

SUBJECT: Regulation U – Credit Secured by Margin Stock

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INTRODUCTION

This release applies to all credit unions, state and federal, which grant loans secured by stock.

EXECUTIVE SUMMARY

Credit unions that extend credit secured by margin stock are subject to Regulation U if the amount of such credit extended or held exceeds certain thresholds. Regulation U requires such a credit union to:

- Register with its Federal Reserve Bank (Form G-1),
- Require borrowers to complete a purpose statement for each margin loan (Form G-3),
- Adhere to margin requirements (currently 50%) for “purpose” loans secured by margin stock, and
- File an annual report of stock-secured lending (Form G-4).

At one time, the requirements described in this release were found in Regulation G. In April 1998, Regulation G was repealed and the requirements transferred to Regulation U.

The following questions and answers on Regulation U were compiled by the Federal Reserve Board (FRRS 5-840) to provide an introduction to the basic areas covered by the regulation. This is not a complete discussion of all the requirements of the regulation and is therefore not a substitute for the regulation itself.

Exhibits to the release include flow charts and FRB staff opinions to clarify coverage and the effects of the Regulation.

QUESTIONS AND ANSWERS

1. What is Regulation U?

Regulation U is a Federal Reserve Board regulation (12 CFR 221) that sets out certain requirements for lenders other than brokers and dealers extending credit secured by margin stock. (See Question 9 for the definition of “margin stock.”)

2. What types of lenders are typically covered by Regulation U?

Regulation U covers not only commercial banks, but also savings and loan associations, federal savings banks, *credit unions*, production credit associations, insurance companies, and companies with employee stock option plans. [Credit unions are included as nonbank lenders.]

3. When does a lender become subject to Regulation U?

A commercial bank is always subject to Regulation U when it extends credit secured by margin stock. A credit union or other nonbank lender becomes subject to Regulation U when it meets either one of the following threshold tests for the amount of margin-stock-secured credit extended or outstanding.

Test 1: Has \$200,000 or more in credit secured directly or indirectly by margin stock been extended in the last calendar quarter? If the answer is yes, the lender is subject to Regulation U.

Test 2: At any time in the last quarter has the amount of margin-stock-secured credit outstanding equaled \$500,000 or more? If yes, then the lender is subject to Regulation U.

4. *If margin stock is taken as additional collateral on a loan, is the loan considered in applying the two tests above?*
Yes.

5. *What happens when one of these tests is met?*

The lender must register with the Federal Reserve Bank in whose District it is located by filling out and sending in Form G-1 (available by calling the local Federal Reserve Bank) within 30 days of the end of the calendar quarter in which one of the two tests is met. Sending in the registration statement Form G-1 is a one-time requirement.

6. *Must such a lender register with the appropriate Federal Reserve Bank even though it is regulated by the Office of Thrift Supervision?*

Yes, all nonbank, nonbroker lenders must register with the Federal Reserve. Compliance with Regulation U by savings and loans and federal savings banks has, since October 8, 1989, been monitored by the Office of Thrift Supervision.

7. *What is the Form G-1 and what information does it require to be disclosed?*

The Form G-1 is a simple four-page form that must be filled out and submitted to the appropriate Federal Reserve Bank by a lender in fulfillment of its requirement to register as a nonbank lender whenever one of the tests mentioned above is met (see Question 3). The Form G-1 requires the registrant-lender to provide the following information:

- Name of registrant
- Address of registrant
- Principal lines of business
- Form of business (corporation, partnership, etc.)
- Names of personnel responsible for maintaining company records
- Purpose of credit extended
- Balance sheet

8. *What responsibilities does a lender take on once it registers with a Federal Reserve Bank as a nonbank lender?*

Regulation U has three important post-registration requirements:

1. The nonbank lender must obtain from the borrower and complete a purpose statement (Form G-3) for each loan secured by margin stock.
2. The nonbank lender must adhere to margin requirements (currently 50 percent) for purpose loans secured by margin stock (see question 10 for the definition of "purpose loan").
3. The nonbank lender must file an annual report of stock-secured lending (Form G-4) as of each June 30.

