

FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 8110]
May 10, 1977

TRADING OF STOCK OPTIONS
Amendment and Revised Proposed Amendment to Regulation T

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 April 28 by the Board of Governors of the Federal Reserve System:

The Board of Governors of the Federal Reserve System today adopted an amendment to Regulation T—margin requirements for brokers and dealers—and proposed a further Regulation T amendment, in both cases affecting the trading of stock options.

Such options may be a “call”—an option to buy stock at a specified price within a given time, or a “put”—a similar option to sell stock.

The Board amended Regulation T to permit a minor easing of the Board’s rules for calculating the margin required on a “straddle” transaction—where both a put and a call in the same stock are held in the customer’s account.

The Board’s rules at present provide special treatment where puts and calls are issued on the same security, with the same expiration date and same exercise price. The revision deletes the requirement that both the put and the call must have the same expiration date and the same exercise price to qualify for the special margin requirement. The margin requirement remains the (30 per cent)* requirement on either the put or the call, whichever is greater, plus any unrealized loss on the other option. Certain other technical requirements regarding straddles were adopted. They are set forth in the attached copy of the amendment of Regulation T.

The new requirements for calculating the margin on straddles will become effective June 1, 1977, to coincide with the beginning of exchange trading of put options recently approved by the Securities and Exchange Commission.

In addition, the Board revised and published for further comment an amendment to Regulation T first suggested last December. As originally proposed, this would have permitted option specialists, in the performance of their market-making function, to purchase, or to sell short on a 25-per cent margin basis, the securities underlying the options in which they specialize.

The Board requested comment on its revised proposal through May 31, 1977.

The proposal as revised would broaden the scope of the rule to permit specialists, as well as option specialists, to purchase stock or options—in connection with transactions in their specialty security—on the 25-per cent margin basis. The Board broadened its proposal in view of the fact that the Securities and Exchange Commission has recently approved rule changes of some regional securities exchanges that, for the first time, will permit stock specialists other than options specialists trading on those exchanges to take positions in options related to the stocks in which they specialize.

The revised proposal makes other technical changes set forth in the text of the Board’s proposal.

*The margin requirement generally applicable to purchases or sales of stock on credit is 50 per cent.

In addition, the Board of Governors issued the following explanatory notice regarding the amendment, effective June 1, that eases its rules for calculating the margin required on a “straddle” transaction:

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule.

SUMMARY: This amendment (1) relaxes the rule to permit a put and a call on the same underlying security but with different exercise prices and different expiration dates to be combined for special margin treatment in the same manner as a “straddle” (a put and a call with identical terms) and (2) deletes reference in the existing

"straddle" rule to the special bond account and the special convertible debt security account as it is impractical to use these accounts for the described transaction.

EFFECTIVE DATE: June 1, 1977.

FOR FURTHER INFORMATION CONTACT: Laura Homer, Chief Attorney, Securities Credit Regulation, Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System, Washington, D.C. 20551 (202-452-2782).

SUPPLEMENTARY INFORMATION: Comments received on the Board's proposal to establish a uniform margin for the writing of options which appeared in the *Federal Register* of August 20, 1975 (40 F.R. 36390) suggested that the proposed rule covering special margin for straddles be enlarged to cover combinations of puts and calls with different terms. At the time the Board adopted the proposed rule (*Federal Register* of October 5, 1976, 41 F.R. 43895) put trading on exchanges had not been authorized by the Securities and Exchange Commission. In a letter dated March 4, 1977, however, the Commission indicated its approval of the exchange trading of puts if certain conditions were met. The Board believes it is appropriate to relax the rule in this area and to remove the references to accounts other than the general account so as to have the amendment effective when put trading begins on or after June 1, 1977. The Board finds that notice and public procedure thereon are unnecessary because the amendment is in response to comments which were received on this specific subject in connection with the proposed general rule and failure to put this amendment into effect before put trading begins on exchanges would be disruptive to customer education and industry operations.

Enclosed is a copy of the June 1 amendment to Regulation T. In addition, printed below is an excerpt from the *Federal Register* of May 5, 1977, containing the text of the Board's revised proposed amendment, regarding credit to exchange specialists; comments should be submitted by May 31, 1977, and may be sent to our Regulations Division.

PAUL A. VOLCKER,
President.

FEDERAL RESERVE SYSTEM

[12 CFR Part 220]

[Reg. T; Docket No. R-0054]

CREDIT TO EXCHANGE SPECIALISTS

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Proposed rule.

