Regulatory Simplification

In 1978 the Board of Governors established a regulatory review program to help minimize the burden of regulation on banking organizations. The objectives of the program are to ensure that the economic consequences of regulation for small business are considered, to afford interested parties the opportunity to participate in designing regulations and comment on them, and to ensure that regulations are written in simple, clear language. Board staff members continually review regulations for their adherence to these objectives and for their consistency with the provisions of the Regulatory Flexibility Act.

Comprehensive Reviews

In 1997 the Board continued the review process mandated by the Regulatory Flexibility Act and by section 303 of the more recent Riegle Community Development and Regulatory Improvement Act. As a result of this process, it adopted revised versions of Regulation T, Regulation U, and Regulation Y. It also eliminated Regulation G (effective in 1998) by revising Regulation U to cover lenders formerly covered by Regulation G. In addition, the Board proposed revising several other major regulations and combining some regulations, thereby reducing the total number of regulations.

Regulatory Revisions Adopted

Regulations G, T, U, and X
Securities Credit Transactions

In 1995 and 1996, the Board proposed revisions to Regulations G, T, and U as part of its comprehensive review of its margin regulations. In 1996, the Board also proposed amendments to the regulations to reflect statutory changes to the Board's margin authority contained in the National Securities Markets Improvement Act of 1996. In December 1997, the Board adopted amendments based on comments on the three proposals. The amendments revise Regulation U, which formerly covered only commercial banks, to also cover lenders formerly subject to Regulation G (lenders other than banks, brokers, and dealers). They also reduce regulatory distinctions between broker–dealers, banks, and other lenders and generally liberalize the treatment of securities credit transactions.

Amendments to Promote Uniformity among Lenders and Reduce Inconsistencies

The Board's margin authority is found in the Securities Exchange Act of 1934 (SEA). The SEA prohibits the Board from regulating extensions of securities credit by banks as comprehensively as it regulates extensions of securities credit by brokers and dealers. In the 1930s, the Board adopted Regulation T to cover brokers and dealers and Regulation U to cover commercial banks. In 1968, it adopted Regulation G to cover lenders other than banks, brokers, and dealers. Regulation G was generally more restrictive than Regulation U. As the Board gained experience with "Regulation G lenders," it amended Regulation G to make it more and more similar to Regulation U. At the beginning of the comprehensive review of Regulations G and U, the primary difference between the regulations was based on section 8(a) of the SEA, which distinguished between bank and nonbank lenders with respect to loans to broker–dealers. Section 8(a) of the SEA was repealed by Congress in 1996, leading the Board to propose combining Regulations G and U. In 1997, the Board announced the extension of Regulation U to cover lenders subject to Regulation G and the elimination of Regulation G, effective April 1, 1998.

Regulation U contains several exemptions from the regular margin requirements for loans made to broker–dealers. The combining of Regulations G and U will result in these exemptions applying to lenders formerly subject to Regulation G. Although the Board amended Regulation T in 1983 to include some of these exemptions, others remained available only in Regulation U. In 1997 the Board announced that all exemptions for loans to brokers and dealers in Regulation U will be extended to Regulation T, so that broker–dealers seeking exempt credit will be able to borrow from all lenders on the same basis.

A significant difference between the coverage of Regulation T and the coverage of Regulations G and U is the treatment of transactions involving nonequity securities. The Board's margin authority under the SEA does not extend to extensions of credit by banks against nonequity securities, and the scope of Regulations G and U has consequently been limited to extensions of credit against equity securities. In contrast, Regulation T covers extensions of credit against both debt and equity securities. To reduce the disparity between broker–dealers and other lenders with respect to extensions of credit against debt securities, the Board eliminated the numerical margin requirement for marginable nonequity securities under Regulation T in 1968 and replaced it with the concept of ''good faith margin.'' Good faith margin is the amount of margin that a broker–dealer, exercising sound credit judgment, would customarily require for a specified security position; it is established without regard to the customer's other assets or securities portions held in connection with unrelated transactions. Although broker–dealers are not required to obtain a specified percentage of margin for the purchase of debt securities, Regulation T still contains rules for debt transactions not found in Regulations G and U. For example, under Regulation T, margin for debt securities must be collected within a specified time period, and a broker–dealer is required to liquidate a customer's securities if the customer does not pay for margin within the required time. In addition, Regulation T does not permit the purchase of a nonequity security to be financed on an unsecured basis or against collateral other than securities. None of these provisions are found in Regulations G and U. In 1996, the Board proposed to further deregulate transactions involving nonequity securities by allowing good faith margin for all nonequity securities and by creating a new account for such transactions that does not have the payment period and the sell-out restrictions applicable to equity security transactions. In addition, the Board proposed to modify the definition of good faith margin to allow broker–dealers to consider the creditworthiness of the borrower as well as the value of the collateral. The proposal was adopted in 1997. It allows the purchase of debt securities by unsecured credit and largely deregulates broker–dealer credit to the debt markets to provide broker–dealers greater parity with banks and other lenders whose credit to the debt markets has not been regulated.

