

**FEDERAL RESERVE BANK
OF NEW YORK**

[Circular No. 9536]
August 16, 1983]

MARGIN REGULATIONS

**— Revision and Simplification of Regulations G and U
— Technical Amendments to Regulation T**

*To All Banks, Brokers and Dealers, and Persons Extending
Securities Credit in the Second Federal Reserve District:*

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

The Federal Reserve Board has adopted complete revisions of its Regulation G — governing the extension of credit on securities by persons other than banks, brokers or dealers — and Regulation U — extension of credit on securities by banks.

The revised regulations become effective August 31, 1983.

The revisions of the two margin regulations were made as part of the Board's regulatory improvement program, under which the Board is reviewing all of its regulations to simplify them, remove obsolete provisions, improve their organization and reduce the burden of compliance. The newly adopted revisions are in substantially the same form as proposed by the Board in February, with modifications reflecting the public comment.

Earlier this year the Board similarly modernized its Regulation T — extensions of credit on securities by brokers and dealers.

Enclosed — for commercial banks in the Second Federal Reserve District — is a copy of the complete text of the revised regulations. They have been reprinted from the *Federal Register* of August 3, 1983. Also enclosed are technical amendments to the revised Regulation T, which was sent to you with our Circular No. 9505, dated June 7, 1983. Additional copies of this material will be furnished upon request directed to our Circulars Division (Tel. No. 212-791-5216).

Questions regarding the revised regulations may be directed to our Regulations Division (Tel. No. 212-791-5914).

ANTHONY M. SOLOMON,
President.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

CREDIT BY BROKERS AND DEALERS

TECHNICAL AMENDMENTS TO REGULATION T

(effective November 21, 1983)

12 CFR Part 220

[Docket No. R-0389]

**Credit By Brokers and Dealers;
Complete Revision and Simplification
of Regulation T; Technical
Amendments**

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule; technical amendments.

SUMMARY: The Board is making technical amendments to its final rule on Regulation T (Credit by Brokers and Dealers) published at 48 FR 23161, May 24, 1983. This action is necessary to correct three typographical errors consisting of one letter and two numbers in section 12 of the regulation.

FOR FURTHER INFORMATION CONTACT:

Robert Lord or Douglas Blass, Attorneys, Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System, Washington, D.C. 20551; (202) 452-2781.

SUPPLEMENTARY INFORMATION: Section 12 of the final rule in 12 CFR 220 (48 FR 23161, 23170, May 24, 1983) is corrected as follows:

Section 220.12(a) (48 FR 23170) is corrected by changing the letter "(f)" to "(e)".

Section 220.12(b)(4)(i) (48 FR 23170) is corrected by changing the number "(6)" to "(5)". The correct cross-reference is "paragraph (b)(5)".

Section 220.12(b)(6) (48 FR 23170) is corrected by changing the number "(4)"

to "(3)". The correct cross-reference is "paragraph (b)(3)".

Board of Governors of the Federal Reserve System, June 2, 1983.

William W. Wiles,
Secretary of the Board.

FEDERAL RESERVE SYSTEM

12 CFR Part 220

**Credit by Brokers and Dealers;
Technical Amendments to Revision
and Simplification of Regulation T**

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final Rule; Technical Amendments.

SUMMARY: The Board is making technical amendments to its final rule on Regulation T (Credit by Brokers and Dealers) published at 48 FR 23161, May 24, 1983. This action is necessary to include language in sections 2 (Definitions) and 17 of the regulation (Requirements for List of OTC Margin Stocks) that was inadvertently omitted or was the result of typographical errors. The language to be included reflects the Board's May 12, 1982 revision of criteria for initial and continued inclusion on the List of OTC margin stocks published at 47 FR 21756, May 20, 1982.

EFFECTIVE DATE: November 21, 1983 or any earlier date after June 20, 1983, at the option of the creditor.

FOR FURTHER INFORMATION CONTACT:

Jamie Lenoci, Financial Analyst, or Douglas Blass, Attorney, Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System, Washington, D.C. 20551, (202) 452-2781.

SUPPLEMENTARY INFORMATION:

The last sentence of § 220.2(s) of the final rule in 12 CFR 220 (48 FR 23161, 23166, May 24, 1983) is corrected to read as follows:

(s) * * * An OTC stock is not considered to be an "OTC margin stock" unless it appears on the Board's periodically published list of OTC margin stocks.

Section 17(a)(3) of the final rule in 12 CFR 220 (48 FR 23161, 23171, May 24, 1983) is corrected to read as follows:

(3) The stock is registered under section 12 of the Act, is issued by an insurance company subject to section 12(g)(2)(G) of the Act, is issued by a closed-end investment management company subject to registration pursuant to section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8), is an American Depositary Receipt (ADR) of a foreign issuer whose securities are registered under section 12 of the Act, or is a stock of an issuer required to file reports under section 15(d) of the Act;

§ 220.17 [corrected]

Section 220.17(a)(9) of the final rule in 12 CFR 220 (48 FR 23161, 23171, May 24, 1983) is corrected to read as follows:

(a) * * *

(9) The issuer or a predecessor in interest has been in existence for at least three years.

* * * * *

Board of Governors of the Federal Reserve System, July 27, 1983.

William W. Wiles,
Secretary of the Board.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

REGULATION G

Securities Credit By Persons Other Than Banks, Brokers, or Dealers

REGULATION U

Credit By Banks for the Purpose of Purchasing or Carrying Margin Stock

(effective August 31, 1983)

Revision and Simplification of Regulations G and U

FEDERAL RESERVE SYSTEM

12 CFR Part 207

[Docket No. R-0457]

Regulation G: Securities Credit by Persons Other Than Banks, Brokers, or Dealers; Complete Revision and Simplification of Regulation G

AGENCY: Board of Governors of the
Federal Reserve System.

ACTION: Final rule.

SUMMARY: Regulation G, governing securities credit extensions by persons other than banks or brokers or dealers, has been revised in its entirety. The new Regulation G is written in simplified language and organized in a more logical fashion. Certain regulatory burdens and obsolete provisions have been removed.

EFFECTIVE DATE: August 31, 1983.

FOR FURTHER INFORMATION CONTACT:

At the Board of Governors of the Federal Reserve System, Washington, D.C. 20551, contact: Laura Homer, Securities Credit Officer, or Robert Lord, Attorney, Division of Banking Supervision and Regulation (202) 452-2781. At the Federal Reserve Bank of New York, contact: Mindy Silverman, Assistant Counsel, (212) 791-5032.

SUPPLEMENTAL INFORMATION: On February 23, 1983, the Board issued for public comment proposals to completely revise and simplify Regulations G and U (12 CFR Parts 207 and 221, respectively),

which govern securities credit extended by banks and other lenders (48 FR 3466, March 1, 1983). Regulation G is being adopted in substantially the same form as proposed, with modifications reflecting the public comments. This final revision incorporates amendments made to Regulation G in January, 1982 which: (1) Removed existing provisions that prohibited lenders subject to the rule from extending both regulated and nonregulated credit to the same borrower and prohibited mixed collateral loans and (2) clarified the definition of the term "indirectly secured" (47 FR 2981, January 21, 1982). It also included the amendment adopted by the Board covering the criteria for inclusion on the Board's List of OTC Margin Stocks (47 FR 21756, May 20, 1982).

This final revision raises the registration threshold for G-lenders to \$200,000 and eliminates the registration requirements for those who arrange but do not extend credit secured by margin securities.

In addition, the existing provision prohibiting unsecured loans to a broker or dealer by a G-lender is removed. The prohibition in section 8 of the Securities Exchange Act of 1934 (1934 Act) (15 U.S.C. 78a et seq.) which prevents anyone except a bank from lending to a broker or dealer on the collateral of registered securities is retained in the regulation.

A further reduction in regulatory burden will be achieved by the

liberalization of the "Plan-lender" provision, which covers extensions of credit under employee stock option and stock purchase plans. The revision will permit companies and their affiliates to finance employee purchases of company stock without a specific scheduled paydown of the loan or a three-year lockup of the stock as is the case in the present rule. The new regulation will continue to permit a company to extend credit to plan participants in excess of the current maximum loan value of the securities.

