

## **FEDERAL RESERVE SYSTEM**

**12 CFR Parts 207, 220 and 221**

**[Regulations G, T and U; Docket No. R-0943]**

**Securities Credit Transactions; Borrowing by Brokers and Dealers**

**AGENCY:** Board of Governors of the Federal Reserve System

**ACTION:** Interpretation.

**SUMMARY:** The Board is issuing an interpretation of its margin regulations (Regulations G, T and U) in response to the enactment of the National Securities Markets Improvement Act of 1996 (the Markets Improvement Act). Under the Markets Improvement Act, the Board no longer has the authority to regulate certain loans to registered broker-dealers unless it finds that such rules are necessary or appropriate in the public interest or for the protection of investors. This interpretation makes clear that the Board has not made such a finding and that provisions in its margin regulations for which the Board no longer has general authority are without effect. The interpretation also identifies the regulatory provisions that the Board has adopted to implement section 8(a) of the Securities Exchange Act of 1934 (the Exchange Act), which limits the sources of credit for broker-dealers, and concludes that these provisions are without effect in light of the repeal of section 8(a) contained in the Markets Improvement Act.

**DATE:** November 19, 1996.

**FOR FURTHER INFORMATION CONTACT:** Oliver Ireland, Associate General Counsel (202) 452-3625; Gregory Baer, Managing Senior Counsel (202) 452-3236; or Scott Holz, Senior Attorney (202) 452-2966, Legal Division; for the hearing impaired only, Telecommunications Device for the Deaf (TDD), Dorothea Thompson (202) 452-3544.

### **SUPPLEMENTARY INFORMATION:**

The Markets Improvement Act (Pub. L. 104-290) affects the Board's margin authority in two ways. First, the Markets Improvement Act amends

section 7 of the Exchange Act (15 U.S.C. 78g) to exclude certain loans<sup>1/</sup> to broker-dealers<sup>2/</sup> from the Board's margin setting authority. The Board is nevertheless authorized to adopt rules and regulations covering these loans if the Board finds such rules are "necessary or appropriate in the public interest or for the protection of investors." Second, the Markets Improvement Act repeals section 8(a) of the Exchange Act (15 U.S.C. 78h(a)). The Board is issuing an interpretation of Regulations G, T and U, which were adopted under the authority of sections 7 and 8(a) of the Exchange Act, to clarify the application of the regulations in light of the enactment of the Markets Improvement Act. In a separate document published elsewhere in today's Federal Register, the Board is proposing amendments to Regulations G, T and U to implement the recent statutory amendments and further the policies behind them.

The interpretation states that the Board has not made a finding that it is "necessary or appropriate in the public interest or for the protection of investors" to impose rules and regulations on loans to members of a national securities exchange or registered brokers or dealers if a substantial portion of their business consists of dealing with persons other than brokers or dealers or the loan is to finance their activities as a market maker or an underwriter. In other words, the interpretation concludes that provisions of Regulations G, T and U are without effect if the credit extended is within the new statutory exclusion. The interpretation also identifies the provisions of the Board's margin regulations adopted to implement section 8(a) of the Exchange Act and concludes that they are without effect in light of the Market Improvement Act's repeal of section 8(a).

## **List of Subjects**

### 12 CFR Parts 207, 220 and 221

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

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<sup>1/</sup> The excluded loans to broker-dealers are: 1. loans to finance market making or underwriting activities, and 2. loans to finance any activity if a "substantial portion" of the broker-dealer's "business consists of transactions with persons other than brokers or dealers."

<sup>2/</sup> The exact language in the Markets Improvement Act covers "a member of a national securities exchange or a registered broker or dealer." Although the Exchange Act defines the terms "broker" and "dealer," the Markets Improvement Act language is restricted to brokers and dealers who are subject to oversight by the Securities and Exchange Commission.

For the reasons set out in the preamble, 12 CFR Parts 207, 220 and 221 are amended as follows:

**PART 207 -- SECURITIES CREDIT BY PERSONS OTHER THAN BANKS, BROKERS, OR DEALERS (REGULATION G)**

1. The authority citation for Part 207 is revised to read as follows:

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

2. Section 207.114 is added to read as follows:

**§ 207.114 Credit to Brokers and Dealers.**

(a) The National Securities Markets Improvement Act of 1996 (Pub. L. 104-290) restricts the Board's margin authority by repealing section 8(a) of the Securities Exchange Act of 1934 (the Exchange Act) and amending section 7 of the Exchange Act to exclude the borrowing by a member of a national securities exchange or a registered broker or dealer "a substantial portion of whose business consists of transactions with persons other than brokers or dealers" and borrowing by a member of a national securities exchange or a registered broker or dealer to finance its activities as a market maker or an underwriter. Notwithstanding this exclusion, the Board may impose such rules and regulations if it determines they are "necessary or appropriate in the public interest or for the protection of investors."

(b) The Board's margin regulations, Regulations G, T and U (12 CFR Parts 207, 220 and 221 respectively), currently contain rules regarding loans to brokers and dealers based on former section 8(a) of the Exchange Act and its interplay with the earlier version of section 7 of the Exchange Act, which instructed the Board to prescribe rules and regulations with respect to the amount of credit that may extended on any nonexempted security.

(c) The Board has not found that it is necessary or appropriate in the public interest or for the protection of investors to impose rules and regulations regarding loans to brokers and dealers covered by the National Securities Markets Improvement Act of 1996. Consequently, the Board believes that extensions of securities credit that are unregulated under section 7, as amended by the National Securities Markets Improvement Act of 1996, currently are not limited by Regulations G, T and U, notwithstanding any provisions to the contrary, because the provisions of section 7, as amended, supersede conflicting provisions of the Board's regulations.

(d) Section 220.15 of Regulation T (12 CFR 220.15), § 221.4 of Regulation U and the reference in § 221.5(a) of Regulation U to "a member bank and a nonmember bank that is in compliance with § 221.4," and the preamble to § 207.4 of Regulation G (12 CFR 207.4) were all adopted by the Board to implement the requirements of former section 8(a) of the Exchange Act. The Board believes that these sections are without effect in light of the repeal of section 8(a) of the Exchange Act. Brokers and dealers are not restricted as to the type of lender to which they may pledge exchange-traded equity securities as collateral for extensions of credit. In addition, a bank, as defined in section 3 of the Exchange Act (15 U.S.C. 78c) and the rules thereunder, may rely on § 221.5 of Regulation U in making loans to brokers and dealers without regard to membership in the Federal Reserve System or the existence of an agreement with the Federal Reserve under former section 8(a) of the Exchange Act.

#### **PART 220 -- CREDIT BY BROKERS AND DEALERS (REGULATION T)**

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

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

2. Section 220.132 is added to read as follows:

##### **§ 220.132 Credit to Brokers and Dealers.**

For text of this interpretation, see § 207.114 of this subchapter.

#### **PART 221 -- CREDIT BY BANKS FOR THE PURPOSE OF PURCHASING OR CARRYING MARGIN STOCKS**

1. The authority citation for Part 221 is revised to read as follows:

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

2. Section 221.125 is added to read as follows:

##### **§ 221.125 Credit to Brokers and Dealers.**

For text of this interpretation, see §207.114 of this subchapter.

By order of the Board of Governors of the Federal Reserve System,  
November 19, 1996.

William W. Wiles  
Secretary of the Board.