Another significant difference between Regulation T and Regulations G and U is their treatment of nonmargin equity securities. Under Regulation T, nonmargin equity securities have no loan value, meaning that the customer must pay for them in full. Under Regulations G and U, nonmargin equity securities used in connection with a covered transaction have ‘‘good faith loan value.’’ In 1996, the Board proposed to expand the definition of ‘‘margin security’’ in Regulation T. After reviewing comments, the Board modified its proposal and in 1997 announced that all securities listed in the NASDAQ Stock Market will become margin securities on January 1, 1999. This amendment reduces the number of nonmargin equity securities under Regulation T, thereby increasing the number of securities eligible for credit at all lenders.

Another amendment to promote uniformity among lenders announced by the Board in 1997 was the exclusion of money market mutual funds from the definition of ‘‘margin stock’’ in Regulation U. The exclusion has the effect of allowing banks and other lenders to extend ‘‘good faith’’ credit against these securities, as has been allowed under Regulation T since July 1996. The Board also amended the regulations to reduce internal inconsistencies. For example, Regulation U prohibited the extension of credit against exchange-traded options while allowing all other exchange-traded equity securities to be purchased with 50 percent margin. In 1997, the Board amended Regulation U to provide a uniform margin requirement of 50 percent for all exchange-traded equities, including options. The Board also reduced the inconsistencies in the section of Regulation T that covers the borrowing and lending of securities so as to provide uniform treatment of all foreign securities and to permit broker–dealers to borrow securities in anticipation of any situation permissible under the regulation.

Amendments to Improve Efficiency and Reduce Unnecessary Costs

The Board has always relied on the listing standards of the national securities exchanges in defining what constitutes a ‘‘margin stock’’ or ‘‘margin security’’ under its margin regulations. Since 1968, however, the Board has made an individualized determination regarding the margin status of many over-the-counter (OTC) stocks and has published a list of marginable stocks, known as the OTC list, on a periodic basis (currently four times a year). Preparation of the list is an expense both to the Board and to the issuers of OTC securities surveyed by the Board. Moreover, publication of a stock’s name on the OTC list lags its qualification as an OTC security under the Board’s criteria by more than four months. In 1997, the Board announced changes to the definitions of ‘‘margin security’’ in Regulation T and ‘‘margin stock’’ in Regulation U that will result in elimination of the Board’s quarterly OTC list by relying on the listing standards of the NASDAQ Stock Market. The changes will allow lenders to extend credit against OTC stocks on the basis of their current trading status without having to wait for the Board to publish its OTC list.

The Board also publishes a list of foreign margin stocks for purposes of Regulation T. Stocks appear on the foreign list after meeting Board criteria or appearing on the Financial Times/Standard & Poor’s World Actuaries Indices (FT/S&P list). The latter group of stocks are included because the Securities and Exchange Commission considers them to have a ‘‘ready market’’ for purposes of broker–dealer capital requirements; the Board amended Regulation T in 1996 to allow margin status for foreign stocks with a ''ready market.'' Stocks added to the FT/S&P list are not marginable until they appear on the Board's quarterly foreign list. In 1997, the Board announced that it will no longer require that a foreign stock with a ''ready market'' appear on its foreign list to be considered a ''margin security'' under Regulation T. This change will allow broker–dealers to extend credit against foreign securities as soon as they are deemed to have a ''ready market'' without waiting for the Board to verify that status by publishing the names of the securities on its foreign list.

In 1995 the Board solicited comment on the mixed collateral provision in Regulation U, which applies to regulated loans that are secured in part by margin stock and in part by other collateral. The Board noted that this provision makes collateral management extremely difficult and appears to be unnecessarily burdensome to effectuate the statutory scheme of margin regulation. In 1997, the Board announced elimination of the separation requirement in the mixed collateral provision. Regulation U lenders will still be required to determine that the combined loan value of collateral is sufficient to support the credit outstanding.

Amendments to Eliminate Outmoded and Duplicative Requirements

As part of its comprehensive review of Regulations G and U, the Board in 1997 announced the deletion of six Board interpretations because they were obsolete or duplicative of regulatory language added after the interpretation was issued. In 1997 the Board recognized the 1996 congressional repeal of section 8(a) of the SEA by deleting the provisions in Regulations G, T, and U that had been adopted to implement section 8(a). The Board also determined that the collateral requirements for the borrowing and lending of securities under Regulation T were unnecessary to effectuate the purposes of Regulation T and therefore duplicative of the SEC's customer protection rules in this area and of the securities self-regulatory organizations' responsibility for overseeing the safety and soundness of member broker–dealers.

Amendment to Reduce Regulatory Burden

Regulation T requires broker–dealers to keep records of customer transactions by recording them in a margin account or other special-purpose account. In general, the requirements for one account may not be met by considering items in another account. As part of its comprehensive review of Regulation T, the Board announced in 1997 that it was reducing the number of Regulation T accounts from nine to five. The remaining account structure recognizes the distinction between cash and margin transactions for customers; it incorporates a new account for nonequity securities transactions and includes a separate account for transactions between broker–dealers.

