

FEDERAL RESERVE BANK  
OF NEW YORK

Circular No. 9164  
October 20, 1981

**AMENDMENT TO REGULATION T**  
**Options on Exempted Debt Securities**

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

Following is the text of a statement issued October 5 by the Board of Governors of the Federal Reserve System:

The Federal Reserve Board today announced that it has adopted an amendment to its Regulation T — Credit by Brokers and Dealers — to require brokers and dealers to obtain “good faith” margin from customers who write uncovered options on government securities.

The amendment is a modification of a proposal made by the Board in June concerning margin requirements for trading of options on government and government agency debt securities. The good faith margin is to be based on the maintenance margins of the exchange that trades the option. Under the amendment, no loan value may be accorded to the option itself.

The attached notice gives details of the amendment as adopted by the Board. It is effective October 26, 1981.

Enclosed is a copy of the amendment. Questions on this matter may be directed to our Regulations Division (Tel. No. 212-791-5914).

ANTHONY M. SOLOMON,  
*President.*

Board of Governors of the Federal Reserve System

CREDIT BY BROKERS AND DEALERS

AMENDMENT TO REGULATION T

(effective October 26, 1981)

FEDERAL RESERVE SYSTEM

12 CFR Part 220

[Docket No. R-0082]

Amendment to Regulation T To Establish Margin Requirements for Options on Exempted Debt Securities

**AGENCY:** Board of Governors of the Federal Reserve System.

**ACTION:** Final rule.

**SUMMARY:** The Board is amending Regulation T (12 CFR Part 220) to provide a separate margin requirement for options on debt securities issued or guaranteed by government entities (exempted debt securities). The Board's existing margin rule for options was adopted to apply to options written on corporate equity securities. Absent this amendment to Regulation T, that rule would be automatically applicable to a new type of option on exempted debt securities for which filings have been made with the Securities and Exchange Commission (SEC). The initial margin required for the writing of uncovered options on Treasury and government agency securities and the specification of appropriate cover under this new amendment rule will be determined by the rules of the exchange on which the option is traded, provided those rules have been approved by the SEC. In addition, brokers and dealers will be required to obtain from customers writing over-the-counter options on exempted debt securities either the margin or the covering security position which is equivalent to the comparable exchange-traded option requirement. The amendment will continue the

Board's present policy of not according loan value to an option so that it cannot be used as collateral for loans for the purpose of purchasing or carrying securities. On June 19, 1981 the Board published two alternative proposed amendments for comment (46 FR 32033) identified as the "good faith proposal" and the "premium based proposal." The rule adopted is a modification of the "good faith proposal".

**EFFECTIVE DATE:** October 26, 1981.

**FOR FURTHER INFORMATION CONTACT:** Laura Homer, Securities Credit Officer, or Bruce Brett, Securities Regulation Analyst, 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 of Governors amends its Regulation T to provide a separate margin for options on exempted debt securities. Public comment was received on two alternative proposals and on issues identified in the Federal Register notice.

An option contract on mortgage pass-through certificates guaranteed by the Government National Mortgage Association (GNMA options) has been approved by the SEC for trading on the Chicago Board Options Exchange (CBOE) and option contracts on Treasury bills, notes and bonds that have been proposed by the New York Stock Exchange (NYSE), American Stock Exchange (AMEX) and CBOE are currently being considered by the SEC (see Securities Exchange Act Release No. 17577, February 26, 1981, and Securities Exchange Act Release No. 17995, May 11, 1981). One of the SEC's

requirements for the approval of trading of GNMA options was that CBOE margin rules conform with the Board's margin requirements.

Twenty-three comments were received. Of those that took a general position on the two alternatives, ten supported the premium based alternative and eight supported the good faith alternative. However, many specific changes were recommended for each alternative. There was no disagreement with the Board's position that the current margin for options in Regulation T was not appropriate for options on exempted debt securities. No commenters on the issue supported the part of the "good faith" proposal giving loan value to the long side of the option and most expressly recommended that the Board deny loan value. The fact that CBOE, NYSE and AMEX had agreed to adopt each other's maintenance margin rules for option contract proposals already filed with the SEC was cited by several commenters as the reason why the "good faith" proposal should be adopted.

The "good faith proposal" adopted by the Board differs in two material respects from the proposal previously published for comment. First, the initial margin will be determined by the rules of the exchange on which the option is traded, subject to approval by the SEC rather than determined by each individual broker/dealer. Second, the definition of what constitutes adequate cover will also be determined by the same exchange rules, subject to SEC approval, rather than specified by the Board.