Changes in Forms F.R. G-1, G-2 and G-4 (OMB No. 7100-0011) arising from these reduced burdens are being submitted to the Office of Management and Budget for approval under the Paperwork Reduction Act.

Explanation of Organizational Changes

The revised Regulation G is divided into seven sections which, in the following order: (1) State the legal basis and scope of the regulation, (2) define the terms used throughout the regulation, (3) state the general requirements for regulated lenders, (4) separately treat loans made to brokers or dealers for specified purposes, (5) provide special treatment for loans to employee stock option and stock purchase plans meeting certain qualifications, (6) set forth the criteria for inclusion on the List of OTC Margin Stocks, and (7) establish the maximum loan value of different types of collateral.

Unless otherwise noted, no substantive changes have been made to the regulation. The regulation has been reorganized in a more logical fashion and the language has been simplified for easier understanding. In addition, obsolete terms and provisions have been removed, and parts of the regulation incorporate Board and staff interpretations issued during the course of administration of the rule.

A section by section analysis of the revised Regulation G follows.

1. *Authority, Purpose and Scope*

This section states the Board's legal authority to promulgate Regulation G, the purpose of the rule, and the fact that its coverage is limited to lenders other than banks, brokers, or dealers that are required to register under the regulation.

2. *Definitions*

This section defines twelve terms used throughout the regulation. All terms of art not defined in the 1934 Act itself are defined in this section. Other terms which have, over the past five decades, achieved "common usage" status in margin regulation parlance have been incorporated into the regulation and are, therefore, defined in this section. Definitions which are scattered throughout the current regulation have been brought within a single definitional section in this revision of Regulation G.

3. *General Requirements*

This section contains the general rules which lenders other than banks, brokers, and dealers ("G-lenders") must follow when extending, maintaining or arranging credit on the collateral of margin securities. It places limits on the amount of credit G-lenders can extend when the purpose is to purchase or carry securities and when the loan is secured by margin securities.

The registration threshold has been raised from \$100,000 to \$200,000 and the registration requirement for G-lenders who merely arrange credit has been eliminated. Registered G-lenders will continue to be subject to restrictions on securities credit that they arrange. In addition, a G-lender will be able to terminate its registration whenever it has not had more than \$200,000 of margin credit outstanding during the preceding six months; the current regulation also requires that the G-lender not extend any new credit during such period.

The "general requirements" section

also contains the "single credit" rule, which directs G-lenders to aggregate the amount of purpose credit extended to a single customer in order to prevent evasion of the rule. This section also specifically permits the use of other collateral with margin securities to support a purpose credit extension. Under the present rule, as written, there is some ambiguity as to whether such "mixed collateral" loans are permissible.

This section also requires G-lenders who extend credit on margin securities to obtain a Form G-3 (OMB No. 7100-0018), which requires the borrower to state the purpose and amount of the loan and list the margin stock used as collateral for the loan. In the case of revolving credit agreements, this section permits the filing of a G-3 form at the time of the initial extension of credit and does not require a new Form G-3 to be executed each time a disbursement is made. "Plan-lenders" who extend credit for company stock option, purchase or ownership plans will not be required to obtain the purpose statement but the information should otherwise be available on the loan documentation.

Withdrawals and substitutions of collateral for an existing loan are permitted by this section (1) as long as such action would not result in an increase in the amount by which the credit exceeds the maximum loan value of the collateral, or (2) at any time that the collateral has loan value in excess of that required by the regulation. In addition, withdrawals of collateral are permitted to enable a customer to participate in an exchange offer, provided any nonmargin, nonexempted securities received in exchange are substituted for the securities withdrawn and treated as margin stock for a period of sixty days after the exchange.

Provisions regarding extensions and maturities of credit, transfers of credit, mistakes made in good faith, and action which a G-lender may take for its own protection have been consolidated in this section. These provisions are scattered throughout the current regulation.

Finally, this section requires a G-lender to file an annual report form (Form G-4) with its local Federal Reserve Bank.

4. *Credit to Brokers and Dealers*

In conformity with section 8 of the 1934 Act, this section prohibits G-lenders from lending, but not arranging, credit on a secured basis to brokers and

dealers except in emergencies or when the public interest so demands. The current prohibition against unsecured loans by G-lenders to brokers and dealers has been removed.

5. *Credit to Finance Employee Stock Plans*

This section liberalizes current rules with respect to credit extended by a corporation to its own employees and officers for the purpose of purchasing the company's stock. The revision will permit companies and their affiliates to finance employee purchases of company stock without a specific loan reduction schedule or a restriction on the disposition of the stock, as required under the present rule. In addition, plan-lenders will be able to finance ESOPs qualified under section 401 of the Internal Revenue Code without regard to margin restrictions. Plan-lenders that otherwise meet the registration requirements of the regulation will continue to be required to register and to file annual reports (Form G-4). The registration and reporting requirements will provide a mechanism by which the Board can monitor future developments with respect to plan-lender credit. Credit for the tax payment required in connection with the exercise of an option may be extended at the same time as the purpose credit is extended with no regulatory constraints.

6. *List of OTC Margin Securities*

This section contains the criteria for initial and continued inclusion on the Board's List of OTC Margin Stocks. These criteria were recently amended to conform more closely with the listing requirements of major securities exchanges (47 FR 21,756, May 20, 1982).

7. *Supplement*

This final section assigns value to various types of collateral for purposes of the regulation. Three specific types of collateral are given loan value: (1) margin stock has a maximum loan value of fifty percent of its current market value; (2) all other collateral, other than puts, calls for combinations thereof, are assigned a "good faith" loan value; and (3) puts, calls and combinations thereof have no loan value.

Final Regulatory Flexibility Analysis

These changes are part of a program to simplify all of the Board's margin regulations and to reduce specific

administrative and regulatory burdens imposed upon lenders. The **Federal Register** document published on March 1, 1983, contained an Initial Regulatory Flexibility Analysis for the complete revision of Regulation G (48 FR 8467). Comments received on the proposal agree with the Board's analysis. The Board, therefore, certifies for the purposes of 5 U.S.C. 605(b) that the changes are not expected to have an adverse impact on a substantial number of small businesses.

List of Subjects in 12 CFR Part 207

Banks, Banking, Brokers, Credit, Federal Reserve System, Margin, Margin requirements, Investments, Reporting and recordkeeping requirements, Securities.

Accordingly, pursuant to sections 3, 7, 8, 17 and 23 of the Securities Exchange Act of 1934, as amended (15 U.S.C. 78c, 78g, 78h, 78q and 78w) the Board revises Part 207 of Regulation G (12 CFR Part 207) to read as follows:

Regulation G

PART 207—SECURITIES CREDIT BY PERSONS OTHER THAN BANKS, BROKERS, OR DEALERS

Sec.

- 207.1 Authority, purpose, and scope.
- 207.2 Definitions.
- 207.3 General requirements.
- 207.4 Credit to broker-dealers.
- 207.5 Employee stock option and stock purchase plans.
- 207.6 Requirements for the List of OTC Margin Stocks.
- 207.7 Supplement; maximum loan value of margin stock and other collateral.

Authority: Sections 3, 7, 8, 17 and 23 of the Securities Exchange Act of 1934, as amended (15 U.S.C. 78c, 78g, 78h, 78q and 78w).

§ 207.1 Authority, purpose, and scope.

(a) **Authority.** Regulation G (this part) is issued by the Board of Governors of the Federal Reserve System (the Board) pursuant to the Securities Exchange Act of 1934 (the Act) (15 U.S.C. 78a et seq.).

(b) **Purpose and scope.** This part applies to persons other than banks, brokers or dealers, who extend or maintain credit secured directly or indirectly by margin stock and who are required to register with the Board under § 207.3(a) of this part. Credit extended by such persons is regulated by limiting the loan value of the collateral securing the credit, if the purpose of the credit is to buy or carry margin stock.

