

FEDERAL RESERVE BANK
OF NEW YORK

Circular No. 6817
October 15, 1971

TEXT OF NEW REGULATION X, "RULES GOVERNING BORROWERS
WHO OBTAIN SECURITIES CREDIT"

Effective November 1, 1971

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

Printed below is an excerpt from the Federal Register, dated October 13, 1971, containing the text of the new Regulation X, "Rules Governing Borrowers Who Obtain Securities Credit," adopted by the Board of Governors of the Federal Reserve System effective November 1, 1971.

The Board of Governors is in the process of printing the new Regulation X and reprinting Regulations G, T, and U (margin regulations applicable primarily to lenders), incorporating all amendments to those regulations to date. These four regulations will be compiled in one printed pamphlet with a single statutory appendix. Copies of the new pamphlet will not be available until later in the year and will be sent to you at that time. (Printed pamphlets of Regulations G, T, and U will not be available as single issues after the new pamphlet is distributed.)

We suggest that those receiving this circular who extend securities credit bring it to the attention of their customer-borrowers.

Additional copies of this circular will be furnished upon request.

ALFRED HAYES,
President.

Title 12—BANKS AND BANKING
Chapter II—Federal Reserve System
SUBCHAPTER A—BOARD OF GOVERNORS OF
THE FEDERAL RESERVE SYSTEM
[Reg. X]
PART 224—RULES GOVERNING BOR-
ROWERS WHO OBTAIN SECURITIES
CREDIT

1. For the purpose of implementing

the provisions of title III of the Financial Recordkeeping and Currency and Foreign Transactions Reporting Act of 1970 (Public Law 91-508, October 26, 1970), which added a new subsection (f) to section 7 of the Securities Exchange Act of 1934 (15 U.S.C. 78a-jj, as amended), the Board of Governors of the Federal Reserve System adopts, effective November 1, 1971, a new Part 224 (Regu-

lation X) as set forth below.

2. The new Part 224 (Regulation X) provides as to a borrower that any credit he obtains in the United States must comply with the margin regulations applicable to his lender, and that if he borrows abroad, his credit must comply with the provisions of the margin regulation that would have been applicable

if the credit had been obtained in the United States. This new part incorporates the substance of certain proposed amendments to Parts 207, 220, and 221 (Regulations G, T, and U) which were initially published in the FEDERAL REGISTER on July 29, 1971, at pages 14030, 14033, and 14035. Other aspects of those proposals are still under consideration by the Board.

3. The new Part 224 (Regulation X) revises the substance of the amendments as initially published, in the manner set forth below.

4. Section 224.3 exempts from the application of subsection (f) of the Securities Exchange Act of 1934 and Part 224 (Regulation X) (a) U.S. citizens permanently residing outside the United States who obtain abroad not in excess of \$5,000 in purpose credit per year or at any one time, (b) credit to foreign firms who may be controlled by or acting on behalf of or in conjunction with U.S. persons to carry out clearing, marketmaking, and arbitrage transactions in offshore debt securities that are convertible into margin securities, and (c) foreign borrowers who are not U.S. persons but are controlled by or acting on behalf of or in conjunction with U.S. persons if the Board grants a specific exemption after a finding that such an exemption is consonant with the purposes of the Securities Exchange Act of 1934 and the new Part 224 (Regulation X) and is warranted by exceptional circumstances.

5. Section 224.4 provides that certain borrowers obtaining credit abroad must prepare and retain a record in conformity with Federal Reserve Form X-1 for a period of 6 years after the credit is extinguished.

6. Section 224.5(a) limits the term "acting on behalf of or in conjunction with" to relationships in which a U.S. person or a foreign person controlled by a U.S. person has a substantial beneficial interest other than an interest derived solely from ownership of less than 50 percent of stock.

7. Section 224.5(d) defines "foreign lender" as a non-U.S. person who is not a foreign branch of a broker/dealer, bank, or G-lender, nor a foreign subsidiary of a broker/dealer, and who in the ordinary course of his business extends, maintains, or arranges purpose credit outside the United States.