9. *What is margin stock?*

"Margin stock" is defined in Regulation U (§ 221.2(i) and includes (1) any equity security registered on a national securities exchange, such as the New York Stock Exchange or American Stock Exchange; (2) any OTC security trading in the National Market System; (3) any warrant or right to purchase a stock described in 1, 2, or 3 above; (4) any debt security convertible into a stock described in 1, 2, or 3 above; or (5) most mutual funds.

10. *What is a purpose loan?*

A purpose loan is a loan whose proceeds are used to buy or carry margin stock. A loan to carry margin stock is one that enables a borrower to maintain, reduce, or retire indebtedness originally incurred to purchase margin stock.

11. *What are the Regulation U requirements for purpose loans secured by margin stock?*

The first requirement is that the borrower complete the form G-3 statement of purpose, which must be signed by the borrower and a representative of the lender. Second, a lender may not extend credit in excess of the maximum loan value as specified in Regulation U. The maximum loan value is now 50 percent of the current market value of the stock, except for plan-lender loans, which are discussed in Question 15. In other words, the largest purpose loan a lender could extend would be one-half the current market value of the margin stock securing the loan (assuming the loan is secured only by margin stock). If the purpose loan is initially in compliance with Regulation, no action is required by the lender if the market value of the stock changes or if the maximum loan value as prescribed by Regulation U changes. It should be noted that the stock securing the loan may be a different stock from the stock that is purchased.

Other rules in Regulation U cover situations such as mixed-collateral purpose loans, withdrawals and substitutions of collateral, loan renewals, extensions of maturity, and loan transfers. For these requirements, a lender should consult the regulation or contact a Federal Reserve Bank.

12. *What is a nonpurpose loan under Regulation U?*

A nonpurpose loan is a loan made for any purpose *other than* purchasing or carrying margin stock.

13. *What are the requirements of Regulation U for nonpurpose loans?*

The only Regulation U requirement is that the borrower complete Form G-3 or Form U-1 if the loan is secured (directly or indirectly) by margin stock. Regulation U places no restriction on the amount of credit that may be extended on nonpurpose loans secured by margin stock.

14. *What is Form G-3?*

Form G-3 is a two page form wherein the borrower must disclose (1) the use to which the loan proceeds will be put, (2) the amount of the loan, and (3) the collateral for the loan. The form is signed by both the borrower and an authorized representative of the lender and must be kept in the lender's records for at least three years after the termination of the credit.

15. *What is a plan-lender?*

A plan-lender is a corporation (including a wholly owned subsidiary, or a thrift organization whose membership is limited to employees and former employees of the corporation, its subsidiaries, or affiliates) that extends credit to its employees, under an employee stock option plan approved by the shareholders, to purchase stock of that corporation, its subsidiaries, or affiliates. Loans under such a plan may be for any amount up to 100 percent of the current market value of the stock. A G-3 purpose statement is not required for these loans.

16. *Does Regulation U contain any special rules for employee stock ownership plans (ESOPs)?*

ESOPs qualified under section 401 of the Internal Revenue Code are entitled to exempt credit. A nonbank lender may extend purpose credit to an ESOP without regard to Regulation H, as long as the lender complies with the registration requirements and files annual reports.

17. *Under Regulation U, what reports must be filed with the Federal Reserve Bank?*

The registration form, Form G-1, is discussed in Question 7. An annual report, Form G-4, must be filed within 30 days of June 30. This form will be supplied by the Reserve Bank prior to June 30. The statement of purpose, Form G-3, should be maintained in each borrower's file. When a lender wants to deregister and is eligible to do so, Form G-2, the deregistration statement, must be filed with the Reserve Bank.

18. *When is a lender eligible to deregister?*

A registered lender may deregister if, during the preceding six calendar months, no more than \$200,000 of credit secured by margin stock is outstanding.

