

**Securities Industry Association**

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May 1, 1998

Mr. William W. Wiles
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Re: Regulations T, U and X; Docket No. R-0995

Dear Mr. Wiles:

The Securities Industry Association ("SIA")¹ and The Bond Market Association ("TBMA")² (collectively, the "Trade Associations") are writing in response to the request by the Board of Governors of the Federal Reserve System (the "Board") for comments on proposed revisions to Regulations T, U and X, 63 Fed. Reg. 2840 (Jan. 16, 1998) (the "Advance Notice"). The Trade Associations appreciate the Board's prompt implementation of the amendments to Section 7 of the Securities Exchange Act of 1934 (the "Exchange Act") effected by the National Securities Markets Improvement Act of 1996 ("NSMIA"), as well as the Board's continuing comprehensive review of its margin rules, and welcome the opportunity to provide additional comments to the Board on this subject.

The Trade Associations strongly support, as they have in the past, the Board's ongoing efforts to update federal margin regulations to address the continuing evolution of the domestic and international financial markets.³ The Board's recent amendments to Regulations T and U, 63 Fed. Reg. 2806 (Jan. 16, 1998) (the "Adopting Release"), reflect a thoughtful and forward-looking assessment of long-term trends in those markets. The Board has taken a leadership role, for example, in establishing a regulatory framework that recognizes portfolio approaches to margin regulation, subject to oversight by self-regulatory organizations ("SROs") and the Securities and Exchange Commission (the "SEC"). Similarly, the Board has actively sought to address the issues posed by the substantial internationalization of major financial markets, including by tailoring certain of its margin requirements to foreign securities and market conventions outside the United States. Moreover, the Board's recent amendments to Regulations T and U (including the merger of Regulations G and U) contain important initiatives that respond to the more general process of regulatory modernization in U.S. financial markets, in which longstanding distinctions between broker-dealers, banks and other lenders no longer retain their traditional significance.

In the comments below, the Trade Associations seek to identify areas in which additional regulatory changes and clarification can continue to achieve the major policy objectives articulated by the Board in its review of the federal margin regulations. In particular, the Trade Associations encourage the Board to take steps to clarify and amend the margin rules in several areas where they continue to impede legitimate corporate finance and capital markets activities without significantly advancing the policy objectives underlying Section 7 of the Exchange Act. These areas include forward transactions in equity securities, credit extended to issuers of securities, private placements of debt securities and hedging transactions. In addition, the Trade Associations support efforts to enhance transaction netting and reduce regulatory uncertainty through significant revisions to the existing structure for cash account transactions under Regulation T. The Trade Associations have also identified a number of specific areas in which certain technical requirements of the Board's rules could be reworked to address more effectively the needs of financial market participants, as well as additional amendments that could enhance achievement of the objectives of NSMIA.

The Trade Associations' comments are divided into three parts. Part One provides an executive summary of the Trade Associations' comments with references to those pages in the letter where a fuller discussion of the Trade Associations' views may be found. Part Two generally follows the Board's subject divisions in the Advance Notice and sets forth the Trade Associations' views on those aspects of Regulations T, U and X with respect to which the Board has solicited comment. To simplify the presentation, the discussion in this Part includes the Trade Associations' general comments on all issues relating to a particular subject even if some of those issues are not specifically mentioned in the discussion of that subject in the Advance Notice. Part Three addresses other topics not discussed by the Board in the Advance Notice, which should be considered as requests for further amendments to or clarifications of Regulations T, U or X, as applicable.

For the convenience of the Board and its staff, we have provided a table of contents for the main body of this letter.

TABLE OF CONTENTS

I. Executive Summary

II. Matters on Which the Board Has Solicited Comment and Related Topics

A. Regulation T

1. Definitions

- a. "Current Market Value."
- b. "Good Faith."
- c. "Margin Security."

2. Margin Account

- a. Guarantees as Collateral.

- b. Cashless Exercise of Employee Benefit Securities

- 3. Cash Account: Net Settlement and Free Riding

- a. Modifications to the 90-Day Freeze and Related Restrictions.

- b. Clarification of Existing Provisions

- 4. Lending Foreign Securities to Foreign Branches of U.S. Banks

- 5. Broker-Dealer Purchases of Privately-Placed Debt Securities

- 6. Presumption of Purpose Credit

- B. Regulation U

- 1. Forms

- a. Purpose Statement.

- b. Other Forms and Registration Requirements.

- 2. Loan Value

- a. OTC Options

- b. Non-Equity Mutual Funds

- 3. Exempted Transactions

- C. Regulation X

- D. All Regulations

- 1. Purpose Statements as Model Forms

- 2. Repurchase of Securities by Issuer

- 3. Forward Transactions

- III. Comments on Other Topics Not Specifically Addressed by the Board

- A. Borrowing by Broker-Dealers -- Implementation of NSMIA

- 1. Scope of "Exempted Borrower" Definition

- a. Market Makers and Underwriters

- b. Affiliates of Exempted Borrowers

- c. Introducing and Clearing Firms

- 2. Conforming Regulation U to Regulation T

- B. Borrowing and Lending of Securities

- 1. Pre-Borrowing of Foreign Securities

2. Dividend Reinvestment and Stock Purchase Plans
3. Borrowing and Lending of Securities by Exempted Borrowers

C. Non-Equity Securities and the Good Faith Account

1. Good Faith Loan Value for Money Market Instruments
2. Use of Money Market Instruments as Cash Equivalents
3. Cross-Marginability of Money Market Instruments

D. Margin Treatment of Transactions in Equity Securities

1. Use of Options to Meet Margin Requirements
2. Arbitrage Transactions and Other Hedged Positions
3. Cover for Options Sold in Cash Account

E. Acquisition of OTC Options

F. Other Issues

1. Definition of "Creditor"
2. Single Credit Rule.
3. Transfers of Credit
4. Good Faith Mistakes

I. Executive Summary.

The following is an executive summary of the Trade Associations' comments set forth in greater detail in Parts Two and Three below.

Matters on Which the Board Has Solicited Comment and Related Topics.

Regulation T.

1. Definitions. The Trade Associations ***do not consider it necessary*** to harmonize the definitions of "current market value" in Regulations T and U, although they do not oppose such a change. The Trade Associations ***recommend*** that the Board amend the definition of "current market value" under Regulation T to recognize the intrinsic value of an in-the-money option at the time it is exercised.

The Trade Associations ***support retaining*** the definition of "good faith" under Regulation T and ***recommend*** that the Board extend the current definition to Regulation U.

With regard to the definition of "margin security," the Trade Associations: (i) ***recommend*** that the Board expand the definition to include (a) debt securities "carrying a warrant or right to subscribe to or purchase" a margin security, (b) any "warrant or right to subscribe to or purchase" a margin security, and (c) any convertible security; (ii) ***recommend*** that

securities "exchangeable" into margin securities be treated as margin securities; and (iii) **recommend** that the Board amend the definition to include (a) ADRs or similar depositary shares whose underlying foreign securities qualify as "foreign margin stocks" and (b) shares of foreign issuers issued pursuant to a New York registry, where the corresponding shares of the issuer issued outside of the United States qualify as "foreign margin stocks."

2. Margin Account. The Trade Associations **recommend** that the Board amend Regulation T to permit a guarantee of a customer's account to be given effect under Regulation T to the extent permitted by a creditor's SRO. The Trade Associations also **recommend** certain technical amendments to facilitate the "cashless exercise" of employee benefit securities.

3. Cash Account: Net Settlement and Free Riding. The Trade Associations **propose** that the 90-day freeze and several related restrictions imposed under the cash account be eliminated and that the Board address free-riding through alternate means. If the Board determines not to adopt this proposal, the Trade Associations request that it **clarify** that the term of the 90-day freeze may be measured, at the option of the broker-dealer, from either the end of the permissible payment period for the purchase of the security or the date of sale of the security.

4. Lending Foreign Securities to Foreign Branches of U.S. Banks. The Trade Associations **request** that the Board amend the Regulation T definition of "foreign person" to encompass foreign branches of U.S. banks (whether acting on their own behalf or as agent for others), thereby permitting loans of foreign securities to such branches under Section 220.10(b).

5. Broker-Dealer Purchases of Privately-Placed Debt Securities. The Trade Associations **request** that the Board clarify that a broker-dealer's purchase of privately-placed debt securities, regardless of whether such purchase is made in an initial offering or in a secondary market transaction, does not involve an extension of credit by the broker-dealer.

6. Presumption of Purpose Credit. The Trade Associations **recommend** that the Board amend Regulations T and U to eliminate the presumption of purpose credit and to permit broker-dealers and other lenders to make good faith determinations as to whether a specific extension of credit is purpose credit.

Regulation U.

1. Forms. The Trade Associations **recommend** that the Board eliminate the requirements to obtain written purpose statements under Regulations T and U, as well as the registration requirements for non-bank Regulation U lenders that do not extend purpose credit.

2. Loan Value. The Trade Associations **recommend** that the Board amend Regulation U to permit a lender to provide good faith loan value for an OTC option if the option is written or guaranteed by the lender or one of its affiliates or otherwise would have loan value under SRO rules. The Trade Associations also **recommend** that the Board exclude from

the Regulation U definition of "margin stock" mutual funds that invest almost exclusively in securities entitled to good faith loan value under Regulation T.

3. Exempted Transactions. The Trade Associations **recommend** that the Board extend the Section 221.6 exemptions for extensions of purpose credit by banks to other (*i.e.*, non-bank) Regulation U lenders as well.

Regulation X. The Trade Associations **urge** the Board to exempt foreign affiliates of exempted borrowers from the scope of Regulation X.

All Regulations.

1. Purpose Statements as Model Forms. As noted above, the Trade Associations **recommend** that the Board permit creditors and lenders to make good faith determinations as to whether credit is purpose or nonpurpose credit, and eliminate the requirement of written purpose statements under both Regulations T and U.

2. Repurchase of Securities by Issuer. The Trade Associations **request** that the Board exclude from the definition of an "extension of credit" any credit extended to an issuer of securities or its affiliates in any transaction involving the issuer's securities.

3. Forward Transactions. The Trade Associations **request** that the Board clarify that its margin regulations apply only to transactions that involve extensions of credit and not to principal transactions, such as forwards, that merely give rise to credit exposures. At a minimum, the Board should, in the Trade Associations' view, impose a "good faith" margin requirement on equity forwards and similar transactions entered into on a principal basis.

Comments on Other Topics Not Specifically Addressed by the Board.

Borrowing by Broker-Dealers -- Implementation of NSMIA.

1. Scope of "Exempted Borrower" Definition. The Trade Associations **recommend** that the Board conform the definition of "exempted borrower" to the NSMIA amendments by including within its scope those registered broker-dealers who are borrowing to finance their activities as market makers or underwriters. The Trade Associations also **urge** the Board to amend the definitions of "exempted borrower" in Section 220.2 of Regulation T and Section 221.2 of Regulation U to include all affiliates of any broker-dealer that qualifies as an "exempted borrower." Finally, the Trade Associations request that the Board **clarify** that, for purposes of satisfying the "exempted borrower" safe harbor requirements, customers whose accounts are introduced by an introducing broker to a clearing firm may be treated as "customers" by both the introducing firm and the clearing firm, regardless of whether the customers' accounts are carried on an omnibus or on a fully disclosed basis.

2. Conforming Regulation U to Regulation T. The Trade Associations **recommend** that the Board make a number of technical amendments that would conform certain provisions of Regulation U applicable to exempted borrowers to the corresponding provisions of Regulation T.

Borrowing and Lending of Securities.

1. Pre-Borrowing of Foreign Securities. For purposes of Section 220.10(a), the Trade Associations **request** the Board to permit the "standard settlement cycle" for foreign securities to be the period in which settlement is required to occur by the rules of the relevant foreign securities market.

2. Dividend Reinvestment and Stock Purchase Plans. The Trade Associations **recommend** that the Board add borrowings for the purpose of participating in dividend reinvestment and stock purchase plans to the list of permitted purposes under Section 220.10.

3. Borrowing and Lending of Securities by Exempted Borrowers. The Trade Associations **request** that the Board clarify that Section 220.10(c) does not require an exempted borrower to "trace" securities it lends and to have a "permitted purpose" for securities that were borrowed from persons other than "exempted borrowers."

Non-Equity Securities and the Good Faith Account.

1. Good Faith Loan Value for Money Market Instruments. The Trade Associations **request** the Board to clarify that transactions in money market instruments, whether viewed as non-equity securities or as nonsecurity assets, may be effected and financed in the good faith account under Section 220.6(a) on a "good faith" basis.

2. Use of Money Market Instruments as Cash Equivalents. The Trade Associations **request** that the Board permit the use of money market instruments (other than commercial paper) as cash equivalents for all purposes under Regulation T.

3. Cross-Marginability of Money Market Instruments. The Trade Associations **urge** the Board to amend Section 220.3(b)(2) so as to permit money market instruments to be treated the same as commodities and foreign exchange positions for purposes of calculating the required margin in the margin account.

