FEDERAL RESERVE SYSTEM

12 CFR Parts 207, 220, and 221

[Regulations G, T, and U; Docket No. R–0923]

Securities Credit Transactions

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Proposed rule.

SUMMARY: In conjunction with a final rule printed elsewhere in today's Federal Register, the Board is considering further amendments to its margin regulations, Regulations G, T, and U. Regulation T covers extensions of credit by and to brokers and dealers; Regulation U covers extensions of credit by banks; and Regulation G covers extensions of credit by all other U.S. lenders.

The Board is proposing to: allow a broker-dealer to extend ''good faith'' credit on any non-equity security rather than only those currently permitted by Board rules; allow lending on non-equity securities to occur in a new ''non-equity'' account, absent the restrictions currently imposed in the margin account; remove restrictions on the ability of broker-dealers to calculate required margin for non-equity securities on a ''portfolio'' basis; ease or eliminate the Board's collateral requirements for the borrowing and lending of securities; exempt lending to foreign persons on foreign securities by foreign branches of U.S. broker dealers; remove a Board interpretation that prevents options from serving as cover in lieu of margin for a short sale; and allow banks to lend against exchange-traded options to the extent permitted by the exchange listing the option.

The Board is also seeking comment on whether it should expand the number of equity securities eligible for loan value under Regulation T, and on whether it should amend Regulations G and U to modify their method for determining which equity securities are eligible for loan value.

DATES: Comments should be received on or before July 1, 1996.

ADDRESSES: Comments should refer to Docket No. R–0923, 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 9:00 a.m. and 5:00 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; Oliver Ireland, Associate General Counsel (202) 452–3625 or Gregory Baer, Managing Senior Counsel (202) 452–3236, Legal Division; for the hearing impaired only, Telecommunications Device for the Deaf (TDD), Dorothea Thompson (202) 452–3544.

SUPPLEMENTARY INFORMATION: Regulation T implements the Board's authority over securities credit extended by broker-dealers under section 7 of the Securities Exchange Act of 1934, 15 U.S.C. 78g (the Act). Section 7 requires the Board to regulate the amount of credit that may be extended on securities by a broker-dealer, requires that collateral for securities purchases consist of ''exempted securities'' (U.S. government and municipal securities) or securities assigned loan value by the Board, and prohibits a broker-dealer from extending unsecured credit for the purpose of purchasing securities. Regulation T establishes the margin that a customer of a broker-dealer must post when engaging in a securities transaction on credit. The ''margin'' for a security is the converse of the security's ''loan value;'' by definition, the two always add up to 100 percent.

Section 7 also authorizes the Board to regulate credit extended by banks and all other U.S. lenders. Regulation U limits credit extended by banks to finance the purchase or carrying by customers of margin equity securities when the credit is collateralized by such securities. 12 CFR Part 221. Regulation G limits credit extended by lenders other than broker-dealers and banks to finance the purchase or carrying of margin equity securities when the credit is collateralized by such securities. 12 CFR Part 207.[1]

In 1995, the Board published for comment a series of amendments to Regulation T that were intended to remove constraints that were hampering developing trends in the securities markets. 60 FR 33763, June 29, 1995. These trends included the erosion of barriers between broker-dealers and other lenders, the globalization of securities markets, the increasing overlap in the businesses of various lenders, and the constant development of new mechanisms for extending securities credit. The Board also solicited comment on broader changes that could be made to Regulation T. The recent effort to modernize Regulation T predated but is now encompassed within the Board's regulatory review under section 303 of the Riegle Community Development and Regulatory Improvement Act of 1994, Pub. L. 103–325.

Extensive comment was received on the Board's 1995 proposal, including voluminous responses from the major securities trade groups. Commenters generally supported the proposed amendments to Regulation T, but also emphasized the need for more wholesale reform.

Today, the Board is elsewhere adopting as a final rule many of the amendments it proposed in 1995. However, the Board is also proposing additional amendments to Regulation T, and seeking comment on provisions of Regulations G and U as well.[2] In addition, the Board seeks comment on any other steps it can take to reduce the burden imposed by Regulation T, including any steps to reduce the accounting and recordkeeping burdens of the regulation, that would be consistent with the purposes and requirements of the Act.

