

debt securities as an alternative to the current requirement that domestic debt securities be registered with the SEC. The Board has adopted the rating requirement for foreign securities because the concept of comity argues against requiring SEC registration. The fact that "mortgage-related securities" require a rating but not SEC registration was Congressionally mandated in the Secondary Mortgage Market Enhancement Act of 1984.

The Board is proposing to strike the word "mortgage" from the second section of the definition of "OTC margin bond" to clarify that all pass-through securities can meet this definition. The Board also confirms that the minimum principal amount required for "OTC margin bonds" applies to shelf registrations of a single issue once the minimum amount has been issued, even though some of the individual tranches sold may be smaller.

Although a 1984 staff opinion took the position that privately-issued Treasury receipts were not exempted securities and not entitled to loan value,<sup>8</sup> the Board, SEC and Treasury Department have become more comfortable over time with viewing these securities as equivalent to exempt securities. For example, a 1994 Board staff opinion concerning the Glass-Steagall Act concluded that the holder of a privately-issued Treasury receipt is, for virtually all purposes, a holder of an interest in the underlying Treasury security.<sup>9</sup> The Board therefore does not object to the treatment of privately-issued Treasury receipts as exempted securities for purposes of Regulation T. The staff opinion to the contrary will be deleted.

#### 4. OTC Margin Stock

A comment was received from an investor who believes stock which does not trade on NASDAQ should be marginable if the issuer has another class of marginable stock whose price is used to determine the sale price of the nonmargin stock. This situation is not being addressed by the proposed amendments. In addition to the complexity of covering such a limited group of stocks, this type of stock cannot be purchased by the general public and therefore no bid prices are available.

#### 5. Nonsecurities Instruments

The Public Securities Association (PSA) and a broker-dealer comment that

creditors should be able to extend credit on commercial paper, certificates of deposit (CDs), and bankers acceptances (BAs). All of these instruments may be used collateral for a nonpurpose loan (i.e., a loan that is not made for the purpose of purchasing, carrying, or trading in securities). Section 7(c) of the Act<sup>10</sup> prohibits the Board from permitting broker-dealers to accept nonsecurities as collateral in a margin account. Although commercial paper is a security and can be held in a margin account, Regulation T denies loan value to domestic debt securities that are not SEC-registered. Therefore, commercial paper is a nonmargin, nonexempted security and the Supplement to Regulation T requires a margin of 100 percent if held in a margin account.

#### B. Cash Account

##### 1. Permissible Transactions

Proposed changes to the cash account concerning options are discussed in this preamble in section I.B.2. In addition, one commenter would like confirmation that customers may purchase CDs and other nonsecurities products in the cash account. A 1988 staff opinion confirmed that industry practice is to use the cash account to record the purchase of both securities and nonsecurities,<sup>11</sup> and the Board is proposing to add language to the cash account section of the regulation to codify this position.

##### 2. Net settlement

In order to guard against free-riding, net settlement of trades in a cash account generally is not permitted. Customers are required to pay for all purchases in full without netting sale proceeds from securities purchased and sold on the same day in order to avoid imposition of the 90-day freeze described in § 220.8(c) of Regulation T. In 1988, Board staff confirmed two statutory exceptions to this general rule for transactions in mortgage-related securities<sup>12</sup> and exempted securities.<sup>13</sup> Some broker-dealers comment that customers should be able to net settle all transactions in a cash account as long as the regulation states that day trading is not permitted in that account. No changes are being proposed in this area as allowing net settlement of all trades in the cash account would complicate a creditor's ability to prevent free-riding in the cash account.

#### 3. 90-Day Freeze

A customer who sells a security purchased in a cash account before making full cash payment must have sufficient funds in the account by trade date for any purchases during the next 90 days. This restriction is known as the "90-day freeze." One broker-dealer suggested the freeze should not apply if the cash account holds marginable securities with sufficient loan value to pay for the securities that have been sold before having been paid for. This suggestion is contrary to the nature of the cash account. A customer who contemplates the need for credit to settle securities purchases should be using a margin account and not a cash account.

Another broker-dealer believes the freeze should not apply if a customer decides to liquidate a purchase made on a DVP basis when the customer is ready to make full payment but the selling broker does not make timely delivery and the security is otherwise unavailable. The Board agrees that a customer should not be subject to the 90-day restriction when it decides to liquidate a transaction that the counterparty cannot complete.

#### C. Other Accounts

##### 1. Arbitrage Account

Transactions effected in the arbitrage account are not subject to Regulation T margin requirements. The SIA and a broker-dealer have requested that the arbitrage account no longer require that the transactions be entered into to take advantage of a concurrent disparity in prices. However, elimination of the requirement that the two transactions yield an immediate gain would expand this special provision beyond those transactions which perform a market function by bringing together the prices of securities or markets which should be the same. Therefore no changes are being proposed to the arbitrage account.

##### 2. Broker-Dealer Credit Account

The broker-dealer credit account is normally available only for broker-dealers.<sup>14</sup> However, the brokerage industry has developed a service known as "prime brokerage" in which a customer maintains a cash and/or margin account with a "prime broker" to record transactions executed at one or more executing brokers. Industry practice has been for the executing broker to use the broker-dealer credit account to record the transactions sent

<sup>8</sup> Staff Opinion of December 13, 1984, *FRRS* 5-628.13.

<sup>9</sup> Staff Opinion of January 10, 1994, *FRRS* 4-655.5.

<sup>10</sup> 15 U.S.C. 78g(c).

<sup>11</sup> *FRRS* 5-615.955.

<sup>12</sup> *FRRS* 5-615.952.

<sup>13</sup> *FRRS* 5-628.17.

<sup>14</sup> As noted in the section on foreign broker-dealers, the Board is proposing to allow foreign broker-dealers to use the broker-dealer credit account when purchasing securities on a DVP basis.