

FEDERAL RESERVE BANK
OF NEW YORK

Circular No. 6680
January 28, 1971

PROPOSED AMENDMENTS TO MARGIN REGULATIONS T AND U
"Block Positioners" and "Third-Market Makers" Exemptions

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

Following is the text of a statement issued January 26 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 from margin requirements credit extended by banks, brokers, and dealers to so-called "block positioners." The Board fixed March 17 as the deadline for the receipt of comment.

Block positioners are securities firms that stand ready to hold substantial blocks of stock for their own account to facilitate the sale or purchase by their customers — primarily institutions — of quantities of stock too large to be absorbed by ordinary trading mechanisms.

The minimum block of stock that could qualify for the proposed exemption would have a market value of \$200,000. A block would also have to be sold by the block positioners within 15 business days, although limited extensions of 5 days at a time could be allowed by the stock exchanges and the National Association of Securities Dealers.

The Board also re-issued for further 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 make a market off the exchanges in stocks that are listed for exchange trading.

The new proposals would subject credit for block positioning activities by all market makers to the same restrictions as those on block positioners. The restrictions would apply to specialists, to over-the-counter firms that make a market in OTC Margin Stocks, and to third market makers. If any of these firms took a single position with a market value of \$200,000 or more, the block would have to be sold within 15 business days, or the credit would cease to be eligible for exemption. The same limited extensions of time could be allowed, however.

Printed below is the text of the proposed amendments. Comments thereon should be submitted by March 17 and may be sent to our Consumer Information and Securities Regulations Department, or directly to the Board of Governors with copies to this Bank. Additional copies of this circular will be furnished upon request.

Alfred Hayes,
President.

(Reg. T)

CREDIT BY BROKERS AND DEALERS

Limitations on Exempt Credit to Specialists

Pursuant to the authority contained in the Securities Exchange Act of 1934 (15 U.S.C. 78g), the Board of Governors proposes to amend Part 220 in the following respects:

Section 220.4 would be amended by revising paragraph (g) to read as follows:

§ 220.4 Special Accounts

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(g) Specialist's account. (1) In a special account designated as a specialist's account, a creditor may effect and finance, for any member of a national securities exchange who is registered and acts as a specialist in securities on the exchange, such member's transactions as a specialist in such securities, or effect and finance, for any joint venture in which the creditor participates, any transactions in any securities of an issue with respect to which all participants, or all participants other than the creditor, are registered and act on a national securities exchange as specialists.

(2) Such specialist's account shall be subject to the same conditions to which it would be subject if it were a general account except that if the specialist's exchange, in addition to the 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 paragraph (g), the requirements of § 220.6(b) regarding joint ventures shall not apply to such accounts and the maximum loan value of a registered security in such account (except a security that has been identified as a security held for investment pursuant to a rule of the Commissioner of Internal Revenue (Regs. section 1-1236-1(d)) shall be as determined by the creditor in good faith: Provided, That in the case of credit extended on any block of stock or portion thereof with a current market value of \$200,000 or more, acquired from a single source at approximately the same time, whether in a single transaction or in several transactions, the requirements of subparagraph (3) of this paragraph (g) shall also apply.

(Reg. U)

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

Limitations on Exempt Credit to Specialists and OTC market makers; Proposal for Exempt Credit to Third-Market Makers and Block-Positioners

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

Section 221.3 would be amended by revising paragraph (o) and subparagraph (1) of paragraph (w) and by adding paragraph (y) and paragraph (z), as set forth below:

§ 221.3 Miscellaneous Provisions

(o) Specialist. In the case of credit extended 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 (except stock that has been identified as a security held for investment pursuant to a rule of the Commissioner of Internal Revenue (Regs. section 1-1236-1(d)) and except a block of stock or portion thereof with a current market value of \$200,000 or more, acquired from a single source at approximately the same time, whether in a single transaction or in several transactions) 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.

(w) OTC market maker exemption. (1) In the case of credit extended to an OTC market maker, as defined in subparagraph (2) of this paragraph (w), for the purpose of purchasing or carrying an OTC margin stock in order to conduct the market-making activity of such a market maker, the maximum loan value of any OTC margin stock (except stock that has been identified as a security held for investment pursuant to a rule of the Commissioner of Internal Revenue (Regs. section 1-1236-1(d)) and except a block of stock or portion thereof with a current market value of \$200,000 or more, acquired from a single source at approximately the same time, whether in a single transaction or in several transactions) shall be determined by the bank in good faith: Provided, That in respect of each such stock the OTC market maker shall have filed with the Securities and Exchange Commission a notice of his intent to begin or continue such market-making activity (Securities and Exchange Commission Form X-17A-12(a)) and all other reports required to be filed by market makers in OTC margin stocks pursuant to a rule of the Commission (Rule 17a-12 (17 CFR 240.17a-12)) and 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 Re-

