FEDERAL RESERVE BANK OF NEW YORK

[Circular No. **9965**
December 10, 1985]

PROPOSED INTERPRETATION OF REGULATION G

Purchase of Debt Securities to Finance Corporate Takeovers

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 issued for public comment an interpretation applying margin requirements to a limited class of transactions used to secure credit for the purpose of acquiring margin stock.

The proposed interpretation of Regulation G (Securities Credit by Persons Other Than Banks, Brokers or Dealers) affects a specific class of borrowing involving debt securities issued by a shell corporation that is used as an acquisition vehicle for purchasing the stock of the target company. The interpretation clarifies that debt securities issued by such a shell corporation are indirectly secured by the stock to be acquired and are thus subject to the margin regulations.

This conclusion is based on the fact that the shell corporation would have substantially no assets other than the margin stock of the company to be acquired and no significant business functions other than to hold the margin stock to facilitate an acquisition. This interpretation would only apply when there is no evidence that the stock is being secured in another manner, such as a guaranty by the parent of the shell corporation.

The proposed interpretation will impact only a limited class of borrowing transactions — those involving shell companies — that clearly come within the scope of the present regulations. No new interpretation has been proposed with respect to a broader class of transactions in which debt obligations are incurred by a company with other income and substantial assets.

Although a comment period is not required, the Board is allowing a short period of public comment on the proposed interpretation, ending on December 23, 1985, in order to provide full assurance of no unintended effects.

Presently, the Board has a 50 percent margin on margin stocks and convertible bonds. This means that a lender may extend credit for half the value of the stock to be purchased.

Attached is a copy of the proposed interpretation of Regulation G, together with an explanatory letter sent to members of Congress who asked the Board to look into the question of the use of below-investment-grade debt securities to finance takeovers. Subject to final review of the public comment, the interpretation will take effect for written contracts to extend credit entered into after December 31, 1985.

Enclosed — for banks and others extending securities credit in this District — is the text of the Board's proposal and a copy of a letter sent by the Board to the Congress regarding the use of debt securities to finance corporate takeovers and on the need for Federal margin regulations in general. Additional copies will be furnished upon request directed to our Circulars Division (Tel. No. 212-791-5216). Comments thereon should be submitted by December 23, 1985, and may be sent to our Regulations Division.

E. GERALD CORRIGAN,
President.

FEDERAL RESERVE SYSTEM

12 CFR Part 207

[Regulation G; Docket No. R-0562]

SECURITIES CREDIT BY PERSONS OTHER THAN BANKS, BROKERS, OR DEALERS

Purchase of Debt Securities to Finance Corporate Takeovers

AGENCY: Board of Governors of the Federal Reserve System

ACTION: Proposed Interpretative Rule; request for comment.

SUMMARY: Questions have been raised as to whether the margin requirements in Regulation G apply to the purchase of debt securities that are issued to finance the acquisition of the margin stock of a target company by a shell corporation as part of a takeover attempt. Because this type of transaction clearly involves "purpose credit" as defined in Regulation G and does not involve any direct security agreement, the resolution of the issue turns on whether the purchaser of these securities would be viewed as a person extending credit "indirectly secured" by the margin stock. The Board has proposed an interpretation of Regulation G that concludes that this type of transaction does constitute an extension of credit that is "indirectly secured" by the target company's margin stock unless there is specific evidence, such as a guaranty by the parent of the shell corporation, that would lead to a contrary conclusion. The proposed interpretation further states that for purposes of the interpretation, there is no difference between privately placed and publicly distributed debt securities.

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The proposed interpretation declines to conclude that debt securities issued by an operating company with income and substantial assets should be presumed to be "indirectly secured" by the margin stock of the target company. In that circumstance, the proposal states that the purchasers of the debt securities may be relying on sources of repayment other than the margin stock for repayment of the credit.

While the proposed interpretation, which is intended to deal with a relatively limited factual situation, is not ordinarily a matter for public comment, in order to assure that there are no unanticipated effects of the proposed interpretation, the Board is providing a short period for public comment on the terms of the proposal. After consideration of the public comments, the Board intends to take final action with respect to this interpretation by December 31, 1985.

The proposed interpretation, if adopted, would not apply to written contracts to extend credit entered into prior to the effective date of the interpretation. See Federal Reserve Regulatory Service ¶ 5-306.