Margin Treatment of Transactions in Equity Securities.

1. Use of Options to Meet Margin Requirements. The Trade Associations **urge** the Board to expand the class of call options that may serve as cover under Section 220.12(c)(2) to include OTC options that are issued or guaranteed by the broker-dealer that holds the margin for the relevant short sale (or one of its affiliates). In addition, the Trade Associations **request** the Board to permit long puts to serve in lieu of margin for long positions in the underlying security if they are either (i) listed or (ii) issued or guaranteed by the carrying broker.

2. Arbitrage Transactions and Other Hedged Positions. The Trade Associations **recommend** that the Board permit all arbitrage transactions to be treated as "bona fide arbitrage transactions" eligible for reduced margin requirements, whether or not they are based on locking in a profit from a current disparity in the prices of two securities. At a minimum, the Board should, in the Trade Associations' view, permit a creditor to provide a customer with "good faith" loan value for any long position in a convertible debt security that is fully-hedged by an offsetting short position in the underlying stock.

3. Cover for Options Sold in Cash Account. The Trade Associations request that the Board explicitly confirm that customers may continue to effect in the cash account the types of covered option transactions that were previously permitted in the cash account prior to the Board's amendment to the definition of "covered option transaction."

Acquisition of OTC Options. The Trade Associations *request* that the Board confirm that the mere purchase of an OTC option does not constitute an "extension of credit" within the meaning of Section 7 of the Exchange Act and Regulations T and U.

Other Issues.

1. Definition of "Creditor." The Trade Associations *recommend* that the Board revise the definition of "creditor" to exclude entities controlled by a broker-dealer, at least insofar as such entities are not engaged in the business of extending, maintaining or arranging purpose credit.

2. Single Credit Rule. The Trade Associations *propose* that the Board eliminate Section 221.3(d) of the "single credit rule" under Regulation U so that Regulation U lenders may allow the release or withdrawal of any collateral if the overall loan value of the pool of collateral is not less than the amount required under Regulation U.

3. Transfers of Credit. The Trade Associations *recommend* that the Board amend Regulation T to permit transfers of credit between broker-dealers and other lenders, subject to conditions similar to those required for transfers between banks and other non-broker-dealer lenders under Section 221.3(i) of Regulation U.

4. Good Faith Mistakes. The Trade Associations *recommend* that the treatment of good faith mistakes under Regulations T and U be made uniform by amending Section 220.3(h) to provide that "[a] mistake in good faith in connection with the extension or maintenance of credit shall not be a violation of this part."

II. Matters on Which the Board Has Solicited Comment and Related Topics.

A. Regulation T.

1. Definitions.

a. "Current Market Value."

The Trade Associations do not consider it necessary to amend the Board's margin regulations, as described in the Advance Notice, to harmonize the definitions of "current market value" in Regulations T and U, although they do not oppose such a change. As noted by the Board, Regulation T requires broker-dealers to determine the "current market value" of a security (for purposes of calculating its loan value) using its total cost of purchase throughout the trade date (instead of referring to the preceding day's closing price), while Regulation U permits banks and other lenders to use either the total cost of purchase (if the credit is used to finance the purchase of the security) or the preceding day's closing price as appearing in any regularly published reporting or quotation service.

The slight difference between the definitions of "current market value" in Regulations T and U appears to be consistent with the different roles played by broker-dealers and other lenders in financing securities purchases. A broker-dealer extending credit in connection with the purchase of a security will in all circumstances know or have access to up-to-the-minute pricing information regarding a security on the trade date. In contrast, a Regulation U lender may not always have the operational systems needed to incorporate such current information, and in any case will not be the party that actually executes the transaction. The option of using the preceding day's closing price on the trade date provides banks and other non-broker-dealer lenders that may not have direct access to contemporaneous trade data with an alternative source of information from which the loan value of the security may be derived.

As a technical matter, the Trade Associations request that the Board amend the definition of "current market value" under Regulation T to provide that, at the time of a customer's exercise of an in-the-money call option, broker-dealers may treat the intrinsic value of the option as part of the purchased security's "current market value" without waiting until the close of business on the exercise date. For example, a customer exercising a call option with a strike price of \$50 per share to purchase a listed equity security trading at \$70 per share should be deemed to have realized immediately the option's intrinsic value of \$20, which may be applied to meet the initial margin requirement on the purchase. Any additional margin released could be transferred to the customer's special memorandum account. In the Trade Associations' view, this modification to the Regulation T definition of "current market value" would reflect the economic realities of an in-the-money call option and result in a considerably more accurate measurement of the purchased security's value than is provided by its purchase price.⁴ Such a modification would also be consistent with the definition of "current market value" under Regulation U, which permits a lender to use a security's closing price on the preceding business day in lieu of its cost of purchase.

b. "Good Faith."

The Trade Associations support retaining the current Regulation T definition of "good faith" and extending that definition to Regulation U. The current definition of "good faith," with its emphasis on "sound credit judgment," has been tailored specifically to address securities credit decisions. Although the definition has presented some difficulties in practice, those difficulties generally have arisen as a result of the historical requirement that good faith credit be determined "without regard to the customer's other assets or securities positions held in connection with unrelated transactions" (and the related obligation not to extend good faith credit in excess of the market value of the specified securities position). The Board has now eliminated these historical difficulties for transactions effected in the new good faith account under Regulation T (by amending the definition of "good faith" and deleting the proposed "liquidate to a deficit" requirement in that account).

In light of the recent amendments to Regulation T, the Trade Associations believe that further revision of the definition of "good faith" under Regulation T is unnecessary (and suggest that the Board conform the definition of "good faith" under Regulation U to that under revised Regulation T).⁵ This approach, by continuing to focus on the relatively well-understood standard of "sound credit judgment," would afford lenders sufficient flexibility without introducing the uncertainties that could result from the adoption of a wholly new standard (such as one based on the Uniform Commercial Code (the "UCC") or drawn from other sources). If the Board should nevertheless

determine to adopt a new definition of "good faith" based on the UCC (as discussed in the Advance Notice), the Trade Associations consider it important at a minimum to adapt that definition to the context of securities credit transactions. In the credit context, the principal question should be whether the level of credit has been established at a commercially reasonable percentage, an issue which varies independently from the question of whether the parties have acted "honestly" or have had "fair dealings" in the sense contemplated by the UCC.⁶ Thus, if the Board adopts an approach based on the UCC definition, the Trade Associations encourage the Board to incorporate solely the portion of that definition that is salient in the context of setting a margin percentage (*i.e.*, the definitional language obligating the use of "reasonable commercial standards").

c. "Margin Security."

The Trade Associations appreciate the Board's recent amendments expanding the definition of "margin security" in Section 220.2, and welcome the Board's request for comment on whether the definition should be further expanded. As reflected in their more specific comments below, SIA and TBMA urge the Board to continue to work toward a regulatory regime permitting broker-dealers to finance equity securities on the same terms as banks and other non-broker-dealer lenders.

The Advance Notice identifies several areas in which technical differences exist between the definitional provisions of Regulation T and Regulation U. These differences include in particular the exclusion, under the Regulation T definition of "margin security," of (i) debt securities "carrying a warrant or right to subscribe to or purchase" a margin security and (ii) any "warrant or right to subscribe to or purchase" a margin security. In the Trade Associations' view, it would be desirable to adopt the Board's suggestion that the Regulation T definition of "margin security" be amended to include each of these categories of instruments currently encompassed by the Regulation U definition of "margin stock."

The Advance Notice also seeks comment on whether the coverage of convertible securities should be expanded to include any convertible security and not just convertible debt securities. In the Trade Associations' view, the marginability of convertible securities under Regulation T should not turn on the formal question of whether they are debt or equity.⁷ The margin value of these convertible securities derives from their link to other margin securities, not from the fact that they represent indebtedness rather than stock or some other category of equity. In addition, to the extent that the definition of "margin security" includes both convertible debt and "warrants" that grant the holder the right to acquire another margin security, it would seem anomalous to exclude convertible preferred stock or other instruments that grant essentially comparable rights. Moreover, the financial markets have developed a variety of highly structured instruments that increasingly straddle the line between debt and equity, and affording comparable treatment of convertible securities falling on either side of the line would enhance the ability of financial market participants to trade in these innovative products.⁸

The Trade Associations also suggest a further technical clarification of the definition of "margin security" in Regulation T to address the development in recent years of an increasing range of products that are "exchangeable" into margin securities. Typically, the issuer of these exchangeable securities is not the issuer of the underlying margin securities (thus raising some question as to whether the securities can appropriately be viewed as "convertible" under

Regulation T), but instead is a party that owns the underlying margin securities or has entered into an equivalent hedge transaction. These instruments, like other convertible securities, fluctuate in value based on the price of the securities into which they can be exchanged, as well as based on the specific interest rate or other amounts payable in respect of the instrument itself. Moreover, the Trade Associations understand that the Board staff has informally taken the position that exchangeable debt securities, like convertible debt securities, may qualify as "margin securities." Accordingly, the Trade Associations recommend that the definition of "margin security" be amended to explicitly include such exchangeable securities.⁹

In addition, the Trade Associations strongly recommend that the Board amend the definition of "margin security" under Regulation T to include (a) all ADRs (or similar depositary shares) on underlying foreign securities that qualify as "foreign margin stocks" and (b) shares of foreign issuers issued pursuant to a New York registry ("New York Shares"), where the corresponding shares of the issuer issued outside of the United States qualify as "foreign margin stocks." As a technical matter, ADRs and New York Shares generally would appear not to qualify as "foreign margin stocks" because they are not "foreign securities" (*i.e.*, securities "issued in a jurisdiction other than the United States"). Nevertheless, such ADRs represent beneficial ownership of "foreign margin stock," and such New York Shares are essentially the same as the corresponding "foreign margin stock" but issued through the facilities of a New York registrar, transfer and paying agent. In addition, the markets for ADRs (or similar depositary shares) and New York Shares are closely related to the markets for the corresponding "foreign margin stock." Moreover, ADRs and certain New York Shares may be exchanged by the holder for shares of the corresponding "foreign margin stock." In view of these similarities between an ADR or New York Share traded in the United States and the corresponding "foreign margin stock," no policy rationale would appear to support imposition of more restrictive margin requirements on the ADRs and New York Shares than on the corresponding foreign securities.

2. Margin Account.

a. Guarantees as Collateral.

The Trade Associations recommend that the Board amend Regulation T to permit a guarantee of a customer's account to be given effect under Regulation T to the extent permitted by a creditor's SRO.¹⁰ As the Advance Notice recognizes, SRO rules have long permitted the margin account of one customer to guarantee the margin account of another.¹¹ The ability of a guaranteed account to rely upon loan value from the guarantor can be useful in a variety of contexts, including for example in connection with related family trusts or corporate affiliates. These benefits, moreover, may be achieved in a manner consistent with the general objectives of the margin rules, if the accounts as a whole are prohibited from receiving greater aggregate leverage than would otherwise be permitted under Regulation T. In addition, the alternative to a guarantee -- a transfer of securities from the guarantor to the guaranteed account -- may not always be possible and, in any event, may prove costly and inefficient. The Trade Associations believe that there is no significant policy justification for requiring actual transfers to be made rather than permitting any margin excess in the guarantor account to satisfy the Regulation T margin call in the guaranteed account.¹²

b. Cashless Exercise of Employee Benefit Securities.

In connection with the "cashless exercise" of employee benefit securities, the Trade Associations recommend that the Board permit creditors to finance a customer's receipt of securities pursuant to any employee benefit plan. As noted in the Advance Notice, Section 220.3(e)(4) in its current form does *not* permit a creditor to finance a customer's receipt of securities that are registered on an SEC form other than Form S-8 (e.g., Forms S-1 or S-3) or that are offered pursuant to an exemption from SEC registration.¹³

The Trade Associations also note that to achieve the Board's intent -- as indicated in one of its prior releases¹⁴ -- to broaden this provision of Regulation T to include securities other than employee stock options (such as employee stock warrants), the reference to "stock" in Section 220.3(e)(4) should be replaced with the term "securities."

3. Cash Account: Net Settlement and Free Riding.

The Trade Associations appreciate the Board's recent clarifications to the "free riding" restrictions of the cash account, particularly its clarification that the 90-day freeze mandated by Section 220.8(c) need not be imposed unless and until an investor fails to pay for a security within the time periods specified by Regulation T. The Trade Associations also favor additional amendments to the "free riding" restrictions designed to afford creditors increased flexibility in netting securities transactions while continuing to accommodate the objective of prompt payment for cash account transactions.¹⁵

a. Modifications to the 90-Day Freeze and Related Restrictions.

The Board has long played an active role in seeking to reduce systemic risk through netting of exposures in the payment and settlement systems for the U.S. and international financial markets. The cash account provisions of Regulation T, which contain several restrictions designed to ensure payment for securities prior to their sale, have proven an obstacle to netting of exposures in the securities markets, particularly in the case of large institutional counterparties that settle transactions on a delivery-versus-payment basis.