19. *What is the effect of deregistering?*

When a lender is eligible to deregister and does so by filing a Form G-2, it ceases to become subject to the requirements of Regulation U. Of course, if the lender extends margin-stock-secured credit above the threshold amount, it would again have to register with the Federal Reserve Bank.

20. *Where can a lender get more information?*

Copies of Regulation U and forms G-1, G-2, G-3, and G-4 may be obtained by writing or calling the Federal Reserve Bank offices listed below:

Chicago:

Division of Consumer and Community Affairs
Federal Reserve Bank of Chicago
230 South LaSalle Street
Chicago, Illinois 60690
(312) 322-5322

Minneapolis:

Division of Supervision & Regulation
Federal Reserve Bank of Minneapolis
90 Hennepin Avenue
Minneapolis, Minnesota 55401
(612) 340-2345

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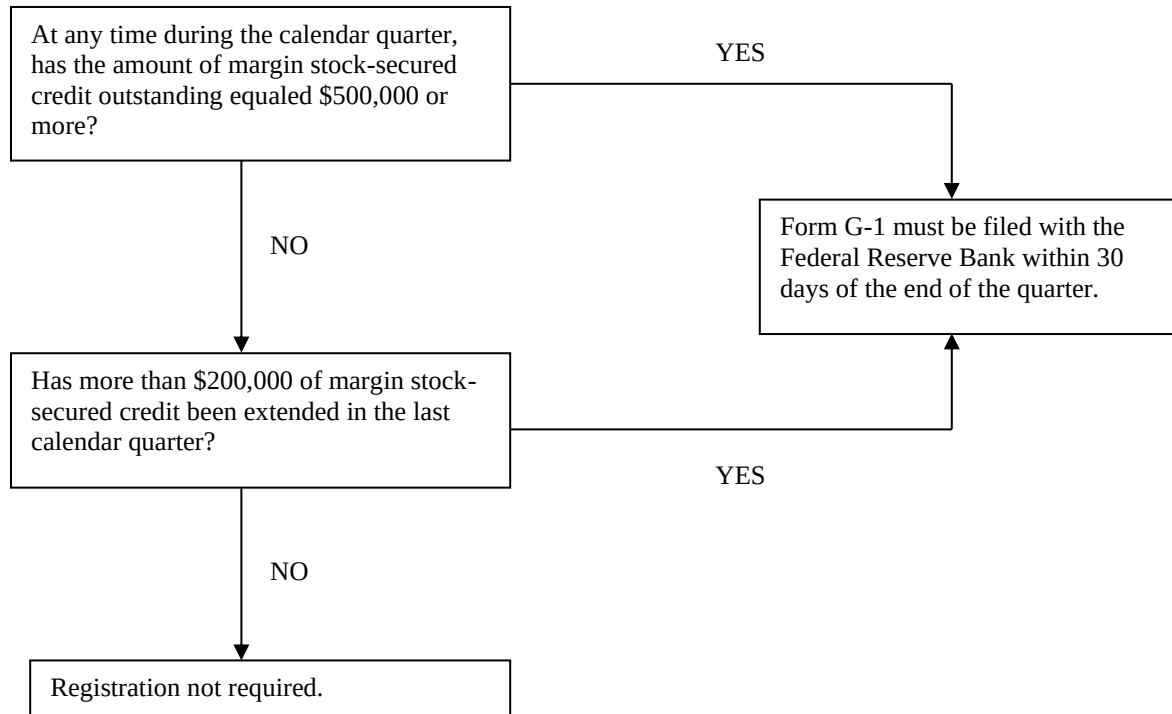
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EXHIBITS:

- A. When Must a Lender Register Under Regulation U?
- B. Regulation U Requirements for a Registered Lender
- C. Selected FRB Staff Opinions Interpreting Regulation U

EXHIBIT A: WHEN MUST A LENDER REGISTER UNDER REGULATION U? (FRRS 5-860)



