

**FEDERAL RESERVE BANK
OF NEW YORK**

[Circular No. **10313**
October 24, 1989]

PROPOSED AMENDMENTS TO REGULATION T
Comment Invited by November 30 on Marginability of Foreign Securities

*To All Banks, Brokers and Dealers, and Others 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 proposed amendments to Regulation T (Credit by Brokers and Dealers) to accommodate the settlement and clearance of transactions in foreign securities and to permit marginability at broker-dealers for foreign securities.

Comments must be submitted to the Board by November 30, 1989.

The proposed amendments are the result of a request from the Securities Industry Association (SIA) to recognize the fact that securities markets have become global.

The amendments would:

- permit foreign "world-class" equity and debt securities to be eligible for margin at broker-dealers on the same basis as margin securities;
- permit recognition and isolation of debt denominated in foreign currencies and allow the foreign world-class securities denominated in that currency to be used as margin for the debt without conversion into dollars;
- ease restrictions on payment and settlement for foreign securities to accommodate the practices of the market where the trade occurs; and
- allow a broker-dealer subject to Regulation T to arrange credit on non-United States securities.

Foreign equity securities would be eligible for margin treatment upon certification that they meet the following criteria:

- listing on an exchange outside the United States;
- continuous availability from that exchange to U.S. creditors of quotations of both bid and asked or last sale prices through an electronic quotation system;
- an aggregate market value for the security of at least \$1 billion;
- a tradeable float of at least 1 million shares;
- an average weekly trading volume of either at least 200,000 shares or the equivalent of \$1 million; and
- the existence of the issuer or a predecessor in interest for at least five years.

The proposal would also make foreign corporate debt securities marginable if the original issue had outstanding a principal amount of \$100 million, the issue is not in default on interest or principal payments, and the issue is rated in one of the two highest rating categories by a nationally recognized statistical rating service.

Comment is also sought as to whether additional or alternative criteria should be adopted to determine the eligibility of specific issues of foreign equity and debt securities.

Printed on the following pages is the text of the Board's proposal, as published in the *Federal Register* of October 10. Comments thereon should be submitted by November 30 and sent to the Board, as indicated in the notice, or to our Compliance Examinations Department.

E. GERALD CORRIGAN,
President.

Proposed Rules

Federal Register

Vol. 54, No. 194

Tuesday, October 10, 1989

This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

FEDERAL RESERVE SYSTEM

12 CFR Part 220

[Regulation T; Docket No. R-0675]

RIN: 7100-AA72

Credit by Brokers and Dealers; Accommodation of Settlement and Clearance of Foreign Securities

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Proposed rule.

SUMMARY: The Board is proposing for public comment amendments to Regulation T to accommodate the increasing internationalization of the securities markets. The amendments, suggested by the Securities Industry Association (SIA), would: (1) Permit foreign "world-class" equity and debt securities to be eligible for margin at broker-dealers on the same basis as margin securities; (2) permit recognition and isolation of debt denominated in foreign currencies and allow the foreign world-class securities denominated in that currency to be used as margin for the debt without conversion into dollars; (3) ease restrictions on payment and settlement for foreign securities to accommodate the practices of the market where the trade occurs; and (4) allow a broker-dealer subject to Regulation T to arrange credit on non-United States securities.

DATE: Comments should be received on or before November 30, 1989.

ADDRESS: Comments, which should refer to Docket R-0675, may be mailed to Mr. William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th Street & 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 the Deaf, Earnestine Hill or Dorothea Thompson, (202) 452-3544.

SUPPLEMENTARY INFORMATION:

I. Marginability of Certain Foreign Securities

At present many foreign equity securities are marginable directly, through trading on national securities exchanges or on NASDAQ, or indirectly, through the use of American Depositary Receipts (ADRs). All of these foreign securities are priced in dollars for trading purposes. This proposal contemplates adding a limited number of foreign equity securities as eligible for margin credit. Any security to be placed on a list to be published by the Board must be certified by a U.S. self-regulatory organization (SRO), such as the New York Stock Exchange (NYSE), which has adopted procedures for determining eligibility that have been approved by the Board. The NYSE has agreed to consider the adoption of such procedures. The securities would be designated "world-class" securities. In general, the eligibility requirements, as proposed by the SIA and modified by the Board, include listing on a securities exchange outside the United States for at least six months; continuous availability from that exchange to U.S. creditors of quotations of both bid and asked or last sale prices through an electronic quotation system; an aggregate market value for the shares of \$1 billion; a tradeable float of 1 million shares; an average weekly trading volume of either 200,000 shares or the equivalent of \$1,000,000; and the existence of the issuer or a predecessor in interest for at least five years. Lower standards for market value and trading volume criteria would be permitted for retention on the list. Comment is requested on additional or alternate criteria for determining the eligibility of both foreign securities exchanges and specific issues of securities.