The Trade Associations believe that, while it is important to continue to impose restrictions on "free riding" in securities, the 90-day freeze and several related restrictions imposed under the cash account are confusing and unduly rigid, and should be eliminated, at least in the case of institutional customers who settle on a delivery-versus-payment basis. These restrictions impede net settlement of transactions in cases where it would be efficient and consistent with the requirements of Regulation T. Instead of relying on these existing provisions, the Trade Associations recommend that the Board address free riding through a combination of (i) a requirement, modeled on current Section 220.8(a)(1), that a customer purchasing a security hold sufficient funds in the account or that the creditor accept in good faith the customer's statement that it will promptly make full cash payment for the security and does not contemplate selling it prior to making such payment, and (ii) reliance on SRO rules that address the subject of free riding (e.g., NYSE Rule 431(f)(9), which expressly prohibits customers from making a "practice, directly or indirectly, of effecting transactions in a cash account where the cost of securities purchased is met by the sale of the same securities").¹⁶

The existing 90-day freeze and related provisions of the cash account effectively bar a

customer from netting payment and delivery obligations in cash account transactions, including in the case of delivery-versus-payment transactions.¹⁷ Under Section 220.8(c), a creditor must impose the freeze, subject only to very limited exceptions, whenever a nonexempted security is "sold without having been previously paid for in full by the customer." This provision (together with related language in Section 220.8(a)(1)(ii)) has been construed to prohibit the net settlement of a purchase and sale transaction in the same security in the cash account, even in cases where the customer did not contemplate the sale at the time of the purchase and had the financial wherewithal to make full payment for the purchased securities.¹⁸ If such a customer sells cash account securities before paying for them, it must therefore remit full payment for the purchase against the broker-dealer's payment of the full proceeds of the sale. As the Board and staff interpretations on this subject make clear, this formalistic exchange of payments is an absolute requirement; netting is strictly prohibited.¹⁹

In practice, the cash account restrictions on net settlement, including in particular the 90-day freeze, have proven difficult to interpret and administer.²⁰ More importantly, they do not appear to be necessary to meet the objectives of Regulation T. Under Section 220.8(a)(1), a creditor may not effect a purchase transaction in the cash account unless the customer has already deposited the cash purchase price or stated that it will promptly make full cash payment for the security and does not contemplate selling it prior to making such payment. This requirement, standing alone, directly addresses the key underlying objective of the cash account: to provide an alternative to the margin account for those customers who intend to pay for their securities rather than seek credit from the broker-dealer.

In cases where a creditor accepts in good faith a customer's statement that it intends to pay for a security before selling it, the Trade Associations do not believe it is necessary -- if the customer subsequently decides to sell the security -- to impose the absolute ban on net settlement that results from the current requirement (enforced by the cancellation and 90-day freeze provisions) that full cash payment occur within the applicable payment period. While recognizing the need to maintain protections against abuse, the Trade Associations view the benefits of netting in this context as greater than the costs of this exceptionally broad prophylactic rule. Notably, the Board itself has not historically considered the 90-day freeze necessary for purchases of exempted securities, even at times when Regulation T was construed to prohibit net settlement of exempted securities in the cash account. Similarly, the 90-day freeze has never been imposed on sales of securities in the cash account -- even though such sales pose a precise mirror image of the credit issues presented by purchases in the cash account. In each case, the Board has relied, without any apparent detriment to the policy objectives of Regulation T, on the more general requirements of Section 220.8(a) mandating acceptance of a good faith statement of intent from the customer.

Section 220.8(a)(1) only permits transactions to occur if the creditor can accept the customer's statement of intent to make prompt payment in "good faith" -- a limitation that effectively prohibits a creditor from allowing transactions to continue in the cash account if the customer routinely fails to live up to its representation. Moreover, the requirement that a creditor accept in good faith a statement of intent from the customer does not stand alone. SRO rules expressly prohibit a customer from making a practice of selling securities before paying for them.²¹ These rules can, in the Trade Association's view, more effectively address the potential for abusive "free riding" in the cash account than the 90-day freeze and related provisions of

Regulation T.22 Reliance on SRO rules would also be consistent with the Board's approach to analogous transactions effected in the margin account. In the context of that account, Regulation T imposes no limitations at all on same-day purchases and sales -- relying instead entirely on SRO "day-trading" rules.²³

b. Clarification of Existing Provisions.

If the Board does not adopt the approach to net settlement and free riding described above, the Trade Associations request that it clarify its position, as expressed in the Adopting Release and the amended rule, regarding application of the 90-day freeze to transactions in which a sale occurs prior to the settlement date for a purchase but before the permissible period for payment has completely elapsed. The text of Section 220.8(c), when read together with the language of the Adopting Release, could raise a question as to whether the 90-day period is to be measured from the sale date or from the end of the permissible payment period for the security. That is, although Section 220.8(c)(1) indicates that "the privilege of delaying payment beyond the trade date shall be withdrawn for 90 calendar days *following the date of sale* of the security," the Board's language in the Adopting Release suggests that "the 90-day freeze . . . *need not be applied* until the permissible payment period has passed."²⁴ Operational or system issues may impose significant constraints on the ability of certain broker-dealers to track the "90-day" freeze from the end of the permissible payment period rather than the date of sale. The Trade Associations accordingly request that the Board codify its position in the Adopting Release in such a way as to make clear that the term of the 90-day freeze may be measured, at the option of the broker-dealer, from either the end of the permissible payment period for the purchase of the security *or* the date of sale of the security.²⁵

4. Lending Foreign Securities to Foreign Branches of U.S. Banks.

The Trade Associations request that the Board amend the Regulation T definition of "foreign person" to encompass foreign branches of U.S. banks (whether acting on their own behalf or as agent for others), thereby permitting loans of foreign securities to such branches under Section 220.10(b). Foreign branches of U.S. banks, while part of entities organized under U.S. law, serve many of the same functions abroad for U.S. banks as foreign subsidiaries serve for other financial market participants. These branches are subject to regulation in accordance with local banking practice, compete directly with non-U.S. branches of foreign banks and foreign subsidiaries of U.S. firms, and are formed for legitimate business reasons unrelated to Regulation T. In addition, while such branches generally are subject to Regulation U, their activities outside the United States have been exempted from the application of that Regulation's margin requirements.²⁶ Accordingly, categorization of these branches as "foreign persons" would be completely consistent with the objectives of the Board's 1996 amendments to Section 220.10 (former Section 220.16).²⁷

5. Broker-Dealer Purchases of Privately-Placed Debt Securities.

The Trade Associations request that the Board clarify and modify the treatment under Regulation T of a broker-dealer's purchase of privately-placed debt securities. In particular, the Trade Associations request that the Board clarify that a broker-dealer's purchase of privately-placed debt securities, regardless of whether such purchase is made in an initial offering or in a secondary market transaction, does not involve an extension of credit by the

broker-dealer. In the Trade Association's view, this clarification should occur as promptly as practicable in light of its importance to the markets for privately-placed securities. Thus, the Trade Associations urge the Board to provide appropriate guidance by interpretation -- as it did in the case of securities sold pursuant to Rule 144A under the Securities Act of 1933 (the "Securities Act") -- which can later be codified (if necessary) in Regulation T as part of the proposed rulemaking anticipated by the Advance Notice.

In a number of prior interpretations, Board staff has taken the position that the purchase by a broker-dealer of a debt security in a private placement involves an "extension of credit" by the broker-dealer to the issuer of the security that is subject to Regulation T. The inflexible application of these interpretations unnecessarily complicates the ability of broker-dealers to position privately-placed fixed income securities, especially commercial paper issued under Section 4(2) of the Securities Act.²⁸ In particular, it imposes artificial limitations on the ability of creditors to acquire privately-placed securities for resale in the context of both their activities as placement agents and as participants in the secondary market. These limitations unnecessarily increase financing costs for issuers and compliance costs for broker-dealers without any corresponding public benefit.

In the Trade Associations' view, a broker-dealer's purchase of securities for resale under an exemption from Securities Act registration, such as Section "4(1½)," should be excluded from the definition of "extension of credit." The Board has already adopted an interpretation that the purchase by a broker-dealer of a debt security for resale under Rule 144A is a permissible "arranging" of credit rather than an "extension of credit" by the broker-dealer.²⁹ Thus, a broker-dealer can purchase a debt security for resale under Rule 144A but cannot purchase an otherwise identical security -- sold contemporaneously by the issuer -- for resale under another Securities Act exemption. The Trade Associations request that the Board's position with respect to resales pursuant to Rule 144A be codified and extended to any debt security that a broker-dealer purchases with the intent to resell, regardless of whether such resale will be made in reliance on Rule 144A or some other exemption from the registration requirements of the Securities Act. This relief would eliminate the existing limitations on the purchase by broker-dealers of privately-placed debt securities without undermining the policy objectives underlying the Board's traditional characterization of such purchases as extensions of credit.

Similarly, purchases of debt securities by a broker-dealer in ordinary secondary market transactions that are not part of a plan or scheme to evade the margin regulations also should be excluded from the meaning of "extension of credit." If secondary market purchases of privately-placed securities by a broker-dealer were subject to the margin requirements, broker-dealers would be substantially prevented from investing in such securities (since such securities are unlikely to be secured with collateral permissible under Regulation T and it generally would be very difficult to obtain a nonpurpose statement in connection with the sale). By permitting broker-dealers to purchase debt securities in ordinary secondary market transactions (where there is no intention by the broker-dealer to evade Regulation T), the Board would significantly enhance the liquidity of privately-placed securities and reduce the transaction costs for participants in this market.³⁰

The Trade Associations also urge the Board to provide similar interpretative relief with respect to Regulation U for purchases of debt securities by non-broker-dealers under Rule 144A and in other private placement transactions. The Board and its staff have previously raised questions

regarding whether, as in the case of Regulation T, the purchase of debt securities in a Rule 144A transaction or another private placement may be an extension of credit to the issuer for purposes of Regulation U -- even though the purchase of comparable debt securities sold in a public offering would not be deemed to involve any extension of credit.

As noted above with respect to Regulation T, the restrictions imposed by the Board's approach in this area unnecessarily increase financing costs for issuers and compliance costs for investors without a corresponding public benefit. Rule 144A offerings and other private placements of debt securities do not have many of the features normally associated with a traditional lender-borrower relationship. More importantly, the Board's current approach substantially limits the ability of affected issuers to choose between a public offering or a Rule 144A offering (or other private placement) of debt securities based upon market conditions and related considerations. The Board's margin requirements should not force issuers to access the capital markets by means of a public offering when a Rule 144A transaction or other private placement would be more efficient, at least where the offering is part of bona fide capital markets transaction.

If the Board determines not to provide relief under Regulation U for all private placements of debt securities, the Board should, at a minimum, confirm that the purchase of debt securities under Rule 144A is not an "extension of credit" for purposes of the Regulation. The Board staff has previously noted that certain Rule 144A offerings may be similar in many ways to a public offering, including where the issuer prepares an offering memorandum containing information that would be required for an SEC-approved prospectus and the underwriter conducts a customary due-diligence investigation.³¹

6. Presumption of Purpose Credit.

The Trade Associations recommend that the Board eliminate Section 220.6(f)(2) of Regulation T (which establishes a presumption of purpose credit) and Section 221.3(c) of Regulation U and permit broker-dealers and other lenders to make good faith determinations as to whether a specific extension of credit is purpose credit. Under such a system, creditors and lenders would be permitted to make a good faith determination that a specific extension of credit is not purpose credit. Although a creditor or lender should continue to be allowed to obtain and rely upon a nonpurpose statement in appropriate cases, this would no longer be the exclusive method by which a nonpurpose determination could occur (*e.g.*, a broker-dealer could determine in good faith that credit extended in the good faith account against money market instruments that are not securities is nonpurpose credit). In the Trade Associations' view, this would be a relatively modest departure from the present regime, under which a broker-dealer may extend nonpurpose credit if it "accepts in good faith from the customer a written statement that [the credit at issue] is not purpose credit."³² Because this amendment would affect only the ways in which broker-dealers or other lenders may evaluate extensions of credit rather than the nature of the credit itself, replacing the written purpose statement requirement with a good faith determination requirement would be an essentially nonsubstantive change to Regulations T and U.³³

At a minimum, the Trade Associations request that the Board revise Regulation T to eliminate the requirement that a creditor obtain a Form T-4 prior to extending nonpurpose credit against money market and nonsecurities instruments in the good faith account. This requirement has

been particularly difficult for broker-dealers to comply with as a practical matter, given the short-term nature of money market instruments and the role that repos and reverse repos play in the markets for such instruments. In the case of money market instruments that are not securities, this change would permit transactions to be effected in such instruments in the good faith account on the same basis as transactions in commodities and foreign exchange.³⁴

B. Regulation U.

1. Forms.

a. Purpose Statement.

As discussed in Part II.A.6 above, the Trade Associations recommend that the Board permit creditors, broker-dealers and other lenders to make good faith determinations as to whether credit is purpose or nonpurpose credit, and eliminate the requirement of written purpose statements under both Regulations T and U.

b. Other Forms and Registration Requirements.