§ 207.2 Definitions.

The terms used in this part have the meanings given them in section 3(a) of the Act or as defined in this section.

(a) "Affiliate" means any person who, directly or indirectly, through one or more intermediaries, controls, or is controlled by, or is under common control with the lender.

(b) "Carrying" credit is credit that enables a customer to maintain, reduce, or retire indebtedness originally incurred to purchase a stock that is currently a margin stock.

(c) "Current market value" of (1) a security means: (i) If quotations are available, the closing sale price of the security on the preceding business day, as appearing in any regularly published reporting or quotation service; or

(ii) If there is no closing sale price, the lender may use any reasonable estimate of the market value of the security as of the close of business on the preceding business day; or

(iii) If the credit is used to finance the purchase of the security, the total cost of purchase, which may include any commissions charged.

(2) Any other collateral means a value determined by any reasonable method.

(d) "Customer" includes any person or persons acting jointly, to or for whom a lender extends or maintains credit.

(e) "Good faith" with respect to: (1) The loan value of collateral means that amount (not exceeding 100 percent of the current market value of the collateral) which a lender, exercising sound credit judgment, would lend without regard to the customer's other assets held as collateral in connection with unrelated transactions.

(2) Accepting a statement or notice from or on behalf of a customer means that the lender or its duly authorized representative is alert to the circumstances surrounding the credit, and if in possession of information that would cause a prudent person not to accept the notice or certification without inquiry, investigates and is satisfied that it is truthful.

(f) "Indirectly secured" (1) includes any arrangement with the customer under which:

(i) The customer's right or ability to sell, pledge, or otherwise dispose of margin stock owned by the customer is in any way restricted while the credit remains outstanding; or

(ii) The exercise of such right is or may be cause for accelerating the maturity of the credit.

(2) Does not include such an arrangement if:

(i) After applying the proceeds of the credit, not more than 25 percent of the value of the assets subject to the arrangement, as determined by any reasonable method, are margin securities;

(ii) It is a lending arrangement that permits accelerating the maturity of the credit as a result of a default or renegotiation of another credit to the customer by another creditor that is not an affiliate of the lender;

(iii) The lender holds the margin stock only in the capacity of custodian, depository, or trustee, or under similar circumstances, and, in good faith, has not relied upon the margin stock as collateral; or

(iv) If the lender, in good faith, has not relied upon the margin stock as collateral in extending or maintaining the credit.

(g) "In the ordinary course of business" means occurring or reasonably expected to occur in carrying out or furthering any business purpose, or in the case of an individual, in the course of any activity for profit or the management or preservation of property.

(h) "Lender" means any person subject to the registration requirements of this part.

(i) "Margin stock" means: (1) Any equity security registered or having unlisted trading privileges on a national securities exchange;

(2) Any OTC margin stock;

(3) Any debt security convertible into a margin stock or carrying a warrant or right to subscribe to or purchase a margin stock;

(4) Any warrant or right to subscribe to or purchase a margin stock; or

(5) Any security issued by an investment company registered under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8), other than:

(i) A company licensed under the Small Business Investment Company Act of 1958, as amended (15 U.S.C. 661); or

(ii) A company which has at least 95 percent of its assets continuously invested in exempted securities (as defined in 15 U.S.C. 78c(12)).

(j) "Maximum loan value" is the percentage of current market value assigned by the Board under section 207.7 of this part to specified types of collateral. The maximum loan value of margin stock is stated as a percentage of current market value. All other

collateral has "good faith" loan value except that puts, calls and combinations thereof have no loan value.

(k) "OTC margin stock" means any equity security not traded on a national securities exchange that the Board has determined has the degree of national investor interest, the depth and breadth of market, the availability of information respecting the security and its issuer, and the character and permanence of the issuer to warrant being treated like an equity security traded on a national securities exchange. An OTC stock is not considered to be an "OTC margin stock" unless it appears on the Board's periodically published list of OTC Margin Stocks.

(l) "Purpose credit" is credit for the purpose, whether immediate, incidental, or ultimate, of buying or carrying a margin stock.

§ 207.3 General requirements.

(a) *Registration; termination of registration.* (1) Every person who, in the ordinary course of business, extends or maintains credit secured, directly or indirectly, by any margin stock shall register on Federal Reserve Form F.R. G-1 (OMB No. 7100-0011) within 30 days after the end of any calendar quarter during which (i) the amount of credit extended equals \$200,000 or more, or (ii) the amount of credit outstanding at any time during that calendar quarter equals \$500,000 or more.

(2) A registered lender may apply to terminate its registration, by filing Federal Reserve Form F.R. G-2 (OMB No. 7100-0011), if the lender has not, during the preceding six calendar months, had more than \$200,000 of such credit outstanding. Registration shall be deemed terminated when the application is approved by the Board.

(b) *Limitation on extending purpose credit.* No lender, except a plan-lender, as defined in § 207.5(a)(1) of this part, shall extend any purpose credit, secured directly or indirectly by margin stock in an amount that exceeds the maximum loan value of the collateral securing the credit, as set forth in § 207.7 of this part.

(c) *Maintaining credit.* A lender may continue to maintain any credit initially in compliance with this part, regardless of:

- (i) Reduction in the customer's equity resulting from change in market prices;
- (ii) Change in the maximum loan value prescribed by this part; or
- (iii) Change in the status of the security (from nonmargin to margin) securing an existing purpose credit.

(d) *Arranging credit.* No lender may arrange for the extension or maintenance of any credit, except upon the same terms and conditions under which the lender itself may extend or maintain credit under this part except this limitation shall not apply with respect to the arranging by a lender for a bank to extend or maintain credit on margin stock or exempted securities.

(e) *Purpose statement.* Except for credit extended under section 207.5 of this part, whenever a lender extends credit secured directly or indirectly by any margin stock, the lender shall require its customer to execute Form F.R. G-3 (OMB No. 7100-0018), which shall be signed and accepted by a duly authorized representative of the lender acting in good faith.

(f) *Purpose statement for revolving credit or multiple draw agreements.* (1) If a lender extends credit, secured directly or indirectly by any margin stock, under a revolving credit or other multiple draw agreement, Form F.R. G-3 can either be executed each time a disbursement is made under the agreement, or at the time the credit arrangement is originally established.

(2) If a purpose statement executed at the time the credit arrangement is initially made indicates that the purpose is to purchase or carry margin stock, the credit will be deemed in compliance with this part if the maximum loan value of the collateral at least equals the aggregate amount of funds actually disbursed. For any purpose credit disbursed under the agreement, the lender shall obtain and attach to the executed Form F.R. G-3 a current list of collateral which adequately supports all credit extended under the agreement.

(g) *Single credit rule.* (1) All purpose credit extended to a customer shall be treated as a single credit, and all the collateral securing such credit shall be considered in determining whether or not the credit complies with this part.

(2) A lender that has extended purpose credit secured by margin stock may not subsequently extend unsecured purpose credit to the same customer unless the combined credit does not exceed the maximum loan value of the margin stock securing the prior credit.

(3) If a lender extended unsecured purpose credit to a customer prior to the extension of purpose credit secured by margin securities, the credits shall be combined and treated as a single credit solely for the purposes of the withdrawal and substitution provision of paragraph (i) of this section.

(4) If a lender extends purpose credit secured by any margin stock and nonpurpose credit to the same customer, the lender shall treat the credits as two separate loans and may not rely upon the required collateral securing the purpose credit for the nonpurpose credit.

(h) *Mixed collateral loans.* A purpose credit secured in part by margin stock, and in part by other collateral shall be treated as two separate loans, one secured by the margin stock and one by all other collateral. A lender may use a single credit agreement, if it maintains records identifying each portion of the credit and its collateral.

(i) *Withdrawals and substitutions.* (1) A lender may permit any withdrawal or substitution of cash or collateral by the customer if the withdrawal or substitution would not:

- (i) Cause the credit to exceed the maximum loan value of the collateral; or
- (ii) Increase the amount by which the credit exceeds the maximum loan value of the collateral.

