

Supporting Statement for the Margin Credit Reports
(FR G-1, FR G-2, FR G-4; OMB No. 7100-0011)
(FR G-3; OMB No. 7100-0018)
(FR T-4; OMB No. 7100-0019)
(FR U-1; OMB No. 7100-0115)

Summary

The Board of Governors of the Federal Reserve System, under delegated authority from the Office of Management and Budget (OMB), proposes to extend for three years, without revision, the following six mandatory reports that collect information on certain extensions of credit secured by margin stock, including the amount and purpose of such credit:

- Registration Statement for Persons Who Extend Credit Secured by Margin Stock (Other Than Banks, Brokers, or Dealers) (FR G-1; OMB No. 7100-0011),
- Deregistration Statement for Persons Registered Pursuant to Regulation U (FR G-2; OMB No. 7100-0011),
- Statement of Purpose for an Extension of Credit Secured by Margin Stock by a Person Subject to Registration Under Regulation U (FR G-3; OMB No. 7100-0018),
- Annual Report (FR G-4; OMB No. 7100-0011),
- Statement of Purpose for an Extension of Credit by a Creditor (FR T-4; OMB No. 7100-0019), and
- Statement of Purpose for an Extension of Credit Secured by Margin Stock (FR U-1; OMB No. 7100-0115).

The Securities Exchange Act of 1934 ('34 Act) authorizes the Federal Reserve to regulate securities credit issued by banks, brokers and dealers, and other lenders. The purpose of FR G-1, FR T-4, and FR G-3, are recordkeeping requirements for banks, brokers and dealers, and other lenders, respectively, to document the purpose of their loans secured by margin stock. Other lenders also must register and deregister with the Federal Reserve using the FR G-1 and FR G-2, respectively, and must file an annual report (FR G-4). The Federal Reserve uses the data to identify lenders subject to Regulation U, to verify compliance with Regulations T, U, and X, and to monitor margin credit. The estimated annual burden for these reports is 156,653 hours. Copies of the reporting forms and instructions are attached.

Background and Justification

The '34 Act authorizes the Federal Reserve to regulate margin credit, that is, the amount of credit that can be extended on any security. The Federal Reserve has implemented its authority with the following two regulations for lenders:

- Regulation T - Credit by Brokers and Dealers
- Regulation U - Credit by Banks or Persons Other Than Brokers or Dealers for the Purpose of Purchasing or Carrying Margin Stocks

and the following regulation for borrowers:

- Regulation X - Borrowers of Securities Credit.

Regulation T has governed credit activities of brokers and dealers since 1934. Regulation U, governing banks, was adopted in 1936. The Federal Reserve adopted Regulation G in 1968 as a companion to Regulation U, to stop unregulated lenders from circumventing the margin requirements of Regulations T and U. Regulation G was merged into Regulation U in April 1998. The Federal Reserve adopted Regulation X in 1971 pursuant to a 1970 amendment to the '34 Act. That amendment made it unlawful for U.S. persons to borrow funds in violation of the Federal Reserve's margin requirements. The regulations, and the information collections required by each, are described below.

Regulation T

Regulation T was adopted in 1934 pursuant to Sections 7 and 8(a) of the '34 Act (15 U.S.C. § 78g) to regulate extensions of credit by brokers and dealers. A broker or dealer is required to obtain a written declaration from a customer that a loan is a nonpurpose loan before extending any credit that does not comply with the margin requirements. Purpose loans are defined as loans to purchase, carry, or trade securities. Nonpurpose loans are loans for purposes other than purchasing, carrying, or trading securities. The declaration requirement was established to implement an exception to the absolute prohibition in the statute against any loan made by a broker or dealer in excess of the current margin requirements, without collateral or on any collateral other than securities. The statutory exception provides that the Federal Reserve, by regulation, may permit such a loan in cases where the credit is not for the purpose of purchasing or carrying securities. Until July 1969, there was no specified format for the declaration. At that time, Regulation T was revised and a standard written declaration was developed and made mandatory as part of the revision.

FR T-4. Regulation T requires that the broker or dealer be aware of the circumstances surrounding the extension of credit and be satisfied that the customer's statement as to the use of the credit is truthful. The FR T-4 provides a written record of the amount of nonpurpose credit being extended, the purpose for which the money is to be used, and a listing and valuation of collateral. The form provides a uniform, convenient method by which the broker or dealer can establish its compliance with the statute and the regulation. The FR T-4 also serves as a good evidentiary tool for the self-regulatory agencies charged with ensuring that brokers and dealers are in compliance with the law.