The Trade Associations request that the Board eliminate registration requirements for non-bank Regulation U lenders who do not extend purpose credit. Given the general level of awareness of the Board's margin regulations in the credit markets and the fact that such lenders are essentially unregulated entities, they should not be subjected to Regulation U's registration requirements merely for the purpose of confirming that they are complying with its substantive provisions.

2. Loan Value.

a. OTC Options.

The Trade Associations appreciate the Board's solicitation of comment regarding the loan value of OTC options under Regulation U, and recommend that the Board amend Regulation U to permit a lender to provide good faith loan value for an OTC option if the option is written or guaranteed by the lender or one of its affiliates or if the option otherwise would have loan value under SRO rules. As discussed in the Advance Notice, recent amendments to Regulation T have made OTC options eligible for loan value as permitted by the rules of the relevant broker-dealer's examining authority. To place broker-dealers and non-broker-dealer lenders on an equal footing, the Board would need to permit such credit under Regulation U on the same terms as currently apply under Regulation T. Since complete parity between Regulations T and U in this area would involve subjecting Regulation U lenders to the requirements of broker-dealer SROs, however, the Trade Associations believe that the solution described above -- allowing lenders to extend good faith credit for options that they or one of their affiliates have written or guaranteed or for other OTC options that may be granted loan value under SRO rules -- is the most practical resolution of this issue at the current time.

b. Non-Equity Mutual Funds.

The Trade Associations believe that the Board should exclude from the Regulation U definition

of "margin stock" mutual funds that invest almost exclusively in securities entitled to good faith loan value under Regulation T. As a practical matter, there does not appear to be any policy justification for drawing a distinction, for margin purposes, between funds that invest predominantly in exempted non-equity securities and those that invest predominantly in non-exempted non-equity securities, since both types of underlying instruments are now eligible for good faith loan value under Regulation T.

3. Exempted Transactions.

The Trade Associations welcome the Board's request for comment on whether the Section 221.6 exemptions for extensions of purpose credit by banks should be extended to other (*i.e.*, non-bank) Regulation U lenders as well. At present, Section 221.6 exempts from Regulation U purpose credit extended by banks when such credit is extended, *inter alia*, to other banks, to foreign banks, outside the United States, or to facilitate certain securities transfers. The Trade Associations believe there is no significant policy justification for limiting the Section 221.6 exemptions to banks, particularly given that most of the exemptions are defined by reference to the nature of the borrower rather than the lender.

C. Regulation X.

SIA and TBMA strongly urge the Board to amend Regulation X to ensure that congressional policy in NSMIA is reflected consistently across the Board's margin regulations. As described in more detail in Part III.A.1 below, the Trade Associations also recommend that the Board amend the definitions of "exempted borrower" in Regulations T and U to include domestic and foreign affiliates of a borrower that meets one or more of the "safe harbor" tests. At a minimum, however, the Trade Associations request that the Board exempt foreign affiliates of exempted borrowers from the scope of Regulation X.³⁵

Regulation X is an anti-evasion rule that currently prohibits "U.S. persons" and "foreign persons controlled by or acting on behalf of or in conjunction with United States persons" from obtaining credit from outside the United States to purchase or carry U.S. securities unless such credit conforms to Regulation T (if the credit is obtained from a foreign branch of a U.S. broker-dealer) or Regulation U (if the credit is obtained from a foreign branch of a U.S. bank or any other lender outside the United States). Because foreign affiliates of exempted borrowers may be "foreign persons controlled by a United States person" for purposes of Regulation X or otherwise subject to its restrictions,³⁶ the ability of such affiliates to obtain credit may be limited by Regulation X -- even though the credit is obtained outside the United States.³⁷ For example, a non-U.S. affiliate of a U.S. broker-dealer may be limited in its ability to finance any inventory it maintains in U.S. "margin stock" (since Regulation X would impose a 50% margin requirement on any such financings).

NSMIA eliminated any policy rationale for the continued application of Regulation X to foreign affiliates of exempted borrowers. NSMIA repealed *all* restrictions on the ability of exempted borrowers to fund their securities activities, whether conducted in the United States or abroad (subject to residual Board authority that has not been exercised to date). In light of this change, the basic premise for application of Regulation X -- that U.S. persons should not evade U.S. margin rules by seeking credit abroad -- simply does not apply in the context of exempted borrowers. No exempted borrower will establish a foreign affiliate to obtain better credit outside

the United States now that it can obtain exempt credit within the United States. Indeed, the fundamental objective of Regulation X -- ensuring that consistent rules apply to borrowings by U.S. persons and foreign affiliates controlled by U.S. persons, regardless of whether effected in the United States or abroad -- is wholly consistent with granting an exemption (and thus parallel treatment) to foreign affiliates of exempted borrowers.

Furthermore, extraterritorial application of the Board's margin regulations to foreign affiliates of U.S. broker-dealers substantially impairs the competitiveness of such foreign affiliates in foreign securities markets, since they are not permitted to obtain securities credit on terms as favorable as those available to foreign broker-dealers operating in the same markets (including foreign broker-dealers with U.S. affiliates that are exempted borrowers). The Board's margin regulations should not be applied in a manner that detracts from the competitiveness of an exempted borrower in foreign securities markets merely because business or regulatory considerations may dictate that such activities be conducted through separately organized affiliates of the exempted borrower.³⁸ The need for Board action to repeal these formalistic barriers to effective foreign competition by affiliates of exempted borrowers has, moreover, become particularly acute since the adoption of NSMIA. Current law creates an asymmetry in the regulation of the funding activities of U.S. and foreign securities firms: borrowings by foreign firms' U.S. affiliates that qualify for the Section 7 exclusions are now exempted from the Board's margin requirements, while substantially identical borrowings by U.S. firms' foreign affiliates remain subject to the Board's margin requirements. Accordingly, SIA and TBMA urge the Board to eliminate this unnecessary burden on the non-U.S. activities of foreign affiliates of exempted borrowers by excluding them from the scope of Regulation X.

D. All Regulations.

1. Purpose Statements as Model Forms.

As discussed in Part II.A.6 above, the Trade Associations recommend that the Board permit creditors and lenders to make good faith determinations as to whether credit is purpose or nonpurpose credit, and eliminate the requirement of written purpose statements under both Regulations T and U.

2. Repurchase of Securities by Issuer.

The Trade Associations also urge the Board to reconsider their previous proposals that any credit extended to an issuer of securities or its affiliates in any transaction involving the issuer's securities be excluded from the definition of an "extension of credit" for purposes of the Board's margin regulations. As noted in the 1995 SIA Comment Letter, prior interpretations of the Board and its staff have provided limited interpretive relief for extensions of credit by a broker-dealer directly to an issuer (not an affiliate) to purchase securities that will be retired immediately upon delivery to the issuer.³⁹ An issuer of securities may, however, have a number of legitimate corporate purposes for engaging in a variety of types of transactions involving its securities that do not involve their immediate retirement. For example, issuers increasingly have found it desirable to achieve important corporate financing and related objectives by engaging in transactions such as forward purchases and sales and put or call options on their securities. Although these transactions provide issuers with an efficient means of raising capital or hedging their obligations in related capital formation activities and do not reflect the type of

speculative securities credit that Regulations T and U were designed to curb, the margin requirements imposed by these Regulations frequently make it uneconomical to conduct these transactions. Accordingly, the Trade Associations believe that the Board should exempt such transactions from the scope of its margin regulations. If the Board declines to exempt such transactions altogether, it should at a minimum grant interpretive relief permitting extensions of non-purpose credit to issuers that do not immediately retire their repurchased securities.⁴⁰

In addition, in some circumstances an issuer may find it desirable, for tax, accounting or other purposes, to conduct transactions involving its own securities through an affiliate. In such cases, lenders should be permitted to provide financing for such transactions so long as they serve a legitimate corporate purpose of the issuer. In the Trade Associations' view, the application of Regulations T and U should not dictate how a corporate group engages in financing or related transactions in the securities of one of its members.

3. Forward Transactions.

In the view of the Trade Associations, the Board should amend its margin regulations to clarify that they do not apply to forwards and other transactions effected on a principal basis that give rise to *credit exposures* but that do not entail an *extension of credit* by one party to the other.⁴¹ The Board's margin regulations, which are drafted to address transactions involving an *extension of credit*, frequently impose margin requirements on transactions involving bilateral credit exposures that do not reflect the fundamental economic relationships between the parties. As discussed in the Advance Notice, the new good faith account permits broker-dealers to effect forwards and other principal transactions involving bilateral credit exposures in the context of non-equity securities. Additional amendments are required with respect to Regulations T and U, however, to clarify the treatment of forwards and similar transactions involving equity securities and to provide for margin requirements consistent with the economic nature of these transactions.⁴²

Bilateral credit exposures may arise out of a number of contractual commitments that do not involve an actual extension of credit by one party to the other. In a forward transaction effected on a principal basis, for example, each party is exposed to the risk that its counterparty will not perform its obligations on the forward settlement date. The seller faces the risk that the buyer will not pay for the securities, and the buyer faces the risk that the seller will not deliver the securities. Neither party has actually advanced funds or securities to the other, and thus neither party has "extended" credit in any conventional sense.

Because Regulations T and U broadly define the concept of "extension of credit" and do not speak expressly to bilateral credit exposures of the type created by forward transactions, they arguably can be read to suggest that merely entering into a forward transaction involves an extension of credit subject to margin requirements. This reading creates a number of conceptual and technical problems. Most notably, if a forward transaction is an "extension of credit" subject to federal margin regulation, it is not clear which party -- the forward seller or the forward purchaser -- is "extending credit" to the other. Indeed, uncertainty on this point has led many broker-dealers to assume that they must take margin under Regulation T whenever they purchase or sell securities on a forward basis. Similarly, under Regulation U it is frequently unclear which party is required to provide margin to the other in a forward transaction. As a matter of logic, however, it would seem impossible for a party to be "extending credit" both

when it is *selling* a security for forward delivery and when it is *purchasing* for forward delivery.

More generally, the ambiguity regarding when a credit exposure becomes an "extension of credit" subject to federal margin regulation has hindered the ability of broker-dealers and other U.S. lenders to enter into innovative financial market transactions. Many categories of derivatives (for example, interest rate swaps) entail an element of credit exposure (since like forward transactions they involve contractual commitments that must be performed in the future). In some instances (including in the case of most swaps), market participants have reached the conclusion that these transactions are not generally subject to margin requirements under Regulation U (and previously Regulation G), even while their status under Regulation T has been more difficult to resolve. In other cases, the uncertainty of market participants has led them to take margin even where economics and policy seemed to suggest margin was unnecessary under Regulation U (such as in the case of issuer forwards collateralized by the issuer's stock, for which the Board staff has granted interpretive relief).⁴³ These uncertainties, moreover, are likely to become more significant in the context of the SEC's proposal to authorize "OTC Derivatives Dealers" specifically to engage in a broad range of securities and other financial derivatives in an entity subject to Regulation U.⁴⁴

The Trade Associations therefore request that the Board clarify that its margin regulations apply only to transactions that involve extensions of credit and not to principal transactions, such as forwards, that merely give rise to credit exposures. This clarification could be made pursuant to the Board's authority under the Exchange Act to determine what types of transactions entail an "extension of credit" and to establish the margin requirements applicable to such transactions. In the event that the Board elects not to exclude principal forward transactions from the definition of "extension of credit," the Trade Associations request that the Board at a minimum impose a "good faith" margin requirement on principal equity forwards and similar transactions.⁴⁵

III. Comments on Other Topics Not Specifically Addressed by the Board.

A. Borrowing by Broker-Dealers -- Implementation of NSMIA.

The Trade Associations appreciate the Board's adoption of safe harbors under Regulations T and U for extensions of credit to "exempted borrowers" -- *i.e.*, broker-dealers that qualify for the NSMIA exemptions contained in Sections 7(c)(2)(A) and 7(d)(2)(C)(i) of the Exchange Act because they have a substantial non-broker-dealer business. These safe harbors will provide market participants with the ability to ascertain with greater certainty whether a broker-dealer is eligible to borrow without restriction under the Board's margin regulations. The Trade Associations propose below several technical refinements to the exempted borrower provisions of Regulations T and U that are intended to enhance the ability of market participants to realize fully the policy objectives of NSMIA.

1. Scope of "Exempted Borrower" Definition.

a. Market Makers and Underwriters.