(2) For purposes of this section, the maximum loan value of the collateral on the day of the withdrawal or substitution shall be used.

(j) *Exchange offers.* To enable a customer to participate in a reorganization, recapitalization, or exchange offer that is made to holders of an issue of margin stock a lender may permit substitution of the securities received. A nonmargin nonexempted security acquired in exchange for a margin stock shall be treated as if it is margin stock for a period of 60 days following the exchange.

(k) *Renewals and extensions of maturity.* A renewal or extension of the maturity of a credit need not be considered a new extension of credit if the amount of the credit is increased only by the addition of interest, service charges, or taxes with respect to the credit.

(l) *Transfers of credit.* (1) A transfer of a credit between customers or lenders shall not be considered a new extension of credit if:

- (i) The original credit was in compliance with this part;
- (ii) The transfer is not made to evade this part;
- (iii) The amount of credit is not increased; and
- (iv) The collateral for the credit is not changed.

(2) Any transfer between customers at the same lender shall be accompanied by a statement by the transferor customer describing the circumstances giving rise to the transfer and shall be

accepted and signed by a duly authorized representative of the lender acting in good faith. The lender shall keep such statement with its records of the transferee account.

(3) When a transfer is made between lenders, the transferee lender shall obtain a copy of the Form F.R. G-3 originally filed with the transferor lender and retain the copy with its records of the transferee account.

(m) *Action for lender's protection.* Nothing in this part shall require a lender to waive or forego any lien, or prevent a lender from taking any action it deems necessary for its protection.

(n) *Mistakes in good faith.* A mistake in good faith in connection with the extension or maintenance of credit shall not be a violation of this part.

(o) *Annual Report.* Every registered lender shall, within 30 days following June 30 of every year, file Form F.R. G-4 (OMB No. 7100-0011).

(p) *Where to register and file applications and reports.* Registration statements, applications to terminate registration, and annual reports shall be filed with the Federal Reserve Bank of the district in which the principal office of the lender is located.

§ 207.4 Credit to Broker-Dealers.

No lender shall extend or maintain credit secured, directly or indirectly, by any margin stock to a creditor who is subject to Part 220 of this Chapter except in the following circumstances:

(a) *Emergency Loans.* Credit extended in good faith reliance upon a certification from the customer that the credit is essential to meet emergency needs arising from exceptional circumstances. Any collateral for such credit shall have good faith loan value.

(b) *Capital Contribution Loans.* Credit that the Board has exempted by order upon a finding that the exemption is necessary or appropriate in the public interest or for the protection of investors, provided the Securities Investor Protection Corporation certifies to the Board that the exemption is appropriate.

§ 207.5 Employee Stock Option and Stock Purchase Plans.

(a) *Plan-lender; eligible plan.* (1) Plan-lender means any corporation, (including a wholly-owned subsidiary, or a lender that is a thrift organization whose membership is limited to employees and former employees of the corporation, its subsidiaries or affiliates)

that extends or maintains credit to finance the acquisition of margin stock of the corporation, its subsidiaries or affiliates under an eligible plan.

(2) *Eligible Plan.* An eligible plan means any employee stock option, purchase, or ownership plan adopted by a corporation and approved by its stockholders that provides for the purchase of margin stock of the corporation, its subsidiaries, or affiliates.

(b) *Credit to exercise rights under or finance an eligible plan.* (1) If a plan-lender extends or maintains credit under an eligible plan, any margin security that directly or indirectly secures that credit shall have good faith loan value.

(2) Credit extended under this section shall be treated separately from credit extended under any other section of this part except sections 207.3(a) and 207.3(o) of this part.

§ 207.6 Requirements for the List of OTC Margin Stocks.

(a) *Requirements for inclusion on the list.* Except as provided in paragraph (d) of this section, an OTC margin stock shall meet the following requirements:

(1) Four or more dealers stand willing to, and do in fact, make a market in such stock and regularly submit bona fide bids and offers to an automated quotations system for their own accounts;

(2) The minimum average bid price of such stock, as determined by the Board, is at least \$5 per share;

(3) The stock is registered under section 12 of the Act, is issued by an insurance company subject to section 12(g)(2)(G) of the Act, is issued by a closed end investment management company subject to registration pursuant to section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8), is an American Depositary Receipt (ADR) of a foreign issuer whose securities are registered under section 12 of the Act, or is a stock of an issuer required to file reports under section 15(d) of the Act;

(4) Daily quotations for both bid and asked prices for the stock are continuously available to the general public;

(5) The stock has been publicly traded for at least six months;

(6) The issuer has at least \$4 million of capital, surplus, and undivided profits;

(7) There are 400,000 or more shares of such security outstanding in addition to

shares held beneficially by officers, directors or beneficial owners of more than 10 percent of the stock;

(8) There are 1,200 or more holders of record, as defined in SEC Rule 12g5-1 (17 CFR 240.12g5-1), of the stock who are not officers, directors or beneficial owners of 10 percent or more of the stock, or the average daily trading volume of such a stock, as determined by the Board, is at least 500 shares; and

(9) The issuer or a predecessor in interest has been in existence for at least three years.

(b) *Requirements for continued inclusion on the list.* Except as provided in paragraph (d) of this section, an OTC margin stock shall meet the following requirements:

(1) Three or more dealers stand willing to, and do in fact, make a market in such stock and regularly submit bona fide bids and offers to an automated quotations system for their own accounts;

(2) The minimum average bid price of such security, as determined by the Board, is at least \$2 per share;

(3) (1) The security is registered as specified in paragraph (a)(3) of this section;

(4) Daily quotations for both bid and asked prices for the stock are continuously available to the general public;

(5) The issuer has at least \$1 million of capital, surplus, and undivided profits;

(6) There are 300,000 or more shares of such stock outstanding in addition to shares held beneficially by officers, directors, or beneficial owners of more than 10 percent of the stock; and

(7) There continue to be 800 or more holders of record, as defined in SEC Rule 12g5-1 (17 CFR 240.12g5-1), of the stock who are not officers, directors, or beneficial owners of 10 percent or more of the stock, or the average daily trading volume of such stock, as determined by the Board, is at least 300 shares.

(c) *Removal from the list of OTC margin stocks.* The Board shall periodically remove from the list any stock that:

(1) Ceases to exist or of which the issuer ceases to exist, or

(2) No longer substantially meet the provisions of paragraph (b) of this section or § 207.2(k).

(d) *Discretionary authority of Board.* Without regard to the other paragraphs of this section, the Board may add to, or omit or remove from, the OTC margin stock list any equity security, if in the judgment of the Board, such action is

necessary or appropriate in the public interest.

(e) *Unlawful representations.* It shall be unlawful for any lender to make, or cause to be made, any representation to the effect that the inclusion of a security on the list OTC margin stocks is evidence that the Board or the SEC has in any way passed upon the merits of, or given approval to, such security or any transactions therein. Any statement in an advertisement or other communication containing a reference to the Board in connection with the list or securities on that list shall be an unlawful representation.

§ 207.7 Supplement: Maximum loan value of margin stock and other collateral.

(a) *Maximum loan value of a margin stock.* The maximum loan value of any margin stock, except options, is fifty per cent of its current market value.

(b) *Maximum loan value of nonmargin stock and all other collateral.* The maximum loan value of a nonmargin stock and all other collateral except puts, calls, or combinations thereof is their good faith loan value.

(c) *Maximum loan value of options.* Whether they are margin stock or not, puts, calls, and combinations thereof have no loan value.

By order of the Board of Governors of the Federal Reserve System, July 28, 1983.

William W. Wiles,

Secretary of the Board.

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12 CFR Part 221

[Docket No. R-0458]

Regulation U: Credit by Banks for the Purpose of Purchasing or Carrying Margin Stock; Complete Revision and Simplification of Regulation U

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule.

SUMMARY: Regulation U, governing securities credit extended by banks, has been revised in its entirety. The new Regulation U is written in simplified language and organized in a more logical fashion. Obsolete provisions and certain regulatory burdens and form-filing requirements have been removed.

