

Legal Department
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Regulation U - Lines of Credit

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Linda
Is this something which
deserves a wider audience?
Perhaps our lawyers plus Robin
Warner?
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I am enclosing for your information the following Board Interpretations and Opinion Letters relating to the application of Regulation U to Lines of Credit:

1. Staff Opinion Letter dated December 5, 1974 (Paragraph 5-890.1).
2. Staff Opinion Letter dated August 16, 1983 (Paragraph 5-900.13).
3. Staff Opinion Letter dated December 2, 1987 (Paragraph 5-900.16).
4. Staff Opinion Letter dated February 29, 1988 (Paragraph 5-900.18).
5. Staff Opinion Letter dated November 9, 1983 (Paragraph 5-917.16).

To try to clarify what these opinion letters state, the Bank may treat a revolving line of credit either as a single loan or as multiple loans. If the revolving credit is to be treated as a single loan, all of the collateral would be pledged at the beginning, providing a two-to-one coverage for the entire line of credit.

As an alternative, the Bank can treat the revolving line of credit as a series of loans and would only need collateral sufficient to cover each disbursement. Each advance under the line would require additional collateral having a maximum loan value sufficient to cover such advance (calculated using the market value as of the time of the draw).

A third alternative is a hybrid of the previous options. The customer could pledge more collateral than needed for the first draw, but not enough to cover the entire amount of the revolving credit. In this case, the Bank could lend the customer any amount up to the maximum loan value of the collateral pledged (50% of the market value as of the commitment date), regardless of subsequent drops in collateral value. If the customer wanted to borrow in excess of the maximum loan value of the collateral held, the customer would be required to pledge additional collateral (valued as of the date of the advance) to cover such advance.

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It might help if we go through a few examples (one assumption throughout examples is that all collateral is margin stock):

1. All collateral pledged at the beginning of the loan.

Line of Credit: \$1,000,000.00.

Market Value of Collateral pledged at establishment of Line:
\$2,300,000.00.

The Borrower may request advances under the Line without any regard to the market value of the collateral during the term of the Line.

2. Bank and Borrower treat each advance under the line of credit as a series of loans.

Line of Credit amount: \$1,000,000.00.

Market value of collateral pledged at establishment of line: 0.

Date Line of Credit is established: January 1, 1993.

Maturity date: January 1, 1994.

- a. On January 15, 1993, the Customer requests an advance under the Line in the amount of \$200,000.00. The Bank must require collateral having a market value of at least \$400,000.00 (market value to be determined at time of advance).

$$[200M \times 2 = 400M]$$

- b. On March 16, the Customer requests an additional advance of \$300,000.00. The outstanding principal balance after funding the advance is \$500,000.00. The market value of the existing collateral on such date is \$600,000.00. The Customer would be required to pledge additional collateral with a market value of at least \$400,000.00 in order to obtain the \$300,000.00 advance.

$$[500M \times 2 = 1MM. \quad 1MM - 600M = 400M]$$

$$[300M \times 2 = 600M]$$

Lesser of 2 calculations: 400M

- c. On April 15, the Customer requests an additional advance of \$200,000.00. The outstanding principal balance after funding the advance is \$700,000.00. The aggregate market value of all collateral is \$1,500,000.00. The Customer would not be required to provide additional collateral.

$[700M \times 2 = 1.400M. \quad 1.400M - 1.500M = N/A]$

$[200M \times 2 = 400M]$

Lesser of 2 calculations: N/A

- d. On July 7, the Customer requests an additional advance of \$100,000.00. The outstanding principal balance after funding the advance is \$800,000.00. The aggregate market value of all collateral on such date is \$1,300,000.00. The Customer would be required to provide additional collateral with a market value of at least \$200,000.00 to obtain the advance of \$100,000.00.

$[800M \times 2 = 1.600M. \quad 1.600M. \quad 1.600M - 1.300M = 300M.]$

$[100M \times 2 = 200M]$

Lesser of 2 calculations: 200M

(The Customer would only be required to provide sufficient collateral to maintain a two-to-one margin against the advance.)

3. Partial pledge of collateral at the beginning of the loan.

Line of Credit: \$1,000,000.00.

Market value of collateral pledged at establishment of line:
\$600,000.00.

Date Line of Credit is established: January 1, 1993.

Maturity Date: January 1, 1994.

(Note: The Customer could borrow up to \$300,000.00 at any time during the term of the loan without a requirement of additional collateral being pledged.)

- a. On February 1, the Customer requests an advance under the line in the amount of \$100,000.00. The Customer would not be required to provide additional collateral for the advance.

$[100M \times 2 = 200M. \quad 200M - 600M = N/A]$

- b. On March 18, the Customer requests an additional advance of \$150,000.00. The outstanding principal balance after funding the advance is \$250,000.00. The Customer would not be required to provide additional collateral for such advance.

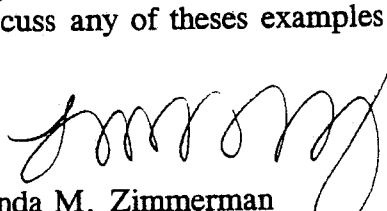
$[250.M \times 2 = 500M. \quad 500M - 600M = N/A]$

- c. On April 20, the Customer requests an additional advance of \$200,000.00. The outstanding principal balance after funding of the advance is \$450,000.00. The aggregate market value of all collateral is \$500,000.00. The Customer would be required to provide additional collateral with a market value of at least \$300,000.00.

[450M x 2 = 900M. 900M - 500M = 400M.]

[200M x 2 = 400M. 400M - 100M = 300M. Note: 100M of the original collateral is available to apply towards this advance.]

If you have any further questions regarding Regulation U or if you would like to discuss any of these examples in greater detail, please do not hesitate to contact me.



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Enclosures

LMZ:sb

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