8. Section 224.5(e) defines "G-lender" as a person not a broker/dealer or a bank who in the ordinary course of his business extends, maintains, or arranges credit secured directly or indirectly by any margin securities and who is subject to the registration requirement of § 207.1(a) of Part 207 (Regulation G).

9. Section 224.5(f) clarifies that the term "indirectly secured" includes any arrangement under which collateral made available by a third person secures credit obtained by a borrower.

10. Section 224.5(g) defines "lender" as a person who in the ordinary course of his business extends, maintains, or arranges for credit, including a G-lender,

a broker/dealer, a bank, and a foreign lender.

11. Section 224.5(h) provides that the term "margin security" will have the meaning of "margin security" in § 207.2 (d) of Part 207 (Regulation G) if the borrower is obtaining credit from a G-lender or a foreign lender, the meaning of "margin security" in § 220.2(f) of Part 220 (Regulation T) if the borrower is obtaining credit from a broker/dealer and the meaning of "margin stock" in § 221.3(v) of Part 221 (Regulation U) if the borrower is obtaining credit from a bank.

12. Section 224.5(i) defines "offshore debt security" as a debt security offered only outside the United States, the purchase of which, by a U.S. person, would give rise to a liability under the Interest Equalization Tax (26 U.S.C. sec. 4911 et seq.).

13. Section 224.5(j) defines "purpose credit" as credit for the purpose of purchasing or carrying securities and lists four examples of purpose credit, one of which includes a presumption that credit secured by any securities is purpose credit unless the borrower has filed the requisite statement of the purpose of the credit under Part 207 (Regulation G), Part 220 (Regulation T), or Part 221 (Regulation U) or can furnish satisfactory proof to the contrary if the credit is obtained from a foreign lender.

14. Section 224.5(k) explains that the term "obtain credit" means to obtain, receive, or enjoy the beneficial use of credit.

15. Section 224.5(l) provides that the term "United States" includes any State of the United States, the District of Columbia, Puerto Rico, the Canal Zone, the Virgin Islands, or any other possession of the United States.

16. Section 224.6(a) provides that a borrower's innocent mistake in connection with obtaining credit shall not be deemed a violation, if prompt action is taken to correct the mistake.

17. Section 224.6(b) clarifies that any person who wilfully aids and abets any other person in a violation of the new Part 224 (Regulation X) is also a violator of such part.

Effective date: November 1, 1971. The effective date was not deferred for the usual 30-day period because the new Part 224 (Regulation X) implements an amendment to the Securities Exchange Act of 1934 which takes effect, by its terms, on November 1, 1971. The substance of the new part has been published for comment, and comments received from persons who would be affected by the new rules have been taken into account in connection with the revisions described above. In these Circumstances, the Board found that it would be in the public interest if the new part became effective simultaneously with the amendment to the Act.

By order of the Board of Governors,
October 7, 1971.

[SEAL]

TYNAN SMITH,
Secretary.

Sec.

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AUTHORITY: The provisions of this Part 224 (Regulation X), issued under sec. 7(f) of the Securities Exchange Act of 1934, as amended (15 U.S.C. 78a-jj, particularly 78g(f)).

§ 224.1 Scope of part.

This Part 224 (Regulation X) contains rules and regulations promulgated by the Board of Governors of the Federal Reserve System (the Board) under the Securities Exchange Act of 1934 as amended (the Act) and applies to all persons described below who obtain, receive, or enjoy the beneficial use of credit for the purpose of purchasing or carrying securities.¹ For definitions of technical terms see § 224.5, Parts 207, 220, and 221 of this chapter (Margin Regulations G, T, and U) and the Statutory Appendix. The purpose of this part (Regulation X) is to prevent the infusion of unregulated credit obtained both outside and within the United States into U.S. securities markets in circumvention of the provisions of the Board's margin regulations or by borrowers falsely certifying the purpose of a loan or otherwise wilfully and intentionally evading the provisions of those regulations. When the term "obtain credit" is used in this part (Regulation X) it means "obtain, receive, or enjoy the beneficial use of credit" and when the term "purpose credit" is used, it means "credit for the purpose of purchasing or carrying securities". When the term "borrower" is used, it means a person who obtains credit. This part (Regulation X) implements section 7(f) of the Act, and generally applies to borrowers who are:

- (a) Persons who obtain credit from within the United States, or
- (b) Those persons who obtain credit from outside the United States who are:
 - (1) U.S. persons,²
 - (2) Foreign persons who are controlled by U.S. persons,³ or
 - (3) Foreign persons acting on behalf of or in conjunction with⁴ U.S. persons.