DATE: Comments must be received by December 23, 1985.

ADDRESS: All comments, which should refer to Docket No. R-0562, should be mailed to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th and Constitution Avenue, N.W., Washington, D.C. 20551, or should be delivered to the Office of the Secretary, Room 2200, Eccles Building, 20th and Constitution Avenue, N.W., between the hours

of 8:45 a.m. and 5:15 p.m. weekdays. Comments may be inspected in Room 1122, Eccles Building between 8:45 a.m. and 5:15 p.m. weekdays.

FOR FURTHER INFORMATION CONTACT: Laura Homer, Securities Credit Officer, Division of Banking Supervision and Regulation, (202) 452-2781; or James Michaels, Attorney, Legal Division, (202) 452-3582.

LISTS OF SUBJECTS IN 12 CFR PART 207: Credit, Margin, Margin requirements, Reporting and recordkeeping requirements, Securities.

Pursuant to the Board's authority under sections 7 and 23 of the Securities Exchange Act of 1934 as amended (15 U.S.C. 78g and w) the Board proposes to adopt the following interpretation and to amend 12 CFR 207 by adding a new § 207.112 to read as follows:

§ 207.112 -- Purchase of Debt Securities to Finance Corporate Takeovers

(a) Questions have been raised as to whether the margin requirements in Regulation G apply to the purchase of debt securities that are issued to finance the acquisition of stock of a target company as part of a takeover attempt.

(b) In some corporate takeovers financed by debt securities, the debt securities would be issued by a shell corporation that is an affiliate of the acquiring company. The

typical shell corporation has virtually no operations, and no significant business function other than to acquire and hold stock of a target company. The shell vehicle would use the proceeds of the debt securities to finance a tender offer for the stock of the target company, which typically is margin stock. If the tender offer is successful, the shell corporation seeks to merge with the target company.

(c) Where the stock of the target company is margin stock (as defined in section 207.2(i)), the purchase of the debt securities issued to finance the acquisition clearly involves "purpose credit" (as defined in section 207.2(l)). In addition, such debt securities typically are purchased only by sophisticated investors in very large minimum denominations, so that the purchasers may be "lenders" for purposes of Regulation G. See 12 C.F.R. § 207.2(h). Since the debt securities typically contain no direct security agreement involving the margin stock, applicability of the lending restrictions of the Regulation turns on whether the arrangement constitutes an extension of credit that is secured indirectly by margin stock.

(d) As the Board has recognized, "indirect security" can encompass a wide variety of arrangements between lenders and borrowers with respect to margin stock collateral that serve to protect the lenders' interest in assuring that a credit is repaid where the lenders do not have a conventional

direct security interest in the collateral. See 12 C.F.R. § 221.113. However, a credit is not indirectly secured by margin stock if the lender in good faith has not relied on the margin stock as collateral in extending or maintaining credit. See 12 C.F.R. § 207.2(f)(2)(iv).

(e) The Board is of the view that, in the situation described above, the debt securities would be indirectly secured by the margin stock to be acquired by the shell acquisition vehicle. The staff has expressed the view that nominally unsecured credit extended to an investment company, a substantial portion of whose assets consist of margin stock, is indirectly secured by the margin stock. See Federal Reserve Regulatory Service ¶ 5-917.12. This opinion notes that the investment company has substantially no assets other than margin stock to support indebtedness and thus credit could not be extended to such a company in good faith without reliance on the margin stock.

(f) The Board believes that this rationale applies to the debt securities issued by the shell acquisition vehicle described above. At the time the debt securities are issued, the shell corporation has substantially no assets to support the credit other than the margin stock that it has acquired or intends to acquire and has no significant business function other than to hold the stock of the target company in order to facilitate the acquisition. Moreover, it is possible that the

shell may hold the margin stock for a significant and indefinite period of time, if defensive measures by the target prevent consummation of the acquistion. Because of the difficulty in predicting the outcome of a contested takeover at the time that credit is extended to the shell corporation, the Board believes that the purchasers of the debt securities could not, in good faith, lend without reliance on the margin stock. The presumption that the credit is indirectly secured by margin stock in these circumstances would not apply if there is additional, specific evidence that lenders could in good faith rely on other assets to support the credit, such as a guaranty by the shell's parent company that has substantial non-margin stock assets.