1. Good Faith Loan Value for all Non-Equity Securities

Regulation T gives ''good faith'' loan value to many but not all debt securities. Good faith loan value means that a broker-dealer may extend credit on a particular security in any amount consistent with sound credit judgment. 12 CFR 220.2. Those debt securities not eligible for good faith loan value receive no loan value and therefore have a margin requirement of 100 percent.

With the adoption of today's final rule, the Board currently assigns a debt security good faith loan value if it is: (1) listed on a U.S. securities exchange, (2) a government or municipal security, (3) an investment grade security; or (4) a less-than-investment grade security that is registered with the Securities and Exchange Commission (SEC) and has an original principal amount of not less than $25,000,000. 12 CFR 220.18(b).

[1] Regulation X covers U.S. borrowers obtaining credit outside the United States. Because Regulation X incorporates the requirements of Regulation T, U, or G (depending on the lender), any amendments to those regulations automatically pass through to Regulation X. Therefore, no amendments to Regulation X are being proposed.

[2] The Board is also continuing to review Regulations G and U as part of its ongoing effort to reduce regulatory burden, as mandated by section 303 of the Riegle Community Development and Regulatory Improvement Act of 1994.

Non-equity securities that are not registered, are not government or municipal securities, and are not investment grade generally will continue to receive no loan value under Regulation T.

In contrast, the Board's Regulations G and U do not impose any margin restrictions on non-broker-dealer lenders (such as banks) when they lend against non-equity securities, even securities that receive no loan value under Regulation T.[3] Foreign broker-dealers and other foreign lenders, with whom U.S. broker dealers increasingly compete worldwide, are generally also unconstrained. Thus, customers who wish to borrow against non-equity securities that receive no loan value under Regulation T, and investors who wish to engage in repo or forward transactions in such securities, may go to these other lenders.

The Board proposes to grant good faith loan value to all non-equity securities. To effectuate this change, the Board is proposing to amend revised section 220.13, discussed below, and section 220.18 (b), (c), and (d) to include all non-equity securities among those securities subject to good faith margin. A new definition of ''non-equity security'' would be added to section 220.2 to include any security that is not an ''equity security'' for purposes of section 3(a)(11) of the Act. This definition of non-equity security may include certain equity-linked securities. The Board seeks comment on whether it should modify the definition of non-equity security to exclude equity-linked securities and, if so, what securities should be excluded.

In a conforming change, the definition of ''OTC margin bond'' in section 220.2 would be deleted; since all non-equity securities would receive loan value, this definition would no longer be required. In another conforming change, the definition of ''margin security'' in section 220.2 would be revised to include any ''non-equity security'' instead of any ''OTC margin bond.''

Expanding the types of non-equity securities eligible for good faith loan value should expand broker-dealers' ability to lend and put them on a more equal footing with other lenders under Regulations G and U. Broker-dealers should be no less competent to determine the loan value of non-investment grade debt securities than a bank or other lender would be. Finally, any remaining regulatory concerns could be addressed by the self-regulatory organizations (SROs), which include the exchanges and the National Association of Securities Dealers, who still would be able to set their own margin requirements for these transactions.

[3] Section 7(d) of the Act prohibits the Board from establishing margin requirements on non-equity securities at banks. 15 U.S.C. 78g(d). When Regulation G was adopted in 1968, it was modeled on Regulation U.

2. Establishment of Non-Equity Account

Other restrictions beyond margin requirements are also currently placed on transactions involving non-equity securities. Currently, any credit extended by a broker-dealer on a non-equity security (other than a security eligible for the government securities account) must be recorded in the margin account. 12 CFR 220.4. These transactions are thus subject to the same restrictions as equity securities with respect to when payments must be made and when positions must be liquidated. On the other hand, because Regulations U and G restrict lending only on equity securities, banks and other lenders may lend on non-equity securities without such Board-imposed restrictions. 12 CFR 221.3(a); 12 CFR 207.3(b).