§ 224.2 General rule.

(a) *Credit obtained from within the United States.* A borrower shall not obtain any purpose credit from within the United States unless he does so in compliance with the following conditions:

(1) Credit obtained from a G-lender shall conform to the provisions of Part 207 of this chapter (Regulation G), which is hereby incorporated in this part

¹ 15 U.S.C. 78g.

² For definition of the term "United States person," see Statutory Appendix, sec. 7(f) (2) (A).

³ For definition of the term "foreign persons controlled by a United States person," see Statutory Appendix, sec. 7(f) (2) (C).

⁴ For definition of the term "acting on behalf of or in conjunction with," see § 224.5(a) (Regulation X).

(Regulation X). When the term "G-lender" is used in this part (Regulation X), it means a person who is not a broker/dealer or bank, who in the ordinary course of his business extends, maintains, or arranges credit that is secured, directly or indirectly, in whole or in part, by collateral that includes any margin securities, and who is subject to the registration requirement of § 207.1 (a) of this chapter (Regulation G).

(2) Credit obtained from a broker/dealer shall conform to the provisions of Part 220 of this chapter (Regulation T), which is hereby incorporated in this part (Regulation X). When the term "broker/dealer" is used in this part (Regulation X), it means a person who is a broker or dealer, including every member of a national securities exchange, and includes a foreign branch or subsidiary of a broker/dealer.

(3) Credit obtained from a bank shall conform to the provisions of Part 221 of this chapter (Regulation U), except for § 221.2(i). Except for such section, Part 221 of this chapter (Regulation U) is hereby incorporated in this part (Regulation X). When the term "bank" is used in this part (Regulation X), it means a bank that is subject to Part 221 of this chapter (Regulation U).⁵

(b) *Credit obtained from outside the United States.* (1) A U.S. person or foreign person controlled by a U.S. person or acting on behalf of or in conjunction with such a person shall not obtain any purpose credit⁶ from outside the United States except in compliance with the following conditions:

(i) Credit obtained from a foreign branch of a G-lender shall conform to the provisions of Part 207 of this chapter (Regulation G), except that the requirement of § 207.1(e) of this chapter as to obtaining a statement of the purpose of the credit shall not apply.

(ii) Credit obtained from a foreign branch or subsidiary of a broker/dealer shall conform to the provisions of Part 220 of this chapter (Regulation T).

(iii) Credit obtained from a foreign branch of a bank shall conform to the provisions of Part 221 of this chapter (Regulation U) which would apply if the credit were obtained from the head office of the bank in the United States, except that the requirement of § 221.3(a) of this chapter (Regulation U) as to obtaining a statement of the purpose of the credit shall not apply.

(iv) Credit obtained from a foreign lender shall conform to the provisions of Part 207 of this chapter (Regulation G) which would apply if the person extending, arranging, or maintaining the credit were a G-lender, except that the requirement of § 207.1(e) of this chapter (Regulation G) as to obtaining a statement of the purpose of the credit shall not apply. When the term "foreign

lender" is used in this part (Regulation X) it means any person, other than a U.S. person, who in the ordinary course of his business extends, maintains, or arranges purpose credit outside the United States and who is not a foreign branch or subsidiary of a broker/dealer, a foreign branch of a bank, or a foreign branch of a G-lender.

(2) The provisions of subparagraph (1) of this paragraph shall not apply to credit extended before November 1, 1971, except that as to credit extended after October 26, 1970, the requirements as to withdrawals and substitutions of collateral shall apply after May 1, 1972, as follows: The requirements in § 207.1(j) of this chapter (Regulation G) shall apply to credit obtained from a foreign branch of a G-lender or from a foreign lender; the requirements in § 220.3(b) of this chapter (Regulation T) shall apply to credit obtained from a foreign branch or subsidiary of a broker/dealer; and the requirements in § 221.1(b) of this chapter (Regulation U) shall apply to credit obtained from a foreign branch of a bank.