Regulation U

Until Regulation G, which applied to nonbank lenders, was combined with Regulation U in 1998, Regulation U applied to securities credit extended only by banks. It was adopted in 1936 as a companion to Regulation T. From 1936 until 1982, banks were required to ascertain the purpose of every loan secured directly or indirectly by stock. If the purpose of the loan was to purchase or carry margin stock, the loan was subject to the margin restrictions in Regulation U.

In March 1982, as part of a comprehensive revision of Regulation U, the collateral test in the regulation was changed so that a purpose loan was subject to the margin restrictions only if it was secured by margin stock, rather than any stock. This change resulted in a significant reduction in respondent burden.

In September 1987, the Federal Reserve adopted an amendment to Regulation U that exempts banks from the requirement of obtaining the FR U-1 from the borrower(s) when banks make loans of \$100,000 or less secured by margin stock. The amendment reduced the total burden hours associated with the FR U-1 more than 50 percent.

The National Securities Markets Improvement Act of 1996 (NSMIA) repealed section 8(a) of the '34 Act, which distinguished between bank and nonbank lenders with respect to broker and dealers, eliminating the need for separate regulations. Regulation G was merged into Regulation U, effective April 1, 1998.¹

FR U-1 Purpose Statement. Prior to 1968, no specific purpose statement was prescribed, and each bank was required to develop its own procedures to comply with the requirements of Regulation U. By 1968, when margin requirements were 70 percent, it had become evident that there was widespread evasion of the margin requirements by some borrowers, who were falsifying the purpose of their loans. At the suggestion of the U.S. Department of Justice (Justice Department), the Federal Reserve System cooperated in the development of the FR U-1 to promote compliance by both borrowers and banks with the requirements of Regulation U. Effective March, 1968, Regulation U was amended to require the execution of the FR U-1 in connection with any bank loan secured directly or indirectly by stock.

The purpose statement was amended in 1969, 1976, 1982, and 1987. The 1976 revisions to the FR U-1 included the addition of items intended to aid the Justice Department in its enforcement actions and in its efforts to deter the use of lost or stolen securities by organized crime. The certification that Regulation U requires on the FR U-1 has substantially deterred the pledging of stolen or counterfeit securities with U.S. banks. In addition to incorporating the exemption for small loans, the 1982 changes to the FR U-1 simplified its language, instructions, and design in accordance with title 8 of the Monetary Control Act of 1980 (Regulatory Simplifications) and the Paperwork Reduction Act of 1980. Even though the exemption for small loans reduced coverage as well as burden, the FR U-1 requirements still covered most bank credit secured by margin stock in terms of total credit outstanding.

The FR U-1 serves as a compliance tool for banks and borrowers, as an efficient supervisory instrument that is used by bank examiners to verify compliance, and, if necessary, as an evidentiary or enforcement tool for use by the Justice Department or the SEC. Also, the purpose statement is useful to banks to enable them to comply with the requirements of Regulation U without having to design their own compliance forms or to write memoranda to substantiate loans exempt from the margin requirements.

¹ The revised Regulation U was renamed, "Credit by Banks and Persons Other Than Brokers or Dealers for the Purpose of Purchasing or Carrying Margin Stocks."

The FR G-1, FR G-2, FR G-3, and FR G-4 reporting forms for nonbank lenders, each in existence in some form since 1968, will remain unchanged except for editorial updates. Although Regulation G has been merged into Regulation U, the designations of the FR G-1, FR G-2, FR G-3, and FR G-4 reporting forms will not change at this time.

FR G-1 Registration Statement. The registration statement is required to enable the Federal Reserve to identify those nonbank lenders subject to Regulation U. Persons registered as nonbank lenders under Regulation U are required to furnish the Federal Reserve with FR G-4 annual reports; the information on the statement aids the Federal Reserve in monitoring stock market credit and administering margin requirements. In addition, registered entities are subject to compliance inspections by the Federal Reserve Board, National Credit Union Administration, Farm Credit Administration, or Office of Thrift Supervision (regulatory agencies).

FR G-2 Deregistration Statement. The FR G-2 deregistration statement is the vehicle for enabling FR G-1 registrants to withdraw from regulation if their stock-secured lending activities no longer exceed the registration requirements specified in Section 221.3(b)(2) of Regulation U. A registered lender may apply to terminate its registration if the lender has not, during the preceding six calendar months, had more than \$200,000 of such credit outstanding. The deregistration requirements are set forth in Regulation U.

