

FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 6973]
July 18, 1972]

AMENDMENTS TO REGULATIONS G, T, AND U
Same-Day Substitutions; Convertible "Hedge" Transactions

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

Following is the text of a statement issued July 13 by the Board of Governors of the Federal Reserve System:

The Board of Governors of the Federal Reserve System announced today approval of a technical amendment to its margin regulations designed to improve the quality of stock market credit. The change, which will become effective September 18, will strengthen the equity position of low-margin accounts when offsetting sales and purchases of stock collateral are made on the same day.

The amendment is the same as the modified proposal published by the Board for additional public comment on June 16. The basic amendment was originally proposed for public comment on April 28. The modifications announced on June 16 affect the manner of calculating the status of margin accounts.

Under the amendment, use of the "same-day substitution" rule will end in accounts where the debt — adjusted as defined in the regulation — is more than 60 per cent of the market value of the stock collateral in the account.

Under the "same-day substitution" rule, customers are permitted to substitute one security for another in their accounts through offsetting purchases and sales made on the same day even if the account is below the initial margin requirement. Presently, no margin customer is required to put up additional equity unless he buys more securities than he sells on that day. This practice makes it possible for customers with undermargined accounts to continue trading for extended periods without putting up additional equity.

The Board's action amends the regulations governing extensions of credit by brokers and dealers (Regulation T) and loans by banks and other lenders (Regulations U and G respectively) for the purpose of purchasing or carrying stocks registered on a national exchange or named in the Board's over-the-counter margin list.

In a second action, the Board adopted, also effective September 18, another technical amendment to Regulation T to permit short sales of stock into which bonds are convertible on the same terms as ordinary short sales of stock.

Enclosed is a copy of the amendments; additional copies will be furnished upon request.

ALFRED HAYES,
President.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

AMENDMENTS TO REGULATIONS G, T, AND U

Effective September 18, 1972

AMENDMENTS TO REGULATION G —
SECURITIES CREDIT BY PERSONS
OTHER THAN BANKS, BROKERS, OR
DEALERS

1. Section 207.1(j)(2) is amended to read as follows:

SECTION 207.1 — GENERAL RULE

* * *

(j) **Withdrawals and substitutions of collateral.*****

(2) *Same-day substitution of collateral.* Except as prohibited by § 207.4(a)(2), in the case of a credit in which the equity ratio is equal to or exceeds the minimum equity ratio as prescribed in § 207.5 (the supplement to the regulation) a lender may permit a substitution of margin securities effected by a purchase and sale on orders executed within the same day: *Provided*, That (i) if the proceeds of the sale exceed the total cost of the purchase, the credit is reduced by at least an amount equal to the retention requirement in respect to the sale less the retention requirement in respect to the purchase, or (ii) if the total cost of the purchase exceeds the proceeds of the sale, the credit may be increased by an amount no greater than the maximum loan value of the securities purchased less the

maximum loan value of the securities sold. If the maximum loan value of the collateral securing the credit has become less than the amount of the credit, the amount of the credit may nonetheless be increased if there is provided additional collateral having maximum loan value at least equal to the amount of increase, or the credit is extended pursuant to § 207.4(a).

2. Section 207.2 is amended by adding paragraph (k) thereto, as follows:

SECTION 207.2 — DEFINITIONS

* * *

(k) The term “**equity ratio**” means the fraction stated as a percentage in which the denominator is the current market value of the collateral having loan value in respect of the credit and the numerator is such current market value minus the amount of the credit currently owing.

3. Section 207.5 (the Supplement to Regulation G) is amended by adding paragraph (f) thereto, as follows:

SECTION 207.5 — SUPPLEMENT

* * *

(f) **Minimum equity ratio.** The minimum equity ratio of a credit subject to § 207.1 is 40 percent.