(3) *Record of credit.* Every borrower subject to this Part 224 (Regulation X) who obtains any credit from a lender described in subdivision (i), (iii), or (iv) of subparagraph (1) of this paragraph if such credit is secured directly or indirectly, in whole or in part, by collateral that includes any security, shall prepare and retain in his records, for at least 6 years after such credit is extinguished, a record substantially in conformity with the requirements of Federal Reserve Form X-1.

§ 224.3 Exemptions.

The following classes of persons shall be exempted from the provisions of section 7(f) of the Act and this part (Regulation X) to the extent described below:

(a) A U.S. person whose permanent residence is outside the United States, and who does not during any calendar year obtain a total of more than \$5,000 or have outstanding at any time during any calendar year a total of more than \$5,000 in credit obtained outside the United States to purchase or carry margin securities.

(b) A borrower who is not a U.S. person, but is controlled by or acting on behalf of or in conjunction with such person, who obtains credit for the purpose of bona fide clearing, market-making, or arbitrage transactions in offshore debt securities that are convertible into margin securities, except that any credit outstanding against collateral consisting of such securities shall be brought into conformity with the other provisions of this part (Regulation X)⁷ upon the conversion of such securities into margin securities.

(c) A borrower who is not a U.S. person, but is controlled by or acting on behalf of or in conjunction with such person, who obtains credit from outside

the United States, which borrower has been exempted by the Board of Governors of the Federal Reserve System, by order, from the requirements of this part (Regulation X), either unconditionally or upon specified terms and conditions or for stated periods, upon a finding that exceptional circumstances warrant the granting of such an exemption, and that the exemption is consonant with the purposes of section 7(f) of the Act and the provisions of this part (Regulation X).

§ 224.4 Reports and records.

Every borrower described in § 224.1 who obtains any credit that is secured directly or indirectly, in whole or in part, by collateral that includes any securities, shall maintain such records and file such reports as may be prescribed by the Board of Governors of the Federal Reserve System to enable it to perform the functions conferred upon it by the Act.

§ 224.5 Definitions.

Unless the context otherwise requires, or it is otherwise specified herein, the terms used in and for the purposes of this part (Regulation X) have the meanings given them in this section, in sections 3 (a) or 7 (f) of the Act, or in Part 207, 220, or 221 of this chapter (Regulation G, T, or U). The relevant portions of sections 3(a) and 7(f) of the Act are set forth in the Statutory Appendix. In the case of inconsistency between definitions appearing in this section and those appearing in Part 207, 220, or 221 of this chapter (Regulation G, T, or U), the definition appearing in the regulation that applies to the particular credit involved, whether Part 207, 220, or 221 of this chapter (Regulation G, T, or U) shall prevail.

(a) The term "acting on behalf of or in conjunction with" in reference to a foreign person means obtaining credit for the purpose of purchasing or carrying a security in which, or in the income or gains or losses from which, a U.S. person or a foreign person controlled by a U.S. person has a substantial direct or indirect beneficial interest. Absent these factors the term does not include an interest derived solely from the ownership of less than 50 percent of the outstanding capital stock issued by such foreign person who is obtaining such credit.

(b) The term "bank" means a bank as defined in section 3(a) (6) of the Act, including a foreign branch of a bank, except that such term does not include a bank which is a member of a national securities exchange, a foreign affiliate of a bank, or a foreign bank.

(c) The term "broker/dealer" means any broker or dealer including every member of a national securities exchange, and includes a foreign branch or subsidiary of a broker/dealer.

(d) The term "foreign lender" means a person, other than a U.S. person, who in the ordinary course of his business extends, maintains, or arranges purpose credit outside the United States and who is not a foreign branch or subsidiary of a broker/dealer, a foreign branch of a bank, or a foreign branch of a G-lender.

⁵ For a definition of the term "bank" meaning "bank that is subject to Regulation U", see § 224.5(b) (Regulation X) and Statutory Appendix, sec. 3(a) (6).

⁶ For a definition of the term "purpose credit" see § 224.5(j) (Regulation X).

