

FEDERAL RESERVE BANK OF DALLAS

DALLAS, TEXAS 75222

Circular No. 82-27
March 10, 1982

REGULATIONS G, T, AND U
SECURITIES CREDIT TRANSACTIONS

Proposed Rulemaking

TO ALL MEMBER BANKS,
OTHER CREDITORS
AND OTHERS CONCERNED IN THE
ELEVENTH FEDERAL RESERVE DISTRICT:

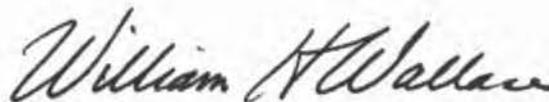
The Board of Governors of the Federal Reserve System, pursuant to its authority under the Securities Exchange Act of 1934, is considering establishing margin requirements for futures contracts based on stock indexes. The Board is requesting comment on a proposed regulatory framework which could be useful in establishing those requirements.

Printed on the following pages are copies of the Board's press release dated February 25, 1982, and a copy of the material as submitted for publication in the Federal Register. Interested persons are invited to submit comments to the Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, D.C. 20551, to be received on or before April 30, 1982. Please refer to Docket No. R-0370 when submitting comments.

Questions regarding the proposed rulemaking should be directed to this Bank's Legal Department, Ext. 6171.

Additional copies of this circular will be furnished upon request to the Department of Communications, Financial and Community Affairs, Ext. 6289.

Sincerely yours,



William H. Wallace
First Vice President

FEDERAL RESERVE press release



For immediate release

February 25, 1982

The Federal Reserve Board today issued for comment a regulatory framework that could be used to establish margin requirements on futures contracts based on stock indexes. Comments should be received by April 30.

Last week, the Board decided not to specify a margin requirement on stock index futures contracts at this time, following action by the Commodity Futures Trading Commission permitting the Kansas City Board of Trade to trade such a contract.

The Board noted actions taken by the KCBOT to increase its own initial margin requirements on these futures contracts and to narrow the definition of hedging for margin purposes. In view of this, the Board decided not to take immediate action of its own.

However, the Board indicated that, because formal margin requirements on stock index futures contracts may be appropriate later to limit the use of speculative credit and to assure competitive equality with stock options -- on which margin requirements are currently imposed -- it plans to monitor the development and operation of this market closely.

The Board therefore asked for comment both on specific issues related to establishment of margin requirements on stock index futures contracts and related instruments and on a proposed framework for such regulation.

The Board's notice in this matter, and its letter to the Chairman of the Commodity Futures Trading Commission, are attached.

Attachments

FEDERAL RESERVE SYSTEM

Regulations G, T and U

[12 CFR 207, 220 and 221]

[Docket No. R-0385]

SECURITIES CREDIT TRANSACTIONS

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Advance notice of proposed rulemaking.

SUMMARY: The Board of Governors, pursuant to its authority under the Securities Exchange Act of 1934, is considering establishing margin requirements for futures contracts based on stock indexes. The Board is now requesting comments on a proposed regulatory framework which could be used to implement a decision to establish margin requirements for futures contracts based on stock indexes.

DATE: Comments should be received on or before April 30, 1982.

ADDRESS: Comments, which should refer to Docket No. R-0385, may be mailed to the Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, D.C. 20551 or delivered to Room B-2223 between 8:45 a.m. and 5:15 p.m. Comments received may also be inspected at Room B-1122 between 8:45 a.m. and 5:15 p.m. except as provided in section 261.6(a) of the Board's Rule Regarding Availability of Information (12 CFR § 261.6(a)).

FOR FURTHER INFORMATION CONTACT: Laura Homer, Securities Credit Officer or Robert Lord, Attorney, Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System, Washington, D.C. 20551 (202) 452-2781.

SUPPLEMENTARY INFORMATION: The Board has reviewed the question of applying margin requirements to any futures contracts involving a broadly-based stock index in light of approval by the Commodity Futures Trading Commission (CFTC) of an application by the Kansas City Board of Trade ("the Applicant") to trade such a contract. In considering the matter, the Board took into account that stock index futures contracts can, to an important degree, compete

with, and be an economic substitute for, stock options, on which margin requirements are currently imposed. In addition to limiting the use of speculative credit, margin requirements, therefore, may be appropriate to assure competitive equality among functionally similar instruments.

The Board understands that the Applicant has raised the initial margin on its stock index futures contract for a non-hedging position to a dollar level approximately equal to ten percent of the current value of the contract, and has raised margin requirements for hedging transactions to one half of that amount. In addition, the Board understands that the Applicant has taken steps to narrow the definition of hedging for margin purposes to better assure that situations permitting the lower margin requirement represent a true hedging transaction, a direction the Board believes appropriate.

The actions by the Applicant would appear to alleviate the need for immediate action by the Board and, consequently, the Board has decided not to specify at this time particular margin requirements on stock index futures contracts such as the one approved by the CFTC. The Board plans to monitor closely the development and operation of the market in stock index futures contracts so that an informed judgment on the matter can be reached based on experience.