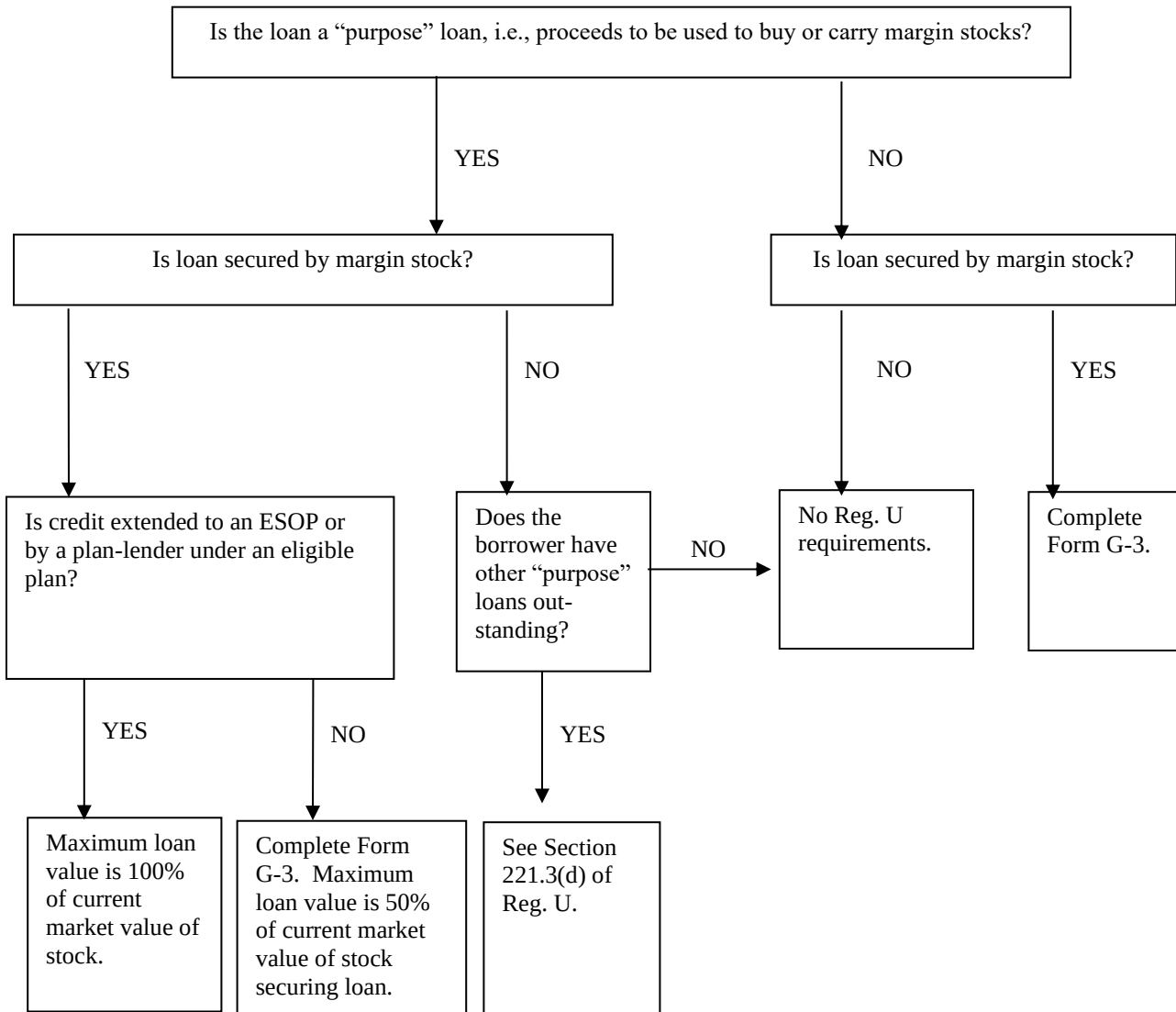


EXHIBIT C: SELECTED FRB STAFF OPINIONS INTERPRETING REGULATION U**1. CREDIT UNION – Stock Option Plan (FRRS 5-880.5)**

A credit union (CU) wants to institute a new program enabling members to purchase stock on the NYSE or AMEX. This plan will be voluntary and will operate through preauthorized payroll deductions. The CU will make book entries of the members' names and the amounts deducted for the plan; collect and hold the monies; and make quarterly transfers of these funds to a broker-dealer, who will purchase the stock for the participants. The CU will not extend credit to its members for the purchase of stock under this plan, monies deposited into its account will not be used as collateral, and the broker-dealer will not extend any credit in connection with the plan. The plan will not violate Board margin regulations since the CU is not extending or arranging any purpose credit.

STAFF OP. of Nov. 8, 1978.

Authority: 12 CFR 207.2(c) (revised 1998; now 12 CFR 221.2.

2. CREDIT UNION – Central Liquidity Facility (FRRS 5-880.51)

The National Credit Union Administration (NCUA) Central Liquidity Facility is not the type of lender to which Regulation G was intended to apply. A review of the procedures to be followed when the facility extends credit indicates that such credit, in all probability, would not be indirectly secured by margin securities for purposes of Regulation G. Furthermore, and more important, section 3(c) of the Securities Exchange Act of 1934 makes section 7 of the act and the Board's margin regulations adopted thereunder (including Regulation G) inapplicable to the NCUA facility. Section 3(c) states that "no provision of this title shall apply to . . . any . . . lending agency which is wholly owned, directly or indirectly, by the United States, or any officer, agent, or employee of any such department, establishment, or agency, acting in the course of his official duty as such, provision makes specific reference to such department, establishment, or agency."

STAFF OP. of Sept. 18, 1979.

Authority: SEA §3(c), 15 USC 78c(c). other than brokers and dealers are subject to Regulation U.

3. EMPLOYEE STOCK OPTION/OWNERSHIP PLAN – Credit Union (FRRS 5-882.15)