⁷ Including Parts 207, 220, or 221 of this chapter (Regulations G, T, and U) where applicable.

(e) The term "G-lender" means a person who is not a broker/dealer or bank, who in the ordinary course of his business extends, maintains, or arranges credit that is secured, directly or indirectly, in whole or in part, by collateral that includes any margin securities, and who is subject to the registration requirement of § 207.1(a) of this chapter (Regulation G).

(f) The term "indirectly secured" includes any arrangement with the lender under which the right or ability to sell, pledge, or otherwise dispose of securities owned by the borrower (or by any other person who has made the use of such securities available to the borrower) is in any way restricted as long as the credit remains outstanding, or under which the exercise of such right, whether by written agreement or otherwise, is or may be cause for acceleration of maturity of the credit. The foregoing shall not apply, however—

(1) If such restriction arises solely by virtue of an arrangement with the lender which pertains generally to the borrower's assets unless a substantial part of such assets consists of margin securities, or

(2) If the lender in good faith has not relied upon such securities as collateral in the extension or maintenance of the particular credit, or

(3) To securities held by the lender only in the capacity of custodian, depository, or trustee, or under similar circumstances, if the lender in good faith has not relied upon such securities as collateral in the extension or maintenance of the particular credit.

(g) The term "lender" means a person who in the ordinary course of his business extends, maintains, or arranges for credit, including a G-lender, a

broker/dealer, a bank, and a foreign lender.

(h) The term "margin security" shall have the meaning of "margin security" as defined in § 207.2(d) of this chapter (Regulation G) if the borrower is obtaining credit from a G-lender or a foreign lender, the meaning of "margin security" as defined in § 220.2(f) of this chapter (Regulation T) if the borrower is obtaining credit from a broker/dealer, and the meaning of "margin stock" as defined in § 221.3(v) of this chapter (Regulation U) if the borrower is obtaining credit from a bank.

(i) The term "offshore debt security," as to this part (Regulation X) means a debt security offered only outside the United States, the purchase of which by a U.S. person would give rise to a liability under the Interest Equalization Tax (26 U.S.C. 4911 et seq.).

(j) The term "purpose credit" means credit for the purpose of purchasing or carrying securities. The purpose of a credit is determined by substance rather than form. The following are some examples of purpose credit.

(1) Credit which is for the purpose, whether immediate, incidental, or ultimate, of purchasing or carrying a security is "purpose credit," despite any temporary application of the funds otherwise.

(2) Credit to enable the borrower to reduce or retire indebtedness which was originally incurred to purchase security is for the purpose of "carrying" such a security.

(3) Credit that is secured directly or indirectly, in whole or in part, by collateral that includes any securities, is presumed to be for the purpose of purchasing or carrying securities, unless the borrower has complied with the require-

ments of Part 207 (Regulation G), Part 220 (Regulation T), and Part 221 of this chapter (Regulation U) as to the statement of the purpose of a credit, if such requirements are applicable, or in the case of credit obtained from a foreign lender, can furnish satisfactory evidence of the use of the credit for a purpose other than purchasing or carrying securities.

(4) An extension of credit provided for in a plan, program, or investment contract offered or sold or otherwise initiated after August 31, 1969, which provides for the acquisition both of any securities and of goods, services, property interests, or investments.

(k) The term "obtain credit" means to obtain, receive, or enjoy the beneficial use of credit.

(l) The term "United States" includes any State of the United States, the District of Columbia, Puerto Rico, the Canal Zone, the Virgin Islands, or any other possession of the United States.

§ 221.6 Miscellaneous provisions.

(a) *Innocent mistake.* An innocent mistake made in good faith by a borrower in connection with the obtaining of a credit shall not be deemed to be a violation of this part (Regulation X) if promptly after discovery of the mistake the borrower takes whatever action is practicable to remedy the noncompliance.

(b) *Aiding or abetting.* Any person who willfully aids or abets the violation by any other person of any provision of this part (Regulation X) shall be deemed to be in violation of this part (Regulation X). For the purpose of this subsection, the term "aids or abets" shall include, but not be limited to, counsels, commands, induces, or procures.

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