FR G-3 Purpose Statement. Any nonbank lender subject to the registration requirements of Regulation U must complete a FR G-3 purpose statement for each extension of credit secured by margin stock unless the credit is extended under Section 221.3(c)(2)(ii). The purpose statement is intended to ensure that a lender does not extend credit to purchase or carry margin stock in excess of the amount permitted by the Federal Reserve pursuant to Regulation U. In the event a question arises in the future concerning that particular transaction, the FR G-3 serves as an evidentiary tool for lenders and inspectors to determine the intention of the parties involved. In addition, all lenders registered pursuant to Regulation U are subject to compliance inspections. The purpose statement serves as a compliance tool for Regulation U lenders, a means to verify compliance during inspections by examiners, and as necessary, an evidentiary or enforcement tool for use by the Justice Department or the SEC.

FR G-4 Annual Report. The information submitted on the annual report is required pursuant to Regulation U to enable the Federal Reserve to monitor the amount of credit secured by margin stock extended by nonbank Regulation U lenders and thus aid the Federal Reserve in administering margin regulations pursuant to the '34 Act. Additionally, this information aids Federal Reserve Banks in processing the deregistration statement for lenders not directly subject to Federal Reserve System compliance inspections. The FR G-4 was last revised in 1998.

Regulation X

Regulation X addresses the responsibilities of the borrower. There is no information collection required by Regulation X. By requiring the borrower as well as the lender to sign a purpose statement, however, whether the FR G-3, FR T-4, or FR U-1, the borrower is put on written notice that he or she is also required to comply with the margin requirements and that there are penalties associated with noncompliance. The Federal Reserve believes that the mere notification of a borrower that he or she could be liable for misrepresenting the purpose of a loan significantly increases compliance.

Description of Information Collections

Purpose Statements (FR U-1, FR T-4, and FR G-3)

Lenders that extend credit as permitted by the Federal Reserve's margin requirements are sometimes required to fill out purpose statements. The FR U-1 purpose statement is used for extensions of credit by banks, the FR T-4 for extensions of credit by brokers and dealers, and the FR G-3 for extensions of credit by other nonbank lenders.

Both the borrower and the lender complete the purpose statement. Each purpose statement consists of three parts. The borrower completes Part I of the form. The borrower is required to do the following: state the amount of the loan and whether or not the purpose of the loan is to purchase, carry or trade in securities (pursuant to Regulation T) or purchase or carry margin stock (pursuant to Regulation U) and, if not, describe the specific purpose of the loan. FR T-4 respondents must also answer a question as to whether the securities serving as collateral will be delivered against payment. The borrower must sign and date the form. The lender completes Part II, which entails listing and valuing any collateral. The lender then signs and dates Part III of the form, acknowledging that the customer's statement is accepted in good faith. Forms are retained by the lender, who is required to hold them for at least three years after the credit is extinguished.

FR G-1 Registration Statement

Section 221.3(b)(1) of Regulation U requires that the FR G-1 be submitted by every person (other than banks, brokers, or dealers) not currently registered, when the amount of credit extended equals \$200,000 or more, or the amount of credit outstanding at any time during that calendar quarter equals \$500,000 or more, in credit secured directly or indirectly, in whole or part, by collateral that includes any margin stock. Information collected on the registration statement consists of certain background questions, information regarding the credit being extended, and dollar amounts of securities credit.

Respondents include federal and state credit unions, insurance companies, savings and loan associations, commercial and consumer credit organizations, production credit associations, small businesses, insurance premium funding plans, plan-lenders and lenders to ESOPs, thrift plans, broker/dealer affiliates, and miscellaneous lenders. The bulk of regulated credit is

extended by plan-lenders and lenders to ESOPs, insurance companies, broker/dealer affiliates, credit unions, and savings and loan associations.

The registration statement remains in effect until an eligible nonbank lender submits a deregistration statement and the deregistration is approved by a Federal Reserve Bank acting under delegated authority. Many lenders have remained registered since 1968. As of October 1, 2004, 691 lenders were registered.

FR G-2 Deregistration Statement

A registered lender may apply to deregister under Section 221.3(b)(2) of Regulation U if the lender has not, during the preceding six months, had more than \$200,000 of margin credit outstanding. The deregistration statement solicits only six items, including the name and phone number of the registrant, the firm's IRS Identification Number (registrants that are natural persons are not required to disclose their Social Security number), the authorizing officer's signature and title, and the date. A lender who has deregistered must reregister if subsequent lending volume exceeds the Regulation U threshold.