(3)(i) In the case of credit extended on any block of stock or portion thereof described in subparagraph (2) of this paragraph (g), the creditor shall identify the credit extended pursuant to this paragraph (g) and all the collateral used to support such credit. (ii) No credit shall be extended pursuant to this paragraph (g) in respect of any such block of stock or portion thereof which the specialist has held continuously for more than 15 business days, and any credit extended pursuant to this paragraph (g) shall be extinguished before the expiration of such 15 day period. (iii) In exceptional cases such 15 day period may on application of the specialist and the creditor be extended for one or more periods limited to 5 business days each commensurate with the circumstances by any regularly constituted committee of a national securities exchange which has jurisdiction over the business conduct of its members, of which the specialist is a member: Provided, That such committee is satisfied that the specialist and the creditor are acting in good faith in making the application and that the circumstances in fact warrant such treatment. (iv) For the purposes of this subparagraph (3), a block of stock or portion thereof shall be treated as not having been held continuously only to the extent that there has been a net sale (or in the case of short positions, net purchase) of such securities (whether or not represented by the same certificate) during such 15 day period and/or such extension.

The proposed change in § 220.4(g) would restrict the ability of specialists to obtain exempted credit from other broker/dealers without regard to the limitations of Part 220 (Regulation T) in connection with substantial blocks of stock positioned in the course of their specialist activity. Such credit would be available for a limited period of time only, and would be in conformity with restrictions similar to those that would be imposed under Part 221 (Regulation U) on credit by banks to finance block positioning by specialists, third-market makers, OTC market makers, and block-positioners. Such period could be extended in exceptional circumstances for one or more additional limited periods, by a committee of the exchange of which the specialist was a member. The change would also clarify that securities held for investment are not eligible for exempt credit under § 220.4(g). The provisions for bank credit to finance specialists and OTC market makers are contained in Part 221 (Regulation U) in § 221.3(o) and § 221.3(w) respectively and proposed amendments to these sections are being published simultaneously with this proposal.

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 these matters by the Board, interested persons are invited to submit relevant data, views, or arguments. Any such material should be submitted in writing to the Secretary, the Board of Governors of the Federal Reserve System, Washington, D.C. 20551, to be received not later than March 17, 1971. Such material will be made available by inspection and copying upon request, except as provided in § 261.6(a) of the Board's Rules Regarding Availability of Information.

serve Form U-2, executed by the OTC market maker who is the recipient of such credit and executed and accepted in good faith* 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 (w) and section 221.3(a).

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(y) Third-market maker exemption. (1) in the case of credit extended to a third-market maker, as defined in subparagraph (2) of this paragraph (y), 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 (i) a convertible security described in section 221.3(t)(1) of this part, (ii) stock that has been identified as a security held for investment pursuant to a rule of the Commissioner of Internal Revenue (Regs. section 1-1236-1(d)) and (iii) a block of stock or portion thereof with a current market value of \$200,000 or more, acquired from a single source at approximately the same time, whether in a single transaction or in several transactions), 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* 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 (y) and section 221.3(a).

(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 Exchange Commission (but in no case does this subparagraph (2) require net capital of more than \$1,000,000), 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.

(3) If all or a portion of the credit extended pursuant to this paragraph (y) ceases to be for the purpose specified in subparagraph (1) or the dealer to whom the credit is extended ceases to be a third-market maker as defined in subparagraph (2), the credit or such portion thereof shall thereupon be treated as "a credit subject to § 221.1".

(z) Block positioner exemption. (1) In the case of credit extended to a block positioner, as defined in subparagraph (2) of this paragraph (z), for the purpose of financing the activity of block positioning, the maximum loan value of any stock obtained in the ordinary course of the activity of block-positioning as described in subparagraph (2) of this paragraph (z) (except (i) a convertible security described in section 221.3(t)(1) of this part and (ii) stock that has been identified as a security held for investment pursuant to a rule of the Commissioner of Internal Revenue (Regs. section 1-1236-1(d)) shall be determined by the bank in good faith: Provided, That in respect of such activity he shall have filed with the Securities and Exchange Commission a notice of undertaking such activity on a form prescribed by the Commission, and all other reports required to be filed by block-positioners: 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-5 and section 221.3(a), executed by the block positioner who is the recipient of such credit and executed and accepted in good faith* 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 block positioning activity, a bank may rely on such a statement if executed and accepted in accordance with the requirements of this paragraph (z) and section 221.3(a). In determining whether or not an extension of time has been granted pursuant to subparagraph (3) of this paragraph (z) and whether or not such extension of time is commensurate with the circumstances the bank may rely on a statement executed by an officer of the exchange or association on behalf of the committee in conformity with the requirements of Federal Reserve Form U-6 and section 221.3(a).

