



American Revolution Bicentennial

FEDERAL RESERVE BANK OF DALLAS

DALLAS, TEXAS 75222

Circular No. 76-145
November 2, 1976

AMENDMENT TO REGULATION T

Uniform Margin Requirements for Writing Options

**TO ALL BANKS, BROKERS/DEALERS,
AND OTHERS CONCERNED IN THE
ELEVENTH FEDERAL RESERVE DISTRICT:**

The Board of Governors of the Federal Reserve System has adopted an amendment to its Regulation T, "Credit by Brokers and Dealers," designed to prevent the excessive use of credit in connection with the issuance, endorsement, or guarantee of puts and calls which are options to sell or buy stock.

The principal effect of the amendment which will become effective January 1, 1977, will be to set the level of margin required for the writing of uncovered options at 30 percent of the market value of the underlying security, with additional adjustment for unrealized losses and gains. This is the current minimum requirement of the major stock exchanges and it is not anticipated that the amendment will require material changes in current industry practices.

No margin will be required where the option is covered, that is, where the security itself, or its equivalent is held in the option writer's account. The amendment specifies what the Board regards as adequate cover.

The amendment will apply to brokers and dealers when they effect transactions in options written by their customers. Under a previous Board ruling no credit may be extended by brokers and dealers to their customers for the purchase of options.

The amendment adopted is basically the same as the proposal which was sent to you with Circular No. 75-121, dated August 20, 1975. The most significant changes made in the amendment since it was proposed are as follows:

- (1) The minimum amount in paragraph (i) (1) of section 220.3 has been changed from 10 percent of the price of the underlying security to a flat \$250. The \$250 minimum is presently in use for exchange-traded calls and is incorporated in the rule changes for puts of the New York, Midwest, and Philadelphia stock

exchanges which were approved by the Securities and Exchange Commission on June 29, 1976.

- (2) Additions to the list of securities positions and paragraph (i) (1) of section 220.3, which may be used in lieu of the margin required, include warrants under certain conditions and long position in puts to allow "puts spreads." The changes are basically consistent with exchange rule changes approved by the Securities and Exchange Commission for maintenance margin.
- (3) A provision for special margin requirements for straddles has been added in subparagraph (4) of section 220.3(i).
- (4) Section 220.4(i) has been amended to allow the writing of covered options on the common stock of the Federal National Mortgage Association (FNMA) in the special bond account. FNMA stock is unique in that it is both an "exempted security" under Regulation T and an equity security traded on a national securities exchange.
- (5) A new provision has been added in section 220.4(j) which will allow the writing of covered options in the special convertible debt security account in the same manner as in the general account.
- (6) Section 220.8(i) has been revised to provide for the use of the current market value of the underlying stock as the basis for the margin calculation for a put instead of the exercise price.

Enclosed is a copy of the amendment to Regulation T, along with a revised supplement to that regulation effective January 1, 1977. Member banks and others that maintain binders should file the enclosed amendment in their binders. Additional copies will be furnished upon request to the Secretary's Office of this Bank (214) 651-6267.

Any questions may be directed to our Regulations Department at (214) 651-6319.

Sincerely yours,

T. W. Plant

First Vice President

Enclosures

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

CREDIT BY BROKERS AND DEALERS

AMENDMENTS TO REGULATION T†

Effective January 1, 1977, Regulation T is amended as follows:

1. In Section 220.3, paragraph (d) is amended and a new paragraph (i) is added as follows:

SECTION 220.3 — GENERAL ACCOUNT

* * * * *

(d) **Adjusted debit balance.** For the purpose of this part, the adjusted debit balance of a general account, special bond account, or special convertible debt security account shall be calculated by taking the sum of the following items:

* * * * *

(5) The amount of margin as provided for in paragraph (i) of this section and section 220.8 (the Supplement to Regulation T) for each transaction involving the issuance, endorsement, or guarantee of any put, call, or combination thereof.