FR G-4 Annual Report

The annual report requires lenders to provide the total amount of credit secured directly or indirectly by margin stock outstanding as of June 30, and the amount of credit secured directly or indirectly by margin stock extended during the year. The information is collected on credit outstanding and extended during the previous year beginning July 1. Lenders are required to indicate whether the loans involved are purpose or nonpurpose and to disclose whether credit is used to fund employee stock option, purchase, or ownership plans. Those lenders funding stock option, purchase, and ownership plans must specify whether such credit was extended pursuant to the special provisions set forth in section 221.4 of Regulation U, which authorizes employers to extend credit to employees and ESOPs with no specified margin.

All lenders registered pursuant to Regulation U, that is, all FR G-1 respondents, are required to file these data pertaining to their lending activities secured by margin stock collateral.

Time Schedule for Information Collection and Publication

The FR G-1 is event generated and must be filed within thirty days following the end of the calendar quarter during which the lender becomes subject to the registration requirements. It is filed with the Federal Reserve Bank of the District in which the principal office of the lender is located. The Reserve Bank staff sends a copy to the Board.

The lender applies to deregister by sending the FR G-2 to the Federal Reserve Bank in the District in which its principal office is located. Upon receipt of the FR G-2, the Reserve Bank confirms that the registrant is eligible to deregister. The Reserve Bank then approves the deregistration under delegated authority from the Board and notifies the Board and the deregistrant of its action.

The registrant files the FR G-4 annual report with the Federal Reserve Bank in the District of its principal place of business within thirty days of the June 30 as-of date.

The FR U-1, FR T-4, and FR G-3 forms are recordkeeping requirements retained by the lender for three years after the credit is extinguished. The Federal Reserve System does not collect or process the information.

Legal Status

The Board's Legal Division has determined that each of the reports is authorized by section 7 of the '34 Act (15 U.S.C. §§78g). The information in the FR G-1 and the FR G-4 is given confidential treatment under the Freedom of Information Act (5 U.S.C. §552 (b)(4)). The FR G-2 does not contain confidential information. The FR G-3, FR T-4, and FR U-1 are not submitted to the Federal Reserve and, as such, no issue of confidentiality arises.

The names of persons and entities registered are available to the public. The public needs to know if the lender is required to register as a nonbank lender under Regulation U because it affects the borrower's responsibilities under Regulation X. Information concerning this system of records was published in the *Federal Register* (46 Fed. Reg. 60995, Dec. 14, 1981), as part of the Federal Reserve System of Records pursuant to the Privacy Act and 12 CFR 261a. It was recently amended to reflect the extension of Regulation U to cover lenders formerly subject to Regulation G (63 Fed. Reg. 10621, March 4, 1998).

Consultation Outside the Agency

There has been no consultation outside the Federal Reserve System.

Sensitive Questions

These collections of information contain no questions of a sensitive nature, as defined by OMB guidelines.

Estimate of Respondent Burden

The annual burden is estimated to be 156,653 hours, as shown in the following table. This represents less than 1 percent of total burden for all Federal Reserve System reports. The total burden comprises both reporting and recordkeeping burden. The total annual reporting burden for the FR G-1, FR G-2, and FR G-4 is 1,506 hours. The number of respondents is based on the number of forms received in 2003. The total recordkeeping burden for the FR G-3, FR T-4, and FR U-1 purpose statements is 155,147 hours. The number of respondents is estimated based on information furnished by brokers and dealers.

	<i>Estimated number of respondents</i>	<i>Annual frequency</i>	<i>Estimated average hours per response</i>	<i>Estimated annual burden hours</i>
FR G-1	39	1	2.50	98
FR G-2	103	1	0.25	26
FR G-4	691	1	2.00	<u>1,382</u>
<i>Total reporting burden</i>				1,506
FR G-3	278	20	0.17	945
FR T-4	138	1	0.17	23
FR U-1	4,278	212	0.17	<u>154,179</u>
<i>Total recordkeeping burden</i>				155,147
<i>Total burden</i>				156,653

Based on an hourly rate of \$20, the annual cost to the public is estimated to be \$3,133,060.

Estimate of Cost to the Federal Reserve System

The estimated current costs to the Federal Reserve System for collecting and processing these reporting forms are \$53,000 per year.