The Trade Associations recommend that the Board conform the definition of "exempted borrower" to the NSMIA amendments by including within its scope those registered broker-dealers who are borrowing to finance their activities as market makers or underwriters. The Trade Associations recognize that the Board has amended Regulations T and U to permit extensions of credit to market makers, specialists and underwriters on a "good faith" margin basis.⁴⁶ Like extensions of credit to broker-dealers with a substantial non-broker-dealer business, however, loans to broker-dealers to finance their activities as market makers or underwriters were explicitly exempted by NSMIA (under Sections 7(c)(2)(B) and 7(d)(2)(C)(ii) of the Exchange Act) from the Board's margin regulations. Consequently, there is no reason to subject these loans to a "good faith" margin or any other requirement under Regulations T and U -- instead, they should be excluded from the scope of the Regulations altogether.⁴⁷ The Trade Associations also believe it important to prevent the confusion that will likely arise if the term "exempted borrower" includes only some of those broker-dealers whose borrowings are exempted under NSMIA. For example, cross references to "exempted borrowers" within Regulations T and U (*e.g.*, Section 220.10), as well as in SRO margin or other regulations, should incorporate all broker-dealers whose borrowings have been exempted by NSMIA, not just those with a substantial non-broker-dealer business.

b. Affiliates of Exempted Borrowers.

The Trade Associations also urge the Board to amend the definitions of "exempted borrower" in Section 220.2 of Regulation T and Section 221.2 of Regulation U to include all affiliates (including subsidiaries) of any broker-dealer that qualifies as an "exempted borrower."⁴⁸ Broker-dealers frequently may obtain financing for their activities from a variety of sources and through a number of affiliates (*e.g.*, through commercial paper issuances by a holding company or by obtaining secured credit in foreign markets through foreign affiliates). The use of commonly-controlled or wholly-owned affiliates to obtain financing reflects a range of bona fide business, legal, tax and other economic and regulatory considerations. Exempted borrowers should not be forced to forgo the benefits of the NSMIA exemptions in order to achieve an optimal corporate organizational structure, especially where the allocation of particular business activities between the broker-dealer and its affiliates is not motivated by any effort to circumvent

the Board's margin rules. There would seem to be little danger that an entity affiliated with an exempted broker-dealer will be the recipient of the sort of excessive credit that the margin regulations were designed to prevent.⁴⁹

c. Introducing and Clearing Firms.

The Trade Associations request clarification by the Board that, for purposes of satisfying the "exempted borrower" safe harbor requirements, customers whose accounts are introduced by an introducing broker to a clearing firm may be treated as "customers" by both the introducing firm and the clearing firm, regardless of whether the customers' accounts are carried on an omnibus or on a fully disclosed basis.⁵⁰ Introduced accounts of non-broker-dealers are generally required to be treated as "customer" accounts by both the introducing and the clearing firms for purposes of a variety of SEC and SRO rules. Moreover, since it is unlikely that firms that are primarily trading entities would be willing to assume the obligations of introducing brokers or clearing firms solely to obtain an exemption from the margin rules, permitting both introducing and clearing firms to treat their non-broker-dealer accounts as customers for purposes of the "exempted borrower" definition would be fully consistent with the policy objectives of NSMIA.

2. Conforming Regulation U to Regulation T.

The Trade Associations recommend that the Board conform certain provisions of Regulation U applicable to exempted borrowers to the corresponding provisions of Regulation T. First, Section 221.1 of Regulation U should be amended to exclude credit extended based on a "good faith determination" that the borrower is an exempted borrower (*i.e.*, Section 221.1(b)(3) of Regulation U should be conformed to Section 220.1(b)(3)(ii) of Regulation T). In the Adopting Release, the Board stated that it "believes lenders should be required to apply a 'good faith' standard in determining whether the Board's margin regulations apply to borrowings by specific broker-dealers." The Trade Associations support this view, which is codified in Section 220.1(b)(3)(ii) of Regulation T. Section 221.1(b)(3) of Regulation U, however, does not permit lenders to rely on a good faith determination that a borrower is exempted, notwithstanding the fact that the Board's statement in the Adopting Release appears to pertain to both Regulation T and Regulation U. In the Trade Associations' view, there is no reason for holding Regulation U lenders responsible for a good faith, albeit incorrect, determination regarding the status of an exempted borrower.⁵¹

Second, Section 221.3(e)(2) of Regulation U should be amended to require a broker-dealer that has ceased to qualify as an exempted borrower to notify its lender of this fact only "before obtaining additional credit" from the lender (*i.e.*, Section 221.3(e)(2) of Regulation U should be conformed to Section 220.3(j)(2) of Regulation T). In the absence of a renewal or new extension of credit, no purpose would be served by imposing on a formerly exempted borrower the obligation to notify its lenders that it has lost its exempted borrower status.

Third, as a technical matter, Section 221.3(e)(1) of Regulation U should be conformed to Section 220.3(j)(1) of Regulation T by replacing the words "[a]n exempted borrower" the first time they appear with the words "[a] member of a national securities exchange or a registered broker or dealer." The Trade Associations do not believe that this clarification would have any substantive effect on the scope of Regulation U.

B. Borrowing and Lending of Securities.

The Trade Associations appreciate the Board's amendment to Section 220.10(a) permitting a creditor who reasonably anticipates a fail to deliver to borrow securities up to one standard settlement cycle in advance of the trade date. SIA and TBMA renew their request, however, that the Board amend Section 220.10 to permit broker-dealers to borrow foreign securities up to one foreign settlement period in advance of a short sale or fail to deliver, and to permit borrowings for the purpose of participating in dividend reinvestment and stock purchase plans. The Trade Associations also request that the Board amend Section 220.10(c) to permit an exempted borrower to on-lend any securities (including securities borrowed from customers) without a "permitted purpose."

1. Pre-Borrowing of Foreign Securities.

The Trade Associations request that, for purposes of Section 220.10(a), the Board permit the "standard settlement cycle" for foreign securities to be the period in which settlement is required to occur by the rules of the relevant foreign securities market. The Board has noted that under Section 220.10 "[t]he phrase 'standard settlement cycle' refers to SEC Rule 15c6-1."⁵² The SEC has exempted from Rule 15c6-1 certain foreign securities for which the settlement period in the local market is longer than three business days.⁵³ Nevertheless, the Board appeared to take the position in the Adopting Release that for purposes of Section 220.10(a) the "standard settlement cycle" for all foreign securities, regardless of local settlement practices, is three business days.

The Board's references to Rule 15c6-1's "standard settlement cycle" appear to be at odds with the SEC's approach to foreign securities under that rule. As noted above, the SEC's exemptions recognize that the settlement periods applicable to foreign securities may be significantly longer than those applicable to U.S. securities. In addition, the Board has recognized the importance of accommodating longer foreign settlement cycles in its recent revisions to the cash account (Section 220.8(b)(1)(ii)). The Trade Associations also believe that any concerns that a longer pre-borrowing period will enhance the ability of market participants to engineer manipulative transactions, such as "squeezes," are misplaced.⁵⁴ No pre-borrowing would be permitted unless the borrower reasonably anticipates the need to cover a short sale or a fail. In addition, the ability to pre-borrow under Section 220.10 applies only to broker-dealers, who in any event are subject to separate restrictions on their trading activities, including prohibitions on market manipulation.

As a practical matter, moreover, prohibiting a broker-dealer from entering into a firm commitment to borrow foreign securities up to a full local settlement period prior to a reasonably anticipated short sale or fail will substantially limit the broker-dealer's ability to obtain those securities in a timely and cost effective manner, especially where the securities trade inactively or are difficult to locate. In markets characterized by a significant level of fails, a securities firm often will not be willing to execute a short sale until after it has actually received borrowed securities to cover the sale -- in other words, it will not have confidence that it has "located" securities for borrowing until the securities are transferred into its account. Of necessity, in such a market the securities firm executing the short sale must enter into a borrowing transaction a full local settlement cycle in advance of the short sale (since it will not receive the borrowed securities in its account until the completion of the settlement cycle).

2. Dividend Reinvestment and Stock Purchase Plans.

The Trade Associations continue to recommend that the Board add borrowings for the purpose of participating in dividend reinvestment and stock purchase plans to the list of permitted purposes under Section 220.10. This would achieve a number of efficiency-enhancing policy objectives, such as reducing the cost of capital to issuers, without significantly undercutting the primary purpose of restricting the borrowing and lending of securities. One of the principal reasons issuers set up such plans is to raise capital periodically without incurring the expensive costs of an underwriting. This goal is furthered, and the free flow of resources to their highest-valued uses in the capital markets thereby improved, by permitting broker-dealers to borrow securities to participate in such plans.

In the Adopting Release, the Board indicated that it "continues to believe that allowing a broker-dealer to borrow customer securities to take advantage of a dividend reinvestment and purchase plan could allow customers to obtain greater credit than could be obtained via a conventional margin loan."⁵⁵ In the Trade Associations' view, however, expanding the list of permitted purposes to include such borrowings would not create a mechanism for avoiding the Board's margin requirements. Dividend reinvestment and stock purchase programs are sufficiently targeted and narrow in application that it would be extremely difficult for a broker-dealer to utilize them so as to circumvent the Board's margin requirements to any significant extent. Ordinarily, a borrowing to participate in a dividend reinvestment or stock purchase program could occur in a given stock only over relevant record dates -- typically no more than once per quarter. Borrowings over the very brief period of time reasonably necessary for the borrower to participate in the plan (e.g., over the applicable record date) do not raise, in the Trade Associations' view, a risk of abuse that is significant enough to outweigh the benefits of broadening participation in such programs.

3. Borrowing and Lending of Securities by Exempted Borrowers.

The Trade Associations request that the Board consider modifying its interpretive position, set forth in the Adopting Release, that an exempted borrower "will not be permitted to borrow securities from a customer or a broker-dealer that is not an exempted borrower in order to relend them unless the relending is for a permitted purpose such as a short sale or fail transaction."⁵⁶ In particular, the Trade Associations request that the Board clarify that Section 220.10(c) does not require an exempted borrower that on-lends borrowed securities to "trace" whether the on-lending transaction involves a permitted purpose, regardless of whether the lender is also an exempted borrower.

Prior to the adoption of NSMIA, broker-dealers could on-lend borrowed securities without tracing the source of the borrowing because each loan was required to have a permitted purpose. Under Sections 220.10(c), as amended by the Board to implement NSMIA, an exempted borrower may now "lend securities without regard to the other provisions of [Regulation T]" -- *i.e.*, without a "permitted purpose." On its face, Section 220.10(c) does not distinguish between securities sourced from the exempted borrower's own inventory or borrowed from another exempted borrower, on the one hand, and securities borrowed from persons who are not exempted borrowers, on the other. The Board's interpretation of Section 220.10(c), however, would appear to require broker-dealers to track the source of any securities they lend and effectively to segregate such securities into these two categories. As a practical matter, broker-dealers generally do not have the operational systems and procedures in place to "trace" these two categories of securities on an ongoing basis, and it would be difficult to develop and implement systems and procedures that would perform this function in a reliable and efficient manner.

The Trade Associations urge the Board to accommodate the operational difficulties that would result from a tracing requirement by rescinding its interpretation of Section 220.10(c) and clarifying that exempted borrowers may lend securities without a permitted purpose, regardless of the source of those securities. In the past, the Board staff has granted comparable interpretive relief in light of the operational burdens that such tracing might require in the context of primary dealers in U.S. government securities.⁵⁷ In the Trade Associations' view, any concerns that the Board may have regarding the potential for this approach to result in circumvention of Regulation T can be adequately addressed by permitting an exempted borrower to borrow securities from non-exempted borrowers only for the purpose of on-lending them in bona fide securities lending transactions.

C. Non-Equity Securities and the Good Faith Account.

1. Good Faith Loan Value for Money Market Instruments.

The Trade Associations greatly appreciate the Board's amendments creating the new good faith account and extending good faith loan value to both non-equity securities and nonsecurities assets. Although the Board's amendments have made it clear that commercial paper and other money market instruments are eligible for good faith loan value for transactions involving non-equity securities, there remains some ambiguity as to the circumstances in which creditors may effect and finance transactions in money market instruments in the good faith account, as opposed merely to accepting them as collateral. Under Section 220.6(a)(1), "[a] creditor may

effect and finance transactions involving the buying, carrying, or trading of any *security* entitled to 'good faith' margin as set forth in § 220.12" (emphasis added). On its face, this provision does not appear to permit transactions in nonsecurities in the good faith account (other than as collateral), and, notwithstanding certain of the Board's prior statements, there continues to be some question as to whether commercial paper is a "security."⁵⁸ In addition, although transactions in nonsecurities assets may be effected in the good faith account under Section 220.6(e), that provision requires a creditor to obtain a "nonpurpose" statement from the customer -- a procedure that is cumbersome and unnecessary.⁵⁹ Accordingly, the Trade Associations request that the Board clarify that transactions in money market instruments, whether viewed as non-equity securities or as nonsecurity assets, may be effected and financed in the good faith account under Section 220.6(a) on a "good faith" basis.