The Board proposes to allow any transaction involving a non-equity security to be effected in a new ''non-equity'' account. For example, a customer could effect in this account: (1) purchases of non-equity securities on credit; (2) repurchase and reverse repurchase agreements with broker-dealers on non-equity securities; and (3) the purchase or sale of options on non-equity securities. All transactions in the account would be subject to good faith margin. In order to ensure that unsecured credit would not be extended under the rubric of good faith margin, the proposed rule would prohibit any transaction or withdrawal that would cause the non-equity account to liquidate to a deficit—that is, cause the marked-to-market value of the securities held in the account to be less than the credit outstanding.

This account would be otherwise unregulated. The absence of restrictions on the terms of credit for non-equity securities would promote equality of treatment between broker-dealers and banks and other lenders, who face no Federal Reserve regulation when they lend on non-equity securities.

The Board seeks comment on whether the creation of a non-equity account would be beneficial and whether the account could be better named. The Board also seeks comment on whether this account could be merged with the government securities account (12 CFR 220.6) or the nonsecurities credit account (220.9) or both.

3. Portfolio Margining

A. Amendment to definition of good faith margin

As noted above, Regulation T currently allows good faith margin on some non-equity securities, and the Board is proposing to extend this treatment to all non-equity securities. ''Good faith margin'' is defined in Regulation T to mean ''the amount of margin which a creditor, exercising sound credit judgment, would customarily require for a *specified security position* and which is *established without regard to the customer's other assets or securities positions held in connection with unrelated transactions*'' (emphasis added). 12 CFR 220.2.

This definition limits so-called ''portfolio margining''—allowing positions to be evaluated as a group and determining collateral requirements based upon estimated changes in the value of that portfolio. (It would continue to do so even if the proposed non-equity account were adopted, as the definition of good faith applies regardless of where the transaction is booked.) Regulation T has defined limited positions that can serve as offsets for each other, but any combination of positions not specifically permitted by the regulation may not offset one another. Commenters have for some time requested greater flexibility to engage in cross-margining (allowing positions in financial futures to offset the margin required for a given securities credit) and more broadly in ''portfolio'' or ''risk-based'' margining.

In order to remove an impediment to portfolio margining, the Board would amend the definition of ''good faith margin'' to eliminate the requirement that such margin be calculated ''for a specified security position * * * without regard to the customer's other assets or securities positions held in connection with unrelated transactions.'' Instead, ''good faith margin'' would be defined to mean ''the amount of margin the creditor would require in exercising sound credit judgment.''

The Board is seeking comment on whether this definition should: (1) apply only in the proposed non-equity account, thereby continuing to limit portfolio margining of securities eligible for good faith margin in the margin account or market functions account; or (2) apply regardless of the account—margin, non-equity, or market functions—in which the transactions are booked. In addition, the Board seeks comment on the extent to which this change would allow SROs and broker-dealers greater flexibility to develop portfolio margining systems. The Board also seeks comment from SROs and others on the potential benefits and burdens of adopting a portfolio margining system in addition to the existing position-based system, and whether changing the definition of good faith margin for any or all accounts is consistent with section 7(b) of the Act.

B. Separation of Accounts

Section 7 of the Act prohibits a broker-dealer from extending securities credit on any collateral other than a security. Accordingly, Regulation T requires that futures contracts and non-securities be accounted for in their own account, and section 220.3(b) of Regulation T generally prohibits using items in one account (including the nonsecurities account) from being used to meet the margin requirements for items in another account (including the margin account). However, with adoption of today's final rule, Regulation T will allow financial futures to serve in lieu of margin for securities options consistent with SRO rules. This treatment is consistent with Section 7 because the broker-dealer is not extending credit on the futures contract when it considers a futures contract in determining the amount of credit it can extend in good faith on a security.

The proposed rule would amend section 220.3(b) to allow explicitly commodities and foreign exchange positions in the nonsecurities account to be considered in calculating margin for *any* securities transaction in the proposed non-equity account or the margin account. The Board would expect that these positions would be valued in accordance with SRO rules, where applicable, or in any event not in excess of their marked-to market value. The proposed rule would also amend section 220.18 to remove a requirement that margin be held for ''each security position.''

