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Federal Reserve Bank - Questions and Answers About Nonbank Lenders Under Regulation U

The following questions and answers on nonbank¹ lenders under Regulation U are intended 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.

1. *Q. What is Regulation U?*

A. 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. *Q. What types of lenders are typically covered by Regulation U?*

A. 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.

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

A. A commercial bank is always subject to Regulation U when it extends credit secured by margin stock. A 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 equalled \$500,000 or more? If yes, then the lender is subject to Regulation U.

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

A. Yes.

¹ For purposes of Regulation U, the Federal Reserve Board classifies savings associations as nonbank lenders.

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

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

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

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

A. Regulation U has three important postregistration 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. *Q. What is margin stock?*

A. "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. *Q. What is a purpose loan?*

A. 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 borrower to maintain, reduce, or retire indebtedness originally incurred to purchase margin stock.

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

A. 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 a purpose loan is initially in compliance with Regulation U, 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 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. *Q. What is a nonpurpose loan under Regulation U?*

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

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

A. 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. *Q. What is Form G-3?*

A. 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. *Q. What is a plan-lender?*

A. 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 subsidiary, 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. *Q. Does Regulation U contain any special rules for employee stock ownership plans (ESOPs)?*

A. 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 U, as long as the lender complies with the registration requirements and files annual reports.

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

A. 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. *Q. When is a lender eligible to deregister?*

A. 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. *Q. What is the effect of deregistering?*

A. When a nonbank 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. *Q. Where can a lender get more information?*

A. 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:

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| 1. Atlanta:
Consumer Affairs Section
Federal Reserve Bank of Atlanta
104 Marietta Street
Atlanta, Georgia 30303
(404) 589-7200 | 8. New York:
Compliance Examinations Division
Federal Reserve Bank of New York
33 Liberty Street
New York, New York 10045
(212) 720-5000 |
| 2. Boston:
Regulations Unit
Federal Reserve Bank of Boston
600 Atlantic Avenue
Boston, Massachusetts 02106
(617) 973-3000 | 9. Philadelphia:
Community and Consumer Affairs Department
Federal Reserve Bank of Philadelphia
Ten Independence Mall
Philadelphia, Pennsylvania 19106
(215) 574-6000 |
| 3. Chicago:
Division of Consumer and Community Affairs
Federal Reserve Bank of Chicago
230 South LaSalle Street
Chicago, Illinois 60690
(312) 322-5322 | 10. Richmond:
Bank Supervision and Regulation
Federal Reserve Bank of Richmond
P.O. Box 27622
Richmond, Virginia 23261
(804) 697-8000 |
| 4. Cleveland:
Division of Supervision & Regulation
Federal Reserve Bank of Cleveland
1455 East Sixth Street
Cleveland, Ohio 44101
(216) 293-8000 | 11. San Francisco
Consumer Affairs Section
Federal Reserve Bank of San Francisco
101 Market Street
San Francisco, California 94105
(415) 974-2000 |
| 5. Dallas:
Supervision and Regulation Department
Federal Reserve Bank of Dallas
2200 N Pearl St.
Dallas, Texas 75201
(214) 744-7484 | 12. St. Louis:
Division of Supervision & Regulation
Federal Reserve Bank of St. Louis
P.O. Box 442
St. Louis, Missouri 63166
(314) 444-8444 |
| 6. Kansas City:
Division of Bank Supervision & Structure
Federal Reserve Bank of Kansas City
925 Grand Avenue
Kansas City, Missouri 64198
(816) 881-2000 | |
| 7. Minneapolis:
Division of Supervision & Regulation
Federal Reserve Bank of Minneapolis
90 Hennepin Avenue
Minneapolis, Minnesota 55401
(612) 340-2345 | |