

FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 8427]
September 28, 1978

AMENDMENT TO REGULATION T

Margin Credit on Unlisted Nonconvertible Corporate Bonds

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

Following is an excerpt from a statement issued by the Board of Governors of the Federal Reserve System announcing an amendment to its Regulation T, "Credit by Brokers and Dealers":

The Federal Reserve Board today [September 20] amended its Regulation T to permit brokers or dealers to extend and maintain credit on certain nonconvertible corporate bonds.

The amendment affects corporate bonds with characteristics specified by the Board that are sold only on the Over the Counter market. Prior to adoption of the amendment, credit could be extended by brokers or dealers only for bonds listed on a national securities exchange.

The Board maintains a list of some 1,100 equity securities sold over the counter on which brokers and dealers may extend credit. This list includes seven convertible corporate bonds (debt issues that may be converted to equity issues).

The amendment adopted provides that credit may be extended and maintained by brokers and dealers also on unlisted nonconvertible corporate bonds sold on the OTC market, which have the following characteristics:

- At the time the credit is extended, the outstanding principal amount of the issue is not less than \$25 million.
- All payments of principal and interest are current.
- The issue was registered with the Securities and Exchange Commission and the issuer is providing current reports under SEC regulations.

The amendment provided that these securities will be designated "OTC margin bonds." ***

The Board of Governors' proposed amendment would have required a 30 percent margin (down payment) on credit extended in connection with the purchase of OTC margin bonds. However, after a review of the characteristics of unlisted and exchange traded corporate bonds—including investment quality, price behavior and marketability—the Board decided to permit extensions of credit on a "good faith" basis for unlisted nonconvertible corporate bonds that meet the Board's criteria, which is the same rule that applies to listed nonconvertible bonds. The amount of credit that may be extended on a good faith basis is the amount brokers or dealers would customarily extend on such collateral, in their best judgment, if there were no other collateral that could be used to protect the loan. The 50 percent margin requirement for convertible corporate bonds listed on a national exchange, or appearing on the Board's OTC list, remains in effect.

Enclosed is a copy of the amendment to Regulation T, effective October 30, 1978. Questions regarding this matter may be directed to our Regulations Division (Tel. No. 212-791-5914).

PAUL A. VOLCKER,
President.

Board of Governors of the Federal Reserve System

CREDIT BY BROKERS AND DEALERS

AMENDMENT TO REGULATION T

(effective October 30, 1978)

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final Rule.

SUMMARY: This amendment will permit brokers and dealers, for the first time, to extend and maintain credit on non-convertible debt securities not listed on national securities exchanges which satisfy certain criteria as to size of issue, availability of information and status of payments for principal and interest. The loan value of these unlisted debt securities will be set at the same "good faith" loan value presently effective for non-convertible debt securities traded on exchanges. The Board is adopting this rule change under authority of sections 7 and 23 of the Securities Exchange Act of 1934 to improve the efficiency of capital markets and to promote competitive equality between brokers and banks.

EFFECTIVE DATE: October 30, 1978.

FOR FURTHER INFORMATION CONTACT: Robert S. Plotkin, Assistant Director, or Laura Homer, Chief Attorney, Securities Regulation, Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System, Washington, D.C. 20551 (202-452-2782).

SUPPLEMENTARY INFORMATION: The Board published for comment a proposal to amend sections 220.4 and 220.8 of Regulation T in the Federal Register on May 16, 1978 (43 FR 21008) and asked for comments. The only substantive difference between that proposal and this adopted amendment is in the loan value which brokers may assign to non-convertible debt securities. The original proposal would have set a uniform 70 percent loan value (i.e., a 30 percent initial margin), for all eligible debt securities. In response to

comments received, the present "good faith" margin rule will be continued for non-convertible debt securities traded on exchanges and extended to non-convertible debt securities meeting certain criteria which will be designated in the rule as "OTC margin bonds." Certain other technical changes suggested by commentators are also incorporated in the adopted amendment.

Accordingly, pursuant to sections 7 and 23 of the Securities Exchange Act of 1934, as amended (15 U.S.C. 78g and w) the Board amends 12 C.F.R. Part 220 as follows:

SECTION 220.2—DEFINITIONS

* * *

(f) The term "margin security" means any registered security, OTC margin stock or OTC margin bond.

* * *

(i) The term "OTC margin bond" means a debt security not traded on a national securities exchange which meets all of the following requirements:

(1) At the time of the extension of credit, a principal amount of not less than \$25,000,000 of the issue is outstanding.

(2) The issue was registered under section 5 of the Securities Act of 1933 and the issuer either files periodic reports pursuant to section 13(a) or 15(d) of the Securities Exchange Act of 1934 or is an insurance company which meets all of the conditions specified in section 12(g) (2) (G) of the Act.

(3) At the time of the extension of credit, the creditor has a reasonable basis for believing that the issuer is not in default on interest or principal payments.

For this Regulation to be complete, retain:

- 1) Regulation T, as amended effective June 1, 1977, printed in the pamphlet "Securities Credit Transactions."
- 2) The Supplement to Regulation T, effective January 1, 1977.
- 3) Amendments effective June 15, 1978 and July 12, 1978.
- 4) This slip sheet.

SECTION 220.4—SPECIAL ACCOUNTS

* * *

(i) *Special bond account.* In a special bond account a creditor may extend and maintain credit on any exempted security, registered non-equity security or OTC margin bond. The maximum loan value of securities held in this account shall be as prescribed from time to time in § 220.8 (the Supplement to Regulation T). Call options may be issued, endorsed or guaranteed in this account on any underlying equity security which is held in this account because it is an exempted security.

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SECTION 220.8—SUPPLEMENT

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(b) *Maximum loan value for special bond account.* The maximum loan value of an exempted security, a registered non-equity security or an OTC margin bond held in a special bond account subject to § 220.4(i) shall be as determined by the creditor in good faith.

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SECTION 220.2—DEFINITIONS

(1) The term "margin security" means any registered security, OTC margin bond or OTC margin bond.

(2) The term "OTC margin bond" means a debt security not traded on a national securities exchange which meets all of the following requirements:

(i) At the time of the extension of credit, a principal amount of not less than \$25,000 of the bond is outstanding.

(ii) The issue was registered under section 2 of the Securities Act of 1933 and the issuer either files periodic reports pursuant to section 13(a) or 13(4) of the Securities Act of 1934 or is an issuer covered by the conditions specified in section 13(c) of the Act.

(iii) At the time of the extension of credit, the creditor has a reasonable basis for believing that the issuer is not in default on interest or principal payments.