The Board also seeks comment on whether further amendments to sections 220.3(b) should be adopted to facilitate portfolio margining—in particular, whether the Board should modify the general prohibition on separation of accounts in section 220.3(b). Doing so could allow any excess margin in one account to be used to meet a margin deficiency in another account. To the extent that such a change were adopted, the Board seeks comment on the continuing need for a Special Memorandum Account. As noted above, the Board is also seeking comment on whether the government securities account, nonsecurities account, and proposed non-equity account should be combined.

C. Implementation

The Board also seeks comment on any implementation problems that might arise with a partial or complete move to portfolio margining, including the need for delaying the effective date of any final rule in order to allow the SROs time to amend their rules.

4. Borrowing and Lending of Securities by Brokers-dealers

In order to facilitate short sales and the curing of failures to deliver a security (fails), Regulation T allows broker-dealers to borrow and lend securities outside of the normal margin requirements for securities purchases. To qualify for this treatment, borrowing and lending transactions must not only relate to a short sale or fail but also be secured by cash or similarly liquid collateral equal to 100 percent of the value of the securities lent.[4] Any borrowing and lending of securities that does not meet both the ''purpose test'' and the ''collateral test'' is usually a financing, is not considered a borrowing and lending of securities for Regulation T purposes, and therefore is conducted in a margin account, subject to the appropriate margin requirement for the underlying security.

Requiring 100 percent collateral (marked to market daily) to secure any stock loan reflects industry practice and is, the Board believes, consistent with prudent securities lending. The SEC imposes similar requirements on the types and amount of collateral a broker-dealer must post when it borrows securities from a customer, and the Department of Labor applies similar requirements to an ERISA pension plan when it lends securities.

Nonetheless, the Board is seeking comment on whether the Board's existing collateral requirements are necessary for Regulation T purposes. Commenters have sought an expansion of eligible collateral to include all securities marginable under Regulation T. Although the Board has expressed concern that Regulation T could be evaded by structuring a financing transaction as a borrowing and lending,[5] the purpose test may be adequate to prevent such an evasion. The purpose test limits the exception to transactions that have a clear market purpose that is verifiable (as any evasion becomes evident within a few days, when no short sale is consummated or the fail proves illusory). The collateral test addresses the evasion issue only indirectly by imposing collateral arrangements that conform to industry practice.

Accordingly, the Board is proposing to amend section 220.16 either to allow any security that qualifies for loan value to serve as collateral, valued at its regulatory loan value,[6] or to require a *bona fide* posting of collateral equal to 100 percent of the value of the securities borrowed, without requiring any specific type of collateral. The Board also seeks comment on whether the collateral requirement of section 220.16 could be eliminated altogether. The Board notes that even if the collateral/ requirements were eliminated, other concerns might merit continued or further regulation by the SROs or the SEC.

5. Extensions of Credit by Foreign Branches of U.S. Broker-Dealers

Most U.S. broker-dealers conduct their overseas operations through separately incorporated subsidiaries of their holding companies. These subsidiaries are not subject to Regulation T or SEC regulations. However, a few firms maintain foreign branches that are subject to Regulation T. The Board is proposing to exclude these foreign branches from Regulation T when they extend credit to foreign persons on foreign securities. This would be analogous to the exclusion from Regulation U of foreign branches of U.S. banks when they extend securities credit.

6. Option as Cover for a Short Sale of an Equity Security

In a short sale, a customer generally sells securities it does not own and borrows those securities from a broker-dealer in order to meet its delivery obligation. The customer is then obligated to redeliver such securities to the broker-dealer at some time in the future, but hopes to obtain those securities for less than the sale price less financing costs. Regulation T currently

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[4] With the adoption of today's final rule, permissible types of collateral include cash, securities issued or guaranteed by the United States or its agencies, certain negotiable bank certificates of deposit and bankers acceptances, and certain irrevocable letters of credit issued by banks, marginable foreign sovereign debt securities, and any collateral acceptable to the SEC when a broker-dealer borrows securities from a customer.

[5] For example, a broker-dealer prohibited by Regulation T from extending a customer 100 percent credit on a security could instead borrow the security from the customer and post 100 percent cash collateral; the customer could then withdraw the cash, evading the 50 percent initial or good faith margin requirement.

