

FEDERAL RESERVE BANK
OF NEW YORK

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Proposed Amendments to Margin Regulations G, T, and U
to Implement the "Over-the-Counter Margin Act"

*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 by the Board of Governors of the Federal Reserve System and released for publication today:

The Board of Governors of the Federal Reserve System announced today proposals to amend margin Regulations G, T, and U to implement the recent amendment to the Securities Exchange Act of 1934. Signed into law on July 29, 1968, the so called "Over-the-Counter Margin Act" (P.L. 90-437) broadens the Board's authority over stock market credit to cover certain securities that are not registered on a national securities exchange, and leaves to the Board the timing and selection of criteria for the application of margin requirements to such "over-the-counter" (OTC) stocks.

Regulation G applies to "credit by persons other than banks, brokers, or dealers for purpose of purchasing or carrying registered equity securities," Regulation T concerns "credit by brokers, dealers, and members of national securities exchanges," while Regulation U covers "credit by banks for the purpose of purchasing or carrying registered stocks."

The proposals, on which the Board has invited comment through the Federal Reserve Banks from interested persons by March 17, 1969, are principally designed to include in the regulations the criteria under which the Board would select the OTC stocks which would be subject to the margin and other requirements of the regulations.

Initially, "OTC margin stock" would be stock, not traded on a national securities exchange, which the Board determines to have the degree of national investor interest, the depth and breadth of market, the availability of information respecting such stocks and their issuers, and the character and permanence of the issuers, to warrant treatment similar to stocks that are registered on such exchanges. The Board would publish a list of "OTC margin stocks" at the time the regulations became effective.

In a related change, bank loans to broker/dealers against inventory positions in OTC margin stocks used to make a bona fide market would be exempt from margin regulation in much the same way as are loans to specialists making a market in stocks registered on exchanges. The criteria used to determine which broker/dealers are entitled to the exemption are designed to ensure, so far as possible, that an "OTC market maker" does in fact make a market in the stock, stands ready at all times (within reason) to buy or sell the stock, and does not unjustifiably "back away" from the market. Any registered broker/dealer would be eligible for designation as an "OTC market maker" if he meets the standards set forth in Regulation U, files with the Securities and Exchange Commission a notice of his intent to begin or continue such market-making activity and continues to file such other reports as are required pursuant to a rule to be adopted by the Commission respecting market makers in OTC margin stocks.

In another change, the definition of "creditor" in Regulation T would be broadened to cover all brokers and dealers. This would bring under provisions of the new margin requirements brokers and dealers who now handle OTC accounts exclusively. In addition, exempt credit through a special omnibus account would be available only to brokers and dealers actually subject to the regulation.

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At present, Regulation T applies to brokers and dealers who are members of an exchange or who transact business through a member firm. Credit which is exempt from margin requirements can be extended by broker-dealers through a special omnibus account to persons, including foreign firms, who certify that they observe the regulation even though they are not subject to it.

The proposed change is not designed to make foreign banks or broker-dealers subject to U.S. supervision, but only to limit the use of the special omnibus account privilege to institutions that certify that they are actually subject to Regulation T. The privilege would no longer be available to organizations—including foreign financial institutions and others—that prefer not to make such a certification.

A special omnibus account is an account in which a member of an exchange may make wholesale transactions for other brokers without regard to margin requirements. These transactions involve customers' securities on which margin requirements have already been imposed at the retail level. The Department of Justice and the SEC recently presented to the House Banking and Currency Committee evidence of abuses whereby special omnibus accounts have been used by some foreign financial institutions to avoid U.S. margin requirements.

If the proposal is adopted, most firms borrowing in special omnibus accounts would not be affected. However, in the case of omnibus account credit extended to brokers or dealers who did not certify that they were subject to Regulation T, no further substitutions of collateral would be permitted after ninety days from the adoption of the amended regulation. Credit extended in such accounts would have to be brought into conformity with ordinary margin requirements within a year.

At the same time the Board incorporated into the current proposal the broadened coverage of margin Regulations G and U that it originally proposed last December. This applied to loans on mutual fund shares and would bring "equity funding" plans or programs under both regulations. Under the current proposal, all brokers or dealers, including those selling equity funding plans or programs, would be subject to Regulation T. Regulation T prohibits loans on mutual fund shares. The Board, at the request of some firms engaged in extending credit on such plans or programs, plans shortly to schedule an oral presentation on this aspect of its proposals.

A number of other conforming changes of a technical nature are also made throughout the regulation as necessary or appropriate.

In a change unrelated to the implementation of P.L. 90-437, the provision in Regulation G regarding stock options and employee stock purchase plans would be amended to make clear that an increase in the current market value of the collateral may be taken into consideration in determining whether its maximum loan value is equal to the outstanding credit owing pursuant to that provision's withdrawal requirements. In other unrelated changes, the time for retaining Federal Reserve Forms G-3 and U-1 (the "purpose statements" required by Regulations G and U) would be reduced from six to three years to ease the burden of record retention, and statements obtained by brokers and dealers in connection with "non-purpose" extensions of credit collateralized by regulated securities would be obtained on a new Federal Reserve Form T-4.

Additional copies of this circular will be furnished upon request.

ALFRED HAYES,
President.