AMENDMENTS TO REGULATION T —
CREDIT BY BROKERS AND
DEALERS

1. Sections 220.3(a), (b)(1), (d)(3), and (g) are amended to read as follows:

SECTION 220.3 — GENERAL ACCOUNT

(a) **Contents of general account.** All financial relations between a creditor and a customer, whether recorded in one record or in more than one record, shall be included in and be deemed to be part of the customer's general account with the creditor, except that the relations which § 220.4 permits to be included in any special account provided for by that section may be included in the appropriate special account, and all transactions in commodities, and, except to the extent provided in paragraph (b)(2) of this section, all transactions in non-equity securities, exempted securities, and in other securities having no loan value in a general account under the provisions of paragraph (c) of this section and § 220.8 (the Supplement to Regulation T) (except unissued securities, short sales and securities positions to offset short sales other than those permitted in § 220.4(j)(5), purchases to cover short sales and contracts involving an endorsement or guarantee of any put, call, or other option), shall be included in the appropriate special account provided for by § 220.4. During any period when such § 220.8 specifies that margin equity securities shall have no loan value in a general account or special convertible debt security account (sometimes referred to herein as "special convertible security account") subject to § 220.4(j), any transaction consisting of a purchase of a security other than a purchase of a security to reduce or close out a short position shall be effected in the special cash account provided for by § 220.4(c) or in some other appropriate special account provided for by § 220.4.

(b) **General rule.** (1) (i) A creditor shall not effect for or with any customer in a general account, special bond account subject to § 220.4(i), or special convertible debt security

account any transaction which, in combination with the other transactions effected in such account on the same day, creates an excess of the adjusted debit balance of such account over the maximum loan value of the securities in such account, or increases any such excess, unless in connection therewith the creditor obtains, as promptly as possible and in any event before the expiration of 5 full business days following the date of such transaction, the deposit into such account of cash or securities in such amount that the cash deposited plus the loan value of the securities deposited equals or exceeds the excess so created or the increase so caused.

(ii) If the adjusted debit balance in a general account or special convertible debt security account, computed using the margin requirement for short sales specified in § 220.8(g)(2) of the Supplement to Regulation T, exceeds the maximum loan value of the securities in such account specified in § 220.8(g)(1), the account is subject to § 220.8(g) (sometimes referred to herein as "account subject to section 8(g)"). If an account is subject to § 220.8(g) as of the close of business on the preceding business day, it shall be subject, in addition to all other requirements applying to the account, to the requirement that the creditor shall not effect any transaction in the account which creates an excess of the adjusted debit balance of such account, computed using the margin requirements for short sales specified in § 220.8(d), over the maximum loan value of the securities in such account specified in § 220.8(a) and (c), or increases any such excess, unless in connection therewith the creditor obtains, as promptly as possible and in any event before the expiration of 5 full business days following the date of such transaction, the deposit into such account of cash or securities in such amount that the cash deposited plus the loan value of the securities deposited equals or exceeds the excess so created or the increase so caused. The required deposit may be reduced by the amount of cash or securities which otherwise could be withdrawn pursuant to the provisions of subparagraph (2) of this para-

graph in connection with any other transactions in the account on the same day.

* * *

(d) **Adjusted debit balance.** For the purpose of this part, the adjusted debit balance of a general account, special bond account, or special convertible debt security account shall be calculated by taking the sum of the following items:***

(3) The current market value of any securities (other than unissued securities) sold short in the general account plus, for each security (other than an exempted security), such amount as the Board shall prescribe from time to time in § 220.8(d) (the Supplement to Regulation T) as the margin required for such short sales, except that such amount so prescribed in such § 220.8(d) need not be included when there are held in the general account or special convertible debt security account the same securities or securities exchangeable or convertible within 90 calendar days, without restriction other than the payment of money, into such securities sold short;

* * *

(g) **Transactions on given day.** (1) For the purpose of paragraph (b)(1) of this section, except in the case of an account subject to section 8(g), the question of whether or not an excess of the adjusted debit balance of a general account, special bond account, or special convertible debt security account over the maximum loan value of the securities in such account is created or increased on a given day shall be determined on the basis of all the transactions in the account on such day exclusive of any deposit of cash, deposit of securities, covering transactions, or other liquidation that has been effected on such day, pursuant to the requirements of paragraph (b) or (e) of this section, in connection with a transaction on a previous day.

(2) In the case of an account subject to section 8(g), the required deposit, under paragraph (b)(1)(ii) of this section in connection with transactions on a given day, shall be equal to the amount by which the reten-

tion requirement of any securities sold for such account on such day exceeds the maximum loan value of any securities purchased in such account on such day. Such computation may be made at the close of trading on such day and shall be made exclusive of any deposit of cash, deposit of securities, covering transactions or other liquidation that has been effected on such day, pursuant to the requirements of paragraph (b) or (e) of this section, in connection with a transaction on a previous day.