SUMMARY: This revision of a proposed amendment to the rule governing credit to exchange specialists, which was published in the *FEDERAL REGISTER* on December 21, 1976 (41 FR 55552), contains changes based upon comments received on the December 21, 1976 proposal. As revised, the proposal will permit options specialists to both purchase and sell short stock underlying the options in which they specialize, with a 25 percent margin requirement. No maintenance requirement is imposed in this revision unless the account, if sold out, would have an unsecured debit balance. The proposed amendment also recognizes new exchange rules approved by the Securities and Exchange Commission which allow trading in puts and calls by specialists on their specialty stock and provides comparable relief for such hedging activities.

DATE: Comments must be received on or before May 31, 1977.

ADDRESS: Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551. All material submitted should be in writing and should include the docket number R-0054.

FOR FURTHER INFORMATION CONTACT:

Laura Homer, Chief Attorney, Securities Credit Regulation, Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System, Washington, D.C. 20551 (202-452-2782).

SUPPLEMENTARY INFORMATION: The December 21, 1976 proposal was intended to assist option specialists in performing their market making functions by permitting them, in certain circumstances, to purchase or sell short, on preferential credit terms, the securities underlying the options in which they specialize. The revised proposal would broaden the scope of permitted offset transactions and extend comparable relief to non-option specialists by permitting them to purchase or write options, on special credit terms, as a hedge for their specialty positions. The additional relating to non-option specialists was made in response to comments

which noted that the Securities and Exchange Commission had recently approved rule changes of some regional securities exchanges which, for the first time, will permit equity specialists on those exchanges to take positions in related options.

The revised proposal eliminates references to the general account and thereby simplifies the calculations the carrying broker must make. Net short or long positions in the specialty security may be margined on a good faith basis.

The original proposal required that additional margin must be provided on any day when a security position established as a permitted offset transaction no longer served that function. The revised proposal allows a five day period for the specialist to either establish a new position to utilize the permitted offset transaction, liquidate the position, or margin it in accordance with current margin requirements of a general account. The original proposal established a daily maintenance requirement in certain circumstances. No maintenance requirements are established in the revision of the proposed rule; however, on any day when an unsecured debit balance would remain if all positions in the account were liquidated, the proposal requires that a margin call must be made and met on the next business day.

To aid in the consideration of this material by the Board, interested persons are invited to submit relevant data, views, comments, or arguments. Any such material should be submitted in writing to the Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551, to be received not later than May 31, 1977. All material submitted should include the docket number R-0054. Such information will be made available for inspection and copying upon request except as provided in § 261.6(a) of the Board's Rules Regarding Availability of Information (12 CFR 261.6(a)).

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

§ 220.4 Special accounts.

(g) *Specialist's account.* (1) In a specialist's account, a creditor may effect and finance for any member of a reporting national securities exchange who is registered and acts as a specialist in securities on the exchange, such member's transactions as a specialist in such securities, or effect and finance for any joint venture in which the creditor participates, transactions in securities of an issue with respect to which all participants, or all participants other than the creditor, are registered and act on a national securities exchange as specialists. (Such transactions are referred to in this paragraph as "specialist transactions.") Specialist transactions may be financed on terms mutually agreeable to the creditor and the specialist: *Provided*, That the securities in which the specialist is registered while serving as collateral in the account may be valued at no more than 100 percent of their current market value and the debit required for short positions in such securities held in the account shall be not less than 100 percent of the current market value of either the securities sold short or the options written.

(2) In this account a specialist in options on a national securities exchange is permitted to establish a long or short position in the securities underlying the options in which such member is registered and acts as a specialist, and a specialist in securities on a national securities exchange is permitted to purchase or write options overlying the securities in which such member is registered and acts as a specialist only under one or more of the following conditions (such transactions are referred to in this paragraph as "permitted offset transactions"):

(i) The account holds short positions in options in which the member is registered and acts as a specialist which are "in or at the money" but only to the extent the positions are not offset in the account by long or short positions in options for an equal or greater number of shares of the same underlying securities which are "in or at the money";

(ii) The account holds long positions in options in which the member is registered and acts as a specialist which are "in or at the money" but only to the extent the positions are not offset in the account by short or long positions in options for an equal or greater number

of shares of the same underlying securities which are "in or at the money";

(iii) The account held a short position in an option against which an exercise notice was tendered;

(iv) The account held a long position in an option which was exercised;

(v) The account holds net long positions in securities (other than options) in which the member is registered and acts as a specialist; or

(vi) The account holds net short positions in securities (other than options) in which the member is registered and acts as a specialist.