The fact that a credit union includes members of the immediate families of employees of any corporation or group of affiliated corporations should not bar that credit union from acting as a plan-lender for employees acquiring a margin stock under a qualified plan. A member of the immediate family of an employee, however, would not be able to finance the acquisition, under a stock option plan, of margin stock of a totally unrelated company or the margin stock of the employee's company.

A credit union can properly act as a plan-lender under section 207.4(a) of Regulation G only to employees and former employees of the corporation, its subsidiaries, or affiliates, who are financing the acquisition of margin stock of the corporation, its subsidiaries, or affiliates, under an eligible plan.

STAFF OP. of Aug. 26, 1983.

Authority: 12 CFR 207.4(a) (revised 1983; now 12 CFR 221.4).

As of April 1, 1998, all lenders other than brokers and dealers are subject to Regulation U.

4. EMPLOYEE STOCK OPTION/OWNERSHIP PLAN – Credit Union with Mixed Membership (FRRS 5-882.2)

A company has a qualified stock option purchase plan for its employees. A credit union makes loans to company employees for the purchase of stock under the plan. The credit union now makes these loans under the general provisions of Regulation G but would like to avail itself of the plan-lender provision when making these loans. Approximately 80 percent of the credit union members are employees of the company; part of the remaining membership consists of employees in other related companies.

Although the membership of the credit union does include some persons who might not be "employees and former employees of the corporation, its subsidiaries, or affiliates," it consists primarily of persons in that category. Therefore, the credit union may act in the capacity of a plan-lender, but only for those members who are employees and former employees of the corporation, its subsidiaries, or affiliates and who are financing the acquisition of company stock under terms of an eligible plan.

STAFF OP. of March 7, 1985.

Authority: 12 CFR 207.5 (revised 1998; now 12 CFR 221.4).

As of April 1, 1998, all lenders are subject to Regulation U.