

FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 6108]
February 1, 1968]

Changes in Margin Regulations

To All Banks, Members of National Securities Exchanges,
and Others Interested, in the Second Federal Reserve District:

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

The Board of Governors of the Federal Reserve System announced today that it has adopted a number of changes to broaden the coverage of, and, in most respects, to tighten its regulations governing the use of credit in stock market transactions. These changes are based on proposals which were published for comment on October 20, 1967. Interested persons were asked to submit their comments in writing by November 20, 1967. The proposals have been revised extensively in the light of numerous comments received in response to the Board's invitation. As adopted, the changes will:

1. Extend the period in which a broker or dealer must obtain the customer's margin deposit on a margin transaction by one day, to five full business days after the transaction. This change will become effective on February 5, 1968. The purpose of this liberalizing proposal is to reduce the current pressures on bookkeeping departments of brokerage firms by insuring that a weekend will always be included in the period of time within which the deposit must be obtained.

The margin required on stock transactions remains unchanged at 70 per cent. This means in effect that anyone buying a \$100 stock on credit must deposit in his margin account at least \$70 in cash, or securities with an equivalent loan value.

2. Impose a new margin requirement on loans made by banks for the purpose of purchasing or carrying securities convertible into registered stock. This requirement will be set independently of the margin requirement for loans to purchase or carry registered stock, and is fixed initially at 50 per cent in recognition of the fact that convertible securities combine characteristics of both stocks and bonds. The same requirement applies to loans by brokers and dealers on registered convertible securities, instead of the present 70 per cent, but margin requirements are removed from loans they make on non-convertible bonds. In consequence, banks, brokers, and dealers will be on substantially the same footing in these respects.

The 50 per cent initial margin requirement applies to all new loans made after February 1, 1968 by banks, brokers and dealers, and other lenders. On loans made by banks between October 20, 1967 and February 1, 1968, a fully margined (50 per cent) status must be achieved by April 10, 1968; bank loans made *before* October 20, 1967 are not affected unless there have been subsequent substitutions of collateral or conversions into stock.

For all lenders—banks, brokers, and others—loans on convertibles that have a margin status below the prescribed 50 per cent will be subject to a 70 per cent "retention requirement": that is, 70 per cent of the proceeds from a sale of these securities will have to be retained to improve the status of the loan until it is margined at the full 50 per cent.

3. Require that non-convertible bonds and exempted securities (e.g., Government securities) on the one hand, and convertible securities on the other, be segregated in two new accounts, separate from the ordinary margin account, in which only stock may be held. The purpose of requiring separate accounts is to foreclose use of the "same-day-substitution" privilege to circumvent the retention requirement for accounts that are below the prescribed margin. Placing convertible securities in a separate account will also, it is believed, avoid some bookkeeping and other mechanical problems which would result from having in the same margin account securities with different loan values.

4. Require that collateral in special subscription accounts—that is, securities acquired by the exercise of subscription rights on the preferential 25 per cent initial margin presently allowed for such acquisitions—be brought into "fully margined" status by payments in four equal quarterly instalments. This provision, as adopted, requires that when a payment is not made, the bank, broker, or dealer sell enough collateral so that the remaining credit will be roughly in the same proportion to the collateral remaining in the account as if the payment had been made. As originally proposed, the

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changes would have required all the collateral in the account to be sold, and the loan paid off, if a payment were missed.

5. Introduce a new regulation (designated "Regulation G") to extend to other lenders margin requirements corresponding to those long applicable to brokers, dealers, and banks on credit extended for the purpose of purchasing or carrying registered equity securities.

The "other lenders" whose security loans are thus put on a corresponding footing with those of banks and brokers include the following: "factors," "collateral lenders," and others whose stock loans usually rise during periods when both margin requirements and stock market activity are high; insurance companies; tax-exempt organizations; credit unions; finance companies; those State-chartered savings and loan associations authorized to make such loans; and anyone acting as agent for a lender—foreign or domestic—in handling securities loans.

The new Regulation G does not apply to any credit extended before February 1, 1968, and persons extending credit in relatively small amounts will not be subject to its requirements. Only credit on registered equity securities (stocks and securities convertible into stock) will be subject to the regulation (as contrasted with the proposals, which applied to credit on all registered securities). Lenders extending more than \$50,000 in credit in any calendar quarter against registered equity securities, or whose loans against such securities amount to \$100,000 at any time during the quarter, must register with the Board by the end of the month following the close of the quarter. Margin requirements will apply to any loan made for the purpose of purchasing or carrying registered equity securities by a person subject to the registration requirement, and all registered lenders must file quarterly reports.

An exception from initial margin requirements is provided for credit extended by corporations to finance the exercise of stock purchase rights granted officers and employees under corporate plans that contain certain safeguards designed to make it less likely that the credit will be repaid with proceeds of the sale of the securities. Exceptions are also made for borrowing to finance plans of this kind, and for rights that were granted prior to February 1, 1968.

6. Require that banks and other persons performing certain services "as agent" for foreign and other stock market lenders obtain a signed statement from their principals to the effect that the activities of the principal conform to the applicable margin regulations. The agent may act in reliance on such a statement. A similar requirement has been inserted into Regulation T, as to services by brokers and dealers. Also, banks and other lenders will be forbidden to arrange for credit on lower margin than they can extend themselves; brokers and dealers have long been subject to this rule.

7. Require that banks and other lenders obtain from the borrower a signed statement of the purpose of any stock-secured loan, on a form prescribed by the Board, determine in good faith that the statement is correct, and sign it as so accepted. A false statement on the form may be punishable by fine or imprisonment. The forms will have to be kept in the records of the bank or lender for at least six years after the credit is extinguished. Loans by brokers and dealers are generally for the purpose of purchasing or carrying securities, and no statement of purpose is ordinarily required in connection with such loans.

In adopting the new provisions relating to convertible securities, the Board also published for comment a proposal to exempt from margin requirements loans made by banks to dealers to finance their market-making activities in convertible securities. If adopted, this exemption would become effective not later than March 11, 1968. Dealers who wish to be eligible for the exemption should begin to file reports promptly on Federal Reserve Form U-3, copies of which will be available from any Federal Reserve Bank. Information supplied on such reports will be accorded confidential treatment, in conformity with the Board's rules.

Margin requirements were established initially in October 1934, under authority Congress granted the Federal Reserve Board in the Securities Exchange Act of 1934 "for the purpose of preventing the excessive use of credit for the purchase or carrying of securities."

Under present law, margin requirements can be applied only to loans for the purpose of purchasing or carrying securities registered on a national securities exchange. The Reserve Board has, however, submitted to Congress a legislative proposal that would provide authority to apply margin regulations also to securities that are actively traded in the over-the-counter market.

Copies of the amended Regulations T and U and of the new Regulation G are in the process of being printed and will be sent to you as soon as they become available. Additional copies of this circular will be furnished upon request.

ALFRED HAYES,
President.