[6] If this option were adopted, ''loan value'' would be defined in Regulation T to mean an amount equal to ''1 minus the margin requirement for the security under this part.''

requires margin of 150 percent for a short sale of an equity security.[7] For example, if a customer sells short 100 shares of XYZ Corp, the broker-dealer retains 100 percent of the proceeds from the sale in the customer's account, and the customer is required to post an additional 50 percent of the sale price. (This parallels the 50 percent margin requirement for a purchase of the stock; in each case, the customer's stake in the transaction must be 50 percent of its price.) However, Regulation T requires margin of only 100 percent—in other words, allows retaining of the proceeds of the sale to suffice—if a ''security exchangeable or convertible * * * into the security sold short'' is held in the customer's account. The most common example of such a security is a convertible bond.

Although it can be argued that both stock warrants and call options qualify as a ''security exchangeable or convertible into another security,'' the Board has only permitted the former to serve in lieu of the additional 50 percent margin for short sales in Regulation T. *See* Board Interpretation 12 CFR 220.126, reprinted in the *Federal Reserve Regulatory Service* at 5–488. Some commenters have criticized this inequality of treatment, and some have asked that a call option—in the above example, a call option for 100 shares of XYZ stock—be allowed to serve in lieu of the additional 50 percent margin requirement.

The Board is seeking comment on whether to allow the use of a call option to offset the short sale of a security and whether doing so would bias the market in favor of short selling. The Board has historically sought to ensure that traders on the short side of the market should not be in a position, with a given amount of funds, to exert greater influence on the market than they could with the same amount of funds if they were trading on the long side. However, under this proposal, a customer wishing to purchase 100 shares of XYZ would be required to come up with 50 percent of the purchase price, but a customer wishing to sell 100 shares of XYZ short would only be required to come up with the premium necessary to purchase a call option for 100 shares of XYZ, a far smaller amount. The Board seeks comment on whether this fact argues against adoption of the proposed change.

[7] If a marginable debt security is sold short, the margin required is 100 percent of the current market value of the security plus the margin required by the creditor in good faith.

7. Eligibility of Equity Securities for Credit Under Regulations G, T, and U

In order to qualify for credit under Regulation T, an equity security must be a mutual fund, a bond convertible into a qualifying equity security, or registered on a national securities exchange, trade in NASDAQ's National Market System, or appear on the Board's quarterly lists of ''marginable OTC stocks'' or ''foreign margin stocks.'' Stocks qualify for inclusion on the Board's lists if they meet Regulation T's definition of ''OTC margin stock'' or ''foreign margin stock.''

A. Foreign Margin Stocks Under Regulation T

The Board is adopting as a final rule an amendment to Regulation T that includes as a foreign margin stock any foreign stock that has a ''ready market'' for purposes of the SEC's net capital rule. 17 CFR 240.15c3–1(c)(11)(i). SEC staff has stated that they will take no action against broker-dealers that treat any foreign stock listed on the Financial Times-Actuaries World Indices as having a ready market for purposes of computing a broker-dealer's net capital. Thus, these stocks will be added to the Board's foreign list.

Although there is considerable overlap between the stocks on the Financial Times Indices and the Board's list of foreign margin stocks, the Financial Times list contains substantially more foreign stocks than the Board's list, and there are also a significant number of foreign stocks that appear on the Board's list but not the Financial Times list. The Board did not receive comment on whether its current list of, and test for, foreign margin stocks would continue to be necessary if this new test were adopted. Accordingly, the Board seeks comment on whether it should rely on the ready market test exclusively and phase out the Board's own test and list.

B. Domestic Margin Stocks

The Board is also seeking comment on whether it should supplement or replace the current criteria for qualification as an OTC margin stock in section 220.17 of Regulation T by allowing a broker-dealer to extend credit on any stock traded on a national securities exchange, quoted on NASDAQ, or otherwise having a ''ready market'' for purposes of the SEC's net capital rule. In the domestic area, SEC staff has taken the position that a stock has a ''ready market'' if: (1) three or more market makers quote its prices through the so-called ''pink sheets,'' and (2) the broker-dealer can show the existence of bona fide inter-dealer trades within five business days before or after the date of valuation that are of sufficient volume to justify a reasonable belief that the price used would support the liquidation of the entire position at or near that price.

