# FEDERAL RESERVE BANK OF NEW YORK

[ Circular No. **10366**
August 8, 1990 ]

## INTERPRETATION OF REGULATION T

### Clarification of SEC Rule 144A Regarding the Purchase and Sale of Debt 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 announced adoption of an interpretation on the applicability of Regulation T (Credit by Brokers and Dealers) to unregistered securities sold and traded pursuant to the Securities and Exchange Commission's new Rule 144A.
>
> The interpretation clarifies that broker-dealers may purchase debt securities from an issuer for resale pursuant to Rule 144A and may make markets in such securities under the investment banking service exception to the arranging section in Regulation T.
>
> The interpretation eliminates any uncertainty broker-dealers might have that their purchase of securities in compliance with Rule 144A could result in a violation of section 7(c) of the Securities Exchange Act of 1934 and Regulation T adopted under the Act.

Printed on the reverse side is the text of the Board's interpretation, which has been reprinted from the *Federal Register* of July 20. Questions on this matter may be directed to our Compliance Examinations Department (Tel. No. 212-720-8136).

E. GERALD CORRIGAN,
*President.*

(OVER)

12 CFR Part 220

[Regulation T; Docket No. R-0702]

## Application of the Arranging Section to Broker-Dealer Activities

**AGENCY:** Board of Governors of the Federal Reserve System.

**ACTION:** Interpretation.

**SUMMARY:** The Board is adopting an interpretation to clarify that broker-dealers may purchase debt securities from an issuer for resale pursuant to Securities and Exchange Commission Rule 144A (17 CFR 230.144A) and may make markets in such securities under the investment banking service exception to the arranging section in Regulation T (12 CFR 220.13). The interpretation is necessary to avoid frustrating the goals of the SEC in adopting Rule 144A. It will eliminate the uncertainty broker-dealers might have that compliance with the procedures laid out in Rule 144A could result in a violation of section 7(c) of the Securities Exchange Act of 1934 and Regulation T adopted thereunder (12 CFR part 220).

**EFFECTIVE DATE:** July 16, 1990.

**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:**

### Public Comment

The procedures of 5 U.S.C. 553(b) regarding notice, public comment, and deferred effective date were not followed in connection with this interpretation because such rulemaking procedures do not apply to interpretations.

### List of Subjects in 12 CFR Part 220

Banks, Banking, Brokers, Credit, Federal Reserve System, Investments, Margin, Margin requirements, National Market System (NMS Security), Reporting and recordkeeping requirements, Securities.

Under the Board's authority pursuant to sections 7 and 23 of the Securities and Exchange Act of 1934, as amended (15 U.S.C. 78g and 78w), 12 CFR part 220 is amended as follows:

## PART 220—CREDIT BY BROKERS AND DEALERS

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

**Authority:** Secs. 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).

2. Section 220.131 is added to read as follows:

**§ 220.131 Application of the arranging section to broker-dealer activities under SEC Rule 144A.**

(a) The Board has been asked whether the purchase by a broker-dealer of debt securities for resale in reliance on Rule 144A of the Securities and Exchange Commission (17 CFR 230.144A) [1] may be considered an arranging of credit permitted as an "investment banking service" under § 220.13(a) of Regulation T.

(b) SEC Rule 144A provides a safe harbor exemption from the registration requirements of the Securities Act of 1933 for resales of restricted securities to "qualified institutional buyers," as defined in the rule. In general, a "qualified institutional buyer" is an institutional investor that in the aggregate owns and invests on a discretionary basis at least $100 million in securities of issuers that are not affiliated with the buyer. Registered broker-dealers need only own and invest on a discretionary basis at least $10 million of securities in order to purchase as principal under the rule. Section 4(2) of the Securities Act of 1933 provides an exemption from the registration requirements for "transactions by an issuer not involving any public offering." Securities acquired in a transaction under section 4(2) cannot be resold without registration under the Act or an exemption therefrom. Rule 144A provides a safe harbor exemption for resales of such securities. Accordingly, broker-dealers that previously acted only as agents in intermediating between issuers and purchasers of privately-placed securities, due to the lack of such a safe harbor, now may purchase privately-placed securities from issuers as principal and resell such securities to "qualified institutional buyers" under Rule 144A.

(c) The Board has consistently treated the purchase of a privately-placed debt security as an extension of credit subject to the margin regulations. If the issuer uses the proceeds to buy securities, the purchase of the privately-placed debt security by a creditor represents an extension of "purpose credit" to the issuer. Section 7(c) of the Securities Exchange Act of 1934 prohibits the extension of purpose credit by a creditor if the credit is unsecured, secured by collateral other than securities, or secured by any security (other than an exempted security) in contravention of Federal Reserve regulations. If a debt security sold pursuant to Rule 144A represents purpose credit and is not properly collateralized by securities, the statute and Regulation T can be viewed as preventing the broker-dealer from taking the security into inventory in spite of the fact that the broker-dealer intends to immediately resell the debt security.

(d) Under § 220.13 of Regulation T, a creditor may arrange credit it cannot itself extend if the arrangement is an "investment banking service" and the credit does not violate Regulations G and U. Investment banking services are defined to include, but not be limited to, "underwritings, private placements, and advice and other services in connection with exchange offers, mergers, or acquisitions, except for underwritings that involve the public distribution of an equity security with installment or other deferred-payment provisions." To comply with Regulations G and U where the proceeds of debt securities sold under Rule 144A may be used to purchase or carry margin stock and the debt securities are secured in whole or in part, directly or indirectly by margin stock (see 12 CFR 207.2(f), 207.112, and 221.2(g)), the margin requirements of the regulations must be met.

(e) The SEC's objective in adopting Rule 144A is to achieve "a more liquid and efficient institutional resale market for unregistered securities." To further this objective, the Board believes it is appropriate for Regulation T purposes to characterize the participation of broker-dealers in this unique and limited market as an "investment banking service." The Board is therefore of the view that the purchase by a creditor of debt securities for resale pursuant to SEC Rule 144A may be considered an investment banking service under the arranging section of Regulation T. The market-making activities of broker-dealers who hold themselves out to other institutions as willing to buy and sell Rule 144A securities on a regular and continuous basis may also be considered an arranging of credit permissible under § 220.13(a) of Regulation T.

By order of the Board of Governors of the Federal Reserve System, July 16, 1990.

**William W. Wiles,**

*Secretary of the Board.*

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[1] Rule 144A, 17 CFR 230.144A, was originally published in the Federal Register at 55 FR 17933, April 30, 1990.