Regulation Y
Bank Holding Companies

In 1996 the Board conducted an extensive review of Regulation Y and issued a proposal for public comment (discussed in last year's REPORT). In April 1997, the Board announced the adoption of revisions to the regulation based on the proposal. The revisions streamline and expedite the process for reviewing bank and nonbank applications submitted by well-run bank holding companies; reorganize and expand the regulatory list of nonbanking activities and remove a number of restrictions on the nonbanking activities of bank holding companies that would not apply to insured banks engaged in the same activities; amend the tying restrictions, including the restrictions on bank holding companies and their nonbank subsidiaries; and make other changes to eliminate unnecessary regulatory burden and to streamline and modernize Regulation Y.

Effective in October, the Board modified the prudential limitations established in its decisions under the Bank Holding Company Act and section 20 of the Glass-Steagall Act permitting nonbank subsidiaries of bank holding companies to underwrite and deal in securities. It eliminated restrictions that have proved unduly burdensome or unnecessary in light of other laws or regulations and consolidated the remaining restrictions in a series of eight operating standards. The Board concluded that the narrower set of restrictions is consistent with safety and soundness, should increase customer service options, and should improve operating efficiencies at section 20 subsidiaries. The new operating standards cover capital requirements for bank holding companies and section 20 subsidiaries, internal controls, interlock restrictions, customer disclosures, credit for clearing purposes, funding of securities purchases, reporting requirements, and the application of sections 23A and 23B of the Federal Reserve Act to foreign banks.

Regulatory Revisions Proposed

Regulations H and P
Membership in the Federal Reserve System, and Bank Protection Act

The Board proposed in March 1997 to amend subpart A of Regulation H, regarding the general provisions for membership in the Federal Reserve System, and subpart E of Regulation H, regarding interpretations. The Board also proposed to incorporate Regulation P into Regulation H. In general, the proposed amendments reorganize, clarify, and reduce the burden of compliance with subpart A. They delete application procedures no longer in effect, reflect the requirements of the Community Reinvestment Act in branch applications, provide for expedited procedures in connection with certain membership and branch applications, and eliminate provisions that no longer have a significant effect. The proposal also eliminates a number of interpretations in Regulation H.

Regulation P implements the requirements of the Bank Protection Act of 1968. The proposal to subsume Regulation P in the revised subpart A of Regulation H would not substantively amend the terms of Regulation P. The proposal to combine the regulations is designed to simplify compliance for state member banks by consolidating the regulatory requirements applying to state member banks into one regulation.

Regulation I
Issue and Cancellation of Federal Reserve Bank Stock

In March the Board proposed amending Regulation I to reduce regulatory burden and to update requirements. The proposed amendments simplify, modernize, and condense the regulation and reflect the replacement of share certificates by a book-entry system. They also codify Board and staff interpretations. Finally, the proposed amendments delete references to specific forms, many of which are obsolete because they no longer exist or no longer have the same identification numbers.

Regulation K
International Banking Operations

After a lengthy review, the Board in December 1997 proposed several revisions to Regulation K. Some of the revisions are intended to improve the international competitiveness of U.S. banking organizations by expanding the number of activities that they may engage in abroad and reducing the regulatory burden associated with the conduct of such activities; other revisions are intended to reduce the regulatory burden on foreign banks operating in the United States by streamlining the application and notice process. The proposed revisions include expansion of the authority of U.S. banking organizations to engage in equity securities underwriting and dealing outside the United States; relaxation of limits on the ability of U.S. banking organizations to make venture capital investments in nonbank organizations outside the United States; a streamlined and expedited review process for U.S. banking organizations to branch abroad, and for foreign banking organizations to establish offices in the United States; expedited review of proposals by well-run U.S. banking organizations to make investments abroad; increased flexibility in the standard for determining whether a foreign banking organization would qualify for certain nonbanking exemptions from the Bank Holding Act; and implementation of statutory changes with respect to increased investments by U.S. banks in Edge Act corporation subsidiaries and to the interstate operations of foreign banks operating in the United States.

Other Regulatory Proposals

In November 1997, the Board proposed amendments to Regulation D for monetary policy purposes that are intended to reduce regulatory burden.

Regulation D
Reserve Requirements of Depository Institutions

The Board proposed amendments to move from the existing system of contemporaneous reserve maintenance for institutions that are weekly reporters to a system under which reserves are maintained on a lagged basis. Under the lagged system, the reserve maintenance period for weekly reporters would begin thirty days after the beginning of a reserve computation period. Under the current system, the reserve maintenance period begins only two days after the beginning of a computation period. The longer time between computation and maintenance of reserves should facilitate compliance by weekly reporting institutions and improve the Board's ability to estimate the need for reserves on a timely basis. ■