EFFECTIVE DATE: August 31, 1983.

FOR FURTHER INFORMATION CONTACT: At the Board of Governors of the

Federal Reserve System, Washington, D.C. 20551, contact: Laura Homer, Securities Credit Office, or Robert Lord, Attorney, Division of Banking Supervision and Regulation, (202) 452-2781. At the Federal Reserve Bank of New York, contact: Mindy Silverman, Assistant Counsel, (212) 791-5032.

SUPPLEMENTARY INFORMATION: On February 23, 1983, the Board issued for public comment proposals to completely revise and simplify Regulations G and U (12 CFR Parts 207 and 221, respectively), which govern securities credit extended by banks and lenders other than banks and broker-dealers (48 FR 8466, March 1, 1983). Pursuant to the proposal, and after receiving public commentary, Regulation U is revised by (1) simplifying the language in all provisions, (2) removing obsolete provisions and certain form-filing requirements, and (3) reordering provisions in a more logical manner. This revision incorporates amendments made to Regulation U in January 1982 which exempted bank credit not secured by margin stock from the regulation and clarified the definition of the term "indirectly secured" (47 FR 2981, January 21, 1982).

Certain filing requirements with respect to loans to OTC and third market makers and block positioners have been removed from the regulation. The related forms, FR U-2, U-3, U-5, and U-6 (OMB No. 7100-0116) therefore, will be eliminated. Also, in cooperation with the Securities and Exchange Commission ("SEC"), references to related SEC forms X-17A-12 (1) and (2), X-17A-16 (1) and (2), and X-17A-17 are being deleted so that the SEC may proceed with its proposal to eliminate these forms (SEC Release No. 34-19595).

Changes involving reduction in reporting burdens have been submitted to the Office of Management and Budget.

A new section has been added to Regulation U to notify nonmember banks who propose to lend to brokers and dealers on registered securities that they are required by statute (15 U.S.C. 78h) to comply with securities credit laws and regulations applicable to member banks. Currently, notice of this requirement is contained in Regulation T (12 CFR Part 220), but not in Regulation U. Notice of this requirement should also be contained in Regulation U since the statute places as affirmative duty of compliance upon banks as well as brokers and dealers. This addition to

Regulation U will not place any new compliance responsibilities on banks.

The Board has removed, in its entirety, current § 221.3(q), which regulates loans to certain lenders. This section was added to Regulation U in 1959 to limit the amount of credit available to "collateral lenders," who were neither banks nor broker-dealers and, therefore, not subject to the Board's then existing margin regulations. A comprehensive regulation (Regulation G, 12 CFR 207) was adopted by the Board in 1968 to cover all lenders other than banks and broker-dealers, including collateral lenders. Because of the adoption of Regulation G, the retention of § 221.3(q) is no longer necessary.

Explanation of Changes

The new Regulation U is divided into eight sections which, in the following order, (1) state the legal basis and scope of the regulation, (2) define the terms used throughout the regulation, (3) state the general rule, (4) require nonmember banks to file agreements with the Board before they engage in securities credit transactions with brokers or dealers, (5) separately treat loans made to brokers or dealers for market facilitating purposes, (6) specify transactions which are exempt from the requirements of the regulation, (7) set forth the criteria for inclusion on the List of OTC Margin Stocks, and (8) establish the maximum loan value of different types of collateral.

A section by section analysis of the new Regulation U follows:

1. Authority, Purpose, and Scope

This section states the Board's legal authority to promulgate Regulation U, the purpose of the rule, and the fact that its coverage is limited to banks.

2. Definitions

This section contains eleven definitions of terms used throughout the regulation. All terms of art not defined in the Securities Exchange Act of 1934 ("1934 Act") (15 U.S.C. 78a et seq.) itself are defined in this section. The term "bank", although defined in the 1934 Act, is defined more precisely in the proposed regulation. Other terms which have, over the past five decades, achieved "common usage" status in margin regulation parlance have been incorporated into the regulation and are, therefore, defined in this section. Some definitions are scattered throughout the current regulation. All such definitions

have been brought within a single definitional section.

The revised definition of "indirectly secured" adopted by the Board in January, 1982 did not contain a specific exception (contained in an earlier definition) that a loan will not be considered "indirectly secured" if a lender in good faith has not relied upon margin stock as collateral. It was not the intent of the Board, however, to remove this exception, and interpretations have been issued making this point clear. To avoid misunderstanding, language has been added to the definition in the new regulation to clarify this point.

In view of comments received, (1) The definition of "good faith" has been revised to clarify that in valuing assets on a "good faith" basis, the bank may not lend more than 100 per cent of the current market value of the collateral and may not look to other assets held as collateral in connection with unrelated transactions; separate extensions of purpose credit may be made on an unsecured basis if the financial circumstances of the borrower otherwise warrant; (2) the definition of "carrying credit" was revised to delete language relating to maintenance of a "position in a margin security"; and (3) the definition of "current market value" was revised to delete references to determinations "in accordance with generally accepted accounting principles". The Board wishes to make clear that book value can be considered a reasonable method of valuation, in appropriate circumstances.

3. General Requirements

A. This section contains the general rules which banks must follow when extending, maintaining, or arranging credit on the collateral of margin stock. It places limits on the amount of credit banks can extend when the purpose is to purchase or carry securities and the loan is secured by margin stock.

B. The "general requirements" section also contains the "single credit" rule, which directs bank to aggregate the amount of purpose credit extended to a single customer in order to prevent evasion of the rule. This section also specifically permits the use of other collateral with margin stock to support a purpose credit. Under the present rule, as written, there is some ambiguity as to whether such "mixed collateral" loans are permissible.

C. This section also requires banks who extend credit on margin stock to obtain a Form FRU-1 (OMB No. 7100-

0115), which requires a borrower to state the purpose and amount of a loan, and list the margin stock used as collateral.

This section also outlines the procedure for obtaining purpose statements in connection with revolving credit or other multiple draw agreements.

Withdrawals and substitutions of collateral for an existing loan are permitted by this section (1) as long as such action would not result in an increase in the amount by which the credit exceeds the maximum loan value of the collateral, or (2) at any time that the collateral has loan value in excess of that required by the regulation. In addition, withdrawals of collateral will be permitted to enable a customer to participate in a reorganization, recapitalization or, an exchange offer, provided any nonmargin securities received in exchange are substituted for the securities withdrawn and treated as margin stock for a period of sixty days following the exchange.

Provisions regarding extensions and maturities of credit, transfers of credit, mistakes made in good faith, and action which a bank may take for its own protection have been consolidated in this section.

4. Agreements of Non-Member Banks

This is a new section of Regulation U. Section 8 of the 1934 Act (15 U.S.C. 78h) prohibits brokers and dealers from borrowing on registered securities in the ordinary course of business unless they borrow from either a member bank or a nonmember bank that has filed an agreement with the Board agreeing to comply with all laws applicable to member banks in connection with securities credit transactions. This statutory requirement is currently embodied in Regulation T (12 CFR 220.15), which is applicable to brokers and dealers. However, it is the nonmember bank which has the affirmative duty to file such agreements (FR T-1 and FR T-2) with the Board. In the interest of providing nonmember banks with more adequate notice of this statutory requirement, this section is being added to Regulation U.

5. Special Purpose Loans to Brokers and Dealers

Since the inception of Regulation U, the Board recognized that banks made certain specialized loans to brokers and dealers which were either short-term loans to facilitate the settlement and

clearance of securities transactions or loans regulated at another level. These loans have always been treated differently from regular margin loans. Provision is made in a separate section, therefore, by which banks may lend on a "good faith" basis to brokers and dealers who borrow for any one or more of the thirteen specialized purposes listed in the regulation. Special treatment of such loans is conditioned upon receipt of certified statements from the broker or dealer as to the purpose of the loan. Comparable exceptions to the general credit limitations are in the current Regulation U, but the proposed rule consolidates all of these exceptions into one section and removes any limitations on the type of collateral securing the loans. In view of comments received, the language of regulation U has been changed to reflect the Board's intent that, unless otherwise noted, the "good faith" requirement applies only to the acceptance of the notice or certification that the loan is for one of the purposes specified in the regulation.

