FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 7942
August 24, 1976]

INTERPRETATION OF REGULATION T

Use of Escrow Receipts for Option Transactions

To All Brokers and Dealers, and Members of National Securities Exchanges, in the Second Federal Reserve District:

The Board of Governors of the Federal Reserve System has issued an interpretation of its Regulation T, "Credit by Brokers and Dealers," regarding the use of escrow receipts for option transactions effected in special cash accounts.

Enclosed is a copy of the interpretation. Any inquiries thereon may be directed to the Securities Regulations Division of our Bank Regulations Department. Additional copies of the enclosure will be furnished upon request.

PAUL A. VOLCKER,
President.

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Federal Reserve Bank of St. Louis

Board of Governors of the Federal Reserve System

CREDIT BY BROKERS AND DEALERS

INTERPRETATION OF REGULATION T

Use of Escrow Receipts for Option Transactions Effected in Special Cash Account

§220.130 **Escrow receipts for option transactions.**

The Board of Governors has interpreted § 220.4(c) of Regulation T as allowing the use of escrow receipts for option transactions effected in a special cash account if the customer represents that the covering securities or funds are held by a bank and the broker independently verifies that the appropriate escrow receipt will be delivered no later than three business days after the option is written.

(a) The Board has been asked whether or not it is permissible under the provisions of § 220.4(c) of Regulation T (12 CFR 220.4(C)) relating to the special cash account, to allow customers to write put and call securities options which are "covered" by the escrow receipt of a bank when the escrow receipt, because of the mechanics of the trade, cannot be delivered to the broker on the day the option is written. When exchange-traded securities options were first introduced in 1973, the Board expressed the view that certain option transactions were permitted in the cash account (1973 *Bulletin* 525; 12 CFR 220.126) under circumstances which indicated their nature as *bona fide* cash transactions. Basically, that interpretation indicates that the special cash account can be used if the underlying securities, or the funds necessary to pay for the securities, are held in the account on the day the option is written. (This is commonly referred to as a "covered" transaction.) The use of "escrow receipts" for option transactions to be effected in a special cash account was not considered by the Board at the time of the 1973 interpretation.

(b) An escrow receipt is an agreement under which a bank represents and warrants that it holds for the account of a customer the securities which are the subject of a call, or the cash to purchase the securities which are the subject of a put, and will continue to hold the same until the option is either exercised or expires. If the option is exercised, the bank will deliver or accept delivery of the appropriate securities against payment, as the circumstances require.

(c) It has been represented to the Board that customers who wish to write covered options in a cash account using escrow receipts are hampered because of procedural delays in transmitting the escrow receipt from the bank to the broker. Up to three business days may elapse before the receipt can be in the physical possession of the broker because, for example, some banks will not issue the receipt until the premium for writing the option is delivered.

(d) The Board is of the view that a broker may effect an option transaction in a special cash account where the customer represents that the required securities or cash are then held for that customer at a bank and the broker independently verifies that the appropriate escrow receipt will be delivered to the broker by the bank as soon as possible but, in no event, later than three business days after the option is written. (The term "bank" as defined in section 3(a)(6) of the Securities Exchange Act of 1934 includes banks, trust companies and those branches of foreign banks which are located in the United States and are supervised and examined by State banking authorities.) Any delay in delivery of the escrow receipt resulting from factors within the customer's control would, of course, cast doubt on the eligibility of the transaction as a *bona fide* cash transaction.

By order of the Board of Governors, August 13, 1976.

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