(3) The maximum loan value of margin securities in such account including any wholly owned margin securities deposited as additional collateral in the account shall be:

(i) Such maximum loan value as the Board shall prescribe from time to time in § 220.8 (the Supplement to Regulation T) where (A) the security is identified as held for investment pursuant to a rule of the Commissioner of Internal Revenue (Regs. section 1-1236-7(d)), or (B) the security is an underlying security or an overlying option, no longer serving as a permitted offset, on which a deposit has been required pursuant to paragraph (g) (6) of this section.

(ii) 75 percent of the current market value of an underlying security or an overlying option that is purchased and held in the account under the terms of paragraph (g) (2) of this section and for five full business days thereafter.

(iii) The maximum loan value as determined by the creditor in good faith for all other margin securities held in the account.

(4) The amount to be included in the adjusted debit balance of the account shall be:

(i) A good faith deposit for short positions qualifying as specialist transactions.

(ii) 125 percent of the current market value of the security sold short or the option written and held in the account under the terms of paragraph (g) (2) of this section and for five full business days thereafter.

(iii) The current market value of the security sold short or the option written plus such amount as the Board shall prescribe from time to time in § 220.8 (the Supplement to Regulation T) when the security is an underlying security or an overlying option, no longer serving as a permitted offset, on which a deposit has been required pursuant to paragraph (g) (6) of this section.

(5) Except as required by paragraph (g) (7), on any day when additional margin is required as a result of transactions in the account, the creditor shall issue a call for an additional deposit of cash or margin securities and allow the specialist a maximum of five full business days to make a deposit sufficient to meet the call.

(6) On any day when the account of an option specialist no longer holds an option position against which the underlying security permitted to be purchased or sold short in the account under the terms of paragraph (g) (2) of this section can be offset, or when the account of a security specialist no longer holds security positions against which the overlying option permitted to be purchased or written in the account under the terms

of paragraph (g) (2) of this section can be offset, the creditor shall have five full business days to either liquidate the position or obtain a deposit into the account of cash or securities equal to the deposit that would be required to establish such a position in the general account, reduced by a sum equal to 25 percent of the current market value of the security. The liquidation or deposit requirement need not be met if a new offsetting position is established in the interim.

(7) Any credit initially extended in conformity with this paragraph may be maintained on a basis mutually agreeable to the creditor and the specialist, except that on any day when the account would liquidate to a deficit, the creditor shall not extend any further credit in the account, and shall issue a call for additional collateral which shall be met by noon of the following business day. In the event sufficient collateral is not deposited in the account the creditor shall take steps to liquidate promptly existing positions in the account.

(8) For the purpose of this paragraph:

(i) A "reporting national securities exchange" is a national securities exchange which submits to the Board of Governors of the Federal Reserve System reports suitable for supplying current information regarding specialists' use of credit pursuant to this paragraph (g).

(ii) The term "joint venture" does not include any account which, by written agreement with a creditor, permits the commingling of the security positions of a specialist or a specialist unit with those of other specialists or specialist units unless such agreement provides for a sharing of profits and losses from the account on some predetermined ratio;

(iii) The term "underlying security" means the security which will be delivered upon exercise of the option;

(iv) The term "overlying option" means (a) a put option purchased or a call option written against an existing long position in the specialist's account, or (b) a call option purchased or a put option written against an existing short position in the specialist's account;

(v) The term "in or at the money" means, with respect to a call option, that the current market price of the underlying security is not more than 5 per cent below the exercise price of the option, and, with respect to a put option, the current market price of the underlying security is not more than 5 per cent above the exercise price of the option.

By order of the Board of Governors,
April 27, 1977.

THEODORE E. ALLISON,
Secretary of the Board.

[FR Doc.77-12856 Filed 5-4-77; 8:45 am]

Board of Governors of the Federal Reserve System

CREDIT BY BROKERS AND DEALERS

AMENDMENT TO REGULATION T

Effective June 1, 1977, pursuant to sections 7 and 23 of the Securities and Exchange Act of 1934, as amended (15 U.S.C. 78g and w), subparagraph (4) of § 220.3(i) is amended to read as follows:

SECTION 220.3 — GENERAL ACCOUNT

* * *

(i) Options. * * *

(4) When both a put and a call are issued, endorsed or guaranteed in a general account on the same number of shares of the same underlying security, the amount of margin required shall be the margin on either the put or the call, whichever is greater, plus any unrealized loss on the other option.

For this Regulation to be complete, retain:

- 1) Regulation T, as amended effective May 15, 1970, printed in the pamphlet "Securities Credit Transactions."
- 2) Amendment pamphlet dated June 1974.
- 3) Amendments effective July 25, 1974; March 3, 1975; November 13, 1975; and January 1, 1977.
- 4) The Supplement to Regulation T, effective January 1, 1977.
- 5) This slip sheet.

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