This proposal would make 1700 NASDAQ stocks, as many as 5400 stocks quoted on the NASD's electronic bulletin board, and an unknown number of additional ''pink sheet'' stocks eligible for broker-dealer credit for the first time. Some of these stocks are thinly traded when compared to currently marginable stocks, including those that qualify as OTC margin stocks. The Board seeks comment on whether such stocks should be eligible to serve as collateral for securities credit.

The Board particularly seeks comment on whether an expansion in the number of OTC margin stocks should be made only for purposes of Regulation T, or for purposes of Regulations G and U as well. Although all the Board's margin regulations currently contain a common definition of ''OTC margin stock,'' this common definition does *not* result in common treatment of all lenders. Under Regulation T, a broker-dealer is *prohibited* from lending on any domestic stock that does not qualify as an OTC margin stock; conversely, a bank or other lender is *unregulated* by Regulations U and G when it lends on any stock that does not qualify as an OTC margin stock. Thus, qualification of a stock as an OTC margin stock *increases* its loan value under Regulation T from zero to 50 percent, but subjects it for the first time to coverage by Regulations G and U and thereby *decreases* its loan value to the extent that banks and other lenders had previously been willing to give the stock loan value of greater than 50 percent. Conversely, disqualification of a stock as an OTC margin stock eliminates its loan value under Regulation T and thereby prevents broker-dealers from lending on it, but eliminates its coverage by Regulations G and U and allows banks and other lenders to lend as much as they deem appropriate.

Thus, using the ready market definition for purposes of Regulations G and U would impose burdens on banks and other lenders. Use of the definition would limit the amount of credit that banks could extend on thousands of additional stocks and would also require banks to obtain a ''purpose statement'' (FR U–1) whenever they lend more than $100,000 on those stocks. In addition, it would no longer be possible for the Board to publish a complete ''List of Marginable OTC

Stocks'' (OTC List), as the stocks that met the SEC's ready market test would be ever changing and outside the Board's control. Banks therefore would be responsible for determining on their own whether a given OTC equity security was subject to Regulation U. The burden imposed on Regulation G lenders would be similar.[8] In addition, the number of lenders potentially covered by Regulation G would expand to include as many as 6600 additional companies to the extent that those companies extended credit to their employees secured with company stock.[9] Although the Board currently alerts companies with OTC margin stock to the possibility of registration under Regulation G, elimination of the OTC list would prevent the Board from continuing this practice.

Accordingly, the Board is seeking comment on possible solutions to the disparate treatment of broker-dealers and other lenders, and the resulting increase in burden for one group whenever burden is reduced for the other. The Board seeks comment on whether it should establish separate regimes for determining coverage by Regulation T on the one hand, and Regulations G and U on the other; for example, any domestic stock that has a ready market for purposes of the SEC's net capital rule might receive loan value under Regulation T, while only domestic stocks that are listed on an exchange might be subject to Regulations G and U.

8. Options Under Regulation U

On December 12, 1995, the Board published proposed amendments to Regulation U, including one that concerned the treatment of exchange-traded options. The proposal mirrored the treatment proposed by the Board for broker-dealers under Regulation T. Specifically, the Board proposed to allow the same 50 percent loan value for long positions in exchange-traded options currently permitted for other exchange-traded equity securities. Because the final rule under Regulation T ties the loan value of these securities to the rules of the exchange authorized to trade the option, the Board is proposing, as a matter of parity between Regulations T and U, to amend Regulation U so that banks can lend against exchange-traded options to the extent permitted by the rules of the options exchanges. The Board seeks comment on the practicality of requiring banks to comply with rules of SROs of which they are not members.

9. Technical Amendments

The Board is also prescribing technical amendments to Regulation T that are intended to streamline and rationalize the regulation without altering its substance. The Board is proposing to add a definition of ''margin equity security,'' a term currently used but not defined in the regulation. The Board is seeking comment on whether the definition of ''covered option transaction'' can be shortened to include ''any transaction eligible for the cash account under the rules of the registered national securities exchange authorized to trade the option or warrant or the creditor's examining authority in the case of an unregistered option provided that all such rules have been approved or amended by the SEC.'' This change could not take effect until the provision in the final rule delegating authority over options to the SROs became effective.