2. Use of Money Market Instruments as Cash Equivalents.

The Trade Associations also request that the Board permit the use of money market instruments (other than commercial paper) as cash equivalents for all purposes under Regulation T. At present, the Board expressly permits the use of "cash equivalents" -- a term that currently includes money market instruments other than commercial paper -- to satisfy option cover requirements via an escrow agreement under Section 220.8. The Trade Associations consider it both permissible and desirable for the Board to authorize creditors to treat such money market instruments and other "cash equivalents" as "cash" for all purposes under the Regulation, including for purposes of transactions in the margin account.⁶⁰ Thus, for example, money market instruments such as certificates of deposit or bankers' acceptances could be used, at the discretion of the creditor, to satisfy margin requirements in the margin account or to satisfy any requirement regarding the deposit of cash in the cash account, without such instruments being liquidated. This approach would be consistent with current market and business practices, under which the liquidity and creditworthiness of money market instruments causes them generally to be regarded as the functional equivalent of cash. It would also be consistent with the Board's authority to determine how the margin requirements it establishes are to be satisfied.⁶¹

In any event, the Trade Associations believe that, at a minimum, all money market instruments should at least enjoy the same "cash equivalence" for purposes of the Regulation T cash account as granted to money market fund shares under a recent Board staff interpretation. In its interpretation, the Board staff indicated that broker-dealers would not be required to redeem money market fund shares held in a customer's cash account to pay for the purchase of a security (and then to reinvest the proceeds from the subsequent sale of the security in money market fund shares) to avoid application of the 90-day freeze, provided that sufficient money market funds shares are "pending" in order to ensure settlement to cover any deficit resulting from the same day purchase and sale.⁶² As with money market fund shares, mandatory liquidation of money market instruments on trade date to cover a customer's payment obligations may entail substantial expense (and, in some cases, the imposition of penalties) and unnecessarily deprive customers of the benefits attendant to ownership of such instruments, while providing minimal additional assurance that the customer will be able to meet its payment obligations on the payment date. Accordingly, the Trade Associations request that, regardless of whether the Board more broadly affords money market instruments the status of "cash equivalents," Regulation T be amended to provide that the 90-day freeze will not apply to a

customer's transactions in a cash account in such circumstances if (i) the customer has in any Regulation T account sufficient money market instruments on the trade date to cover the purchase price of a security, ⁶³ (ii) the broker-dealer has authorization to liquidate the instruments (if necessary) to satisfy the customer's payment obligations, and (iii) the broker-dealer "pends" a sufficient quantity of such instruments to cover any deficit that may be incurred. ⁶⁴

3. Cross-Marginability of Money Market Instruments.

The Trade Associations welcome the Board's amendments to Section 220.3(b)(2) permitting commodities and foreign exchange positions to be considered in calculating margin requirements on securities positions, and wish to emphasize the degree to which these amendments have removed some of the burdens formerly imposed on customers seeking to hedge their portfolios in accordance with modern risk-management techniques. The reasoning that led the Board to permit cross-margining of commodities and foreign exchange positions applies equally to positions in money market instruments, and the Trade Associations accordingly urge the Board to further amend Section 220.3(b)(2) to permit money market instruments to be treated the same as commodities and foreign exchange positions for purposes of calculating the required margin in the margin account. Such an amendment would be an additional step toward a more general policy of allowing broker-dealers to rely on cross-margining between securities transactions and financial futures and other nonsecurities products, and would bring Regulation T closer to fully recognizing the vast array of opportunities for hedging, arbitrage and basis trading that result from the relationships between short-term credit instruments and other assets.

D. Margin Treatment of Transactions in Equity Securities.

The Trade Associations commend the Board for its recent efforts to achieve parity in the treatment of broker-dealer and non-broker-dealer lenders under Regulations T and U. The Trade Associations wish to encourage the Board to continue to eliminate regulatory barriers to such equal treatment, and to work toward the goal of permitting creditors subject to Regulation T to finance positions in equity (and non-equity) securities to the same extent as lenders subject to Regulation U.

1. Use of Options to Meet Margin Requirements.

The Trade Associations appreciate the Board's decision to rescind its interpretation that options are not securities "exchangeable or convertible into other securities, within 90 calendar days, without restriction other than the payment of money." The Trade Associations urge the Board to expand the class of call options that may serve as cover under Section 220.12(c)(2) to include OTC options that are issued or guaranteed by the broker-dealer that holds the margin for the relevant short sale (or one of its affiliates). Allowing such OTC call options to serve as full cover for a short sale would be a relatively small expansion of the range of permissible activities under Regulation T. Moreover, any issues of counterparty credit risk normally associated with OTC call options -- as in the current "partial cover" regime -- would be fully addressed by requiring the option to have been issued or guaranteed by the creditor holding the

short position (or one of its affiliates).

In addition, the Trade Associations request that the Board reconsider whether it should permit long puts to serve in lieu of margin for long positions in the underlying security if they are either (i) listed or (ii) issued or guaranteed by the carrying broker. In the Adopting Release, the Board appeared to acknowledge that such offsets are acceptable in principle but reasoned that they "may be appropriate in the context of a future portfolio margining system." Because of the nature of the process by which such margining systems must be developed and approved, it may be some years before creditors are actually able to employ such offsets in the context of a portfolio margining framework. In the interim, the Trade Associations urge the Board to amend Regulation T to recognize explicitly this type of offsetting position.

2. Arbitrage Transactions and Other Hedged Positions.

The Trade Associations reiterate their request that the Board permit all arbitrage transactions to be treated as "bona fide arbitrage transactions" eligible for reduced margin requirements, whether or not they are based on locking in a profit from a current disparity in the prices of two securities. More generally, the Trade Associations urge the Board to consider creating exceptions to its margin requirements for all types of hedged or limited risk positions.

The Board stated in the Adopting Release that arbitrage transactions not entered into based on a current price disparity "do not comport with the underlying policy of the arbitrage account of allowing special credit for transactions that perform a market function by eliminating real-time disparities in pricing between identical or closely related securities."⁶⁵ In the Trade Associations' view, however, such transactions should be eligible for reduced margin requirements -- either under the arbitrage provisions of the good faith account or elsewhere under Regulation T -- because they involve a hedged position of limited risk.⁶⁶ These transactions do not pose any greater risk for the customer than arbitrage transactions satisfying the strict requirements established by the Board. As such, they should be accorded similar margin treatment.⁶⁷

In the Trade Associations' view, any hedged customer positions -- not just arbitrage transactions -- should be subject to reduced margin requirements under Regulation T. Customer transactions that are hedged do not involve the types of speculation or leverage that the margin requirements of Regulation T are designed to address. Indeed, Regulation T does not require margin, or requires reduced margin, in a number of situations in which a customer's position is hedged, such as where a customer writes a covered put or call option or where a customer covers a short position with a long position or a security convertible or exchangeable for the security sold short. In addition, certain hedged transactions, such as convertible arbitrages and covered options, have been appropriately addressed by SRO margin rules that recognize the risk-reduction inherent in the offsetting hedge and apply a maintenance margin requirement to the combined position that is lower than the initial margin requirement under Regulation T.⁶⁸

Accordingly, the Trade Associations urge the Board to amend Regulations T and U to recognize and facilitate the risk-reducing benefits of transactions that involve offsetting risk positions, regardless of whether they "lock-in" a profit.⁶⁹ Alternatively, the Board could amend Regulation T to permit a creditor's SRO to determine the types of offsetting transactions for which no margin or reduced margin requirements apply.

At a minimum, the Trade Associations recommend that the Board permit a creditor to provide a customer with "good faith" loan value for any long position in a convertible debt security that is fully-hedged by an offsetting short position in the underlying stock. At present, the maximum loan value under Section 220.12 for a convertible debt security -- which is a "margin security" -- is 50 percent of the market value of the security. Where any future changes in the value of the convertible security are fully-hedged by an offsetting short position, however, there would not appear to be any policy justification for limiting the amount of loan value that may be provided for that security.

3. Cover for Options Sold in Cash Account.

The Trade Associations appreciate the Board's efforts to create a "shorter and simpler Regulation T" by amending the definition of "covered option transaction" for purposes of the cash account to refer to SRO rules generically.⁷⁰ SIA and TBMA understand that, as noted by the Board, this amendment was intended to be implemented "without having a substantive effect on broker-dealers."⁷¹ As a technical matter, however, SIA and TBMA note that the Board's elimination of the first two paragraphs in the former definition of "covered option transaction" -- which explicitly permitted short calls to be covered by the underlying asset and short puts to be covered by cash or cash equivalents -- may have created some ambiguity regarding the types of covered options that may be written in the cash account, since at present it is not clear that SRO rules specifically authorize the types of covered option transactions described in those two paragraphs.⁷² The Trade Associations therefore request that the Board explicitly confirm that customers may continue to effect in the cash account the types of covered option transactions that were previously permitted in that account, while enabling the SROs to approve, on an ongoing basis, other types of covered or "limited risk" transactions that may be effected in the cash account.

The Trade Associations also recommend that the Board expand the category of assets that may serve as cover pursuant to SRO rules to include, in addition to cash or cash equivalents, the assets underlying the option⁷³ or other assets approved by the SRO. The SROs should be provided the flexibility to identify situations in which the asset underlying an option or warrant, or another asset, may appropriately serve as "cover" for a transaction involving the option or warrant.⁷⁴

E. Acquisition of OTC Options.

The Trade Associations request that the Board confirm that the mere purchase of an OTC option does not constitute an "extension of credit" within the meaning of Section 7 of the Exchange Act and Regulations T and U. Although the Board's margin regulations have long implicitly treated the acquisition of an option as the purchase of a security, there remains some ambiguity as to whether such a transaction might also be somehow deemed to entail an extension of credit from the purchaser of the option to its seller.

In the Trade Associations' view, the purchaser of an OTC option is neither lending money to the seller nor otherwise guaranteeing or providing credit support to the seller's contractual obligations. The purchaser of an option assumes no liability to any third party; indeed, the purchaser of an option, having paid the purchase price, acquires (by definition) only rights and no liability to anyone. Particularly in the case of an option on an equity security, the purchaser

of an option is in a position indistinguishable from that of a purchaser of a warrant. From a credit perspective, the purchaser of an OTC option is thus in a position similar to that of a creditor or lender purchasing a warrant or other equity security, transactions that the Board has already confirmed do not involve extensions of credit under Regulation T.⁷⁵ To the Trade Associations' knowledge, there is no authority to suggest that the treatment of such transactions should be any different under Regulation U, or that the meaning of "extension of credit" should be any broader under that Regulation than under Regulation T.⁷⁶

The Trade Associations believe that, as in the case of other long securities positions held by creditors, financial responsibility requirements such as the SEC's net capital regulations best address, from a regulatory perspective, the potential market and credit exposure of a creditor that purchases an OTC option in a principal capacity.⁷⁷ Because such options do not involve the loan of money by the creditor or lender to the customer, the deferred payment by the customer of the purchase price of a security, the delayed delivery of a security by the customer, or the incurrence by the creditor or lender of an obligation to a third party on behalf of a customer, they do not involve an "extension of credit" to the customer in any traditional sense.⁷⁸ In addition, as recognized in a 1984 study by the Board staff, options margin has traditionally been viewed as "a form of bond to guarantee performance and not an extension of credit as conventionally defined."⁷⁹

F. Other Issues.

1. Definition of "Creditor."

The Trade Associations also recommend that the Board revise the existing definition of "creditor" to exclude entities controlled by a broker-dealer, at least insofar as such entities are not engaged in the business of extending, maintaining or arranging purpose credit.⁸⁰ In the Trade Associations' view, the imposition of "creditor" status on entities controlled by broker-dealers is overly restrictive and unnecessary to achieve the purposes of Regulation T. Read literally, the current definition of "creditor" is particularly burdensome, for example, in the case of a subsidiary of a broker-dealer engaged entirely in other businesses, such as real estate, or an investment partnership that has a broker-dealer as its managing general partner, even where the partnership is not engaged in investing in securities and most of its equity is contributed by third parties who are not broker-dealers. Such "creditor" status imposes a number of burdens on these entities, including the potential requirement that they obtain a "purpose statement" for any nonpurpose credit they extend and potential limitations on their ability to sell their own securities on credit. These concerns are especially acute for affiliates of broker-dealers that are not controlled by a holding company.⁸¹

2. Single Credit Rule.

SIA and TBMA appreciate the Board's elimination of the mixed collateral loan provisions of Regulation U and request that the Board also eliminate Section 221.3(d) of the single credit rule under Regulation U. Like the former mixed collateral rule, Section 221.3(d) requires lenders to segregate certain loans for purposes of determining compliance with the collateral limitations of Regulation U. In particular, Section 221.3(d) requires a lender extending both purpose credit secured by margin stock and nonpurpose credit to the same customer to treat the two credits as two separate loans, and to ensure that the collateral securing the purpose credit is not relied

upon for the nonpurpose credit. This requirement, together with the withdrawal and substitution provisions of Regulation U, imposes difficult operational and collateral management burdens on lenders. Consistent with the Board's rationale in eliminating the mixed collateral rule (*i.e.*, reliance on good faith determinations of the adequacy of collateral by a lender), Section 221.3(d) should be eliminated and Regulation U lenders should be permitted to allow the release or withdrawal of any collateral if the overall loan value of the pool of collateral is not less than the amount required under Regulation U.

