



FEDERAL RESERVE BANK
OF DALLAS

WILLIAM H. WALLACE
FIRST VICE PRESIDENT

August 7, 1985

DALLAS, TEXAS 75222

Circular 85-104

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

SUBJECT

Amendment to Regulation T -- Credit By Brokers and Dealers

DETAILS

The Board of Governors of the Federal Reserve System has announced an amendment effective September 30, 1985, that changes the initial margin requirements for the writing of options on equity securities. The amendment will permit a uniform premium-based system of margin requirements for all types of option contracts.

The Board also indicates that it is considering deleting paragraphs (c)(3)(4)(5) and (6) in Section 220.5 of Regulation T if the exchanges and the NASD incorporate the substance of those provisions in their rates.

ATTACHMENTS

The Board's press release and the amendment as submitted for publication in the Federal Register are attached.

MORE INFORMATION

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

Sincerely yours,

William H. Wallace

FEDERAL RESERVE press release



For immediate release

June 21, 1985

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

The amendment becomes effective September 30, 1985.

The amendment will permit a uniform premium-based system of margin requirements for all types of option contracts. This system will incorporate the maintenance margin required by the national securities exchanges or associations under rules approved by the Securities and Exchange Commission. This action is intended to reduce computer programming requirements for the brokerage industry because it will use one basic program for all types of options.

The Board's notice is attached.

-0-

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: Final Rule.

SUMMARY: The Board is amending 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 states 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. It will no longer specify what that amount is for options on equity securities and will consolidate the existing provisions for different option products into a single rule. A further provision is added to cover options not effected on exchanges or association facilities.

EFFECTIVE DATE: September 30, 1985.

FOR FURTHER INFORMATION CONTACT: Laura Homer, Securities Credit Officer or Susan Meyers, Securities Regulation Analyst, Division of Banking Supervision and Regulation, (202) 452-2781, or Joy W. O'Connell, Telecommunication Device for the Deaf (TDD) (202) 452-3244.

SUPPLEMENTARY INFORMATION:

A new margining system for the writing of options has been proposed to the SEC by the exchanges that trade options. The formula for any option product would be the premium, plus a percentage of the current market value of the underlying security, index, or other instrument on which the option is based, minus the amount the option is "out of the money". A minimum amount would be established for each option. This amount and the percentage of current market value for each product has been established for existing products based upon annualized volatility studies. They reflect the risks involved for the broker of adverse price movements over a period of time. The Board's existing rules for option products would accommodate this new system with the exception of the rule for an option on a single equity security. The Board proposed an amendment to the equity option provision (50 Fed. Reg. 5766, Feb. 12, 1985) in order to facilitate the industry's change to the "premium plus" system.

Comments were all favorable to the "premium plus" concept. One commenter, however, voiced concern over the delegation of authority to the SROs. Commenters and the SEC staff have asked for a delayed effective date so that computer programs can be changed to the new system. A three-month period has been provided to allow for computer program changes and for SEC action on the rule changes that will implement the new margining system.

The Board also wishes to give notice that it is considering deleting paragraph (c) (3) (4) (5) and (6) in section 220.5 of Regulation T if all of the exchanges and the NASD incorporate the substance of those provisions in the SRO rules. Each of the various national securities exchanges and the NASD should notify the Board when similar rules have been adopted.

FINAL REGULATORY FLEXIBILITY ANALYSIS:

The Initial Regulatory Flexibility Analysis indicated that the change proposed would reduce some administrative and regulatory burdens faced by the brokerage community and was not expected to have any adverse impact on a substantial number of small businesses. No comments to the contrary were received. The Board, therefore, certifies for purposes of 5 U.S.C. 605(b) that this amendment to Regulation T will not 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, Reporting and Recordkeeping Requirements, Securities.

Accordingly, the Board amends 12 C.F.R. 220 (Regulation T) as set forth below:

PART 220 — CREDIT BY BROKERS AND DEALERS

1. The authority citation for 12 C.F.R. 220 is revised to read as follows:

AUTHORITY: Secs. 3, 7, 8, 17 and 23 of The Securities Exchange Act of 1934, as amended (15 U.S.C. 78c, 78g, 78h, 78q and 78w).

2. Section 220.5 (c) (2) is revised to read as set forth below:

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).

* * * * *

3. Section 220.18 is revised to read as follows:

SECTION 220.18 -- Supplement: Margin Requirements

The required margin for each security position held in a margin account shall be as follows:

(a) Margin equity security, except for an exempted security or a long position in an option: 50 percent of the current market value of the security.

(b) Exempted security, registered nonconvertible debt security or OTC margin bond: the margin required by the creditor in good faith.

(c) Short sale of nonexempted security: 150 percent of the current market value of the security, or 100 percent of the current market value if a security exchangeable or convertible within 90 calendar days without restriction other than the payment of money into the security sold short is held in the account.

(d) Short sale of an exempted security: 100 percent of the current market value of the security plus the margin required by the creditor in good faith.

(e) Nonmargin, nonexempted security or a long position in any option: 100 percent of the current market value.

(f) Short put or short call on a security, certificate of deposit, securities index or foreign currency:

(1) in the case of puts and calls issued by a registered clearing corporation and listed or traded on a registered national securities exchange or a registered securities association, the amount, or other position (except

in the case of an option on an equity security), specified by the rules of the registered national securities exchange or the registered securities association authorized to trade the option, provided that all such rules have been approved or amended by the SEC; or

(2) in the case of all other puts and calls, the amount, or other position (except in the case of an option on an equity security), specified by the maintenance rules of the creditor's self-regulatory organization.

By order of the Board of Governors of the Federal Reserve System,
June 19, 1985.

(signed) William W. Wiles

William W. Wiles
Secretary of the Board