

INTRODUCTION

This Handbook Section briefly describes Regulation U requirements and offers guidelines to you as the regulator in determining compliance with Regulation U.

The Federal Reserve Board (FRB) issued this regulation pursuant to the Securities Exchange Act of 1934 to prevent the excessive use of credit when purchasing or carrying margin stock. The regulation sets out certain requirements for banks and others including savings associations who extend or maintain credit secured directly or indirectly by margin stock. Regulation T governs the extension of credit by brokers and dealers. The reporting requirements and lending restrictions of Regulation U apply only to those institutions required to register.

Until April 1, 1998, 12 CFR Part 207 - Securities Credit by Persons other than Banks, Brokers, or Dealers (Regulation G) governed savings associations. The National Securities Markets Improvement Act of 1996 ("NSMIA") repealed section 8(a) of the Securities Exchange Act of 1934 (the '34 Act). Section 8(a) of the '34 Act mandated a distinction between bank and nonbank lenders with respect to loans to broker-dealers. Regulation U prior to April 1, 1998, applied exclusively to banks. The FRB concluded that with repeal of Section 8(a) of the '34 Act there was no longer a need to distinguish between Regulations G and U. With certain exceptions, the FRB incorporated provisions of Regulation G into amended Regulation U under the revised title: Credit by Banks and Persons Other than Brokers or Dealers for the Purpose of Purchasing or Carrying Margin Stock (Regulation U).

Registration

Any savings association that extends credit, directly or indirectly secured by margin stock, and that meets either of the following two requirements must register with the Federal Reserve Board:

- extending margin-stock-secured credit in any calendar quarter equaling \$200,000 or more, or
- maintaining margin-stock-secured credit outstanding at any time during a calendar quarter totaling \$500,000 or more.

Margin stock consists primarily of equity securities, convertible debt, and mutual funds.

Federal Reserve Form FR G-1 (OMB Control Number 7100-0011) (see Appendix B)¹ is the vehicle a savings association uses to register. The savings association mails the form to the Federal Reserve Bank serving the area of the savings association's principal office. A savings association must register within 30 days after the end of the calendar quarter in which it becomes subject to Regulation U. Registration under Regulation U sets both lending restrictions and reporting requirements on savings associations.

Lending Restrictions

Regulation U prohibits lenders from extending credit in excess of the maximum loan value if the purpose of the credit is to buy or carry margin stock. Credits of this nature are "purpose loans." The maximum loan value of any margin stock is 50 percent of its current market value. Regulation U thus prohibits savings associations from lending on more than 50 percent of the current market value of margin stock if the purpose of the loan is to buy or carry margin stock.

Each purpose credit extended to a customer, including revolving credit or multiple draw agreements, is subject to the "single credit rule." All purpose credit extended to a customer is a single credit. Compliance includes aggregation of all collateral. Withdrawal provisions of the Regulation consider all secured and unsecured credit.

The maximum loan value is the good-faith basis, not to exceed 100 percent of the current fair market value of the collateral, if the proceeds of a

margin-stock-secured loan are for a purpose other than to purchase or carry margin stock. Good-faith basis is the amount that a lender would be willing to lend without regard to any other assets of the borrower. Credits of this nature are "non-purpose loans."

The Regulation allows lenders to permit any withdrawal or substitution of cash or collateral by the customer if the withdrawal or substitution would not cause the credit to exceed the maximum loan value of the collateral or increase the amount by which the credit exceeds the maximum loan value of the collateral.

Margin stock has good faith loan value if it secures directly or indirectly credit extended by a plan lender under an eligible plan. Credit extended by plan lenders on the basis of eligible plans secured by margin stock is separate from other credit secured by margin stock, except for registration and reporting requirements. A plan lender includes any corporation (including any thrift organization whose members are employees and former employees of the organization) that extends or maintains credit to finance the acquisition of margin stock of the organization under an eligible plan. Any stockholder approved employee stock option, purchase or ownership plan adopted by a corporation that provides for the purchase of margin stock of the corporation, its subsidiaries or affiliates are eligible plans. Savings associations also may extend and maintain purpose credit to qualified ESOPs under Regulation U, subject only to the regulation's registration and reporting requirements.

Lenders other than broker-dealers may extend 50 percent loan value against listed options; such options qualify as margin stock. Except for options that qualify as margin stock, puts, calls and combinations thereof have no loan value. Regulation U permits savings associations to extend and maintain special purpose credit to brokers and dealers without regard to the general purpose credit requirements and maximum loan value of margin stock and other collateral restrictions. The types of special credit include: hypothecation loans, temporary advances in payment-against-delivery transactions, loans for securities in transit or trans-

fer, intra-day loans, arbitrage loans, market maker and specialist loans, underwriter loans, emergency loans, capital contribution loans and credit to clearing brokers or dealers.

Exempted Borrowers

Regulation U provides that certain borrowers are exempt. Exempted borrowers consist of national securities exchange members and certain brokers and dealers whose business consists of transactions with persons other than brokers or dealers. There are a number of accounts and dollar and percentage of gross revenue tests to determine eligibility of such borrowers for exemption.

Reporting and Regulatory Requirements

Registered lenders file with the Federal Reserve Bank an Annual Report, on Federal Reserve Form FR G-4 (OMB Control Number 7100-0011) (see Appendix E)¹ showing their lending activities secured by margin stock. Registered lenders file this form for the year ended June 30. This form contains the amount of such credit outstanding and extended during a calendar year. Registered savings associations file this report along with a copy of their balance sheet.

Federal Reserve Form FR G-3 entitled "Statement of Purpose for an Extension of Credit Secured by Margin Securities by a Person Subject to Registration Under Regulation G" must accompany each credit secured by margin securities. (OMB Control Number 7100-0018.) (See Appendix D)¹. Both the borrower and the lender complete the purpose statement for every margin-stock-secured loan extended, except for employee stock purchase plans. The lender obtains a current list of collateral that adequately supports all credit extended under the agreement. The collateral list remains with the executed FRB Form G-3. Neither OTS nor the FRB receives FRB Form G-3. Rather, the savings association keeps the form for three years after the credit is paid-off. The Office of Thrift Supervision is responsible for monitoring compliance with Regulation U by savings associations. The Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, Federal Reserve Board, National Credit Union Administration,

and Farm Credit Administration are responsible for Regulation U compliance by entities under their supervision.

Deregistration

A registered savings association may apply to terminate its registration, by filing Federal Reserve Form FR G-2 (OMB control number 7100-0011) (see Appendix C)¹, with its district Federal Reserve Bank, if the savings association has not, during the preceding six calendar months, had more than \$200,000 of margin-stock-secured credit outstanding. A savings association is deregistered upon approval by the FRB.

REFERENCES**Code of Federal Regulations (12 CFR)**

Part 221 Credit by Banks and Persons
Other Than Brokers or Dealers for the
Purpose of Purchasing or Carrying
Margin Stock (Regulation U)

United States Code (15 USC)

Part 78 Securities Exchange Act of 1934

Federal Reserve Board - Rulings and Interpretations of Regulation U

1 OMB granted the FRB an extension of time to use this form beyond the printed expiration date.