Regulatory Flexibility Act

The Board has concluded after reviewing the proposed regulation that, if adopted, it would not impose a significant economic hardship on small institutions. The proposal does not necessitate the development of sophisticated recordkeeping or reporting systems by small institutions; nor will small institutions need to seek out the expertise of specialized accountants, lawyers, or managers in order to comply with the regulation. The proposal is designed to reduce the complexity and burden of Regulation T. The Board therefore certifies pursuant to section 605b of the Regulatory Flexibility Act (5 U.S.C. 605b) that the proposal, if adopted, will not have a significantly adverse economic impact on a substantial number of small entities within the meaning of the Regulatory Flexibility Act (5 U.S.C. 601 *et. seq.*).

Paperwork Reduction Act

In accordance with section 3506 of the Paperwork Reduction Act of 1995 (44 U.S.C. Ch. 35; 5 CFR 1320 Appendix A.1), the Board reviewed the proposed rule under the authority delegated to the Board by the Office of Management and Budget. Comments on the collections of information should be sent to the Office of Management and Budget, Paperwork Reduction Projects 7100–0001 (or 7100–0004), Washington, DC 20503, with copies of such comments to be sent to Mary M. McLaughlin, Federal Reserve Board Clearance Officer, Division of Research and Statistics, Mail Stop 97, Board of Governors of the Federal Reserve System, Washington, DC 20551.

The collection of information implications of the proposal to amend this regulation are found in 12 CFR part 220. This information is required to evidence compliance with the requirements of the Securities Exchange Act of 1934 (15 U.S.C. 78g). The respondents are for-profit financial institutions (7100–0001) and public corporations (7100–0004).

Implications for Reporting

The proposal to change the definition of ''OTC margin stock by allowing a broker-dealer to extend credit on any stock traded on a national securities exchange, quoted on NASDAQ, or otherwise having a 'ready market' * * *'' could lead to an increase in the number of respondents for the OTC Margin Stock Report (FR 2048; OMB No. 7100–0004) because of the increase in the number of firms whose stock would be marginable. The burden per response of 0.25 hours would not change. However, if it is decided that the stock of any firm listed on the NASD SmallCap market is automatically marginable, as currently is the case for the stocks of firms listed on the NASD National Market System, the FR 2048 could be eliminated. Currently, the FR 2048 is filed by approximately 75 respondents each quarter. The current annual burden of the FR 2048 is estimated to be 75 hours. Based on an hourly cost of $20, the annual cost to the public is estimated to be $1,500.

The Federal Reserve may not conduct or sponsor, and an organization is not required to respond to, an information collection unless it displays a currently valid OMB control number.

Comments are invited on: (a) whether the proposed amendments to this collection of information are necessary for the proper performance of the Federal Reserve's functions; including whether the information has practical utility; (b) the accuracy of the Federal Reserve's estimate of the burden of the proposed information collection, including the cost of compliance; (c) ways to enhance the quality, utility, and clarity of the information to be collected; and (d) ways to minimize the burden of information collection on respondents, including through the use of automated collection techniques or other forms of information technology.

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[8] Regulation G does not contain a paperwork exemption for loans of $100,000 or less, so all loans secured by these new OTC margin stocks would require a ''purpose statement'' (Form FR G–3).

[9] Companies that extend credit to employers in connection with an employee benefit plan adopted by the company and approved by its stockholders are not subject to the 50 percent requirement normally imposed on loans secured by margin stock. 12 CFR 207.5. However, these companies must register with the Federal Reserve and provide annual reports of their securities credit activities.

List of Subjects

12 CFR Part 207

Banks, banking, Credit, Federal Reserve System, Reporting and recordkeeping requirements, Securities.

12 CFR Parts 220 and 221

Banks, banking, Bonds, Brokers, Credit, Federal Reserve System, Margin, Margin requirements, Investment companies, Investments, Reporting and recordkeeping requirements, Securities.

For the reasons set out in the preamble, the Board proposes to amend 12 CFR Part 220 as follows:

PART 220—CREDIT BY BROKERS AND DEALERS (REGULATION T)

1. The authority citation for Part 220 continues to read as follows:

Authority: 15 U.S.C. 78c, 78g, 78h, 78q, and 78w.