(g) The Board's conclusion is also supported by the fact that in these circumstances there is a practical restriction on the ability of a shell corporation to dispose of the margin stock of the target company. "Indirectly secured" is defined in section 207.2(f) of the regulation to include any arrangement under which 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. The purchasers of debt securities issued by a shell acquisition vehicle to finance a takeover attempt clearly understand that the shell intends to acquire the margin stock of the target company in order to effect the acquisition of that company. This understanding represents a practical

restriction on the ability of the shell corporation to dispose of the target's margin stock and to acquire other assets with the proceeds of the credit.

(h) In addition, questions have been raised as to whether the margin regulations would apply where an operating company, rather than a shell acquisition vehicle, issues debt securities to finance the acquisition of margin stock of a particular company. The Board is of the opinion that in this context, these debt securities, as a general matter, should not necessarily be presumed to be "indirectly secured" by the margin stock of the target company. A borrowing company with business operations would ordinarily have income and substantial assets, without regard to the target's stock, and therefore the purchasers may be relying on sources of repayment other than the target's stock for repayment of the credit. The circumstances of a particular transaction, however, may provide specific evidence, in accordance with 12 C.F.R. § 207.2(f)(1), that a lender has relied upon the margin stock as collateral.

(i) For purposes of this interpretation, the Board does not recognize any difference between privately placed and publicly distributed debt securities. Any credit provided through the purchase of debt securities issued by a shell acquisition vehicle to facilitate a corporate takeover, that is in excess of the threshold levels specified in Regulation G,

may require that the purchaser register as a Regulation G lender and that the credit comply with the conditions and limitations of the Regulation.

Board of Governors of the Federal Reserve System, December 6, 1985.

William W. Wiles
Secretary of the Board

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

PAUL A. VOLCKER
CHAIRMAN

December 6, 1985

Dear Senator :

This is in response to your letter dated October 1, 1985, concerning the use of debt securities to finance the acquisition of stock as part of a corporate takeover attempt. Your letter expresses concern about the growth of debt security-financed takeover attempts and their effect on the economy and financial system. You request that the Board use its authority under section 7 of the Securities Exchange Act of 1934 to restrict the use of such debt securities in connection with the financing of corporate takeovers, either by interpreting existing margin rules or by adopting additional specific rules to deal with this matter.

Many of the issues raised in your letter have also been raised in petitions filed with the Board by corporations that are targets of hostile takeover attempts financed in large part by below-investment-grade debt securities. These petitions have requested the Board to find that the lending restrictions contained in the Board's Regulation G apply to debt securities that are issued by a shell corporation set up by the acquiring firm to effect the acquisition or that are issued by the acquiring firm in amounts that greatly exceed its net worth.

The lending restrictions in the Board's Regulation G apply to credit extended by a lender (other than a bank or a broker/dealer) for the purpose of buying margin stock where the credit is directly or indirectly secured by margin stock. Typically, debt securities issued in connection with the acquisition of a target company's stock are purchased in large minimum denominations by large commercial firms and other sophisticated purchasers that may be lenders for purposes of Regulation G. Such transactions clearly involve "purpose credit" as defined in the Regulation. Since such securities

typically are not directly secured by margin stock or other collateral, the lending restrictions in Regulation G would apply only if the credit extended by the purchasers of the debt securities is indirectly secured by the margin stock.

The Board has considered the applicability of the margin rules to the purchase of debt securities to finance takeover attempts and has proposed an interpretation of the existing regulation, a copy of which is enclosed for your convenience. While public comment on such an interpretation is not required and would normally not be expected, particularly in the light of the limited application of the interpretation, in this instance in order to provide full assurance of no unintended effects, the Board is allowing a short period of public comment, ending on December 23, 1985. Subject to final review after such comment, the interpretation will take effect for written contracts to extend credit entered into after December 31, 1985.

The interpretation states that, absent compelling evidence to the contrary, one limited class of transactions are subject to margin requirements. That class involves only those debt securities issued by a shell corporation that is used as an acquisition vehicle in the context of a corporate takeover. Such debt securities are indirectly secured by the stock to be acquired and thus subject to the restrictions of the margin regulations.

