



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

March 5, 2008

Mary Kostopoulos, Esq.
Moses & Singer LLP
405 Lexington Avenue
New York, New York 11238

Dear Ms. Kostopoulos:

This is in response to your email inquiry received on February 21, 2008, concerning the status of auction rate preferred securities under Regulation T ("Credit by Brokers and Dealers," 12 CFR Part 220). Regulation T has been adopted pursuant to the Securities Exchange Act of 1934 (the Act) and terms used in the regulation have the meanings given them in section 3(a) of the Act (15 U.S.C. 78c(a)), unless they have been defined by the Board in section 220.2 of Regulation T.

Under Regulation T, a security can generally be classified as belonging to one of three categories: margin, nonmargin, or exempted security. U.S. broker-dealers are prohibited from extending credit against nonmargin securities, unless the loan is a nonpurpose loan, that is, for a purpose other than buying, carrying, or trading in securities (see section 220.6(e) of Regulation T). Broker-dealers may extend purpose credit against margin and exempted securities. Exempted securities are defined in section 3(a)(12) of the Act to include government and municipal securities. Broker-dealers may extend up to 50 percent loan value against margin equity securities. Broker-dealers may extend "good faith" credit against debt and exempted securities. Margin requirements are listed in section 220.12 of Regulation T.

We understand that auction rate securities are securities whose interest or dividend rate is reset periodically. Auction rate securities may be issued in the form of debt or preferred stock. If an auction rate security is not an *equity security* as defined in section 3(a)(11) of the Act, it will satisfy the third clause of the definition of *margin security* in section 220.2 of Regulation T ("any nonequity security"). We understand your use of the phrase "auction rate preferred securities" to refer to auction rate securities that are *equity securities* under the Act.

You have asked about the margin status of auction rate preferred securities issued by municipalities and corporations. It is our understanding that municipalities accessing the auction rate market do so with debt offerings and there are no auction rate preferred securities issued by municipalities. Section 220.12(b) of Regulation T permits "good faith" margining for both nonequity and exempted securities.

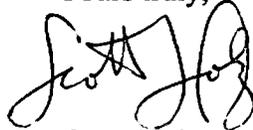
A corporate auction rate preferred security that meets one of the other clauses of the definition of *margin security* in Regulation T will be margin eligible. To our knowledge, no auction rate preferred security is registered, or has unlisted trading privileges on, a national securities exchange, and no auction rate preferred security is a debt convertible into a margin security. We are also unaware of any auction rate preferred security issued by an open-end investment company or unit investment trust registered under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8). An auction rate preferred security with any of these characteristics would be a *margin security* under Regulation T.

There are two additional scenarios under which auction rate preferred securities may be marginable, although we are unaware of the existence of any securities that meet these criteria. The first applies to an auction rate preferred security issued in a jurisdiction other than the United States. Such a security may qualify as a *margin security* if it meets the Regulation T definition of *foreign margin stock*. This requires a determination that the foreign equity security is deemed to have a “ready market” under SEC Rule 15c3-1 (17 CFR 240.15c3-1) or a “no-action” position issued by the Securities and Exchange Commission. The second scenario involves a closed-end investment company whose securities meet the definition of *exempted securities mutual fund* in Regulation T. This requires the company to have at least 95 percent of its assets continuously invested in exempted securities. Auction rate preferred securities issued by such a closed-end investment company are entitled to “good faith” margining under section 220.12(b) of Regulation T.

The foregoing analysis shows that the margin status of an auction rate security is not affected by its auction feature. In summary, based on our understanding of these products, an auction rate preferred security is unlikely to be marginable under Regulation T. If the security meets any of the clauses of the Regulation T definition of *margin security* described in the preceding two paragraphs however, it would be entitled to 50 percent loan value under section 220.12(a) of the regulation. If the security meets the Regulation T definition of *exempted securities mutual fund*, it would be eligible for “good faith” credit under section 220.12(b) of the regulation. Otherwise, it will be classified as a *nonmargin, nonexempted security* and the customer will be required pursuant to section 220.12(e) of Regulation T to maintain margin equal to 100 percent of the current market value of the security. In other words, the security will have no loan value at a U.S. broker-dealer, unless used as collateral for nonpurpose credit pursuant to section 220.6(e) of Regulation T.

We trust that you will find this information helpful. This is a staff opinion only, as the matter has not been presented to the Board.

Yours truly,

A handwritten signature in black ink, appearing to read "Scott Holz", written in a cursive style.

Scott Holz
Senior Counsel