institutions in the Second Federal Reserve District:*

Following is the text of a statement issued May 15 by the Board of Governors of the Federal Reserve System:

The Board of Governors of the Federal Reserve System today issued for comment a proposal to exempt so-called "Third market makers" from margin requirements for credit they obtain from banks to carry on their market making activity.

Third market makers are firms that are not members of a stock exchange but make a market in stocks listed on exchanges. Loans to exchange specialists making a market in registered stocks are already exempt from margin requirements and the Board has under consideration a proposal to exempt bank credit to firms which make markets in over-the-counter stocks that would become subject to margin requirements.

The proposal is in the form of an amendment to Regulation U entitled "Credit by Banks for the Purpose of Purchasing or Carrying Registered Stocks." Third market makers normally obtain credit from banks.

Comments on the proposal should be submitted to the Board through the Federal Reserve Banks by June 16, 1969. A copy of the proposal is attached.

Printed on the reverse side is the text of the proposed amendment in the form in which it was forwarded for publication in the *Federal Register*.

Comments on the proposed amendment should be submitted by June 16 and should be sent to our Bank Examinations Department. Additional copies of this circular will be furnished upon request.

ALFRED HAYES,  
*President.*

(OVER)

# FEDERAL RESERVE SYSTEM

[12 CFR Part 221]

[Reg. U]

## CREDIT 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 by adding paragraph (x) to read as follows:

#### § 221.3 Miscellaneous Provisions

\* \* \*

(x) *Third market maker exemption.*—(1) In the case of credit extended to a Third market maker, as defined in subparagraph (2) of this paragraph (x), for the purpose of purchasing or carrying a stock that is registered on a national securities exchange (other than a convertible security described in section 221.3 (t) (1) of this part) in order to conduct the market making activity of such a market maker, the maximum loan value of any such stock, except stock that has been identified as a security held for investment pursuant to a rule of the Commissioner of the Internal Revenue (Regs. section 1-1236-1(d)), shall be determined by the bank in good faith: *Provided*, That in respect of each such stock he shall, at least ten full business days prior to such extension of credit, have filed with the Securities and Exchange Commission a notice of his intent to begin or continue such market making activity, and all other reports required to be filed by Third market makers pursuant to a rule of the Securities and Exchange Commission, and except when such activity is unlawful shall not have ceased to engage in such market making activity: *And provided further*, That the bank shall obtain and retain in its records for at least three years after such credit is extinguished a statement in conformity with the requirements of Federal Reserve Form U-3, executed by the Third market maker who is the recipient of such credit and executed and accepted in good faith<sup>11</sup> by a duly authorized officer of the bank prior to such extension. In determining whether or not an extension of credit is for the purpose of conducting such market making activity, a bank may rely on such a statement, if executed and accepted in accordance with the requirements of this paragraph (x).

(2) A Third market maker with respect to a stock that is registered on a national securities exchange is a dealer who has and maintains net capital, as defined in a rule of the Securities and Exchange Commission (Rule 15c3-1 (17 CFR 240.15c3-1)), of \$250,000 for each such stock in respect of which he has filed and not withdrawn a notice with the Securities and Ex-

<sup>11</sup> As described in section 221.3(a).

change Commission (but in no case does this subparagraph (2) require net capital of more than \$1,500,000), who is in compliance with such rule of the Commission and who, except when such activity is unlawful, meets all the following conditions with respect to such stock: (i) he furnishes bona fide, competitive bid and offer quotations at all times to other broker/dealers on request, (ii) he is ready, willing, and able to effect transactions for his own account in reasonable amounts, and at his quoted prices, with other brokers and dealers, (iii) he does no more than 25 per cent of his business in the stock with other market makers and national securities exchanges and (iv) he has a reasonable average rate of inventory turnover on the stock.

\* \* \*

The proposed change in § 221.3 is to provide an exemption for bank credit extended to broker/dealers that are not members of any national securities exchange in connection with their market making function in the "third market", that is, the "over-the-counter" market for exchange-listed stocks.

This proposal closely parallels a similar exemption, published for comment by the Board (*Federal Register* of February 15, 1969; 34 F.R. 2268, 2272) for broker/dealers making a market in certain stock, not registered on a national securities exchange (OTC stock), to be selected by the Board for inclusion on its list of OTC margin stock. Any broker/dealer registered pursuant to section 15 of the Securities Exchange Act of 1934 (15 U.S.C. 78o) would be eligible for the proposed "Third market maker" exemption if he met the standards set forth in the regulation (including maintaining certain minimum net capital), had filed with the Securities and Exchange Commission a notice of his intent to begin or continue such "market making" activity, and continued to file such other reports as were required pursuant to a rule respecting market makers in the "third market" that the Commission would adopt. The bank would have to obtain a statement on a new form designated F.R. Form U-3, from the market maker that he is properly registered and will use the credit obtained pursuant to the exemption to finance such activities.

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 June 16, 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 5th day of May, 1969.

By order of the Board of Governors.

ROBERT P. FORRESTAL,  
*Assistant Secretary.*