This conclusion is based on the fact that the shell corporation would have substantially no assets other than the margin stock of the company to be acquired and no significant business function other than to hold the margin stock to facilitate the acquisition of the target company. Therefore, loans to such companies cannot, in good faith, be made without reliance on the stock as security. The interpretation is also supported by the fact that there is a practical restriction on the shell corporation's ability to dispose of the margin stock acquired in light of the clear understanding of the lenders that the proceeds of the credit will be used by the shell corporation to acquire sufficient margin stock to control a particular target company. The presumption that the borrowing was indirectly secured in these circumstances would not apply if there is additional, specific evidence that lenders could in good faith rely on other assets to support the credit, such as a guaranty by the shell's parent company that has substantial non-margin stock assets.

In considering this interpretation, the Board recognized that more commonly takeovers financed with debt

securities do not entail use of a shell corporation. Instead, the debt is issued by a company engaged in an ongoing business and having substantial assets other than margin stock. The Board has considered the applicability of the margin rules to such debt securities and is of the opinion that the purchase of these debt securities should not be presumed to be "indirectly secured" by the margin stock of the company to be acquired. Since the borrowing company ordinarily would have income and substantial assets in addition to the margin stock to be acquired, the purchasers of the debt securities should not be presumed to be relying solely on the margin stock as the source of repayment of the credit.

Thus, the proposed interpretation will impact only a limited class of borrowing transactions -- those involving shell companies -- that appear quite clearly to come within the scope of the present regulations. On the other hand, the Board did not conclude that a broader class of transactions fall within the margin regulations -- those where the debt obligation is that of a borrowing company with income and substantial assets. The Board believes it is not possible to establish a presumption that such a company's borrowings are indirectly secured by the margin stock. Accordingly, the interpretation which the Board has proposed deals with one limited financing technique, and would not affect borrowing by other methods to accomplish merger or acquisition transactions.

More generally, earlier this year the Board testified before Congress regarding the effect of the recent increase in merger and takeover activity on the credit markets. The Board expressed its concern about debt-financed acquisition activity and indicated its intent to continue to monitor merger and takeover activity and its effects on the financial markets. The Board does share your concern about the broad movement toward higher leverage, because of the implied reduction in the financial strength of business firms. Margin regulations do not appear well adapted to dealing with the broader problem. However, I would point out that, among other factors, present provisions of the tax code do greatly favor the use of debt rather than equity instruments, and could be addressed directly.

I should also note in a letter to various members of Congress dated January 11, 1985, a copy of which is enclosed for your convenient reference, the Board stated that there are at present serious questions as to the need for continuing federal regulation to further the objectives originally sought by Congress when it enacted section 7 of the Securities Exchange Act of 1934. The current takeover controversy points up the need for Congressional reexamination of those goals in

light of the structural and technological changes that have occurred in financial markets in the past 50 years.

Two members of the Board dissented from this interpretation, specifically noting that margin requirements need to be reassessed as the appropriate means of carrying out the objectives that Congress has sought to achieve through these requirements and, accordingly, felt new interpretations of margin requirements were inappropriate at this time. Moreover, they noted that the approach adopted by the Board was also likely to be ineffective as a means of addressing problems associated with debt financing of takeovers in view of the variety of techniques that can and will be employed to finance corporate acquisitions and that fall outside the scope of the regulations. Finally, the dissenting members do not believe that the Board should presume that debt securities issued by a shell corporation in a corporate takeover are indirectly secured by the stock of the target company, since the purchasers of such securities may be relying on the income and assets of the target company, rather than its stock, for repayment of the debt.

Sincerely,

/s/ Paul A. Volcker

Enclosure

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

January 11, 1985

PAUL A. VOLCKER
CHAIRMAN

The Honorable Jesse Helms
Chairman
Committee on Agriculture, Nutrition
and Forestry
United States Senate
Washington, D. C. 20510

Dear Chairman Helms:

The Federal Reserve Board is pleased to submit for the consideration of the Congress the enclosed study, A Review and Evaluation of Federal Margin Regulation, that has been prepared by its staff.