3. Transfers of Credit.

The Board should amend Regulation T to permit transfers of credit between broker-dealers and other lenders subject to conditions similar to those required for transfers between banks and other non-broker-dealer lenders under Section 221.3(i) of Regulation U. The Trade Associations see no reason why such transfers should be permissible under Regulation U but impermissible under Regulation T. Given the substantial restrictions on such transfers contained in Section 221.3(i)(1), the Trade Associations believe that it would in no way subvert the policies underlying Regulation T to permit transfers on substantially the same terms as are permitted under Regulation U, both as between broker-dealers and between broker-dealers and non-broker-dealers.

4. Good Faith Mistakes.

Consistent with its general policy of eliminating unnecessary differences between Regulations T and U, the Board should provide for uniform treatment of good faith mistakes under the two Regulations. Currently, Section 220.3(h) of Regulation T provides that good faith mistakes shall not constitute violations of Regulation T "if, promptly after the discovery of the mistake, the creditor takes appropriate corrective action." Section 221.3(k) of Regulation U, by contrast, simply states that good faith mistakes do not constitute violations of Regulation U, and does not impose any requirement of post-hoc corrective action. In the Trade Associations' view, there is no policy justification for the difference between the two provisions. The treatment of good faith mistakes should be made uniform by amending Section 220.3(h) to provide that "[a] mistake in good faith in connection with the extension or maintenance of credit shall not be a violation of this part" (*i.e.*, by conforming Section 220.3(h) of Regulation T to Section 221.3(k) of Regulation U).

* * * * *

SIA, TBMA and their members appreciate the opportunity to comment on the Advance Notice and would be pleased to discuss any of the comments in this letter with the Board or its staff. If we can be of further assistance to the Board in this regard, please do not hesitate to call Gerard J. Quinn (212-618-0507) of SIA or Paul Saltzman (212-440-9459) or Patricia Brigantic (212-440-9454) of TBMA. You are also welcome to contact Giovanni P. Prezioso (202-974-1650) or Robert W. Cook (202-974-1538) of Cleary, Gottlieb, Steen & Hamilton, special counsel to SIA and TBMA in this matter, or Anthony J. Leitner (212-902-5730) of Goldman, Sachs & Co. or Marcy Engel (212-783-5957) of Salomon Smith Barney, on behalf of SIA's Ad Hoc Committee on Regulation T and the TBMA Working Group on Regulation T.

Very truly yours,

Anthony J. Leitner

Marcy Engel

cc:

Mr. J. Virgil Mattingly, Jr.

Mr. Oliver Ireland

Mr. Gregory A. Baer

Mr. Scott J. Holz

Board of Governors of the Federal Reserve System

Mr. Richard Lindsey

Mr. Robert L.D. Colby

Mr. Michael A. Macchiaroli

Ms. Catherine McGuire

Securities and Exchange Commission

Mr. Raymond J. Hennessy

Mr. Donald van Weezel

Mr. Richard Nowicki

Mr. Albert Lucks

New York Stock Exchange, Inc.

Mr. Richard G. Ketchum

Mr. Thomas R. Cassella

Mr. Samuel Luque

National Association of Securities Dealers, Inc.

Footnotes:

1. SIA is the leading proponent of capital markets, bringing together the shared interests of about 800 securities firms throughout North America to accomplish common goals. SIA members -- including investment banks, broker-dealers, specialists, and mutual fund companies -- are active in all markets in all phases of corporate and public finance. In the United States, SIA members collectively account for approximately 90 percent, or \$100 billion, of securities firms' revenues and employ about 350,000 individuals. They manage the accounts of more than 50 million investors directly and tens of millions of investors indirectly through corporate, thrift and pension plans. More information about SIA can be found at its internet website <http://www.sia.com>.

2. TBMA represents approximately 200 securities firms and banks that underwrite, trade and sell debt securities, both domestically and internationally. Its members include all of the primary dealers recognized by the Federal Reserve Bank of New York, as well as other government securities dealers. More information about TBMA can be found at its internet website <http://www.bondmarkets.com>.

3. See, e.g., Letter to William W. Wiles, Secretary of the Board, from Marcy Engel and Anthony J. Leitner, Co-Chairs, SIA Ad Hoc Committee on Regulation T, and Mindy R. Connelley, Chair, TBMA Regulation T Working Group and Member of the Board of Directors (the "1997 SIA/TBMA Comment Letter") (responding to 61 Fed. Reg. 60,168 (Nov. 26, 1996)); Letter to

William W. Wiles, Secretary of the Board, from Marcy Engel and Anthony J. Leitner, Co-Chairs, SIA Ad Hoc Committee on Regulation T (the "1996 SIA Comment Letter") (responding to 61 Fed. Reg. 20,399 (May 6, 1996)); Letter to William W. Wiles, Secretary of the Board, from Paul Saltzman, Senior Vice President and General Counsel, TBMA (the "1996 TBMA Comment Letter") (responding to 61 Fed. Reg. 20,399 (May 6, 1996)).

4. The Trade Associations note that treating such intrinsic value as part of "current market value" is consistent with Board staff interpretations on the "cashless exercise" of employee benefit securities. See, e.g., Fed. Res. Reg. Serv. ¶ 5-677.51 (staff opinion of Dec. 28, 1988).

5. See Part III.A.2 *infra*.

6. The Trade Associations naturally support the obligation of all commercial parties to act honestly and to deal fairly in their business activities, an obligation that extends to transactions regardless of whether they are subject to a "good faith" margin requirement.

7. In the context of Regulation U, where the definition of "margin stock" plays a key role in determining whether a particular transaction is subject to the Regulation, it may be desirable not to disrupt existing practices and to continue to exclude convertible equity securities from the definition of "margin stock."

8. The Trade Associations also request that the Board specifically address the margin status of those securities (both debt and equity) that are convertible into debt securities. In particular, it would be helpful if the Board clarified that debt convertible into debt would be treated as a non-equity security (and therefore eligible for good faith loan value), and that preferred stock convertible into debt would be viewed as an equity security convertible into a margin security (and therefore eligible for 50% loan value).

9. If the Board were to adopt each of the changes to the definition of "margin security" discussed above, the definition would include "any security convertible or exchangeable into a margin security, any security carrying a warrant or right to subscribe to or purchase a margin security, and any warrant or right to subscribe to or purchase a margin security."

More generally, the Trade Associations request that the Board confirm that exchangeable securities issued by an entity other than the issuer of the underlying securities also qualify as exchangeable or convertible securities for purposes of the other provisions under Regulation T that refer to exchangeable or convertible securities, including the arbitrage transaction provisions of the good faith account (Section 220.6(b)) and the provisions setting forth short sale margin requirements (Section 220.12(c)(2)).

10. See 1996 SIA Comment Letter at 55. The Trade Associations would expect any such amendments to include appropriate restrictions to ensure that the two accounts comply, on a consolidated basis, with the leverage limitations of Regulation T (e.g., by mandating that the required margin be calculated as if there were a single special memorandum account).

11. See, e.g., New York Stock Exchange, Inc. ("NYSE") Rule 431(f)(4); National Association of Securities Dealers, Inc. ("NASD") Rule 2520(f)(4).

12. Since the overall credit extended to the guarantor and the guaranteed accounts must

comply with Regulation T, the Trade Associations believe it would be appropriate explicitly to confirm that the guarantor account would not be subject to the registration and other requirements of Regulation U, at least in cases of transactions involving related family trusts and between corporate affiliates.

13. If the Board has referred to Form S-8 because it desires to limit the class of customers who may borrow pursuant to Section 220.3(e)(4) to those persons eligible to purchase securities registered on Form S-8, the Trade Associations recommend that the Board implement this intended limitation by adding an additional sentence to the end of the paragraph to read as follows: "For purposes of this paragraph, the term customer shall include any person to whom the securities could have been sold if the plan were registered on Form S-8." If the Board adopts this approach, the words "registered on SEC Form S-8 or the withholding taxes for an employee stock award plan" should be deleted from Section 220.3(e)(4).

14. 60 Fed. Reg. 33,763 (June 29, 1995) (the "1995 Release").

15. The Trade Associations do not propose at present any specific changes to the treatment of "free riding" under Regulation U. The treatment of free riding under that Regulation has given rise to issues of considerable complexity that have been the subject of numerous interpretations by the Board and its staff. See, e.g., Fed. Res. Reg. Serv. ¶¶ 5-942.21 (staff opinion of Apr. 24, 1992); 5-942.2 (staff opinion of Apr. 24, 1992); 5-942.15 (staff opinion of July 18, 1989); and 5-942.18 (staff opinion of May 16, 1989); see also Fed. Res. Reg. Serv. ¶ 5-942.22 (Mar. 16, 1993) (policy letter of the Board's Division of Banking Supervision and Regulation to the Federal Reserve Banks). In light of the risk of creating new ambiguity under those Regulation U interpretations and the close relationship between restrictions under Regulation U and Regulation T, the Trade Associations ask that the Board continue to review the status of free riding under Regulation U in light of any potential future amendments to Regulation T. In particular, to the extent that the Board adopts any of the proposed changes to the cash account described in this letter, it would be desirable to make conforming changes to Regulation U that will confirm that no violation will arise under that Regulation in circumstances where a transaction is permissible under Regulation T.

16. As a technical matter, the changes requested by the Trade Associations to enhance net settlement would require the Board to (i) eliminate or significantly revise Sections 220.8(b) (in particular the cancellation provision in (b)(4)) and (c) in deference to SRO restrictions on free-riding and (ii) make a conforming change to Section 220.8(a)(1) by deleting the words "before selling it" the first time they appear.

17. As the Trade Associations have noted in the past, see Letter to William W. Wiles, Secretary of the Board, from Marcy Engel and Anthony J. Leitner, Co-Chairs, SIA Ad Hoc Committee on Regulation T at 50-51 (Sept. 29, 1995) (the "1995 SIA Comment Letter"), Regulation T's restrictions on free riding are both underinclusive and overinclusive -- underinclusive insofar as they permit conduct at least as egregious as that which has concerned the Board staff in the past, see, e.g., Fed. Res. Reg. Serv. ¶ 5-942.2 and 5-942.21 (staff opinion of Apr. 24, 1992) and 5-942.18 (staff opinion of May 16, 1990), and overinclusive to the extent that they prohibit conduct that is completely benign. Institutional investors, for example, are effectively prohibited from managing their portfolios so as to make efficient use of uninvested cash balances. Active management of cash balances -- which is an affirmative obligation imposed on investment

managers -- is obviously not the sort of conduct that the free riding prohibition was meant to curtail.

18. See, e.g., Fed. Res. Reg. Serv. ¶¶ 5-615.94 (staff opinions of Sept. 30, 1986, and Mar. 30, 1987) and 5-615.93 (staff opinion of Oct. 31, 1985).

19. See, e.g., Fed. Res. Reg. Serv. ¶ 5.615.94 (staff opinions of Sept. 30, 1986, and Mar. 30, 1987).

20. Numerous interpretive letters have been sought from the Board and its staff to provide guidance on the application of the cash account and the 90-day freeze. See, e.g., Fed. Res. Reg. Serv. ¶¶ 5-615.94 (staff opinions of Sept. 30, 1986, and Mar. 30, 1987) and 5-942.22 (staff opinion of Mar. 16, 1993).

21. See, e.g., NYSE Rule 431(f)(9); NASD Rule 2520(f)(9).

22. In many ways, the problems associated with regulating "free riding" are similar to those that led the Board recently to delegate regulation of covered option transactions to the SROs.

23. See, e.g., NYSE Rule 431(f)(8)(B); NASD Rule 2520(f)(8)(B). In the event that the Board declines to eliminate the 90-day freeze in its entirety, the Trade Associations request that it consider doing so at a minimum for delivery-versus-payment transactions.

24. Adopting Release at 2817.

25. In this connection, the Trade Associations also request that the Board amend Section 220.8(c) of Regulation T so as to treat money market instruments as cash equivalents for purposes of the application of the 90-day freeze in the cash account. See Part III.C.2 *infra*.

26. See Regulation U, Section 221.6; Fed. Res. Reg. Serv. ¶ 5-884.67 (staff opinion of Mar. 24, 1989). Regulation S also exempts from the definition of "U.S. person" a bona fide foreign branch or agency of a U.S. bank. See Securities Act Rule 902(o)(6).

27. 61 Fed. Reg. 20,388.

28. As TBMA has noted in prior correspondence to the Board, current interpretations of Regulation T significantly restrict the ability of a broker-dealer to take into inventory commercial paper offered pursuant to Section 4(2) of the Securities Act, even though the broker-dealer's only purpose in doing so is to facilitate the offering in view of certain market mechanics and to resell the commercial paper as soon as possible. See Letter to Laura M. Homer, Assistant Director, Division of Banking Supervision and Regulation, from Paul Saltzman, Senior Vice President and General Counsel, TBMA (Feb. 23, 1996).

29. Fed. Res. Reg. Serv. ¶ 5-470.1 (Board interpretation of July 20, 1990).

30. The Trade Associations' proposals in this regard would be consistent with the Board's recent amendments to Regulation T that permit transactions in debt securities to occur without regulation by the Board's margin requirements.