* * * * *

(i) **Options.** (1) The amount to be included in the adjusted debit balance of an account as the margin required for each transaction involving the issuance, endorsement, or guarantee of any put or call shall be such amount as the Board shall prescribe from time to time in section 220.8 (the Supplement to Regulation T) as the margin required for the writing of options, increased by any unrealized loss on each such commitment, or reduced by any excess of the exercise price over the current market value of the underlying security in the case of a call or any excess of the

current market value of the underlying security over the exercise price in the case of a put. Such sum, however, shall not exceed the current market value of the underlying security in the case of a call, or the exercise price in the case of a put, nor be less than \$250 in the case of either a call or a put. Such sum need not be included in the adjusted debit balance when there is held in the account any of the following:

(i) The underlying security in the case of a call or a short position in the underlying security in the case of a put;

(ii) Securities immediately convertible into or exchangeable for the underlying security without restriction or the payment of money in the case of a call, provided that the right to convert or exchange does not expire on or before the expiration date of the option.

(iii) An agreement under which a bank, which is holding the underlying securities or the required cash, is obligated to deliver, in the case of a call, or accept, in the case of a put, the underlying securities against payment of the exercise price upon exercise of the option;

(iv) A long position in a call on the same number of shares of the same underlying security which does not expire before the expiration date of the call issued, endorsed, or guaranteed, provided that there is also added to the adjusted debit balance the amount, if any, by which the exercise price of such long position exceeds the exercise price of the call issued, endorsed, or guaranteed;

†For this Regulation to be complete retain:

- 1) Printed pamphlet containing Regulations X, G, T, and U entitled "Securities Credit Transactions" dated November 1, 1971;
- 2) Amendments effective September 5, 1972, September 18, 1972, October 16, 1972, January 1, 1973, and May 23, 1973 (One sheet);
- 3) Amendments effective July 25, 1974, March 3, 1975, and November 13, 1975;
- 4) Supplement effective August 6, 1976; and
- 5) This slip sheet effective on the dates as shown herein.

(v) A long position in a put on the same number of shares of the same underlying security which does not expire before the expiration date of the put issued, endorsed, or guaranteed, provided that there is also added to the adjusted debit balance the amount, if any, by which the exercise price of the put issued, endorsed, or guaranteed exceeds the exercise price of such long position; or

(vi) A warrant to purchase the underlying security, in the case of a call, which does not expire on or before the expiration date of the call, provided that there is also added to the adjusted debit balance the amount, if any, by which the exercise price of the warrant exceeds the exercise price of the call, issued, endorsed, or guaranteed. A warrant used in lieu of the required margin under this provision shall have no loan value in the account.

(2) When a security held in the account serves in lieu of the margin required for a call, such security shall be valued at no greater than the exercise price of the call.

(3) When a short position held in the account serves in lieu of the margin required for a put, the amount prescribed by paragraph (d)(3) of this section as to the amount to be added to the adjusted debit balance in respect of short sales shall be increased by any unrealized loss on the position.

(4) When both a put and a call are issued, endorsed, or guaranteed in a general account, special bond account, or special convertible debt security account on the same number of shares of the same underlying security with the same expiration date and the same exercise price (a straddle), the amount of margin required shall be the margin on either the put or the call whichever is greater plus any unrealized loss on the other option.

(5) Any security position held in the account which serves in lieu of the margin required for a put or a call shall be unavailable to support any other option transaction in the account.

(6) The customer may either designate at the time the option order is entered which security position held in the account is to serve in lieu of the margin required or have a standing agreement with the creditor as to the method to be used for making the determination on any given day as to which security position will be used in lieu of the margin to support an option transaction.

2. In Section 220.4, paragraph (i) is amended and a new subparagraph (6) is added to paragraph (j) set forth below:

SECTION 220.4 — SPECIAL ACCOUNTS

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(i) **Special bond account.** In a special bond account a creditor may effect and finance transactions in exempted securities and registered non-equity securities for any customer.⁵ Call options may be issued, endorsed, or guaranteed in this account on shares of any underlying equity security which is held in this account because it is an exempted security.