The origins of this study can be traced to the April 1982 hearings of the Subcommittee on Telecommunications, Consumer Protection and Finance of the House Committee on Energy and Commerce, which focused on the reauthorization of the Commodity Futures Trading Commission (CFTC) and on associated legislation to resolve jurisdictional issues between that agency and the Securities and Exchange Commission (SEC). In those hearings, Governor J. Charles Partee, representing the Board, indicated that, in light of the development of new financial futures and options instruments, the Board intended to undertake a reassessment of federal margin regulation.

The enclosed study was started soon after the hearings and was well underway by late 1982 when the Congress, in the Futures Trading Act of 1982, directed the CFTC, SEC and Federal Reserve Board to conduct a study of the economic implication of futures and options markets, a study that was submitted to the Congress at the end of last year. In planning for the Congressionally mandated study, participating agencies decided that the Board's staff should carry through on the margin study it had in progress--supported by the input of other agencies--and that margin-related issues would not be addressed in the general study of futures and options markets. It was further agreed, however, that the study of margin regulation would be sent to the U.S. Treasury, the CFTC and the SEC to obtain their comments and recommendations before the study was submitted to the Congress. Letters sent to the Board from the agencies, presenting their comments, are attached to the study. The specific approaches proposed in this letter have not been reviewed by those agencies.

Chapter I of the study includes a summary of the major findings and also reviews alternative approaches that might be adopted with regard to the regulation of margins in securities and related markets. Later chapters examine in depth the range of issues pertaining to federal margin regulation. Consequently, this letter contains only a brief sketch of the considerations that led the Board to the recommendations set out below.

In the Securities Exchange Act of 1934, which directed the Federal Reserve to regulate margin arrangements in securities markets, the Congress sought three main objectives: (A) to constrain the diversion of credit into stock market speculation from uses in commerce, industry, and agriculture; (B) to protect unsophisticated investors; and (C) to forestall excessive price fluctuations in the stock market. A reading of the legislative history indicates that Congress was considerably less concerned about protecting brokers and other lenders against loss, because experience during the 1929 stock market crash, as well as in earlier periods of market strain, appeared to demonstrate that the providers of credit to finance securities purchases generally had followed practices that enabled them to avoid serious losses. An important point to be noted from this brief review is that the Federal Reserve, in endeavoring to achieve the objectives sought by the Congress, has always set initial margin requirements at levels higher than seemed necessary to provide brokers and other lenders adequate protection against loss.

After a review of the staff's analysis, the Board has concluded that high governmentally set margins are not needed to help achieve balance in the distribution of available credit. Credit-financed purchases of stock do not permanently absorb the savings of the economy (a point relating to objective A). The flows of funds in these transactions typically simply facilitate the transfer of ownership of existing corporate assets. If margin borrowings are large, there could be market frictions that could alter, in a marginal way, the flow of credit to different borrower groups, but the total availability of funds for real capital formation is not likely to be materially affected. In any event, the direct use of credit to finance stock portfolios has become much less important relative to the size of the economy and financial markets than it was in the early 1930s.

With regard to objective B, the Board has concluded that the relatively high margin requirements that result from

federal margin regulation do have the desirable effect of providing protection for unsophisticated investors. However, there are alternative ways of investing or speculating in stocks, including obtaining unsecured credit or loans secured by assets other than stock, and trading in other financial instruments for which lower margins are required. In effect, margin requirements are avoided, to some degree, at greater cost and inconvenience. Uniform margin requirements also are uneven in the protection they provide in that the same margin ratio is required to acquire a stock whose price is highly volatile--and thus highly risky--as one whose price is relatively stable. In the face of these drawbacks and inefficiencies, the Board believes that it is preferable to rely on methods other than high federal margin requirements--including disclosure--to protect unsophisticated market participants.

In the Board's view, the study's findings also cast significant doubt on the need to retain high initial margins to prevent excessive fluctuations of stock prices. This conclusion is based on the study's review of the results of a considerable volume of research carried out by financial analysts and economists over the past 30 years or so. In particular, evidence presented in the study suggests that credit-financed trading does not have an important influence on the behavior of stock prices. This appears to be an implication of the fact that over the past 50 years, when margin requirements have been relatively high and the volume of margin credit outstanding relatively low, the amplitude of fluctuations in stock prices has not differed greatly from that recorded before the imposition of federal margin regulation, with the exception of the late 1920s. The character of the stock market also has changed, in that institutions that do not trade on margin are now a much larger factor. And the call loan market no longer serves, as it did in the 1920s and before, as a place where banks and corporations maintain a substantial portion of their liquidity reserves. Thus, abrupt shifts in liquidity needs do not appear to have the same potential for causing problems for the stock market during times of financial strain.