Although the Board has decided not to specify margin requirements on stock index futures contracts at this time, there is a clear possibility that Board action may be necessary in the future. Therefore, the Board is asking for comment on specific issues, including a regulatory framework suggested by its staff, so that the Board may be fully prepared in the event a formal margin regulation become necessary. The public is asked to comment on the following specific issues in connection with stock index futures contracts and related instruments:

1. The appropriate level of margin;
2. the appropriate definition of a hedged transaction;
3. the use of Regulation G or T to cover futures commission merchants that may not otherwise be subject to the Board's margin regulations;
4. the proper customer account to use in Regulation T for these instruments; and
5. the treatment of bank loans and loans from other lenders for the purpose of meeting margin calls and related costs.

The objective of several of the foregoing questions is to design a regulatory framework that would create the least operational problems for broker-dealers presently subject to Regulation T and those firms not presently covered, while providing comparable treatment of the two groups. Specific comment is invited with respect to the following framework which has been suggested by Board staff.

First, a futures commission merchant would be considered a "creditor" subject to Regulation T, but only with respect to transactions in stock index futures contracts. Second, any Regulation T "creditor" who executes a stock index futures contract for a public customer would be required to obtain a specified initial margin. Third, transactions in stock index futures contracts would be required to be maintained in the "special commodity account" which presently exists in Regulation T. Fourth, credit extended to customers by banks and other lenders for the purpose of meeting a commitment under a stock index futures contract would be considered "purpose" credit. Thus, credit extended for such a purpose would be subject to the current margin level applicable to other "purpose" loans collateralized by margin securities. Finally, the level of margin would be placed in the Supplement to Regulation T with other margin levels.

By order of the Board of Governors of the Federal Reserve System, February 24, 1982.

(signed) William W. Wiles

William W. Wiles
Secretary of the Board

[SEAL]



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

PAUL A. VOLCKER
CHAIRMAN

February 17, 1982

The Honorable Philip McBride Johnson
Chairman
Commodity Futures Trading Commission
2033 K Street, N.W.
Washington, D.C. 20581

Dear Mr. Chairman:

This is in response to our discussions concerning the announced plans of the Kansas City Board of Trade ("KCBOT") to initiate trading on the KCBOT in a futures contract for cash settlement based on the Value Line Average, a broadly based stock price index. I understand that on February 16 the Commission approved the KCBOT's application for approval to trade in stock market index futures contracts.

The Board has reviewed the question of applying margin requirements to the KCBOT futures contract. As you know, we believe that the Board's authority to impose margin requirements under the Securities Exchange Act authorizes the imposition of margin requirements on the type of futures contracts proposed by the KCBOT. Moreover, in considering this matter it is important to take into account that the stock market futures contract proposed by the KCBOT can, to an important degree, compete with, and be an economic substitute for, options contracts, on which margin requirements are currently imposed. Thus, margin requirements may be appropriate not only to limit use of credit for speculative purposes, but also to assure competitive equality among functionally similar instruments.

We understand, however, that the board of directors of the KCBOT on February 16, 1982, has acted to raise initial margin requirements on the futures contract for a non-hedging position to the level of \$6,500, approximately equal to 10 per cent of the current value of the contract, and to raise margin requirements for hedging transactions to approximately one-half of the non-hedging margin. We also understand that the KCBOT has taken a step towards narrowing the definition of "hedging" so as to better assure that situations in which the lower margin requirement would apply represent a true hedging situation, a direction the Board believes appropriate.

These self-regulatory actions by the KCBOT would appear to alleviate the need for any immediate action by the Board, and, consequently, the Board has decided not to specify at this time particular margin

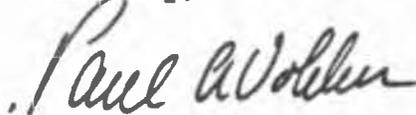
The Honorable Philip McBride Johnson
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requirements on stock index futures contracts such as the ECBOT futures contract. We do plan to monitor closely the development and operation of the market in stock index futures contracts as it develops so that we can reach an informed judgment, based on expertise, as to whether imposition of a formal rule with respect to margin requirements would be appropriate. We would welcome working with the CFTC in following market developments, and I have asked my staff to cooperate fully with yours in monitoring developments.

So that we may be fully prepared in the event a formal margin regulation becomes necessary in the light of market developments and experience, we are inviting interested parties to submit comments on the establishment of margin requirements on stock market index futures contracts and related instruments. To facilitate comments, we will publish a proposed framework for such regulations and relevant questions. The Board plans to review this matter in about six months.

I appreciate your efforts to work with us and to keep us informed of developments in this area.

Sincerely,

A handwritten signature in cursive script, reading "Paul A. Volcker". The signature is written in dark ink and is positioned below the typed name "Paul A. Volcker".