(j) **Special convertible debt security account.*****

(6) Without regard to the margin required for the writing of options in section 220.8(j) (Supplement to Regulation T), call options may be issued, endorsed, or guaranteed in this account on the number of shares of an underlying security into which a margin debt security held in the account is convertible, and put options may be issued, endorsed, or guaranteed in this account on the number of shares of an underlying security sold short in the account. Such option positions may be carried in the account in conformity with the requirements of section 220.3(d) and (i).

⁵For the maximum loan value of such securities see section 220.8(b), the Supplement to Regulation T.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

SUPPLEMENT TO REGULATION T

Effective January 1, 1977

SECTION 220.8 — SUPPLEMENT

(a) **Maximum loan value for general accounts.** The maximum loan value of securities in a general account subject to §220.3 shall be:

(1) Of a registered non-equity security held in the account on March 11, 1968, and continuously thereafter, and of a margin equity security (except as provided in §220.3(c) and paragraphs (b), (c), and (f) of this section), 50 percent of the current market value of such securities.

(2) Of an exempted security held in the account on March 11, 1968, and continuously thereafter, the maximum loan value of the security as determined by the creditor in good faith.

(b) **Maximum loan value for a special bond account.** The maximum loan value of an exempted security and of a registered non-equity security pursuant to §220.4(i) shall be the maximum loan value of the security as determined by the creditor in good faith.

(c) **Maximum loan value for special convertible debt security account.** The maximum loan value of a margin security eligible for a special convertible security account pursuant to §220.4(j) shall be 50 percent of the current market value of the security.

(d) **Margin required for short sales.** The amount to be included in the adjusted debit balance of a general account, pursuant to §220.3(d)(3), as margin required for short sales of securities (other than exempted securities) shall be 50 percent of the current market value of each security.

(e) **Retention requirement.** In the case of an account which would have an excess of the adjusted debit balance of the account over the maximum loan value of the securities in the account following a withdrawal of cash or securities from the account, pursuant to §220.3(b)(2):

(1) The "retention requirement" of an exempted security held in the general account on March 11, 1968, and continuously thereafter, shall be equal to its maximum loan value as determined by the creditor in good faith, and the "retention requirement" of a registered non-equity security held in such account on March 11, 1968, and continuously thereafter, and of a margin security, shall be 70 percent of the current market value of the security.

(2) In the case of a special bond account subject to §220.4(i), the retention requirement of an exempted security and of a registered non-equity security shall be equal to the maximum loan value of the security.

(3) In the case of a special convertible security account subject to §220.4(j) which would have an excess of the adjusted debit balance of the account over the maximum loan value of the securities in the account following a withdrawal of cash or securities from the account, the retention requirement of a security having loan value in the account shall be 70 percent of the current market value of the security.

(4) For the purpose of effecting a transfer from a general account to a special convertible security account subject to §220.4(j), the retention requirement of a security described in §220.4(j), shall be 70 percent of its current market value.

(f) **Securities having no loan value in a general account.** No securities other than an exempted security or registered non-equity security held in the account on March 11, 1968, and continuously thereafter, and a margin security, shall have any loan value in a general account except that a margin security eligible for the special convertible debt security account pursuant to §220.4(j) shall have loan value only if held in the account on March 11, 1968, and continuously thereafter; and no put, call, or combination thereof shall have loan value in a general account.

(g) **Account subject to section 8(g).** For purposes of the computation described in §220.3(b)(1)(ii),

(1) The maximum loan value of a registered non-equity security held in the account on March 11, 1968, and continuously thereafter, and of a margin equity security shall be 70 percent of the current market value of such security, and the maximum loan value of an exempted security held in the account on March 11, 1968, and continuously thereafter, shall be the maximum loan value of the security as determined by the creditor in good faith.

(2) The amount to be included in the adjusted debit balance of the account pursuant to §220.3(d)(3) as margin required for short sales of securities (other than exempted securities) shall be 30 percent of the current market value of each security.

(3) For the period November 5, 1974, through November 2, 1975, all transactions permitted by §§220.3(b)(1) and 220.3(g) for accounts not subject to section 8(g) shall also be permitted in accounts subject to section 8(g).