The Board retains authority to itself to set margin with respect to these option contracts if future circumstances should warrant. For example, this authority

For this Regulation to be complete, retain:

- 1) Regulation T, as amended effective June 1, 1977, printed in the pamphlet "Securities Credit Transactions."
- 2) Supplement to Regulation T (section 220.8) dated October 1978, effective October 30, 1978.
- 3) Amendments effective July 12, 1978, October 30, 1978, June 2, 1980, August 11, 1980, November 3, 1980, and July 13, 1981.
- 4) This slip sheet.

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may be invoked without prior notice in an emergency, or if the Board determines that the level of margin prevailing is not adequate to forestall speculative price movements that could have adverse effects on the underlying securities markets.

## PART 220—CREDIT BY BROKERS AND DEALERS

Accordingly, pursuant to sections 7 and 23 of the Securities Exchange Act of 1934, as amended (15 U.S.C. 78g, 78w) the Board adopts the following amendments to § 220.4(i) and § 220.8 (b) and (j) of Regulation T (12 CFR Part 220):

1. Section 220.4(i) is revised to read as follows:

### § 220.4 Special accounts.

(i) *Special bond account.* (1) In a special bond account a creditor may extend and maintain credit on any exempted security, registered non-equity security, or OTC margin bond. The maximum loan value of securities held in this account shall be as prescribed from time to time in § 220.8 of this part (the supplement to Regulation T).

(2) Put and call options on exempted securities may be issued, endorsed or guaranteed in this account if either a security position in lieu of margin (cover) is held in the account or the amount of margin prescribed by the Board from time to time in § 220.8 of this part (the supplement to Regulation T) is included in the adjusted debit balance.

(3) A security position held in the account may serve in lieu of the margin required for writing a call or a put, if the following conditions are met:

(i) For writing a call, the covering long security position shall be valued at no more than the exercise price of the call or

(ii) For writing a put, the amount of margin required for a covering short security position shall be based on a value not less than the exercise price of the put.

(4) 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.

(5) 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.

2. Section 220.8 (b) and (j) are revised to read as follows:

### § 220.8 Supplement.

(b) *Maximum loan value for a special bond account.* The maximum loan value of an exempted security, an OTC margin bond, or a registered nonequity security which is not a put, call or combination thereof shall be as determined by the creditor in good faith. No put, call or combination thereof shall have any loan value.

(j) *Margin required for the writing of options.* (1) 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 § 220.3 of this part, as the margin required for the issuance, endorsement, or guarantee of any put or call on an equity security shall be 30 per cent of the current market value of the underlying security with an adjustment for any applicable increase or reduction.

(2) The amount to be included in the adjusted debit balance of an account pursuant to § 220.4(i) of this part as the margin required for the issuance, endorsement, or guarantee of a put or call on an exempted debt security or the security position to be held in lieu of margin shall be equivalent to (i) The amount specified by the rules of the national securities exchange on which the option is traded provided that all such rules have been approved or amended by the Securities and Exchange Commission pursuant to sections 19(b) or 19(c) of the Securities Exchange Act of 1934, or (ii) in the case of an option on an exempted debt security which is not traded on an exchange an amount or security position which the creditor in good faith deems to be equivalent to the margin or the cover on comparable exchange-traded options.

### Regulatory Flexibility Analysis

The Board of Governors of the Federal Reserve System has amended Regulation T to establish a margin requirement for options on exempted debt securities that is separate from and less stringent than the Regulation T margin requirement that applies to

options on equity securities. The need to amend the regulation follows from the approval by the SEC to allow trading of such exempted debt security options beginning as early as October, 1981. The Board amended the Regulation in such a way that the margin required for writing these "interest rate" options will be determined by the rules of the exchanges trading such options.

By adopting industry standards that are subject to approval by the SEC before implementation, the Board sought to create a margin regulatory structure that was flexible enough to match the margins and the risks of a variety of different "interest rate" options and that was consistent with the goal of minimal regulatory complexity and the need for adequate regulatory oversight. This approach to regulation streamlines regulatory compliance. That is, instead of possibly having to meet a separate initial margin requirement of the Federal Reserve and a maintenance margin rule of an exchange, brokers must only satisfy an exchange standard. Such a reduction in regulatory overlap is expected to be particularly beneficial to many small brokers, for whom compliance costs constitute a large proportion of administrative expenses.

Regulatory burden is further reduced by explicitly relating the margin requirement to that established by the exchange trading the option contract; any remaining burden upon self-regulatory organizations (SROs)—specifically, securities exchanges and the National Association of Securities Dealers—to write rules will be confined to the particular products that trade in their respective markets. Moreover, as a result of these Regulation T amendments, no SRO should be in a position to influence the trading of options in another market by setting different margin levels for its member organizations than were deemed appropriate by the exchange upon which the option is traded and were approved by the SEC.

By order of the Board of Governors of the Federal Reserve System, October 2, 1981.

William W. Wiles,  
Secretary of the Board.

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