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(h) For the reasons indicated above, it is the opinion of the Board of Governors that the extension of credit here involved is not of the kind which the margin requirements are intended to regulate and that the transaction described does not involve an unlawful extension of credit as far as this part is concerned.

(i) The foregoing interpretation relates, of course, only to cases of the type described. It should not be regarded as governing any other situations; for example, the interpretation does not deal with cases where securities are being transferred to someone other than the issuer, or to the issuer for a purpose other than immediate retirement. Whether the margin requirements are inapplicable to any such situations would depend upon the relevant facts of actual cases presented.

[27 FR 12346, Dec. 13, 1962]

§ 220.120 [Reserved]

§ 220.121 Applicability of margin requirements to joint account between two creditors.

(a) The Board has recently been asked whether extensions of credit in a joint account between two brokerage firms, a member of a national securities exchange (''Firm X'') and a member of the National Association of Securities Dealers (''Firm Y'') are subject to the margin requirements of this part (Regulation T). It is understood that similar joint accounts are not uncommon, and it appears that the margin requirements of the regulation are not consistently applied to extensions of credit in the accounts.

(b) When the account in question was opened, Firm Y deposited $5,000 with Firm X and has made no further deposit in the account, except for the monthly settlement described below. Both firms have the privilege of buying and selling specified securities in the account, but it appears that Firm X initiates most of the transactions therein. Trading volume may run from half a million to a million dollars a month. Firm X carries the ''official'' ledger of the account and sends Firm Y a monthly statement with a complete record of all transactions effected during the month. Settlement is then made in accordance with the agreement between the two firms, which provides that profits and losses shall be shared equally on a fifty-fifty basis. However, all transactions are confirmed and reconfirmed between the two on a daily basis.

(c) Section 220.3(a) provides that

> All financial relations between a creditor and a customer, whether recorded in one record or in more than one record, shall be included in and be deemed to be part of the customer's general account with the creditor, * * *.

and § 220.2(c) defines the term ''customer'' to include

> * * * any person, or any group of persons acting jointly, * * * to or for whom a creditor is extending or maintaining any credit * * *

In the course of a normal month's operations, both Firm X and Firm Y are at one time or another extending credit to the joint account, since both make purchases for the account that are not ''settled'' until the month's end. Consequently, the account would be a ''customer'' within the above definition.

(d) Section 220.6(b) provides, with respect to the account of a joint adventure in which a creditor participates, that

> * * * the adjusted debit balance of the account shall include, in addition to the items specified in § 220.3(d), any amount by which the creditor's contribution to the joint adventure exceeds the contribution which he would have made if he had contributed merely in proportion to his right to share in the profits of the joint adventure.

In addition, the final paragraph of § 220.2(c) states that the definition of ''customer''

> * * * includes any joint adventure in which a creditor participates and which would be considered a customer of the creditor if the creditor were not a participant.

(e) The above provisions clearly evince the Board's intent that the regulation shall cover trading accounts in which a creditor participates. If additional confirmation were needed, it is supplied by the fact that the Board found it needful specifically to exempt from ordinary margin requirements

credit extended to certain joint accounts in which a creditor participates. These include the account in which transactions of odd-lot dealers may be financed under § 220.4(f) (4), and the specialist's account under § 220.4(g). Accordingly, the Board concluded that the joint account between Firm X and Firm Y is a ''customer'' within the meaning of the regulation, and that extensions of credit in the account are subject to margin requirements.

[31 FR 7169, May 17, 1966]

§ 220.122 "Deep in the money put and call options" as extensions of credit.

(a) The Board of Governors has been asked to determine whether the business of selling instruments described as ''deep in the money put and call options'' would involve an extension of credit for the purposes of the Board's regulations governing margin requirements for securities transactions. Most of such options would be of the ''call'' type, such as the following proposal that was presented to the Board for its consideration:

> If X stock is selling at $100 per share, the customer would pay about $3,250 for a contract to purchase 100 shares of X at $70 per share within a 30-day period. The contract would be guaranteed by an exchange member, as are standard ''puts'' and ''calls''. When the contract is made with the customer, the seller, who will also be the writer of the contract, will immediately purchase 100 shares of X at $100 per share through the guarantor member firm in a margin account. If the customer exercises the option, the shares will be delivered to him; if the option is not exercised, the writer will sell the shares in the margin account to close out the transaction. As a practical matter, it is anticipated that the customer will exercise the option in almost every case.

(b) An ordinary ''put'' is an option given to a person to sell to the writer of the put a specified amount of securities at a stated price within a certain time. A ''call'' is an option given to a person to buy from the writer a specified amount of securities at a stated price within a certain time. To be freely saleable, options must be indorsed, or guaranteed, by a member firm of the exchange on which the security is registered. The guarantor charges a fee for this service.

(c) The option embodied in the normal put or call is exercisable either at the market price of the security at the time the option is written, or some ''points away'' from the market. The price of a normal option is modest by comparison with the margin required to take a position. Writers of normal options are persons who are satisfied with the current price of a security, and are prepared to purchase or sell at that price, with the small profit provided by the fee. Moreover, since a large proportion of all options are never exercised, a person who customarily writes normal options can anticipate that the fee would be clear profit in many cases, and he will not be obligated to buy or sell the stock in question.

(d) The stock exchanges require that the writer of an option deposit and maintain in his margin account with the indorser 30 percent of the current market price in the case of a call (unless he has a long position in the stock) and 25 percent in the case of a put (unless he has a short position in the stock). Many indorsing firms in fact require larger deposits. Under § 220.3(a) of Regulation T, all financial relations between a broker and his customer must be included in the customer's general account, unless specifically eligible for one of the special accounts authorized by § 220.4. Accordingly, the writer, as a customer of the member firm, must make a deposit, which is included in his general account.

(e) In order to prevent the deposit from being available against other margin purchases, and in effect counted twice, § 220.3(d)(5) requires that in computing the customer's adjusted debit balance, there shall be included ''the amount of any margin customarily required by the creditor in connection with his endorsement or guarantee of any put, call, or other option''. No other margin deposit is required in connection with a normal put or call option under Regulation T.

(f) Turning to the ''deep in the money'' proposed option contract described above, the price paid by the buyer can be divided into (1) a deposit of 30 percent of the current market