The provisions regarding credit extended to block positioners, OTC market makers, and third market makers will no longer require the filing of board forms FR U-2, U-3, U-5 and U-6. In conjunction with this change, the regulation will delete references to the related SEC Forms X-17A-12(1), X-17A-16(1), and X-17A-17. This will obviate the need for filing these forms with the SEC as a prerequisite to eligibility for special credit. In coordination with the Board, the SEC is rescinding its rules pursuant to which these forms are required.

6. Exempted Transactions

This section exempts from Regulation U eight specific kinds of nonbroker-dealer bank loans. All but one of these exemptions are contained in various sections of the current regulation. The proposed rule consolidates the existing exemptions into one section. A new exemption is provided for loans to employee stock ownership plans (ESOPs) qualified under section 401 of the Internal Revenue Code. The purpose of this new exemption is to permit banks to treat loans to employee stock ownership plans in the same manner as they are now permitted to treat loans to similar corporate lenders referred to as "plan lenders."

7. List of OTC Margin Stocks

This section contains the criteria for initial and continued inclusion on the

Board's List of OTC Margin Securities. These criteria were amended to more closely conform with the listing requirements of major exchanges (47 FR 21,756, May 20, 1982).

8. Supplement

This final section assigns value to various types of collateral for purposes of the regulation. Three specific types of collateral are given loan value: (1) Margin stock has a maximum loan value of fifty per cent of its current market value; (2) all other collateral, other than puts, calls or combinations thereof, are assigned a "good faith" loan value; and (3) except for loans to specialists to finance specialist transactions, puts, calls and combinations are given no loan value.

9. Combining Regulations G and U

The Board requested specific public comment on the question whether Regulations G and U should be combined to form a new comprehensive regulation with various subchapters or whether the two regulations should be maintained separately in their simplified forms. The majority of those responding to this question opposed combining the regulations on the basis that doing so could lead to more confusion than clarity and that separate regulations are warranted in light of differences between the two types of lenders. Regulations G and U will, therefore, be maintained separately in their simplified forms.

Final Regulatory Flexibility Analysis

The Revision of Regulation U is part of a program to simplify all of the board's margin regulations, generally, and to reduce specific administrative and regulatory burdens imposed upon banks. The **Federal Register** document published on March 1, 1983 contained an Initial Regulatory Flexibility Analysis for the complete revision of Regulation U (48 FR 8472). Comments received on the proposal agree with the Board's analysis. The Board, therefore, certifies for the purposes of 5 U.S.C. 605(b) that the changes proposed are not expected to have any adverse impact on a substantial number of small businesses.

List of Subjects in 12 CFR Part 221

Banks, Banking, Brokers, Credit, Federal Reserve System, Margin, Margin requirements, Investments, Reporting and recordkeeping requirements, Securities.

Accordingly, pursuant to sections 3, 7, 8 and 23 of the Securities Exchange Act of 1934, as amended (15 U.S.C. 78c, 78g, 78h and 78w), Part 221 (Regulation U) is completely revised to read as follows:

PART 221—CREDIT BY BANKS FOR THE PURPOSE OF PURCHASING OR CARRYING MARGIN STOCK

Sec.

- 221.1 Authority, purpose, and scope.
- 221.2 Definitions.
- 221.3 General requirements.
- 221.4 Agreements of nonmember banks.
- 221.5 Special purpose loans to brokers and dealers.
- 221.6 Exempted transactions.
- 221.7 Requirements for the List of OTC Margin Stocks.

Sec.

- 221.8 Supplement; maximum loan value of margin stock and other collateral.

Authority: Sections 3, 7, 8 and 23 of the Securities Exchange Act of 1934, as amended (15 U.S.C. 78c, 78g, 78h and 78w).

§ 221.1 Authority, purpose, and scope.

(a) **Authority.** Regulation U ("this part") is issued by the Board of Governors of the Federal Reserve System ("the Board") pursuant to the Securities Exchange Act of 1934 (the "Act") (15 U.S.C. 78a et seq.).

(b) **Purpose and scope.** This part imposes credit restrictions upon "banks" (as defined in § 221.2(b) of this part) that extend credit for the purpose of buying or carrying margin stock if the credit is secured directly or indirectly by margin stock. Banks may not extend more than the maximum loan value of the collateral securing such credit, as set by the Board in § 221.8 (the Supplement).

§ 221.2 Definitions.

The terms used in this part have the meanings given them in section 3(a) of the Act or as defined in this section.

(a) **"Affiliate"** means: (1) Any bank holding company of which a bank is a subsidiary within the meaning of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1841(d));

(2) Any other subsidiary of such bank holding company; and

(3) Any other corporation, business trust, association, or other similar organization that is an affiliate as defined in section 2(b) of the Banking Act of 1933 (12 U.S.C. 221a(c)).

(b)(1) **"Bank"** has the meaning given to it in section 3(a)(6) of the Act (15 U.S.C. 78c(a)(6)) and includes: (i) Any subsidiary of a bank;

(ii) Any corporation organized under

section 25(a) of the Federal Reserve Act (12 U.S.C. 611); and

(iii) Any agency or branch of a foreign bank located within the United States.

(2) **"Bank"** does not include: (i) Any savings and loan association,

(ii) Any credit union,

(iii) Any lending institution that is an instrumentality or agency of the United States, or

(iv) Any member of a national securities exchange.

(c) **"Carrying"** credit is credit that enables a customer to maintain, reduce, or retire indebtedness originally incurred to purchase a security that is currently a margin stock.

(d) **"Current market value"** of (1) a security means: (i) If quotations are available, the closing sale price of the security on the preceding business day, as appearing on any regularly published reporting or quotation service; or

(ii) If there is no closing sale price, the bank may use any reasonable estimate of the market value of the security as of the close of business on the preceding business day; or

(iii) If the credit is used to finance the purchase of the security, the total cost of purchase, which may include any commissions charged.

(2) Any other collateral means a value determined by any reasonable method in accordance with sound banking practices.

(e) **"Customer"** includes any person or persons acting jointly, to or for whom a bank extends or maintains credit.

(f) **"Good faith"** with respect to: (1) The loan value of collateral, means that amount (not exceeding 100 per cent of the current market value of the collateral) which a bank, exercising sound banking judgment, would lend, without regard to the customer's other assets held as collateral in connection with unrelated transactions.

(2) Accepting notice or certification from or on behalf of a customer means that the bank or its duly authorized representative is alert to the circumstances surrounding the credit, and if in possession of information that would cause a prudent person not to accept the notice or certification without inquiry, investigates and is satisfied that it is truthful;

(g) **"Indirectly secured"** (1) Includes any arrangement with the customer under which:

(i) The customer's right or ability to sell, pledge, or otherwise dispose of

margin stock owned by the customer is in any way restricted while the credit remains outstanding; or

(ii) The exercise of such right is or may be caused for accelerating the maturity of the credit.

(2) Does not include such an arrangement if:

(i) After applying the proceeds of the credit, not more than 25 percent of the value (as determined by any reasonable method) of the assets subject to the arrangement is represented by margin stock;

(ii) It is a lending arrangement that permits accelerating the maturity of the credit as a result of a default or renegotiation of another credit to the customer by another lender that is not an affiliate of the bank;

(iii) The bank holds the margin stock only in the capacity of custodian, depository, or trustee, or under similar circumstances, and, in good faith, has not relied upon the margin stock as collateral; or

(iv) The bank, in good faith, has not relied upon the margin stock as collateral in extending or maintaining the particular credit.

(h) "Margin stock" means: (1) Any equity security registered or having unlisted trading privileges on a national securities exchange;

(2) Any OTC margin stock;

(3) Any debt security convertible into a margin stock, or carrying a warrant or right to subscribe to or purchase a margin stock;

(4) Any warrant or right to subscribe to or purchase a margin stock; or

(5) Any security issued by an investment company registered under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8), other than:

(i) A company licensed under the Small Business Investment Company Act of 1958, as amended (15 U.S.C. 661), or

(ii) A company which has at least 95 per cent of its assets continuously invested in exempted securities (as defined in 15 U.S.C. 78c(12)).