The proposal would also make foreign corporate debt securities marginable if the original issue had outstanding a principal amount of at least \$100,000,000, the issue is not in default on interest or principal payments, and the issue is rated in one of the two highest rating categories by a nationally recognized

statistical rating service. The proposal also provides for the marginability of foreign debt unrated at the effective date of the proposed rule if a subsequent unsecured debt issue of at least \$100,000,000 of the same issuer receives the required high rating. The SEC presently recognizes five statistical rating organizations: Duff and Phelps; Fitch Investor Services; Moody's Investor Services; McCarthy, Crisanti & Maffei; and Standard & Poor's. Comment is requested on alternate criteria for marginability of foreign corporate debt securities.

II. Use of Foreign Currency

The present regulation requires, in relevant part, that all debits and credits be expressed in dollars. Loan value of securities denominated in other currencies must be translated into dollars when they are used to contribute loan value in a margin account. If payment for a margin call is received in foreign currency, it must be converted into dollars before deposit into the margin account. Under the proposal, "dollars only" accounting would no longer be required and foreign currency could be deposited and maintained in a margin account. By the use of a subaccount or other methods of record-keeping in the margin account, the proposal would permit separate computations for all debits denominated in a specific foreign currency and secured by separately identified foreign world-class securities denominated in that currency. Under the current practice of denominating all transactions in dollars, an increase in the value of any collateral can be applied to any other securities transactions in the margin account. By insulating transactions denominated in foreign currencies, the proposal contemplates that no equity for Regulation T purposes could be realized from this foreign currency or foreign-currency-denominated security against dollar deficiencies or deficiencies in other foreign currencies. However, the proposal should not prevent the combination of the foreign and dollar currency positions for maintenance rules of the SROs. In addition, the segregation of all transactions in foreign marginable securities and attendant debt would be optional. The current practice of denominating all transactions and debt in dollars in the margin account would still be available. The SIA proposal also

provides that foreign currency held in a bank account under the creditor's control could offset a debit or requirement denominated in such foreign currency. While the Board believes there should be no barrier to this procedure, the specific provision proposed by the SIA to clarify that foreign currency so held can be given value to reduce a foreign currency debit or requirement is not being proposed as the Board believes it is implicit in the regulatory language that is being proposed.

III. Settlement

There is a wide variety of settlement times and procedures throughout the financial markets of the world. In the United States the usual time for settling trades in equity securities under exchange rules is five business days. However, there are other settlement periods provided for trades in government securities and futures products. In the United Kingdom there is fortnightly settlement. In France a batch settlement system is used, with all trades on or after the beginning date of the month's settlement period due no later than the beginning date of the next month's published settlement date. Transactions on the Brussels Stock Exchange in Belgium are settled in a manner similar to the procedure in France. Most Japanese transactions settle on the third business day after execution.

An existing provision in Regulation T for cash transactions permits up to 35 days for settlement in a delivery against payment (DVP) system if the extra time is required because of the mechanics of the trade and is not related to the purchaser's willingness or ability to pay. This proposal contemplates cash settlement of all foreign securities transactions in a foreign market on the earlier of the date required by rules of a competent authority over that market or 35 days from trade date (which is the outside time for settlement in DVP transactions). It is expected that this proposal will accommodate the shortening of settlement periods for cash transactions (as has been suggested by most commenters in light of the implicit risks in the widely varying systems now in place in the world) without further amendment to the rule.

IV. Arranging

The "arranging" section of Regulation T, with several exceptions, prohibits a broker-dealer from arranging credit unless it is credit that the broker-dealer can itself extend. Since most foreign securities are not "margin securities" on

which a broker-dealer can extend or maintain credit, U.S. brokers and their overseas branches are prevented from assisting U.S. and foreign customers in obtaining any credit for their purchase. Because the securities are non-U.S. securities a borrower is not regulated under Regulation X as to the amount of credit he or she can obtain from foreign broker-dealers or foreign banks. In addition, U.S. banks are free to lend a "good faith" amount on these non-margin securities and can also arrange the credit. United States brokers are thus competitively disadvantaged in serving customers who might wish to borrow. The proposal would permit broker-dealers to arrange credit for any customer with a foreign lender to purchase non-U.S. securities. While the SIA proposed placing on U.S. broker-dealers the burden of ascertaining the legality of the credit being extended abroad, the Board believes this is a responsibility that the foreign lender will meet.

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—CREDIT BY BROKERS AND DEALERS

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

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

2. In § 220.2, "or" is removed at the end of paragraph (o)(4); the period is removed at the end of paragraph (o)(5) and "; or" is added; and new paragraphs (o)(6), (r)(5), and (z) are added to read as follows:

§ 220.2 Definitions.

* * * * *

(o) "Margin security" means:

* * * * *

(6) Any world-class security.

* * * * *

(r) "OTC margin bond" means:

* * * * *

(5) A foreign debt security that meets all of the following requirements:

(i) At the time of original issue, a principal amount of at least \$100,000,000 was outstanding;

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

(iii) At the time of the extension of credit, the issue is rated in one of the two highest rating categories by a nationally recognized statistical rating organization, except that an issue that has not been rated as of the effective date of this provision shall be considered an "OTC margin bond" if a subsequent unsecured issue of at least \$100,000,000 of the same issuer is rated in one of the two highest rating categories by a nationally recognized statistical rating organization.

