

FEDERAL RESERVE BANK
OF NEW YORK

Circular No. 6764
July 19, 1971

TEXT OF REVISED PROPOSALS TO AMEND REGULATIONS G, T, AND U

To All Persons Extending Securities Credit
in the Second Federal Reserve District:

Printed below is an excerpt from the Federal Register of July 16, containing the text of the revised proposals to amend margin Regulations G, T, and U that were announced by the Board of Governors of the Federal Reserve System on July 9; the text of that announcement was contained in our Circular No. 6761, dated July 12, 1971. The proposed amendments set forth conditions under which credit may be obtained for the purpose of providing capital to broker-dealer firms without regard to initial margin requirements. Comments thereon should be submitted by August 20 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.

FEDERAL RESERVE SYSTEM

[12 CFR Parts 207, 220, 221]

[Regs. G, T, and U]

**CREDIT TO CONTRIBUTE CAPITAL TO
BROKERS AND DEALERS**

Notice of Proposed Rule Making

Securities credit by persons other than banks, brokers, or dealers; credit by brokers and dealers; credit by banks for the purpose of purchasing or carrying margin stock.

Pursuant to the authority contained in the Securities Exchange Act of 1934 (15 U.S.C. 78g), the Board of Governors proposes to revise its proposals to amend Parts 207, 220, and 221 (36 F.R. 7754-7756, Apr. 24, 1971) in the following respects:

1. Paragraph (f) of § 207.1 would be amended as set forth below:

§ 207.1 General Rule.

(f) *Credit extended to broker or dealer subject to Regulation T.* (1) No lender shall extend or maintain any credit for

the purpose of purchasing or carrying any margin security to any broker or dealer who is subject to Part 220 of this chapter (Regulation T), and after October 1, 1971, no lender shall extend any credit to any customer to enable the customer to contribute capital to any broker or dealer who is subject to such part, whether such contribution is in the form of a loan to such broker or dealer (whether subordinated or not) or of equities in the account of partners, or to purchase stock, in, any broker or dealer who is subject to such part, whether with or without collateral (other than exempted securities). Where the credit or the proceeds of the loan or other contribution or purchase of stock is to be used in the ordinary course of business of such customer or such broker or dealer, such credit is presumed to be for the purpose of purchasing or carrying margin securities unless the lender has in his records a statement to the contrary obtained and executed in conformity with the requirements of paragraph (e) of this section.

(2) The prohibition of this paragraph (f) shall not apply to credit which is unsecured or secured by collateral other

than registered securities which is made to a dealer¹ to aid in the distribution of securities to customers not through the medium of a national securities exchange, or extended to a customer who is a broker or dealer subject to Part 220 of this chapter or to a customer for the purpose of making a loan or contribution of capital to such broker or dealer or to purchase stock in a broker or dealer when such stock is purchased directly from the issuer and not as part of a public distribution if the extension of credit, loan or other contribution is in conformity with the requirements regarding satisfactory subordination agreements or equities in the account of partners of a rule of the Securities and Exchange Commission (Rule 15c-1 (c) (2) (A), (c) (4), and (c) (7) (17 CFR 240.15c3-1 (c) (2) (A), (c) (4), and (c) (7)) or of the capital rules of an exchange of which the broker or dealer is a member if the members thereof are exempt therefrom by Rule 15c3-1(b) (2) of the Commission (17 CFR 240.15c3-1 (b) (2)) or to purchase stock in a

¹ As defined in 15 U.S.C. 78c(a) (5).

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broker or dealer which is a corporation: *Provided*, That in the case of credit described in this paragraph that is extended after October 1, 1971, and in the case of any renewal of such credit extended between April 17, 1971, and October 1, 1971, such extension of credit is subject to the following further conditions: (i) Such credit has the approval of an appropriate committee of a national securities exchange or a national securities association, and the committee, in addition to being satisfied that the credit is not in contravention of any rule of the exchange or association, is satisfied that, if the broker or dealer or an affiliated corporation of such broker or dealer does any dealing in securities for its own account, the credit is not for the purpose of increasing the amount of such dealing, (ii) in no event can the subordinated loan or contribution be repaid or the stock be redeemed except (a) with the approval of an appropriate committee of a national securities exchange or national securities association in the case of the death, disability, or (in the case of a partner, officer, or employee of the broker dealer) involuntary retirement (or if the amount of such repayment or redemption is \$10,000 or less, any retirement, whether voluntary or involuntary) of the customer, or (b) until 1 year after the subordinated extension of credit, loan, or contribution was first made or stock first purchased and until 6 months after the giving of written notice by the customer to such broker or dealer, the Commission, the Securities Investor Protection Corporation, and any national securities exchange or national securities association of which such broker or dealer is a member of intent to demand repayment of the extension of credit, loan, or contribution or redemption of the stock, (iii) in no event may such credit, loan or contribution be repaid or the stock be redeemed if the effect of such payment or redemption would reduce the net capital of such broker or dealer below the amount required by the net capital rule or capital rule to which such broker or dealer is subject, or would otherwise be inconsistent with such rule, (iv) all of the proceeds of such extension of credit are so loaned or contributed to the capital of such broker or dealer or used to purchase such stock, and (v) the proceeds of any withdrawals of such loan or contribution of capital from such broker or dealer by the customer or redemption of such stock shall be used to reduce or retire said extension of credit.

