U.[4] Board staff believes that the supervisory structure for banking institutions and the requirement that banks establish credit agreements before financing these transactions will lead banks to impose some additional limitations themselves, but because the additional requirements applicable to broker-dealers are not contained in Regulation T, they cannot be imposed by Regulation U.

2. Mixed-Collateral Loans

Regulation U does not apply to extensions of securities credit that are not secured at least in part by margin stock. Loans secured in part by margin stock and in part by other collateral are known as ''mixed-collateral'' loans and Regulation U has always required some kind of separation for these types of loans. Although a single credit agreement may be used,[5] § 221.3(e) of Regulation U states that a loan secured in part by margin stock and in part by other collateral ''shall be treated as two separate loans.'' This separation requirement has been the subject of numerous inquiries since the last revision of Regulation U and has led to this proposal for a relaxation of the regulation in this area.[6]

The section on mixed-collateral loans does not present a problem when first applied at the time the loan commitment is made, as it merely requires a bank to determine the loan value of margin stock collateral and then verify that the other collateral has a good faith loan value sufficient to make up the difference between the loan value of the margin stock and the amount of credit being extended and to allocate the credit secured by each tranche.

There have been, however, a number of inquiries concerning the interplay of § 221.3(e) (mixed-collateral loans) and § 221.3(f) (withdrawals and substitutions) of Regulation U. As an example, suppose the value of a customer's nonmargin stock collateral has increased over time but the value of the margin stock has not. In spite of the fact that the overall value of the collateral has increased, the customer cannot withdraw margin stock because this ''separate'' loan does not have sufficient loan value to permit the withdrawal. In other words, changes in collateral value in one tranche have no effect on the other tranche. This separation requirement makes collateral management extremely difficult.

Board staff has tried to respond to inquiries in this area through interpretation of the existing regulation.[7] However, in light of the growth of revolving credit agreements secured by more than just margin stock, it appears that the current rule is unnecessarily burdensome to effectuate the statutory scheme of regulation.[8]

The proposed amendment to the section on mixed collateral loans would still require the regulatory segregation of collateral, but would expand the types of collateral that could be securing loans that currently can only be secured by margin stock to include all financial instruments (stocks, bonds, and cash equivalents).[9] Acting in good faith, a bank would be able to value all financial instruments in accordance with the margin requirements in the Supplement to Regulation U (§ 221.8) and permit substitutions within this group in conformity with the section on withdrawals and substitutions, meaning the aggregate loan value of the substituted collateral must at least equal the aggregate loan value of the collateral withdrawn. Under the proposed amendment, credit secured by nonfinancial collateral, such as real estate, would continue to be treated as a separate loan. Comment is invited on the continuing need for separation of collateral between financial instruments and other collateral.

3. Conforming Amendments

Although the Board's margin regulations provide a level playing field for lenders extending purpose credit secured by margin stock, statutory and other considerations have always made the scope of Regulations G and U less broad than that of Regulation T.[10] Two of the proposed amendments to Regulation T would make it less restrictive than Regulation U, leading the Board to propose conforming amendments. The two amendments would allow 50 percent margin for exchange-traded options (currently given no loan value) and good faith loan value for money market mutual funds (currently given 50 percent loan value). In addition, the definitions of ''cash equivalent'' and ''examining authority'' would be added from the Regulation T proposal to the definitional section of Regulation U.

4. Technical Amendments

Two technical amendments are proposed. The first would add a sentence to the ''single-credit rule'' to reflect a 1991 Board interpretation allowing the lead bank to perform Regulation U compliance for syndicated loans. The other would reinsert language inadvertently deleted in 1983 from one of the Regulation U exemptions for credit extended to persons other than broker-dealers.[11]

5. Section-by-Section Explanation of Proposed Changes to Regulation U

Section 221.1 Authority, Purpose and Scope.

No substantive changes.

Section 221.2 Definitions.

(1) Eliminate letter designations for definitions in § 221.2 and references thereto in §§ 221.1(b), 221.3(a) and 221.7(c)(2).

(2) Add definitions (from Regulation T) for *cash equivalent* and *examining authority* (referred to in § 221.5(c)(9)(ii)).

[4] Although the Board does not have a maintenance margin in its regulations, broker-dealers are required to monitor extensions of securities credit under SRO rules, call for additional collateral when market values fall below a specified percentage, and sell some of the customer's securities if the additional collateral is not received. In addition, SRO rules require customers opening margin accounts to deposit a minimum amount of equity in cash or securities (generally $2000).

[5] The ability of a bank to use a single credit agreement was a reform instituted in 1983. Before that time, separate credit agreements were required for the stock collateral and the nonstock collateral.

[6] Before 1983, Regulation U covered loans secured by any stock. A ''mixed-collateral'' loan was one secured in part by stock and in part by other collateral. Now that the regulation's scope has been reduced to cover only loans secured by margin stock, a ''mixed-collateral'' loan is one secured in part by margin stock and in part by other collateral. ''Other collateral'' may include stock that would have been covered under the previous version of Regulation U and therefore not subject to the provisions covering mixed-collateral loans. This reduction in the scope of the regulation had the unintended effect of reducing the flexibility for withdrawals and substitutions of collateral for mixed-collateral loans.

[7] See, e.g., *Federal Reserve Regulatory Service* 5–923.2, 5–923.41, and 5–923.42.

[8] Many customers who have securities to pledge as collateral have more than just margin stock (they often have debt securities as well). The section on mixed-collateral loans presumes there will be no change in the collateral once it has been pledged. The number of inquiries in this area is an indication that this is often not the case.

[9] One of the goals of the section on mixed-collateral loans is to ensure that a lender does not inflate the loan value of nonmargin collateral to offset the fact that the margin regulations limit the value of margin stock to 50 percent of its current market value. Most financial instruments have readily available prices, lessening the possibility for evasion of the margin requirements. Other collateral, such as real estate, boats and automobiles, is more likely to have a less well agreed upon market value.

[10] For example, although the Securities Exchange Act of 1934 requires the Board to set margins for all purchases of securities, it specifically excludes bank loans on nonconvertible debt securities.

[11] The exemption for credit to a customer to temporarily finance the purchase or sale of securities for prompt delivery contained a restriction prohibiting its use for securities purchased at a broker-dealer. This restriction was inadvertently dropped in 1983 and it is being reinserted.