To sum up, the analysis presented in the staff study raises serious doubts as to the need for continuing federal regulation to foster the objectives originally sought by the Congress in passing this legislation. In the Board's view, the primary purpose of margin regulation today should be to ensure the integrity of the marketplace, in large part by seeing that there are adequate protections against significant credit loss for brokers, banks, and other lenders.

There is, however, another consideration that needs to be taken into account. Stock-based futures and options contracts can serve as close substitutes for establishing leveraged positions in common stocks for some important purposes. Moreover, markets for these "derivative" instruments are tightly linked with the underlying cash market for stocks by the activities of arbitrageurs. Consequently, it would appear that considerations of competitive equity and of establishing a logically consistent structure of regulation would point to the desirability of margins on the cash market and on these "derivative" instruments being in closer alignment. Thus, if high margins were to continue to be required in the cash market, it would seem appropriate to raise margins in these "derivative" markets by a significant amount. At some point, the imposition of markedly higher margins in these latter markets might well adversely affect their trading volume and liquidity, with adverse implications for the useful economic functions that were discussed in the inter-agency study of futures and options. But, should requirements on "derivative" instruments remain at or near their current levels, competitive considerations point toward significantly lower requirements for the cash markets.

For the above reasons, the Board has concluded that, except in extraordinary circumstances, there no longer remains sufficient justification for maintaining securities margins at levels substantially higher than needed to protect brokers and other lenders against loss from customer default. Accordingly, the Board recommends that the Congress give serious consideration to adopting a new approach toward margin regulation. One such approach might be to repeal existing regulation, effectively turning over responsibility for setting margins to the members of the various securities exchanges and other institutions that make margin loans. As previously noted, past experience suggests that such entities, independently or through self-regulatory organizations, generally have maintained margins adequate to protect themselves against loss, and in extraordinary circumstances they could be raised.

In the Board's view, however, a preferable approach would be for the Congress to amend existing legislation in a way that, while assigning authority for setting margins specifically to the various self-regulatory organizations (SROs), would encourage the organizations to coordinate their margin-setting activities to ensure that the structure of margin requirements established is consistent with maintaining the safety of the

marketplace and avoiding unreasonable and unnecessary competitive advantages. The legislation might also require that banks, savings and loans, and other lenders not extend securities credit on terms more favorable than those permitted by the SROs.

Conceivably, the above arrangement might be carried out without the involvement of any federal agency. In the Board's view, however, such coordination would be difficult to achieve, and would risk a "least common denominator" approach, without some element of federal oversight of the process. Such involvement could be carried out by a council of federal agencies whose responsibility mainly would be to monitor the actions of the SROs. The council should have the power to veto actions being taken by the SROs, should it deem that appropriate. Beyond mere notification, however, it does not seem necessary that the SROs be required to obtain the council's prior approval before changing margin arrangements. In addition to this responsibility, it may be desirable to assign to the council standby powers that would allow it to step in and take appropriate actions in the event that coordinating efforts of SROs fail or of any unforeseen emergency.

If the Congress were to decide to establish such a council, it would seem clear that the CFTC and the SEC, given their close involvement in the day-to-day workings of the markets and their responsibilities for establishing and overseeing the general regulatory framework in place in these markets, should be members of the council. Most certainly it would seem appropriate to assign these agencies the responsibility for the day-to-day monitoring of the cooperative actions of the SROs. There would seem clear advantages to be gained, however, if one other agency were designated to sit on the council. A third agency would provide a tie-breaking vote and thus tend to foster expeditious decision-making. Still another reason for a third member would be that a substantial amount of securities credit is provided by banks and other lenders not subject to the jurisdiction of the various exchanges and the SEC and CFTC, so that a bank regulatory agency could add a needed element of expertise to the council's deliberations. Given the Federal Reserve's long experience in regulating margins, it is a logical candidate to serve in this capacity. However, consideration could be given to assigning the function to the U.S. Treasury, which also has broad responsibility in the financial sphere.

Sincerely,

Paul A Volcker

Enclosure