

FEDERAL RESERVE BANK
OF NEW YORK

Circular No. 6949
June 2, 1972

REVISED PROPOSED AMENDMENTS TO 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 May 30 by the Board of Governors of the Federal Reserve System:

The Board of Governors of the Federal Reserve System today re-issued for comment a modified proposal to exempt from margin requirements certain credit extended to so-called "block positioners" and third-market makers.

The Board's proposal, which also applies new reporting requirements to exchange specialists and Over-the-Counter market makers, is being published simultaneously with registration and reporting proposals issued by the Securities and Exchange Commission in this field.

Comment on the Board's proposal should be received by June 30.

Block positioners are securities firms that stand ready to hold amounts of stock for their own account sufficient to facilitate the sale or purchase by their customers—primarily institutions—of quantities too large to be absorbed by normal exchange transactions.

The minimum block of stock that could qualify for the exemption from margin requirements would have a market value of \$200,000. A block would also have to be sold by the block positioner within 20 days (instead of 15 days as originally proposed), although limited extensions of 5 days at a time could be allowed by the stock exchanges and the National Association of Securities Dealers.

The modified proposal also would:

—Require a specialist to report through a stock exchange to the Board on the blocks of stock that he holds and the credit extended to carry those blocks. (This provision replaces an original proposal that would have required a specialist to dispose of a block within 15 days.)

—Require third-market makers and Over-the-Counter market makers to register and file reports with the Securities and Exchange Commission about their market-making activities. (The original proposal would also have required third-market makers and OTC market makers to dispose of a block within 15 days.)

—Change the net capital requirements for third-market makers and block positioners to reflect the range deemed necessary for carrying out these functions.

Third-market makers are firms that make a market off the exchanges in stocks that are listed for exchange trading.

Printed on the following pages is the text of the revised proposed amendments. Comments thereon should be submitted by June 30 and may be sent to our Regulations and Bank Analysis Department. Additional copies of this circular will be furnished upon request.

ALFRED HAYES,
President.

(Regs. T and U)

CREDIT BY BROKERS AND DEALERS

**CREDIT BY BANKS FOR THE PURPOSE OF
PURCHASING OR CARRYING MARGIN STOCKS**

**Exempt Credit to Specialists, OTC Market Makers,
Third-Market Makers and Block Positioners**

By notice of proposed rulemaking published in the Federal Register on February 4, 1971 (36 F. R. 2412-2414), the Board of Governors proposed to exempt from margin requirements credit extended by banks and brokers or dealers to block positioners, and credit extended by banks to third-market makers to carry on their market making activities. The proposals would have subjected to certain conditions credit for block positioning activities by all market makers, including specialists, block positioners, over-the-counter firms making a market in OTC margin stocks, and third-market makers.

Following consideration of the comments received, the Board has withdrawn certain parts of the proposed revisions of paragraph (g) of § 220.4 (Regulation T) and paragraphs (o), (w) and (y) of § 221.3 (Regulation U) pertaining to limitations on exempt credit to specialists, OTC market makers, and third-market makers. The Board is republishing, with certain modifications in the proposed language, paragraph (g) of § 220.4, and paragraphs (w), (y) and (z) of § 221.3, with simultaneous publication of proposed rules in this area by the Securities and Exchange Commission appearing elsewhere in this issue of the Federal Register.

The Board also proposes at this time an amendment to § 221.3(a) to conform with the existing practice under which banks need not obtain purpose statements in connection with transactions arising out of the ordinary course of broker/dealer business.

The text of the proposed amendments, as revised, is 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 is a national securities exchange which requires and submits to the Board of Governors of the Federal Reserve System reports suitable for supplying current information regarding specialist's 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.