2. Section 220.2 is amended as follows:

a. By adding a new definition of *Margin equity security* in alphabetical order;

b. By revising paragraph (3) in the definition of *Margin security*;

c. By adding a new definition of *Non-equity security* in alphabetical order;

d. By removing the definition of *OTC margin bond*.

The additions and revisions read as follows:

§ 220.2 Definitions.

* * * * *

Margin equity security means a margin security that is an equity security (as defined in section 3(a)(11) of the Act.).

* * * * *

Margin security * * *

(3) Any non-equity security;

* * * * *

Non-equity security means a security that is not an equity security (as defined in section 3(a)(11) of the Act).

* * * * *

3. Section 220.3(b) is revised to read as follows:

§ 220.3 General provisions.

* * * * *

(b) *Separation of accounts*—(1) *In general.* The requirements of one account may not be met by considering items in another account. If withdrawals of cash or securities are permitted under the regulation, written entries shall be made when cash or securities are used for purposes of meeting requirements in another account.

(2) *Exceptions.* Notwithstanding paragraph (b) (1) of this section—

(i) For purposes of calculating the required margin for a security in the non-equity account or margin account, assets described in § 220.9(a) (1) or (2) may serve in lieu of margin;

(ii) Transfers may be effected between the margin account and the special memorandum account pursuant to §§ 220.4 and 220.5.

* * * * *

4. Section 220.4(b)(1) is revised to read as follows:

§ 220.4 Margin account.

* * * * *

(b) *Required margin*—(1) *Applicability.* The required margin for long or short positions in securities is set forth in § 220.18 (the Supplement) and is subject to the following exceptions and special provisions.

* * * * *

5. The text of § 220.13 is redesignated as paragraph (j) of § 220.3, the section heading of § 220.13 is redesignated as the heading of newly designated paragraph (j) of § 220.3, and § 220.13 is removed.

6. New section 220.13 is added to read as follows:

§ 220.13 Non-equity account.

(a) *Permissible transactions.* In a non-equity account, a creditor may effect and finance any transaction involving any non-equity security. No transaction or withdrawal shall be allowed if it would cause the account to liquidate to a deficit.

(b) *Required margin.* The required margin for transactions effected in the non-equity account is set forth in § 220.18 (the Supplement).

7. Section 220.16 is amended by revising the second sentence of paragraph (a) and the last sentence of paragraph (b) to read as follows:

§ 220.16 Borrowing and lending securities.

Option 1 for Paragraph (a)

(a) * * * Each borrowing shall be secured by a deposit of one or more of the following: cash, cash equivalents, foreign sovereign nonconvertible debt securities that are margin securities, collateral acceptable for borrowings of securities pursuant to SEC Rule 15c3–3 (17 CFR 240.15c3–3), irrevocable letters of credit issued by a bank insured by the Federal Deposit Insurance Corporation or a foreign bank that has filed an agreement with the Board on Form FR T–1, T–2, or any margin security, valued at its loan value.* * *

Option 2 for Paragraph (a)

(a) * * * Each borrowing shall be secured by a *bona fide* deposit of collateral equal to at least 100 percent of the market value of the securities borrowed.* * *

(b) * * * Each borrowing shall be secured by a *bona fide* deposit of collateral equal to at least 100 percent of the market value of the securities borrowed.

8. Section 220.18 is amended by revising the introductory text and paragraphs (b) through (d) to read as follows:

§ 220.18 Supplement: Margin requirements.

The required margin for positions held in a margin account shall be as follows:

* * * * *

(b) Exempted security, non-equity security, money market mutual fund, or exempted securities mutual fund: the margin required by the creditor in good faith or the percentage set by the regulatory authority where the trade occurs, whichever is greater.

(c) Short sale of a nonexempted security, except for a non-equity security: 150 percent of the current market value of the security, or 100 percent of the current market value if a security exchangeable or convertible within 90 calendar days without restriction other than the payment of money into the security sold short is held in the account.

(d) Short sale of an exempted security or non-equity security: 100 percent of the current market value of the security plus the margin required by the creditor in good faith.

* * * * *

By order of the Board of Governors of the Federal Reserve System, April 24, 1996.

William W. Wiles,

Secretary of the Board.

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