

FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 10236
May 3, 1988]

MARGIN CREDIT ON FOREIGN SOVEREIGN DEBT SECURITIES

Proposed Amendment to Regulation T
Comment Invited by May 27

*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 a proposed amendment to Regulation T (Credit by Brokers and Dealers) to make certain foreign sovereign debt securities marginable.

The proposed amendment to Regulation T would permit brokers and dealers to extend "good faith" loan value on long-term debt securities issued or guaranteed as a general obligation by a foreign sovereign, its provinces or states, or a supranational entity if there is available an explicit or implicit rating in one of the two highest rating categories by a nationally recognized statistical rating organization.

Comment should be submitted to the Board by May 27, 1988.

Printed below is the text of the Board's proposal, as published in the *Federal Register* of April 26. Comments thereon should be submitted by May 27 either to the Board, as indicated in the notice, or to our Compliance Examinations Department.

E. GERALD CORRIGAN,
President.

FEDERAL RESERVE SYSTEM

12 CFR Part 220

[Docket No. R-0633]

**Regulation T; Credit by Brokers and
Dealers; Foreign Sovereign Debt
Securities**

AGENCY: Board of Governors of the
Federal Reserve System.

ACTION: Proposed rule.

SUMMARY: The Board is proposing for
public comment an amendment to

Regulation T that will permit broker-dealers to extend good faith loan value on long-term debt securities issued or guaranteed by a foreign sovereign, its provinces or states, or a supranational entity if there is available an explicit or implicit rating in one of the two highest rating categories by a nationally recognized statistical rating organization.

DATE: Comments should be received on or before May 27, 1988.

ADDRESS: Comments, which should refer to Docket No. R-0633, may be mailed to Mr. William W. Wiles, Secretary, Board

of Governors of the Federal Reserve System, 20th Street and Constitution Avenue NW., Washington, DC 20551, or delivered at the C Street Entrance between 8:45 a.m. and 5:15 p.m. weekdays to Room B-2223. Comments may be inspected in Room B-1122 between 8:45 a.m. and 5:15 p.m. weekdays.

FOR FURTHER INFORMATION CONTACT: Laura Homer, Securities Credit Officer, or Scott Holz, Attorney, Division of Banking Supervision and Regulation, (202) 452-2781. For the hearing impaired only, Telecommunications Service for

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the Deaf, Earnestine Hill or Dorothea Thompson, (202) 452-3544.

SUPPLEMENTARY INFORMATION: The Board has received requests from two major broker-dealers to expand the definition of "OTC margin bond" in Regulation T to include long-term nonconvertible debt securities issued or guaranteed by foreign sovereigns, their provinces or states, or supranational entities. While these securities are currently eligible for "good faith loan value" at banks, foreign broker-dealers, and other lenders, U.S. broker-dealers are unable to extend any credit on these instruments unless they are registered with the Securities and Exchange Commission or the customer pledges that the borrowed funds will not be used to purchase or carry securities.

The provisions of the definition of "OTC margin bond" that currently preclude marginability for most foreign sovereign debt securities are the requirements that the securities have been issued in an offering registered under the Securities Act of 1933 and that the issuer file reports under the Securities Exchange Act of 1934. Last year the Board amended the definition of OTC margin bond to include any "mortgage related security" as defined in the Secondary Mortgage Market Enhancement Act of 1984. The amendment had the effect of making privately placed mortgage related securities eligible for good faith loan value at broker-dealers. This was the first time nonexempt securities not registered with the SEC were allowed as collateral for securities-related loans at broker-dealers. Congress' definition of mortgage related security includes a requirement that the security be rated in one of the two highest rating categories by a nationally recognized statistical rating organization. The current proposal contemplates marginability only where a similarly high explicit or implicit rating is available.

A discussion of the terms used in the proposed amendment follows:

Implicit ratings. Issues, not issuers, are rated. Part of the review of a private issue involves the evaluation of the country's creditworthiness, with the sovereign's evaluation providing a ceiling for any issuer resident in that country. Therefore, if any private issuer

in a country is rated in the highest rating category, the sovereign must also be rated in the highest rating category. This is known as an "implicit" rating of the sovereign.

Supranational entities.

"Supranational entity" is generally understood to mean an institution organized for a specific purpose by two or more sovereign governments. The long-term debt securities of some supranational entities, such as the International Bank for Reconstruction and Development (the World Bank), the Inter-American Development Bank, African Development Bank, and Asian Development Bank are exempted securities for purposes of the Securities Exchange Act of 1934 and therefore already marginable on a good faith basis. Other supranationals would be treated the same as foreign sovereigns under this proposal. The Board has previously published a list of exempt foreign, international, and supranational entities in connection with time deposits under Regulation D (see 12 CFR 204.125; FRRS 2-280). Supranationals named in this list, as well as other supranational entities including the Nordic Investment Bank and Eurofima, will be covered by the proposed amendment. Guidance from the Board or its staff should be sought as to the eligibility of other supranational entities.

Nationally recognized statistical rating organizations. At the present time, the SEC considers the following organizations to be "nationally recognized statistical rating organizations": Duff and Phelps, Inc.; Fitch Investors Services, Inc.; Moody's Investors Services, Inc.; McCarthy, Crisanti & Maffei; and Standard & Poor's Corporation (see Securities Exchange Act Release No. 34-2448 (May 5, 1987) at n. 2). These five organizations, however, are not all involved in rating foreign issues.

Long-term debt. "Long-term debt" is understood to mean having an original maturity date more than 365 days from the date of issuance.

Regulatory Flexibility Act

The Board believes there will be no significant economic impact on a substantial number of small entities if this proposal is adopted. Comments are

invited on this statement.

Paperwork Reduction Act

No additional reporting requirements or modification to existing reporting requirements are proposed.

List of Subjects in 12 CFR Part 220

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

For the reasons set out in this Notice, and pursuant to the Board's authority under 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 proposes to amend 12 CFR Part 220 as follows:

PART 220—[AMENDED]

1. The authority citation for Part 220 continues to read as follows:

Authority: 15 U.S.C. 78c, 78g, 78h, 78q, and 78w.

2. A new paragraph (r)(4) is proposed to be added to § 220.2 as follows:

§ 220.2 Definitions.

* * * * *

(r) "OTC margin bond" means: * * *

(4) A debt security issued or guaranteed as a general obligation by the government of a foreign country, its provinces or states, or a supranational entity, if at the time of the extension of credit one of the following is rated in one of the two highest rating categories by a nationally recognized statistical rating organization:

- (i) the issue,
 - (ii) the issuer or guarantor (implicitly),
- or
- (iii) other outstanding unsecured long-term debt securities issued or guaranteed by the government or entity.
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Board of Governors of the Federal Reserve System, April 20, 1988.

William W. Wiles,

Secretary of the Board.

[FR Doc. 88-9068 Filed 4-25-88; 8:45 am]

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