(3) The Board of Governors of the Federal Reserve System may by order exempt from the prohibitions of this paragraph (f) and the requirements of this part, either unconditionally or upon specified terms and conditions or for stated periods, any loan for the purpose of making a loan or providing capital to a person who is subject to Part 220 of this chapter (Regulation T), upon a finding that the granting of such an exemption is necessary or appropriate in the public interest or for the protection of investors: *Provided*, That the Securities

Investor Protection Corporation shall have certified to the Board that such action is appropriate under the circumstances.

2. Section 220.4 would be amended by revising paragraph (f) (2) as set forth below:

§ 220.4 Special accounts.

(f) *Special miscellaneous account.*

(2) (i) Subject to the provisions of subdivisions (iii) and (iv) of this subparagraph extend and maintain credit, (a) to or for any partner of a firm which is a member of a national securities exchange to enable such partner to make a contribution of capital to such firm, or to purchase stock in an affiliated corporation of such firm, or (b) to or for any person who is or will become the holder of stock of a corporation which is a member of a national securities exchange to enable such person to purchase stock in such corporation, or to purchase stock in an affiliated corporation of such corporation; provided the lender as well as the borrower is a partner in such member firm or a stockholder in such member corporation, or the lender is a firm or a stockholder in such member corporation, or the lender is a firm or corporation which is a member of a national securities exchange and the borrower is a partner in such firm or a stockholder in such corporation;

(ii) Subject to the provisions of subdivision (iii) of this subparagraph and with respect to credit described in (b) of this subdivision subject to subdivision (iv) of this subparagraph extend and maintain subordinated credit to another creditor for capital purposes: *Provided*, That:

(a) Either the lender or the borrower is a firm or corporation which is a member of a national securities exchange, the other party to the credit is an affiliated corporation of such member firm or corporation, and, in addition to the fact that an appropriate committee of the exchange is satisfied that the credit is not in contravention of any rule of the exchange, the credit has the approval of such committee, or

(b) The lender as well as the borrower is a member of such exchange, the credit has the approval of an appropriate committee of the exchange, and the committee, in addition to being satisfied that the credit is not in contravention of any rule of the exchange, is satisfied that the credit is outside the ordinary course of the lender's business, and that, if the borrower's firm or corporation or an affiliated corporation of such firm or corporation does any dealing in securities for its own account, the credit is not for the purpose of increasing the amount of such dealing.

(iii) For the purpose of subdivisions (i), (ii), and (iv) of this subparagraph, the term "affiliated corporation" means a corporation all the common stock of which is owned directly or indirectly by the member firm or general partners and employees of the firm, or by the member

corporation or holders of voting stock and employees of the corporation and an appropriate committee of the exchange has approved the member firm's or member corporation's affiliation with such affiliated corporation.

(iv) No credit shall be extended pursuant to this subparagraph after October 1, 1971, and no such credit extended between April 16, 1971, and October 1, 1971, shall be renewed unless (a) in no event can the subordinated loan or contribution be repaid or the stock be redeemed except (1) with the approval of an appropriate committee of a national securities exchange or national securities association in the case of the death, disability, or (in the case of a partner, officer, or employee of the broker or dealer) involuntary retirement (or if the amount of such repayment or redemption is \$10,000 or less, any retirement, whether voluntary or involuntary) of the borrower, or (2) until 1 year after such loan or contribution was first made or such stock first purchased and until 6 months after the giving of written notice by the borrower to the firm, the Securities and Exchange Commission, the Securities Investor Protection Corporation, and any national securities exchange or national securities association of which such broker or dealer is a member of intent to demand repayment of such loan or contribution or redemption of such stock, (b) in no event may such loan or other contribution of capital be repaid or the stock be redeemed by a creditor to whom the loan or contribution was made or whose stock was the subject of purchase, if the effect of such payment or redemption would reduce the net capital of such creditor below the amount required by the net capital rule or capital rule to which such creditor is subject, or would otherwise be inconsistent with such rule; (c) all of the proceeds of such extension of credit are so loaned or contributed to the capital of such firm or affiliated corporation or used to purchase such stock and (d) the proceeds of any withdrawal of such loan or contribution of capital from such creditor or redemption of such stock shall be used to reduce or retire said extension of credit.

