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(d) In the case of credit for the purpose of purchasing or carrying securities (purpose credit), §220.8 of the regulation (the Supplement to Regulation T) does not permit any loan value to be given securities that are not registered on a national securities exchange, included on the Board's OTC Margin List, or exempted by statute from the regulation.

(e) The courts have consistently held investment programs such as those described above to be ''securities'' for purpose of both the Securities Act of 1933 and the Securities Exchange Act of 1934. The courts have also held that the two statutes are to be construed together. Tax-shelter programs, accordingly, are securities for purposes of Regulation T. They also are not registered on a national securities exchange, included on the Board's OTC Margin List, or exempted by statute from the regulation.

(f) Accordingly, the Board concludes that the sale by a broker/dealer of tax-shelter programs containing a provision that payment for the program may be made in installments would constitute ''arranging'' for the extension of credit to purchase or carry securities in violation of the prohibitions of §§220.7(a) and 220.8 of Regulation T.

[37 FR 6568, Mar. 31, 1972]

§220.125–220.126 [Reserved]

§220.127 Independent broker/dealers arranging credit in connection with the sale of insurance premium funding programs.

(a) The Board's September 5, 1972, clarifying amendment to §220.4(k) set forth that creditors who arrange credit for the acquisition of mutual fund shares and insurance are also permitted to sell mutual fund shares without insurance under the provisions of the special cash account. It should be understood, of course, that such account provides a relatively short credit period of up to 7 business days even with so-called cash transactions. This amendment was in accordance with the Board's understanding in 1969, when the insurance premium funding provisions were adopted in §220.4(k), that firms engaged in a general securities business would not also be engaged in the sale and arranging of credit in connection with such insurance premium funding programs.

(b) The 1972 amendment eliminated from §220.4(k) the requirement that, to be eligible for the provisions of the section, a creditor had to be the issuer, or a subsidiary or affiliate of the issuer, of programs which combine the acquisition of both mutual fund shares and insurance. Thus the amendment permits an independent broker/dealer to sell such a program and to arrange for financing in that connection. In reaching such decision, the Board again relied upon the earlier understanding that independent broker/dealers who would sell such programs would not be engaged in transacting a general securities business.

(c) In response to a specific view recently expressed, the Board agrees that under Regulation T:

> * * * a broker/dealer dealing in special insurance premium funding products can only extend credit in connection with such products or in connection with the sale of shares of registered investment companies under the cash accounts * * * (and) cannot engage in the general securities business or sell any securities other than shares * * * (in) registered investment companies through a cash account or any other manner involving the extension of credit.

(d) There is a way, of course, as has been indicated, that an independent broker/dealer might be able to sell other than shares of registered investment companies without creating any conflict with the regulation. Such sales could be executed on a ''funds on hand'' basis and in the case of payment by check, would have to include the collection of such check. It is understood from industry sources, however, that few if any independent broker/dealers engage solely in a ''fund on hand'' type of operation.

[38 FR 11066, May 4, 1973]

§220.128 Treatment of simultaneous long and short positions in the same margin account when put or call options or combinations thereof on such stock are also outstanding in the account.

(a) The Board was recently asked whether under Regulation T, ''Credit by Brokers and Dealers'' (12 CFR part

220), if there are simultaneous long and short positions in the same security in the same margin account (often referred to as a short sale ''against the box''), such positions may be used to supply the place of the deposit of margin ordinarily required in connection with the guarantee by a creditor of a put or call option or combination thereof on such stock.

(b) The applicable provisions of regulation T are §220.3(d)(3) and (5) and §220.3(g)(4) and (5) which provide as follows:

(d) * * * the adjusted debit balance of a general account * * * shall be calculated by taking the sum of the following items:

* * * * *

(3) The current market value of any securities (other than unissued securities) sold short in the general account plus, for each security (other than an exempted security), such amount as the board shall prescribe from time to time in §220.8(d) (the supplement to regulation T) as the margin required for such short sales, except that such amount so prescribed in such §220.8(d) need not be included when there are held in the general account * * * the same securities or securities exchangeable or convertible within 90 calendar days, without restriction other than the payment of money, into such securities sold short;

* * * * *

(5) The amount of any margin customarily required by the creditor in connection with his endorsement or guarantee of any put, call, or other option;

* * * * *

(g) * * * (4) Any transaction which serves to meet the requirements of paragraph (e) of this section or otherwise serves to permit any offsetting transaction in an account shall, to that extent, be unavailable to permit any other transaction in such account.

(5) For the purposes of this part (regulation T), if a security has maximum loan value under paragraph (c)(1) of this section in a general account, or under §220.4(j) in a special convertible debt security account, a sale of the same security (even though not the same certificate) in such account shall be deemed to be a long sale and shall not be deemed to be or treated as a short sale.