(2) A block positioner is a dealer who (i) is registered with the Securities and Exchange Commission under section 15 of the Securities Exchange Act of 1934 (15 U.S.C. 78o) and has a minimum net capital, as defined in a rule of the Securities and Exchange Commission (Rule 15c3-1 (17 CFR 240.15c3-1)) or in the capital rules of an exchange of which he is a member if the members thereof are exempt therefrom by Rule 15c3-1 (b) (2) of the Commission (17CFR 240.15c3-1(b)(2)), of \$250,000, or who is a registered specialist on a national securities exchange, (ii) engages in the activity of purchasing long or selling short as principal, from time to time, from or to a customer (other than a partner or a joint venture or other entity in which a partner of the dealer, or the dealer itself, par-

ticipates, or a person "associated with" such dealer as defined in section 3(a) (18) of the Securities Exchange Act of 1934) a block of stock (other than a convertible security as described in section 221.3 (t) (1) of this part) with a current market value of \$200,000 or more, in a single transaction to facilitate a sale or purchase by such customer, (iii) certifies to the lending bank that he has determined in the exercise of reasonable diligence that the block could not be sold to or purchased from others on equivalent or better terms, and (iv) sells the shares comprising such block as rapidly as possible commensurate with the circumstances.

(3) No credit shall be extended or maintained pursuant to this paragraph (z) in respect of any such block of stock or portion thereof which the block-positioner has held continuously for more than 15 business days, and any credit extended pursuant to this paragraph (z) shall be extinguished or brought into conformity with the initial margin requirements of sections 221.1 and 221.4 before the expiration of such 15 day period. For the purposes of this subparagraph, a block or portion thereof shall be treated as not having been held continuously only to the extent that there has been a net sale (or in the case of short positions, net purchase) of such securities (whether or not represented by the same certificate) during such 15 day period.

(4) In exceptional cases the 15 day period specified in subparagraph (3) of this paragraph (z) may on the application of the block-positioner, be extended for one or more periods limited to 5 business days each commensurate with the circumstances by any regularly constituted committee of a national securities exchange having jurisdiction over the business conduct of its members, of which the block-positioner is a member or through which his transactions are effected, or by a committee of a national securities association: Provided, That such committee is satisfied that the block-positioner is acting in good faith in making the application and that the circumstances in fact warrant such treatment.

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The proposed change in section 221.3(o) would restrict the ability of specialists to obtain credit from banks without regard to the limitations of Part 221 (Regulation U) in connection with substantial blocks of stock positioned in the course of their specialist activity. Such credit would be available only in conformity with the requirements of proposed section 221.3(z), and not otherwise. This restriction is similar to that which would be imposed under Part 220 (Regulation T) on credit by broker/dealers to finance block-positioning by specialists. The change would also clarify that securities held by specialists for investment are not eligible for exempt credit under section 221.3(o).

The proposed change in section 221.3(w) would restrict the ability of OTC market makers to obtain exempted credit from banks without regard to the limitations of Part 221 (Regulation U) in connection with substantial blocks of stock positioned in the course of their market-making activity. Such credit would be available only in conformity with the re-

quirements of proposed section 221.3(z), and not otherwise.

Section 221.3(x), proposed for comment by the Board of Governors on May 5, 1969 (34 Federal Register 7823, May 16, 1969), would be revised as section 221.3(y), and would restrict the ability of third-market makers to obtain credit from banks without regard to the limitations of Part 221 (Regulation U) in connection with substantial blocks of stock positioned in the course of their market-making activity. Such credit would be available only in conformity with the requirements of proposed section 221.3(z), and not otherwise. The revision would also provide that if the credit ceased to be for the purpose of making such a market, or the customer ceased to be a third-market maker, the remaining credit would become restricted in accordance with the provisions of sections 221.1 and 221.4 of this part. A similar provision applies to OTC market makers under section 221.3(w).

The proposed paragraph (z) of section 221.3 would permit certain broker/dealers (including qualifying specialists, third-market makers, and OTC market makers) to obtain credit from banks without regard to the restrictions of Part 221 (Regulation U) in connection with their activities as block-positioners. However, the credit would have to be brought into conformity with the initial margin requirements imposed by Part 221 if (1) the credit ceased to be for the purpose of carrying on such an activity, or (2) the dealer ceased to be a block-positioner. In any event, credit extended pursuant to paragraph (z) would have to be paid back or brought into conformity with ordinary margin requirements within 15 business days, unless extended in exceptional cases, for one or more additional periods limited to 5 business days each by appropriate procedures.

For credit to be in connection with block-positioning, the broker/dealer must certify that the credit is used to buy a substantial amount of securities in order to facilitate a securities transaction too large to be handled through normal channels. The credit would enable the broker/dealer to acquire for his own account that part of the transaction that the market could not otherwise absorb; he must thereafter close his position as quickly as circumstances permit. Any credit extended in connection with the transaction thereafter becomes subject to the ordinary initial margin requirements imposed by Part 221.

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