(h) **Requirements for inclusion on List of OTC Margin Stocks.** Except as provided in subparagraph (4) of §220.2(e), OTC margin stock shall meet the requirements that:

(1) The stock is subject to registration under section 12(g)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78l(g)(1)), is issued by an insurance company subject to section 12(g)(2)(G) (15 U.S.C. 78l(g)(2)(G)) that has at least \$1 million of capital and surplus, or is issued by a closed-end investment management company subject to registration pursuant to section 8 of the Investment Company Act of 1940 (15 U.S.C. §80a-8),

(2) Four or more dealers stand willing to, and do in fact, make a market in such stock including making regularly published *bona fide* bids and offers for such stock for their own accounts, or the stock is registered on a securities exchange that is exempted by the Securities and Exchange Commission from registration as a national securities exchange pursuant to section 5 of the Securities Exchange Act of 1934 (15 U.S.C. 78e),

(3) There are 1,200 or more holders of record, as defined in SEC Rule 12g5-1 (17 CFR §240.12g5-1), of the stock who are not officers, directors, or beneficial owners of 10 percent or more of the stock, or the average daily trading volume of such stock, as determined by the Board, is at least 500 shares,

(4) The issuer is organized under the laws of the United States or a State⁹ and it, or a predecessor in interest, has been in existence for at least 3 years,

(5) The stock has been publicly traded for at least 6 months,

(6) Daily quotations for both bid and asked prices for the stock are continuously available to the general public, and

(7) There are 500,000 or more shares of such stock outstanding in addition to shares held beneficially by officers, directors, or beneficial owners of more than 10 percent of the stock; and shall meet two of the three additional requirements that:

(8) The shares described in subparagraph (7) of this paragraph have a market value of at least \$5 million,

(9) The minimum average bid price of such stock, as determined by the Board, is at least \$5 per share, and

(10) The issuer has at least \$5 million of capital, surplus, and undivided profits.

(i) **Requirements for continued inclusion on List of OTC Margin Stocks.** Except as provided in subparagraph (4) of §220.2(e), OTC margin stock shall meet the requirements that:

(1) The stock continues to be subject to registration under section 12(g)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78l(g)(1)), or if issued by an insurance company such issuer continues to be subject to section 12(g)(2)(G) (15 U.S.C. 78l(g)(2)(G)) and to have at least \$1 million of capital and surplus, or if issued by a closed-end investment management company such issuer continues to be subject to registration pursuant to section 8 of the Investment Company Act of 1940 (15 U.S.C. §80a-8),

(2) Three or more dealers stand willing to, and do in fact, make a market in such stock including making regularly published *bona fide* bids and offers for such stock for their own accounts, or the stock is registered on a securities exchange that is exempted by the Securities and Exchange Commission from registration as a national securities exchange pursuant to section 5 of the Securities Exchange Act of 1934 (15 U.S.C. 78e),

(3) There continue to be 800 or more holders of record, as defined in SEC rule 12g5-1 (17 CFR §240.12g5-1) of the stock who are not officers, directors, or beneficial owners of 10 percent or more of the stock, or the average daily trading volume of such stock, as determined by the Board, is at least 300 shares,

(4) The issuer continues to be a U.S. corporation,

(5) Daily quotations for both bid and asked prices for the stock are continuously available to the general public, and

(6) There are 300,000 or more shares of such stock outstanding in addition to shares held beneficially by officers, directors, or beneficial owners of more than 10 percent of the stock; and shall meet two of the three additional requirements that:

(7) The shares described in subparagraph (6) of this paragraph continue to have a market value of at least \$2.5 million,

(8) The minimum average bid price of such stock, as determined by the Board, is at least \$3 per share, and

(9) The issuer continues to have at least \$2.5 million of capital, surplus, and undivided profits.

(j) **Margin required for the writing of options.** The amount to be included in the adjusted debit balance of a general account, special bond account, or special convertible debt security account pursuant to paragraphs (d)(5) and (i) of section 220.3, as the margin required for the issuance, endorsement, or guarantee of any put or call shall be 30 percent of the current market value of the underlying security with an adjustment for any applicable increase or reduction.

⁹As defined in 15 U.S.C. 78c(a)(16).