(c) Rule 431 of the New York Stock Exchange requires that a creditor obtain a minimum deposit of 25 percent of the current market value of the optioned stock in connection with his issuance or guarantee of a put, and at least 30 percent in the case of a call (and that such position be ''marked to the market''), but permits a short position in the stock to serve in lieu of the required deposit in the case of a put and a long position to serve in the case of a call. Thus, where the appropriate position is held in an account, that position may serve as the margin required by §220.3(d)(5).

(d) In a short sale ''against the box,'' however, the customer is both long and short the same security. He may have established either position, properly margined, prior to taking the other, or he may have deposited fully paid securities in his margin account on the same day he makes a short sale of such securities. In either case, he will have directed his broker to borrow securities elsewhere in order to make delivery on the short sale rather than using his long position for this purpose (see also 17 CFR 240.3b–3).

(e) Generally speaking, a customer makes a short sale ''against the box'' for tax reasons. Regulation T, however, provides in §220.3(g) that the two positions must be ''netted out'' for the purposes of the calculations required by the regulation. Thus, the board concludes that neither position would be available to serve as the deposit of margin required in connection with the endorsement by the creditor of an option.

(f) A similar conclusion obtains under §220.3(d)(3). That section provides, in essence, that the margin otherwise required in connection with a short sale need not be included in the account if the customer has in the account a long position in the same security. In §220.3(g) (4), however, it is provided that ''[A]ny transaction which * * * serves to permit any offsetting transaction in an account shall, to that extent, be unavailable to permit any other transaction in such account.'' Thus, if a customer has, for example, a long position in a security and that long position has been used to supply the margin required in connection with

a short sale of the same security, then the long position is unavailable to serve as the margin required in connection with the creditor's endorsement of a call option on such security.

(g) A situation was also described in which a customer has purported to establish simultaneous offsetting long and short positions by executing a ''cross'' or wash sale of the security on the same day. In this situation, no change in the beneficial ownership of stock has taken place. Since there is no actual ''*contra*'' party to either transaction, and no stock has been borrowed or delivered to accomplish the short sale, such fictitious positions would have no value for purposes of the Board's margin regulations. Indeed, the adoption of such a scheme in connection with an overall strategy involving the issuance, endorsement, or guarantee of put or call options or combinations thereof appears to be manipulative and may have been employed for the purpose of circumventing the requirements of the regulations.

[38 FR 12098, May 9, 1973]

§§ 220.129–220.130 [Reserved]

§ 220.131 Application of the arranging section to broker-dealer activities under SEC Rule 144A.

(a) The Board has been asked whether the purchase by a broker-dealer of debt securities for resale in reliance on Rule 144A of the Securities and Exchange Commission (17 CFR 230.144A)[1] may be considered an arranging of credit permitted as an ''investment banking service'' under § 220.13(a) of Regulation T.

(b) SEC Rule 144A provides a safe harbor exemption from the registration requirements of the Securities Act of 1933 for resales of restricted securities to *qualified institutional buyers*, as defined in the rule. In general, a *qualified institutional buyer* is an institutional investor that in the aggregate owns and invests on a discretionary basis at least $100 million in securities of issuers that are not affiliated with the buyer. Registered broker-dealers need only own and invest on a discretionary basis at least $10 million of securities in order to purchase as principal under the rule. Section 4(2) of the Securities Act of 1933 provides an exemption from the registration requirements for ''transactions by an issuer not involving any public offering.'' Securities acquired in a transaction under section 4(2) cannot be resold without registration under the Act or an exemption therefrom. Rule 144A provides a safe harbor exemption for resales of such securities. Accordingly, broker-dealers that previously acted only as agents in intermediating between issuers and purchasers of privately-placed securities, due to the lack of such a safe harbor, now may purchase privately-placed securities from issuers as principal and resell such securities to ''qualified institutional buyers'' under Rule 144A.

(c) The Board has consistently treated the purchase of a privately-placed debt security as an extension of credit subject to the margin regulations. If the issuer uses the proceeds to buy securities, the purchase of the privately-placed debt security by a creditor represents an extension of ''purpose credit'' to the issuer. Section 7(c) of the Securities Exchange Act of 1934 prohibits the extension of purpose credit by a creditor if the credit is unsecured, secured by collateral other than securities, or secured by any security (other than an exempted security) in contravention of Federal Reserve regulations. If a debt security sold pursuant to Rule 144A represents purpose credit and is not properly collateralized by securities, the statute and Regulation T can be viewed as preventing the broker-dealer from taking the security into inventory in spite of the fact that the broker-dealer intends to immediately resell the debt security.

(d) Under § 220.13 of Regulation T, a creditor may arrange credit it cannot itself extend if the arrangement is an ''investment banking service'' and the credit does not violate Regulations G and U. Investment banking services are defined to include, but not be limited to, ''underwritings, private placements, and advice and other services in connection with exchange offers, mergers, or acquisitions, except for

[1] Rule 144A, 17 CFR 230.144A, was originally published in the FEDERAL REGISTER at 55 FR 17933, April 30, 1990.