(i) "Maximum loan value" is the percentage of current market value assigned by the Board under § 221.8 of this part to specified types of collateral. The maximum loan value of margin stock is stated as a percentage of its current market value. Puts, calls and combinations thereof have no loan value except for purposes of § 221.5(c)(10) of this part. All other collateral has "good faith" loan value.

(j) "OTC margin stock" is any equity security not traded on a national securities exchange that the Board has determined has the degree of national investor interest, the depth and breadth of market, the availability of information respecting the security and its issuer, and the character and permanence of the issuer to warrant being treated like an equity security traded on a national securities exchange. An OTC stock is not considered to be an "OTC margin stock" unless it appears on the Board's periodically published list of OTC margin stocks.

(k) "Purpose credit" is any credit for the purpose, whether immediate, incidental, or ultimate, of buying or carrying margin stock.

§ 221.3 General requirements.

(a) *Extending, maintaining, and arranging credit.* (1) *Extending credit.* No bank shall extend any purpose credit, secured directly or indirectly by margin stock, in an amount that exceeds the maximum loan value of the collateral securing the credit. The maximum loan value of margin stock (set forth in § 221.8 of this part) is assigned by the Board in terms of a percentage of the current market value of the margin stock. All other collateral has "good faith" loan value, as defined in § 221.2(f) of this part.

(2) *Maintaining credit.* A bank may continue to maintain any credit initially extended in compliance with this part, regardless of:

(i) Reduction in the customer's equity resulting from change in market prices;

(ii) Change in the maximum loan value prescribed by this part; or

(iii) Change in the status of the security (from nonmargin to margin) securing an existing purpose credit.

(3) *Arranging credit.* No bank may arrange for the extension or maintenance of any purpose credit, except upon the same terms and conditions under which the bank itself may extend or maintain purpose credit under this part.

(b) *Purpose statement.* (1) Except for credit extended under paragraph (c) of this section, whenever a bank extends credit secured directly or indirectly by any margin stock, the bank shall require its customer to execute Form F.R. U-1 (OMB No. 7100-0115), which shall be signed and accepted by a duly authorized officer of the bank acting in good faith.

(c) *Purpose statement for revolving credit or multiple-draw agreements.*

(i) If a bank extends credit, secured directly or indirectly by any margin stock, under a revolving credit or other multiple-draw agreement, Form F.R. U-1 can either be executed each time a disbursement is made under the agreement, or at the time the credit arrangement is originally established.

(ii) If a purpose statement executed at the time the credit arrangement is initially made indicates that the purpose is to purchase or carry margin stock, the credit will be deemed in compliance with this part if the maximum loan value of the collateral at least equals the aggregate amount of funds actually disbursed. For any purpose credit disbursed under the agreement, the bank shall obtain and attach to the executed Form F.R. U-1 a current list of collateral which adequately supports all credit extended under the agreement.

(d) *Single credit rule.* (1) All purpose credit extended to a customer shall be treated as a single credit, and all the collateral securing such credit shall be considered in determining whether or not the credit complies with this part.

(2) A bank that has extended purpose credit secured by margin stock may not subsequently extend unsecured purpose credit to the same customer unless the combined credit does not exceed the maximum loan value of the collateral securing the prior credit.

(3) If a bank extended unsecured purpose credit to a customer prior to the extension of purpose credit secured by margin stock, the credits shall be combined and treated as a single credit solely for the purposes of the withdrawal and substitution provision of paragraph (f) of this section.

(4) If a bank extends purpose credit secured by any margin stock and non-purpose credit to the same customer, the bank shall treat the credits as two separate loans and may not rely upon the required collateral securing the purpose credit for the nonpurpose credit.

(e) *Mixed collateral loans.* A purpose credit secured in part by margin stock, and in part by other collateral shall be treated as two separate loans, one secured by margin stock and one by all other collateral. A bank may use a single credit agreement, if it maintains records identifying each portion of the credit and its collateral.

(f) *Withdrawals and substitutions.* (1) A bank may permit any withdrawal or substitution of cash or collateral by the

customer if the withdrawal or substitution would not:

- (i) Cause the credit to exceed the maximum loan value of the collateral; or
- (ii) Increase the amount by which the credit exceeds the maximum loan value of the collateral.

(2) For purposes of this section, the maximum loan value of the collateral on the day of the withdrawal or substitution shall be used.

(g) *Exchange offers.* To enable a customer to participate in a reorganization, recapitalization or exchange offer that is made to holders of an issue of margin stock, a bank may permit substitution of the securities received. A nonmargin, nonexempted security acquired in exchange for a margin stock shall be treated as if it is margin stock for a period of 60 days following the exchange.

(h) *Renewals and extensions of maturity.* A renewal or extension of maturity of a credit need not be considered a new extension of credit if the amount of the credit is increased only by the addition of interest, service charges, or taxes with respect to the credit.

(i) *Transfers of credit.* (1) A transfer of a credit between customers or banks shall not be considered a new extension of credit if:

- (i) The original credit was in compliance with this part;
- (ii) The transfer is not made to evade this part;
- (iii) The amount of credit is not increased; and
- (iv) The collateral for the credit is not changed.

(2) Any transfer between customers at the same bank shall be accompanied by a statement by the transferor customer describing the circumstances giving rise to the transfer and shall be accepted and signed by an officer of the bank acting in good faith. The bank shall keep such statement with its records of the transferee account.

(3) When a transfer is made between banks, the transferee bank shall obtain a copy of the form F.R. U-1 originally filed with the transferor bank and retain the copy with its records of the transferee account.

(j) *Action for bank's protection.* Nothing in this part shall require a bank to waive or forego any lien or prevent a bank from taking any action it deems necessary in good faith for its protection.

(k) *Mistakes in good faith.* A mistake

in good faith in connection with the extension of maintenance of credit shall not be a violation of this part.

§ 221.4 Agreements of nonmember banks.

(a) Banks that are not members of the Federal Reserve System shall file an agreement that conforms to the requirements of section 8(a) of the Act (See Form T-1 for domestic nonmember banks and Form T-2 for all other nonmember banks) prior to extending any credit secured by any nonexempt security registered on a national securities exchange to persons subject to Part 220 of this Chapter, who are borrowing in the ordinary course of business.

(b) Any nonmember bank may terminate its agreement upon written notification to the Board.

§ 221.5 Special purpose loans to brokers and dealers

(a) *Special purpose loans.* A member bank and a nonmember bank that is in compliance with § 221.4 of this part, may extend and maintain purpose credit to brokers and dealers without regard to the limitations set forth in § 221.3 and 221.8 of this part, if the credit is for any of the specific purposes and meets the conditions set forth in paragraph (c) of this section.

(b) *Written notice.* Prior to extending credit for more than a day under this section, the bank shall obtain and accept in good faith a written notice or certification from the borrower as to the purposes of the loan. The written notice or certification shall be evidence of continued eligibility for the special credit provisions until the borrower notifies the bank that it is no longer eligible or the bank has information that would cause a reasonable person to question whether the credit is being used for the purpose specified.

(c) *Types of special purpose credit.* The types of credit that may be extended and maintained on a good faith basis are as follows:

(1) *Hypothecation loans.* Credit secured by hypothecated customer securities that, according to written notice received from the broker or dealer, may be hypothecated by the broker or dealer under Securities and Exchange Commission ("SEC") rules.

(2) *Temporary advances in payment-against-delivery transactions.* Credit to finance the purchase or sale of securities for prompt delivery, if the credit is to be

repaid upon completion of the transaction.

(3) *Loans for securities in transit or transfer.* Credit to finance securities in transit or surrendered for transfer, if the credit is to be repaid upon completion of the transaction.

(4) *Intra-day loans.* Credit to enable a broker or dealer to pay for securities, if the credit is to be repaid on the same day it is extended.