(3) In any case in which an excess so created, or increase so caused, by transactions on a given day does not exceed \$100, the creditor need not obtain the deposit specified therefor in paragraph (b)(1) of this section.

(4) Any transaction which serves to meet the requirements of paragraph (e) of this section or otherwise serves to permit any offsetting transaction in an account shall, to that extent, be unavailable to permit any other transaction in such account.

(5) For the purposes of this part (Regulation T), if a security has maximum loan value under paragraph (c)(1) of this section in a general account, or under § 220.4(j) in a special convertible debt security account, a sale of the same security (even though not the same certificate) in such account shall be deemed to be a long sale and shall not be deemed to be or treated as a short sale.

2. Section 220.4(j)(4) is amended and subparagraph (5) is added thereto, as follows:

SECTION 220.4 — SPECIAL ACCOUNTS

* * *

(j) **Special convertible debt security account.*****

(4) In the event any convertible debt security held in this account is to be converted to a stock, such security shall upon conversion be transferred to the customer's general account against a deposit of cash or margin securities eligible for an extension of credit in this account (counted at their maximum loan value) equal to at least the maximum loan

value of the security so transferred without regard to the retention requirement of § 220.3(b)(2).

(5) In a special convertible debt security account the amount of margin equity securities into which a margin debt security held in the account is convertible may be sold short without regard to the margin required for short sales in § 220.8(d) (Supplement to Regulation T), and such short position may be carried in the special convertible debt security account in conformity with the exception provided in § 220.3(d)(3).

3. Section 220.8 (the Supplement to Regulation T) is amended by redesignating paragraphs (g) and (h) as paragraphs (h) and (i), respectively, and by adding a new paragraph (g) thereto, as follows:

SECTION 220.8 — SUPPLEMENT

* * *

(g) **Account subject to section 8(g).** For purposes of the computation described in § 220.3(b)(1)(ii),

(1) The maximum loan value of a registered non-equity security held in the account on March 11, 1968, and continuously thereafter, and of a margin equity security shall be 60 per cent of the current market value of such security, and the maximum loan value of an exempted security held in the account on March 11, 1968, and continuously thereafter shall be the maximum loan value of the security as determined by the creditor in good faith.

(2) The amount to be included in the adjusted debit balance of the account pursuant to § 220.3(d)(3) as margin required for short sales of securities (other than exempted securities) shall be 40 per cent of the current market value of each security.

4. In §220.2(e)(2), the reference to §220.8(g) is changed to §220.8(h); and in §220.2(e)(3)(ii), the reference to §220.8(h) is changed to §220.8(i).

AMENDMENTS TO REGULATION U —
CREDIT BY BANKS FOR THE
PURPOSE OF PURCHASING OR
CARRYING MARGIN STOCKS

1. Section 221.1(c) is amended to read as follows:

SECTION 221.1 — GENERAL RULE

* * *

(c) **Same-day transactions.** (1) Except as provided in § 221.3(r)(1), a bank may in the case of a credit in which the equity ratio is equal to or exceeds the minimum equity ratio as prescribed in § 221.4 (the supplement to the regulation) permit a substitution of stock whether margin or non-margin, effected by a purchase and sale on orders executed within the same day: *Provided*, That (i) if the proceeds of the sale exceed the total cost of the purchase, the credit is reduced by at least an amount equal to the “retention requirement” with respect to the sale less the “retention requirement” with respect to the purchase, or (ii) if the total cost of the purchase exceeds the proceeds of the sale, the credit may be increased by an amount no greater than the maximum loan value of the stock purchased less the maximum loan value of the stock sold. If the maximum loan value of the collateral securing the credit has become less than the amount of the credit, the amount of the credit may nonetheless be increased if there is provided additional collateral having maximum loan value at least equal to the amount of the increase.

(2) For the purpose of this paragraph, the term “equity ratio” means the fraction (stated as a percentage) in which the denominator is the current market value of the collateral having loan value in respect of the credit and the numerator is such current market value minus the amount of the credit currently owing.

2. Section 221.4 (the Supplement to Regulation U) is amended by adding paragraph (f) thereto, as follows:

SECTION 221.4 — SUPPLEMENT

* * *

(f) **Minimum equity ratio.** The minimum equity ratio of a credit subject to § 221.1 is 40 percent.