31. Fed. Res. Reg. Serv. ¶ 5-385.35 (staff opinion of Aug. 30, 1996).

32. Regulation T, Section 220.6(e)(2). See also Regulation U, Section 221.3(c)(1). If the Board declines to eliminate the presumption of purpose credit, it should institute uniform requirements for purpose statements under Regulations T and U.
33. The modification proposed by the Trade Associations would also be consistent with the Board's recent amendments to the definition of "good faith" under Regulations T and U, which clarify the requirements applicable to a broker-dealer when it makes a good faith determination. SIA and TBMA also note that under the provisions regarding exempted borrowers recently adopted by the Board, a creditor may make a good faith determination that a counterparty is an "exempted borrower" without requiring a written statement from the counterparty.
34. See also Part III.C below with respect to the treatment of money market instruments under Regulation T.
35. Although the definition of a "foreign person controlled by a United States person" in Regulation X is based on the definition of that phrase in Section 7(f)(2)(C) of the Exchange Act, the Board has authority (under Section 7(f)(3) of the Exchange Act) to exempt any class of "foreign persons controlled by a United States person" from the application of Section 7(f).
36. The Regulation defines a "foreign person controlled by a United States person" to include "any noncorporate entity in which United States persons directly or indirectly have more than a 50 per centum beneficial interest, and any corporation in which one or more United States persons, directly or indirectly, own stock possessing more than 50 per centum of the total combined voting power of all classes of stock entitled to vote, or more than 50 per centum of the total value of shares of all classes of stock." Regulation X, Section 224.2(c).
37. Since foreign branches of an exempted borrower are part of the same legal entity as the "home office" of the exempted borrower, extensions of credit to such foreign branches should be exempt from the Board's margin regulations to the same extent as extensions of credit to such "home office."
38. The amendments requested by the Trade Associations would be consistent with the Board's recently adopted amendments to Regulation T that enhance the ability of U.S. broker-dealers to compete as providers of securities credit in foreign markets. See Adopting Release at 2816 (approving amendments that exclude foreign branches of U.S. broker-dealers from Regulation T when they extend credit to foreign persons on foreign securities).
39. See Fed. Res. Reg. Serv. ¶¶ 5-490 (Board interpretation of 1962); 5-694 (Board ruling of June 5, 1972); 5-677.21 (staff opinion of May 28, 1987); and 5-675 (staff opinion of June 24, 1977).
40. The Trade Associations note and appreciate the Board staff's recent interpretations under Regulation U regarding forward transactions with issuers but believe the Board must provide more comprehensive and explicit relief for transactions with issuers. See Fed. Res. Reg. Serv. ¶¶ 5-942.25 (staff opinion of Aug. 15, 1996) and 5-963 (staff opinions of Feb. 13, 1996, and Feb. 14, 1996).

41. Prior comment letters also have touched on this issue. See 1996 SIA Comment Letter at 46-47; 1995 SIA Comment Letter at 71-73.

42. In this regard, the Trade Associations recognize that it may be appropriate to distinguish between forwards and other bilateral transactions entered into by a broker-dealer as principal (i.e., proprietary transactions) and transactions in which a broker-dealer guarantees a customer's performance to a third party (e.g., a broker-dealer guaranteeing the performance of a customer's forward delivery obligations to a third party). Such a distinction would be analogous to the distinction suggested in Part III.E between broker-dealer purchases of OTC options and guarantees or other extensions of credit support in connection with them.

43. See Fed. Res. Reg. Serv. ¶¶ 5-942.25 (staff opinion of Aug. 15, 1996) and 5-963 (staff opinions of Feb. 13, 1996, and Feb. 14, 1996).

44. See note 77, *infra*.

45. The Trade Associations also request that the Board confirm that forward sales of a fixed or variable number of shares, under which upon entering into the transaction the purchaser pays the purchase price (or provides cash collateral) to the seller against the seller's deposit as collateral of the maximum amount of shares that will be deliverable by the seller on the forward settlement date (i.e., prepaid or collateralized forwards), do not constitute extensions of credit for purposes of Section 7 of the Exchange Act or the Board's margin regulations.

46. Regulation T, Section 220.7(g)(5) and (6); Regulation U, Section 221.5(c)(6) and (7).

47. The Trade Associations note that Regulation T (and, if amended as proposed in Part III.A.2 below, Regulation U) would still require a "good faith" determination that a borrower qualifies as an exempted borrower.

48. As noted in Part II.C above, SIA and TBMA also request that all foreign affiliates of exempted borrowers be excluded from the scope of Regulation X.

49. If the Board determines not to permit all affiliates of "exempted borrowers" to qualify as "exempted borrowers," the Trade Associations request, at a minimum, that such affiliates be deemed "exempted borrowers" in those cases where they are borrowing to finance the activities of the broker-dealer that is an "exempted borrower."

50. The SEC's recent release approving amendments to NYSE Rule 431 indicates that introducing firms may qualify as "exempted borrowers" if they have a "substantial customer business," but does not address whether a clearing firm may count the same customers in determining whether it is an "exempted borrower." Release No. 34-39813 (Mar. 27, 1998), 63 Fed. Reg. 16,849 (Apr. 6, 1998).

51. We recognize that the Board may have determined that the "good faith mistake" provision of Regulation U (Section 221.3(k)) is adequate to address this concern. If so, it would be helpful for the Board expressly to confirm the application of this provision in the context of "exempted borrower" determinations. As discussed in Part III.F.4 below, the Trade Associations continue to favor harmonization of the good faith mistake provisions of Regulations T and U.

52. Adopting Release at 2811 n.20 (citation omitted). See also 61 Fed. Reg. at 20,388 ("[T]he standard settlement cycle is contained in SEC Rule 15c6-1 and is currently three business days.").
53. See SEC Release No. 34-35750, 60 Fed. Reg. 27,994 (May 26, 1995) (exempting certain transactions in foreign securities from Rule 15c6-1).
54. Adopting Release at 2811.
55. *Id.*
56. *Id.*
57. Fed. Res. Reg. Serv. ¶ 5-615.19 (staff opinion of Mar. 4, 1991).
58. In the 1995 Release, the Board stated that "[a]lthough commercial paper is a security and can be held in a margin account, Regulation T denies loan value to domestic debt securities that are not SEC-registered. Therefore, commercial paper is a nonmargin, nonexempted security and the Supplement to Regulation T requires a margin of 100 percent if held in a margin account." 1995 Release at 33,767. In view of this statement by the Board and the recent inclusion of all non-equity securities in Section 220.12(b), it appears that, under the Board's reasoning, commercial paper should now qualify for "good faith" loan value for purposes of the Board's margin requirements. The Trade Associations, however, question whether commercial paper should be viewed as a "security" under the Exchange Act, given that the definition of that term in Section 3(a)(10) specifically excludes "any note . . . which has a maturity at the time of issuance not exceeding nine months, exclusive of days of grace." Thus, the Trade Associations seek explicit confirmation that commercial paper is entitled to "good faith" loan value (at a level equivalent to non-equity securities), regardless of whether the commercial paper falls within the Exchange Act definition of "security."
59. As discussed in Part II.A.6 above, SIA and TBMA request that the Board eliminate the requirement that a creditor obtain a "nonpurpose" statement prior to extending nonpurpose credit to a customer.
60. The Trade Associations note in this connection that Section 7 of the Exchange Act grants the Board plenary authority to prescribe rules and regulations to establish margin requirements for securities positions which, under Section 7(b), may be lower or higher than the percentages set out in Section 7(a) of the Exchange Act. Under this broad grant of authority, the Board should be able to continue the practice, already well-established, of determining the time and manner of payment for securities and the nature of the cash or "cash equivalents" that can be used to make such payments, as well as the "offsets" (including in some cases futures and other nonsecurities) that may serve in lieu of margin.
61. The Board has frequently exercised this authority to determine the nature of cash or "cash equivalents" that can be used to make payments for securities -- for example, by permitting payment to be made by check, draft or security (Section 220.3(e)) or by foreign currency (Section 220.3(i)).
62. See Fed. Res. Reg. Serv. ¶ 5-616.13 (staff opinion of Aug. 29, 1997). The Trade

Associations also request that the Board codify this interpretation in Regulation T.

63. Such money market instruments could be held, for example, in the good faith account.

64. As a technical matter, of course, it may be necessary to re-evaluate this recommendation in light of any changes to the 90-day freeze and other cash account provisions discussed in Part II.A.3 above.

65. Adopting Release at 2813 n.32.

66. The Trade Associations also believe that these transactions perform an important "market function" by reducing market inefficiencies, even though their role in eliminating price disparities may not be as evident as in the case of transactions satisfying the current requirements of a "bona fide arbitrage transaction."

67. If the Board is of the view that it is inappropriate to permit such transactions to be effected under Section 220.6(b) of the good faith account, the Trade Associations request that the Board establish reduced margin requirements for such transactions elsewhere under Regulation T.

68. See, e.g., NYSE Rule 431(e)(1); NASD Rule 2520(e)(1).

69. SIA has previously proposed specific language for implementing such amendments. See 1996 SIA Comment Letter at 41-42.

70. Adopting Release at 2816-17.

71. Id.

72. For example, NYSE Rule 431(f)(2)(m) permits option transactions to be effected in a customer's cash account if "[t]he transaction is permissible under Section 220.8 of Regulation T."

73. The Trade Associations note that the term "underlying asset" -- which was used for purposes of the former definition of "covered option transaction" as well as the definition of "escrow agreement" -- continues to be defined in Section 220.2 of Regulation T.

74. To implement this recommendation, subparagraph (1) of the current definition of "covered option transaction" should be revised to read as follows: "the amount at risk is held in the account or via an escrow receipt in cash, cash equivalents, the underlying asset or other assets."

75. See Fed. Res. Reg. Serv. ¶ 5-553 (staff opinion of Nov. 24, 1972) (a "broker-dealer would not be arranging for illegal credit (1) if the exercise of warrants [relating to a limited partnership investment] is discretionary with the investor and (2) if the investor who decides to exercise the warrant must pay the full purchase price within seven business days of the date of exercise (the date of exercise here would be the date on which the obligations of both parties become fixed for purposes of Regulation T)"); see also Fed. Res. Reg. Serv. ¶ 5-588 (staff opinion of Nov. 21, 1977) (would reach a contrary conclusion if the investor, like the purchaser of a deep-in-the money option, "had no real choice but to exercise the...option").

76. The Trade Associations believe it would be desirable to adopt a parallel interpretation on this question under Regulations T and U. Indeed, Section 7 of the Exchange Act uses the same words ("it shall be unlawful ... to extend or maintain credit or to arrange for the extension or maintenance of credit") in both Section 7(c) (which provides the general statutory basis for Regulation T) and in Section 7(d) (which provides the statutory basis for Regulation U).

77. The SEC's recent proposal (OTC Derivatives Dealers, 62 Fed. Reg. 67,940 (Dec. 30, 1997)), to establish a form of limited regulation for certain non-broker-dealer entities that engage in over-the-counter securities derivatives activities ("OTC Derivatives Dealers") highlights the importance of clarifying the margin treatment of these transactions. Under the rules proposed by the SEC, OTC Derivatives Dealers would be Regulation U lenders that may engage in the business of purchasing OTC options from customers who wish to take a short position in an OTC derivatives transaction. The Trade Associations note that, under the SEC's proposal, OTC Derivatives Dealers would be subject to a different net capital standard than fully regulated broker-dealers and would be required to maintain tentative net capital of at least \$100 million and net capital of at least \$20 million.

78. In considering a transaction in which a U.S. broker-dealer proposed to act as the agent of a U.S. institutional customer in the sale of an OTC option on foreign securities written by the customer in favor of a foreign broker-dealer, the Board staff appeared to support this reasoning. The Board staff stated that the Regulation T margin requirement for options has "always contemplated some liability on the part of the broker-dealer who carried the short option position in a customer's account," noting that under the proposed transaction the broker-dealer "would have no obligation, by guarantee, endorsement or otherwise," with respect to the writer's performance of the option. See Fed. Res. Reg. Serv. ¶ 5-666.27 (staff opinion of Oct. 22, 1991).

79. A Review and Evaluation of Federal Margin Regulations, Study by the Staff of the Board of Governors of the Federal Reserve System (Dec. 1984), at 51. See also *Drasner v. Thomson McKinnon Securities, Inc.*, 433 F. Supp. 485 (S.D.N.Y. 1977).

80. Any requirement that a controlled entity not be engaged in the business of extending, maintaining or arranging purpose credit should explicitly permit credit to be extended or arranged by an entity to finance the purchase of its own securities.

81. In addition, the current definition of creditor may impose the lending restrictions of Regulation T on credit extended by directors, officers, partners, branch managers and registered representatives of broker-dealers, even where the credit is not clearly related to the business of the broker-dealer and does not involve the credit of the broker-dealer. It is not clear what types of credit activities these individuals may be involved in that should be subject to Regulation T. With the repeal of the general arranging prohibition of Regulation T, any credit extended directly by these individuals should be deemed arranged by the broker-dealer and subject to Regulation U.