3. Section 221.2 would be amended by revising paragraph (m) and § 221.3 would be amended by adding paragraph (b) (4) and revising paragraph (q) as set forth below:

§ 221.2 Exceptions to general rule.

(m) Any credit extended to a broker or dealer subject to Part 220 (Regulation T) or to a customer for the purpose of making a loan or contribution of capital to such broker or dealer if the loan or contribution is in conformity with the requirements regarding satisfactory subordination agreements or equities in the accounts of partners of a rule of the Securities and Exchange Commission (Rule 15c3-1 (c) (2) (a), (c) (4), and (c) (7)) (17 CFR 240.15c3-1 (c) (2) (a), (c) (4), and (c) (7)) or the capital rules of

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an exchange of which the broker or dealer is a member if the members thereof are exempt therefrom by Rule 15c3-1 (b)(2) of the Commission (17 CFR 240.15c3-1(b)(2)) or to purchase stock in a broker or dealer which is a corporation when such stock is purchased directly from the issuer and not as part of a public distribution: *Provided*, That in the case of credit described in this paragraph that is extended after October 1, 1971, and any renewal of such credit extended to a broker or dealer between July 9, 1971, and October 1, 1971, or extended to a customer to make such a loan or contribution of capital to, or to purchase such stock in a broker or dealer between April 16, 1971, and October 1, 1971, such subordinated loan, contribution, or purchase of stock is subject to the following further conditions: (1) Such credit has the approval of an appropriate committee of a national securities exchange or a national securities association and the committee, in addition to being satisfied that the credit is not in contravention of any rules of the exchange or association, is satisfied that, if the broker or dealer or an affiliated corporation of such broker or dealer does any dealing in securities for its own account, the credit is not for the purpose of increasing the amount of such dealing; (2) in no event can the subordinated loan or contribution be repaid or the stock be redeemed except (i) with the approval of an appropriate committee of a national securities exchange or national securities association in the case of the death, disability or (in the case of a partner, officer, or employee of the broker or dealer) involuntary retirement (or if the amount of such repayment or redemption is \$10,000 or less, any retirement, whether voluntary or involuntary) of the customer, or (ii) until 1 year after the subordinated loan or contribution was first made or stock first purchased and until 6 months after the giving of written notice by the customer to the broker or dealer, the Commission, the Securities Investor Protection Corporation, and any national securities exchange or national securities association of which such broker or dealer is a member of intent to demand repayment of the loan or contribution or redemption of the stock, (3) in no event may such loan or contribution be repaid or the stock be redeemed if the effect of such payment or redemption would reduce the net capital of the broker or dealer below the amount required by any net capital or capital rule to which the broker or dealer is subject, or would otherwise be inconsistent with such rule, (4) all of the proceeds of such extension of credit are so loaned or contributed to the capital of such firm or affiliated corporation, or used to purchase such stock and (5) the proceeds of any withdrawal of such loan or contribution of capital from such broker or dealer or redemption of such stock shall be used to reduce or retire said extension of credit.

§ 221.3 Miscellaneous provisions.

(b) Purpose of a credit. . . .

(4) Credit extended to a broker or dealer subject to Part 220 (Regulation T), or to enable a customer to contribute capital to such a broker or dealer, whether such contribution is in the form of a loan to the broker or dealer (whether subordinated or not), or of equities in the accounts of partners, or a purchase of stock in an incorporated broker or dealer when such stock is purchased directly from the issuer and not as part of a public distribution³ is "purpose" credit.

(q) *Credit required to be secured.* Any credit extended (1) for a purpose described in paragraph (b)(4) of this section or (2) to a customer not subject to this part or to Part 220 of this chapter (Regulation T) who is engaged principally, or as one of the customer's important activities, in the business of extending credit for the purpose of purchasing or carrying margin stocks, is a credit for the purpose of purchasing or carrying such stocks unless the credit and its purposes are effectively and unmistakably separated and disassociated from any financing or refinancing of any purchasing or carrying of or trading in such stocks. Any such credit described in paragraph (b)(4) of this section or extended to any such customer unless the credit is so separated and disassociated or is excepted by § 221.2, is a credit "subject to § 221.1" regardless of whether or not the credit is secured by any stock; and no bank shall extend any such credit subject to § 221.1 without collateral or without the credit being secured as would be required by this part if it were secured by any stock. Any such credit subject to § 221.1 shall be subject to the other provisions of this part applicable to credit subject to § 221.1, including provisions regarding withdrawal and substitution of collateral.