* * * * *

(z) "World-class security" means:

(1) An equity security that is neither a registered security nor an OTC margin stock and that appears on the Board's periodically published List of Marginable Foreign Stocks, based on a certification by a self-regulatory organization under procedures approved by the Board; or

(2) A debt security convertible into an equity security that appears on the Board's List of Marginable Foreign Stocks.

3. In § 220.4, a new sentence is added to the end of paragraph (c)(1) to read as follows:

§ 220.4 Margin account.

* * * * *

(c) When additional margin is required—(1) Computing deficiency. * * * To the extent that debits in a margin account are denominated in foreign currency secured by specifically identified foreign margin securities as provided in section 220.5(g), each foreign currency debit position shall be considered separately for purposes of computing a deficiency and no credit shall be given to such specifically identified foreign margin securities for purposes of computing equity in the margin account either in United States dollars or in any other specific foreign currency.

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4. In § 220.5, a new paragraph (g) is added to read as follows:

§ 220.5 Margin account exceptions and special provisions.

(g) *Credit denominated in foreign currency.* A creditor may extend credit denominated in a foreign currency secured by foreign margin securities denominated or traded in the same foreign currency and specifically identified on the creditor's books and records as securing the foreign currency debit.

5. In § 220.8, paragraph (b)(1) introductory text is revised; paragraphs (b)(1) (i) through (iv) are redesignated as shown below:

Old paragraph designation	New paragraph designation
(i)	(A)
(ii)	(B)
(iii)	(C)
(iv)	(D)
(A)	(1)
(B)	(2)
(C)	(3)

and new paragraphs (b)(1)(i) and (b)(1)(ii) are added to read as follows:

§ 220.8 Cash account.

(b) *Time periods for payment; cancellation or liquidation—(1) Full cash payment.* A creditor shall obtain full cash payment for customer purchases—

(i) Within seven business days of the date:

(ii) In the case of purchase of a foreign security, on the earlier of:

(A) The date on which settlement is required to occur by the rules of the foreign securities exchange or the date by which local brokers and dealers in the foreign market are required to settle trades; or

(B) The maximum time permitted by this part for delivery against payment transactions.

6. In § 220.13, "or" is removed at the end of paragraphs (a) and (b); the period is removed at the end of paragraph (c) and "; or" is added; and new paragraph (d) is added to read as follows:

§ 220.13 Arranging for loans by others.

(d) Credit extended by a foreign person to purchase non-United States securities.

7. In § 220.17, the section heading and the headings to paragraphs (a) and (b) are revised; the reference to paragraph (d) in paragraphs (a) and (b) is changed to read paragraph (f); paragraphs (c), (d), and (e) are redesignated as paragraphs (e), (f), and (g) and revised; and new paragraphs (c) and (d) are added to read as follows:

§ 220.17 Requirements for lists of marginable OTC and foreign stocks.

(a) *Requirements for inclusion on the list of marginable OTC stocks.*

(b) *Requirements for continued inclusion on the list of marginable OTC stocks.*

(c) *Requirements for inclusion on the list of marginable foreign stocks.* Except as provided in paragraph (f) of this section, a marginable foreign stock shall meet the following requirements:

(1) The security is listed for trading on a foreign securities exchange and has been trading on such exchange for at least six months;

(2) Daily quotations for both bid and asked or last sale prices for the security provided by the foreign exchange on which the security is traded are continuously available to creditors in the United States pursuant to an electronic quotation system;

(3) The aggregate market value of shares, the ownership of which is unrestricted, is not less than \$1 billion;

(4) There are 1,000,000 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 shares outstanding;

(5) The average weekly trading volume of such security during the preceding six months is either at least 200,000 shares or \$1 million; and

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

(d) *Requirements for continued inclusion on the list of marginable foreign stocks.* Except as provided in

paragraph (f) of this section, a marginable foreign stock shall meet the following requirements:

(1) The security continues to meet the requirements specified in paragraphs (c) (1) and (2) of this section;

(2) The aggregate market value of shares, the ownership of which is unrestricted, is not less than \$500 million; and

(3) The average weekly trading volume of such security during the preceding six months is either at least 100,000 shares or \$500,000.

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

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

(2) No longer substantially meets the provisions of paragraphs (b) or (d) of this section or § 220.2(s).

(f) *Discretionary authority of Board.* Without regard to other paragraphs of this section, the Board may add to, or omit or remove from the lists of marginable OTC and foreign stocks any equity security, if in the judgment of the Board, such action is necessary or appropriate in the public interest.

(g) *Unlawful representations.* It shall be unlawful for any creditor to make, or cause to be made, any representation to the effect that the inclusion of a security on the lists of marginable OTC or foreign 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 lists or stocks on those lists shall be an unlawful representation.

8. In § 220.18, the phrase "or the percentage set by the regulatory authority where the trade occurs, whichever is greater" is added before the period at the end of paragraphs (a) and (b).

By order of the Board of Governors of the Federal Reserve System, September 29, 1989.
William W. Wiles,

Secretary of the Board.

[FR Doc. 89-23773 Filed 10-6-89; 8:45 am]

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