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§ 221.3 — MISCELLANEOUS PROVISIONS

(a) *Required statement as to stock-secured credit.* In connection with an extension of credit secured directly or indirectly by any stock, the bank shall obtain and retain in its records for at least 3 years after such credit is extinguished a statement in conformity with the requirements of Federal Reserve Form U-1 executed by the recipient of such extension of credit (sometimes referred to as the "customer") and executed and accepted in good faith by a duly authorized officer of the bank prior to such extension: *Provided*, That this requirement shall not apply to any credit described in paragraphs (o), (w), (x), (y), or (z) of this section or § 221.2 of this part except for credit described in paragraphs 221.2(f), (g), and (h) extended to persons who are not brokers or dealers subject to Part 220 of this Chapter (Regulation T). In determining whether or not an extension of credit is for the purpose specified in § 221.1 or for any of the purposes specified in § 221.2 the bank may rely on the statement executed by the customer if accepted in good faith. To accept the customer's statement in good faith, the officer must (1) be alert to the circumstances surrounding the credit and (2) if he has any information which would cause a prudent man not to accept the statement without inquiry, have investigated and be satisfied that the customer's statement is truthful.

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(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))) shall be as determined by the bank in good faith: *Provided*, That the specialist's exchange is a national securities exchange which requires and submits to the Board of Governors of the Federal Reserve System reports suitable for

supplying current information regarding specialists' use of credit pursuant to this section.

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(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))) 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 (1)) and all other reports required to be filed by market makers in OTC margin stock pursuant to a rule of the Commission (Rule 17a-12 (17 CFR 240.17a-12)), shall not have ceased to engage in such market-making activity, and shall have a reasonable average rate of inventory turnover in such stock: *And provided further*, That the bank shall obtain and retain in its records for at least 3 years after such credit is extinguished a statement in conformity with the requirements of Federal Reserve Form U-2, executed by the OTC market maker who is the recipient of such credit and executed and accepted in good faith⁹ 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 paragraph (a) of this section.

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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 paragraph (t) (1) of this section) in order to conduct the market-making activity of such a market maker, the maximum loan value of any stock (except (i) a convertible security described in paragraph (t) (1) of this section, 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 each such stock he shall, at least five 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 3 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 faith¹⁰ 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 paragraph (a) of this section.

(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)), 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 (17 CFR 240.15c3-1(b)(2)), of \$100,000 plus \$20,000 for each stock in excess of five 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 in the stocks for which he makes a market at all times 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/or on national securities exchanges except as odd-lot dealer, alternate specialist, or alternate odd-lot dealer specialist, and (iv) he has a reasonable average rate of inventory turnover on the stock.

(3) If all or portion of the credit extended pursuant to this paragraph (y) ceases to be for the purpose specified in subparagraph (1) of this paragraph or the dealer to whom the credit is extended ceases to be a third-market maker as defined in subparagraph (2) of this paragraph, 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 sub-

⁹ As described in paragraph (a) of this section.

¹⁰ As described in paragraph (a) of this section.

paragraph (2) of this paragraph (z), for the purpose of financing the activity of block positioning, the maximum loan value of any margin 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 paragraph (t)(1) of this section 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 as prescribed by the Commission, and all reports required to be filed by block-positioners: *And provided further*, That the bank shall obtain and retain in its records for at least 3 years after such credit is extinguished a statement in conformity with the requirements of Federal Reserve Form U-5 and paragraph (a) of this section, executed by the block positioner who is the recipient of such credit and executed and accepted in good faith¹¹ 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 paragraph (a) of this section. 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 paragraph (a) of this section.

(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 (17 CFR 240.15c3-1(b)(2)), of \$1,000,000, (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, participates 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 paragraph (t)(1) of this section) with a current market value of \$200,000 or more in a single transaction or in several transactions at approximately the same time from a single source 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 20 business days, and any credit extended pursuant to this paragraph (z) shall be extinguished or brought into conformity with the initial margin requirements of §§ 221.1 and 221.4 before the expiration of such 20-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 20-day period.

(4) In exceptional cases the 20-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 block transaction was effected, or by a committee of a national securities association, if effected in the over-the-counter market: *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.

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)).

The proposed amendments, as revised, are re-published primarily for the purpose of enabling interested persons to study them concurrently with the proposed rules in this area by the Securities and Exchange Commission appearing elsewhere in this issue of the Federal Register.

Additional data, views or comments on the Board's proposed amendments, as revised, may be submitted in writing to the Secretary, Board of Governors of the Federal Reserve System, Washington, D. C. 20551, to be received not later than June 30, 1972. Such materials 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, May 22, 1972.

¹¹ As described in paragraph (a) of this section.