(5) *Arbitrage loans.* Credit to finance proprietary or customer bona fide arbitrage transactions. For the purpose of this section "bona fide arbitrage" means:

(i) Purchase or sale of a security in one market, together with an offsetting sale or purchase of the same security in a different market at nearly the same time as practicable, for the purpose of taking advantage of a difference in prices in the two markets; or

(ii) Purchase of a security that is, without restriction other than the payment of money, exchangeable or convertible within 90 calendar days of the purchase into a second security, together with an offsetting sale of the second security at or about the same time, for the purpose of taking advantage of a concurrent disparity in the price of the two securities.

(6) *Distribution loans.* Credit to finance the distribution of securities to customers.

(7) *Odd-lot loans.* Credit to finance the odd lot transactions of a person registered as an odd lot dealer on a national securities exchange.

(8) *Emergency loans.* Credit that is essential to meet emergency needs of the broker-dealer business arising from exceptional circumstances.

(9) *Capital contribution loans.* (i) Credit that Board has exempted by order upon a finding that the exemption is necessary or appropriate in the public interest or for the protection of investors, provided the Securities Investor Protection Corporation certifies to the Board that the exemption is appropriate; or

(ii) Credit to a customer for the purpose of making a subordinated loan or capital contribution to a broker or dealer in conformity with the SEC's net capital rules and the rules of the broker's or dealer's Examining Authority, provided:

(A) The customer reduces the credit by the amount of any reduction in the loan or contribution to the broker or dealer; and

(B) The credit is not used to purchase securities issued by the broker or dealer in a public distribution.

(10) Loans to specialists.

Credit extended to finance the speciality security and permitted offset positions of members of a national securities exchange who are registered and acting as specialists on the exchange, provided the credit is extended on a good faith loan value basis.

(11) OTC market maker credit. Credit to a dealer who has given written notice to the bank that it is a "qualified OTC market maker" in an OTC margin security as defined in SEC Rule 3b-8 (17 CFR 240.3b-8) and that the credit will be used solely for the purpose of financing the market making activity, provided the credit is extended on a good faith loan value basis.

(12) Third market maker loans. Credit to a dealer who has given written notice to the bank that it is a "qualified third market maker," as defined in SEC Rule 3b-8 (17 CFR 240.3b-8), and that the credit will be used solely for the purpose of financing positions in securities assumed as a "qualified third market maker," provided the credit is extended on a good faith loan value basis.

(13) Block positioner credit. Credit to a dealer who has given written notice to the bank that it is a "qualified block positioner" for a block of securities, as defined in SEC Rule 3b-8 (17 CFR 240.3b-8), and that the credit will be used to finance a position in that block, provided the credit is extended on a good faith loan value basis.

§ 221.6 Exempted transactions.

A bank may extend and maintain purpose credit without regard to the provisions of this part if such credit is extended:

- (a) To any bank;
- (b) To any foreign banking institution;
- (c) Outside the United States;
- (d) To an employee stock ownership plan (ESOP) qualified under section 401 of the Internal Revenue Code (26 U.S.C. 401);
- (e) To any "plan lender" as defined in Part 207 of this Chapter to finance such a plan, provided the bank has no recourse to any securities purchased pursuant to the plan;
- (f) To any customer, other than a broker or dealer, to temporarily finance the purchase or sale of securities for prompt deliver, if the credit is to be repaid in the ordinary course of

business upon completion of the transaction;

(g) Against securities in transit, if the credit is not extended to enable the customer to pay for securities purchased in an account subject to Part 220 of this Chapter; or

(h) To enable a customer to meet emergency expenses not reasonably foreseeable, and if the extension of credit is supported by a statement executed by the customer and accepted and signed by an officer of the bank acting in good faith. For this purpose, emergency expenses include expenses arising from circumstances such as the death or disability of the customer, or some other change in circumstances involving extreme hardship, not reasonably foreseeable at the time the credit was extended. The opportunity to realize monetary gain or to avoid loss is not a "change in circumstances" for this purpose.

§ 221.7 Requirements for the list of OTC margin stocks.

(a) *Requirements for inclusion on the list.* Except as provided in paragraph (d) of this section, an OTC margin stock shall meet the following requirements:

(1) Four or more dealers stand willing to, and do in fact, make a market in such stock and regularly submit bona fide bids and offers to an automated quotations system for their own accounts;

(2) The minimum average bid price of such stock, as determined by the Board, is at least \$5 per share;

(3) The stock is registered under section 12 of the Act, is issued by an insurance company subject to section (12)(g)(2)(G) of the Act, is issued by a closed end investment management company subject to registration pursuant to section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8), is an American Depository Receipt (ADR) of a foreign issuer whose securities are registered under section 12 of the Act, or is a stock of an issuer required to file reports under section 15(d) of the Act;

(4) Daily quotations for both bid and asked prices for the stock are continuously available to the general public;

(5) The stock has been publicly traded for at least six months;

(6) The issuer had at least \$4 million of capital, surplus, and undivided profits;

(7) There are 400,000 or more shares of

such stock outstanding in addition to shares held beneficially by officers, directors or beneficial owners of more than 10 percent of the stock;

(8) There are 1,200 or more holders of record, as defined in SEC Rule 12g5-1 (17 CFR 240.12g5-1), of the stock who are not officers, directors or beneficial owners of ten percent or more of the stock, or the average daily trading volume of such a stock as determined by the Board, is at least 500 shares; and

(9) The issuer or a predecessor in interest has been in existence for at least three years.

(b) *Requirements for continued inclusion on the list.* Except as provided in paragraph (d) of this section, an OTC margin stock shall meet the following requirements:

(1) Three or more dealers stand willing to, and do in fact make a market in such stock and regularly submit bona fide bids and offers to an automated quotations system for their own accounts;

(2) The minimum average bid price of such stocks, as determined by the Board, is at least \$2 per share;

(3) The stock is registered as specified in paragraph (a)(3) of this section;

(4) Daily quotations for both bid and asked prices for the stock are continuously available to the general public;

(5) The issuer has at least \$1 million of capital, surplus, and undivided profits;

(6) There are 300,000 or more shares of such stock outstanding in addition to shares held beneficially by officers, directors, or beneficial owners of more than 10 percent of the stock; and

(7) There continue to be 800 or more holders of record, as defined in SEC Rule 12g5-1 (17 CFR 240.12g5-1), of the stock who are not officers, directors, or beneficial owners of ten percent or more of the stock, or the average daily trading volume of such stock, as determined by the Board, is at least 300 shares.

(c) *Removal from the list.* The Board shall periodically remove from the list any stock that:

(1) ceases to exist or of which the issuer ceases to exist, or

(2) no longer substantially meets the provisions of paragraph (b) of this section or § 221.2(j).

(d) *Discretionary authority of Board.* Without regard to the other paragraphs of this section, the Board may add to, or omit or remove from, the OTC margin stock list, any equity security, if in the judgment of the Board, such action is

necessary or appropriate in the public interest.

(e) *Unlawful representations.* It shall be unlawful for any bank to make, or cause to be made, any representation to the effect that the inclusion of a security on the list of OTC margin stocks is evidence that the Board or the SEC has in any way passed upon the merits of, or given approval to, such security or any transactions therein. Any statement in an advertisement or other similar communication containing a reference to the Board in connection with the list or

stocks on that list shall be an unlawful representation.

§ 221.8 Supplement, maximum loan value of margin stock and other collateral.

(a) *Maximum loan value of margin stock.* The maximum loan value of any margin stock except options is fifty per cent of its current market value.

(b) *Maximum loan value of nonmargin stock and all other collateral.* The maximum loan value of nonmargin stock

and all other collateral except puts, calls, or combinations thereof is their good faith loan value.

(c) *Maximum loan value of options.* Except for purposes of § 221.5(c)(10) of this part, puts, calls, and combinations thereof have no loan value.

By order of the Board of Governors of the Federal Reserve System, July 28, 1983.

William W. Wiles,
Secretary of the Board.

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