4. The proposed revision of paragraph (f) in § 207.1 would delay the effective date of the amendment to October 1, 1971; clarify that the prohibition of this paragraph does not apply to credit on exempted securities; clarify that the exemption provided by paragraph (f)(2) is not available for publicly traded stock in an incorporated broker or dealer; remove the requirement that credit of the kind described therein be actually secured and substitute a requirement that an appropriate committee of the exchange or national securities association of which the broker or dealer is a member be satisfied that the proceeds of the credit will not be used to increase the amount of dealing in securities by the

³ When credit is extended to purchase stock in a broker or dealer other than directly from the issuer or other than in a public distribution such credit of course is "purpose" credit if the stock is "margin stock" as described in § 221.3(v).

broker or dealer for its own account; provide that credit is eligible for the exemption even though an amount up to \$10,000 is withdrawable with the permission of an appropriate committee of an exchange or national securities association upon the retirement of a partner, officer, or employee of the broker or dealer before expiration of the 1-year waiting period; provide that notice of withdrawal of the contribution may be given after 6 months of the initial 1-year waiting period have passed; and provide that such notice must be given to any exchange or national securities association of which the broker or dealer is a member, as well as to the broker or dealer itself, the Commission, and the Securities Investor Protection Corporation.

5. The proposed revision of paragraph (f)(2) in § 220.4 would clarify that the restrictions imposed by subdivision (iv) do not apply to credit extended by a firm to its partners or by an incorporated broker/dealer to its officers or employees, or officers or employees of its affiliated corporations; would delay the effective date of the amendment to October 1, 1971; provide that credit is eligible for the exemption even though an amount up to \$10,000 is withdrawable with the permission of appropriate committee of an exchange or national securities association upon the retirement of a partner, officer, or employee of the broker or dealer before the expiration of the 1-year waiting period; provide that notice of withdrawal of the contribution may be given after 6 months of the initial 1-year waiting period have passed; and provide that such notice must be given to any exchange or national securities association of which the broker or dealer is a member, as well as to the broker or dealer itself, the Commission, and the Securities Investor Protection Corporation.

6. The proposed revision of paragraph (m) in § 221.2 would provide that credit extended directly by banks to brokers and dealers would be subject to the same restrictions on withdrawal as credit extended to third persons for the purpose of making contributions of capital to the brokers and dealers; clarify that the exemption is not available for publicly traded stock in an incorporated broker or dealer; remove the requirement that credit of the kind described therein be actually secured and substitute a requirement that an appropriate committee of the exchange or national securities association of which the broker or dealer is a member be satisfied that the proceeds of the credit will not be used to increase the amount of dealing in securities by the broker or dealer for its own account; provide that credit is eligible for the exemption even though an amount up to \$10,000 is withdrawable upon the retirement of a partner, officer, or employee of the broker or dealer before expiration of the 1-year waiting period; provide that notice of withdrawal of the contribution may be given after 6 months of the initial 1-year waiting period have passed; and

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provide that such notice must be given to any exchange or national securities association of which the broker or dealer is a member, as well as to the broker or dealer itself, the Commission, and the Securities Investor Protection Corporation.

7. The revision to the proposed new paragraph (b) (4) of § 221.3 would clarify that credit extended directly to a broker or dealer, by a bank, for the purpose of providing capital to the broker or dealer is "purpose" credit, but that credit to purchase or carry publicly traded stock of a broker or dealer is not "purpose" credit (unless the stock is itself a margin stock).

8. The proposed new paragraph (c) (2) of § 221.3 is deleted.

9. Paragraph (q) of § 221.3 would be amended to provide that credit extended for the purpose of providing capital to

a broker or dealer, as described in paragraph (b) (4) of § 221.3, must be secured by collateral held by the bank unless segregated and disassociated from the business of purchasing and carrying securities, or exempted by § 221.2.

If adopted by the Board, the changes will apply to credit extended by banks, broker/dealers, and persons subject to Regulation G after October 1, 1971, and to renewals after October 1, 1971, of credit extended by banks after April 16, 1971, except in the case of credit extended by banks directly to broker/dealers where the restrictions would apply to such credit extended after October 1, 1971, and to renewals after October 1, 1971, of such credit extended after July 9, 1971.

This notice is published pursuant to section 553(b) of title 5, United States Code, and § 262.2(a) of the rules of pro-

cedure 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 August 20, 1971. Such material will be made available for inspection and copying upon request, except as provided in § 261.6(a) of the Board's Rules Regarding Availability of Information.

By order of the Board of Governors,
July 6, 1971.

[SEAL]

KENNETH A. KENYON,
Deputy Secretary.

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