FEDERAL RESERVE BANK
OF DALLAS

WILLIAM H. WALLACE
FIRST VICE PRESIDENT

DALLAS, TEXAS 75222

February 27, 1985

Circular 85-28

TO: The Chief Executive Officer of all
member banks and others concerned in
the Eleventh Federal Reserve District

SUBJECT

Regulation T -- Credit by Brokers and Dealers, request for public comment

DETAILS

The Board of Governors of the Federal Reserve System has issued for public comment a proposal that would change the initial margin requirements for the writing of options on equity securities. The proposed amendment would require an initial margin that is identical to the maintenance margin required by the national securities exchanges or associations under rules that have been approved by the Securities and Exchange Commission. Complete details are provided with this circular.

Comments should be addressed to Mr. William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, Washington, D. C., 20551. All correspondence should refer to Docket No. R-0538, and must be received by March 15, 1985.

ATTACHMENTS

The Board's press release and the notice as published in the Federal Register are attached.

MORE INFORMATION

For further information, please contact this Bank's Legal Department at (214) 651-6228.

Sincerely yours,

William H. Wallace

FEDERAL RESERVE press release

For Immediate Release February 6, 1985

The Federal Reserve Board today proposed for comment an amendment to Regulation T (Credit by Brokers and Dealers) that would change the initial margin requirements for the writing of options on equity securities.

Comment is requested by March 15, 1985.

The Board presently specifies the margin requirement for the writing of options on equity securities at 30 percent of the value of the underlying securities plus any unrealized loss or minus any unrealized gain. The proposed amendment would require an initial margin that is identical to the maintenance margin required by the national securities exchanges or associations under rules that have been approved by the Securities and Exchange Commission. The proposal is consistent with the Board's existing policy of requiring initial margin deposits for the writing of other types of option contracts -- such as options on government securities, certificates of deposits, and stock indexes -- which are the same as the exchanges' maintenance margin requirements.

The Board's proposal responds to a request by five self-regulatory organizations (American Stock Exchange, Chicago Board Options Exchange, New York Stock Exchange, Philadelphia Stock Exchange, and the Pacific Stock Exchange) that the Board restructure initial margins to allow for the adoption of a premium-based uniform system of margin requirements for all types of options contracts. Proposed rule changes by these exchanges to implement a premium-based margin system have been filed with the Securities and Exchange Commission.

The Board's notice is attached.

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Attachment

Federal Reserve System

Regulation T

(12 CFR 220)

[Docket No. R-0538]

Credit By Brokers and Dealers

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Proposed Rule.

SUMMARY: The Board is proposing to amend Regulation T (12 CFR 220, Credit By Brokers and Dealers) in order to continue the Board's present policy of requiring an initial margin for the writing of options that is identical to the maintenance margin required by exchange or association rules that have been approved by the Securities and Exchange Commission ("SEC"). The amendment would state that the initial margin shall be the amount specified by the rules of the national securities exchanges or association authorized to trade the option if the SEC has approved the rules.

DATE: Comments should be received on or before March 15, 1985.

ADDRESS: Comments, should refer to Docket No. R-0538, and may be mailed to Mr. William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, D.C. 20551 or delivered to the C Street Entrance between 8:45 a.m. and 5:15 p.m.

FOR FURTHER INFORMATION CONTACT: Laura Homer, Securities Credit Officer, Division of Banking Supervision and Regulation, (202) 452-2781, or, for the economic analysis, Carolyn Davis, Economist, Division of Research and Statistics (202)452-3633.

SUPPLEMENTARY INFORMATION:

Approval of rule changes by the SEC for a new margining system for all options is being sought by the New York Stock Exchange, American Stock Exchange, Chicago Board Options Exchange, Pacific Stock Exchange and Philadelphia Stock Exchange. The proposed system would use a formula applicable to all current and future options and will be composed of the premium plus a percentage of the current market value of the underlying instrument minus the amount the option is out-of-the-money. A minimum amount will be established under the proposed system for each option. Both the percentage of the underlying instrument and the minimum amount have been established for those options now in existence. They are based upon annualized volatility studies and reflect the risks involved for the broker of adverse price movements over a period of time. The Board's present margin requirement for the writing of an uncovered option on a single stock is 30 percent of the current market value of the underlying security plus any unrealized loss or minus any unrealized gain. Margin requirements for other types of options presently follow the maintenance requirements of the exchange trading the option. If this proposed change is adopted by the Board, and the SEC approves the self-regulatory organizations' rule changes, all initial margin requirements for the writing of options will be at the same level as the maintenance standards established by the exchanges and approved by the SEC.

INITIAL REGULATORY FLEXIBILITY ANALYSIS:

The change proposed by this action would reduce some administrative and regulatory burdens faced by the brokerage community. The Board certifies for purposes of 5 U.S.C. § 605(b), therefore, that the proposed amendment to Regulation T is not expected to have any adverse impact on a substantial number of small businesses.

List of Subjects in 12 CFR Part 220

Banks, Banking, Borrowers, Brokers, Credit, Federal Reserve System, Margin, Margin Requirements, Investments, Securities.

Accordingly, pursuant to sections 7 and 23 of the Securities Exchange Act of 1934, as amended (15 U.S.C. §§ 78g and 78w) the Board proposes to amend Regulation T (12 CFR 220) as follows:

1. Section 220.5 would be amended by revising paragraph (c) to read as follows:

SECTION 220.5 -- Margin Account Exceptions and Special Provisions

* * * * *

(c) * * *

(2) Margin for options on equity securities. The required margin for each transaction involving any short put or short call on an equity security shall be the amount set forth in section 220.18 (the Supplement).

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2. Section 220.18 would be amended by revising paragraph (c) as follows:

SECTION 220.18 -- Supplement: Margin Requirements

* * * * *

(c) Short put or short call on an equity security. The amount specified by the rules of the national securities exchange or association authorized to trade the option, provided that all such rules have been approved or amended by the SEC.

By order of the Board of Governors of the Federal Reserve System, February 6, 1985.

(signed) William W. Wiles

William W. Wiles
Secretary of the Board