

Proposed Rules

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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 221

[Regulation U; Docket No. R-0905]

RIN 7100-AB65

Securities Credit Transactions; Review of Regulation U, "Credit by Banks for the Purpose of Purchasing or Carrying Margin Stocks"

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Proposed rule.

SUMMARY: The Board is proposing amendments to Regulation U, the regulation that covers extensions of credit by banks that are secured in whole or in part by those publicly traded securities defined as "margin stock". These amendments are being proposed as part of the Board's program to periodically review its regulations as well as to fulfill the requirements of section 303 of the Riegle Community Redevelopment and Regulatory Improvement Act of 1994. Two of the most important effects of the proposed amendments would be to provide: Explicit guidance for banks financing margin stock purchased by their customers through a broker-dealer on a delivery-versus-payment (or C.O.D.) basis; and greater flexibility for withdrawals and substitutions of collateral when margin stock is pledged along with cash equivalents and other securities by treating the entire credit as a single loan. In addition, amendments would conform Regulation U to changes recently proposed for Regulation T regarding increased loan value for exchange-traded options and money market mutual funds. Technical amendments would update the regulation to reflect a 1991 Board interpretation allowing lead banks to apply Regulation U to syndicated loans independent of other credit extended by syndicate banks and restore language indicating that the exemption for temporary financing of customer

securities transactions does not apply to securities purchased at a broker-dealer.

DATES: Comments should be received on or before February 15, 1996.

ADDRESSES: Comments should refer to Docket No. R-0905, and may be mailed to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW., Washington, DC 20551. Comments also may be delivered to Room B-222 of the Eccles Building between 8:45 a.m. and 5:15 p.m. weekdays, or to the guard station in the Eccles Building courtyard on 20th Street, NW. (between Constitution Avenue and C Street, NW.) at any time. Comments received will be available for inspection in Room MP-500 of the Martin Building between 9 a.m. and 5 p.m. weekdays, except as provided in 12 CFR 261.8 of the Board's rules regarding availability of information.

FOR FURTHER INFORMATION CONTACT: Scott Holz, Senior Attorney, or Angela Desmond, Senior Counsel, Division of Banking Supervision and Regulation, (202) 452-2781. For users of Telecommunications Device for the Deaf (TDD), please contact Dorothea Thompson, (202) 452-3544.

SUPPLEMENTARY INFORMATION: The Board is proposing amendments to Regulation U (12 CFR part 221), "Credit by Banks for the Purpose of Purchasing or Carrying Margin Stocks," as part of its program to periodically review its regulations and to satisfy requirements under section 303 of the Riegle Community Redevelopment and Regulatory Improvement Act of 1994. The proposed amendments include coverage of bank financing of securities purchased by customers through a broker-dealer on a cash basis and treatment of mixed-collateral loans (loans secured in part by margin stock and in part by other collateral) as a single loan if all collateral consists of securities and cash equivalents. Conforming amendments are proposed in light of the recently published amendments to Regulation T (12 CFR part 220), "Credit by Brokers and Dealers" (see 60 FR 33763; June 29, 1995) that would increase the loan value of exchange-traded options and money market mutual funds. Two technical amendments are discussed below.

In addition to the amendments described in this proposal, comment is invited on all areas of Regulation U,

including (but not limited to) whether the regulation can be eliminated, simplified, or the burdens imposed thereunder eased.

1. Financing of Securities Purchased on a DVP Basis

Banks often act as custodians for their customers' securities. These securities are generally purchased via a registered broker-dealer in a cash account and sent to the bank on a delivery-versus-payment (DVP) basis.¹ Banks traditionally have not accepted securities in a DVP transaction if the customer does not have the funds to make full payment on hand at the bank. Accepting securities without having the customer's full payment on hand involves a credit relationship similar to a customer using a margin account at a broker-dealer.

In the past few years, System examiners and staff of the Securities and Exchange Commission have alleged that certain banks were financing these DVP purchases without documentation and in excess of margin requirements contained in Regulation U. The banks were found in violation of Regulation U or settled charges without admitting or denying their culpability.²

Provided customers have sufficient collateral, Board staff believes financing of securities purchases can be accommodated within the existing provision for revolving-credit agreements found in § 221.3(c) of Regulation U, with the addition of some clarifying language.³ However, it should be noted that this will not result in exactly equal regulation between banks and broker-dealers because the combination of Board, SEC, and SRO rules applicable to broker-dealers in this area cannot be recreated in Regulation

¹ Customers purchase securities at a broker-dealer on either a cash or margin basis, using either a cash or margin account. When a customer purchases a security on a cash basis, he either deposits the full purchase price in the cash account or asks to have the security sent to his agent (usually a custodial bank) against full payment of the purchase price. This latter method is described in section 220.2(e) of Regulation T as a *delivery against payment, payment against delivery*, or *C.O.D. transaction* and is generally referred to by the industry as a DVP transaction.

² See, e.g., *SEC v. Hansen*, 726 F. Supp. 74 (S.D.N.Y. 1989).

³ Applying the section on revolving-credit agreements will ensure that banks financing such purchases establish credit limits for their customers, including limits on intraday trading.