

tends to equalize prices between markets and between equivalent securities. Because the relatively high initial cost of a put or call option must be deducted from the potential profit due to the disparity in price between the two securities, it is not likely that true arbitrage would take place between an option and an underlying security. Such options would be used, rather, for purposes of "hedging," that is to say, to protect an investor against loss while he holds a security in the hope of profiting by changes in its price. Such market strategies may be beneficial to individual investors. However, they do not perform a comparable market function.

(g) Section 221.2 of this chapter provides that "a bank may extend and may maintain any credit for the purpose specified in §221.1, without regard to the limitations prescribed therein, or in §221.3(t), if the credit comes within any of the following descriptions." Paragraph (j) contains the following description: "Any credit extended to a member of a national securities exchange for the purpose of financing his or his customers' bona fide arbitrage transactions in securities." The Board has concluded that a purchase of a put or call is not embraced within the term in §220.4(d) "a purchase of a security which is, without restriction other than the payment of money exchangeable or convertible * * * into a second security" so as to qualify such purchase, when effected together with an offsetting sale of the second security, as a bona fide arbitrage transaction, and the Board's conclusion is also applicable to paragraph (j) of §221.2.

[38 FR 5237, Feb. 27, 1973]

§220.127 Independent broker/dealers arranging credit in connection with the sale of insurance premium funding programs.

(a) The Board's September 5, 1972, clarifying amendment to §220.4(k) set forth that creditors who arrange credit for the acquisition of mutual fund shares and insurance are also permitted to sell mutual fund shares without insurance under the provisions of the special cash account. It should be understood, of course, that such account provides a relatively short credit

period of up to 7 business days even with so-called cash transactions. This amendment was in accordance with the Board's understanding in 1969, when the insurance premium funding provisions were adopted in §220.4(k), that firms engaged in a general securities business would not also be engaged in the sale and arranging of credit in connection with such insurance premium funding programs.

(b) The 1972 amendment eliminated from §220.4(k) the requirement that, to be eligible for the provisions of the section, a creditor had to be the issuer, or a subsidiary or affiliate of the issuer, of programs which combine the acquisition of both mutual fund shares and insurance. Thus the amendment permits an independent broker/dealer to sell such a program and to arrange for financing in that connection. In reaching such decision, the Board again relied upon the earlier understanding that independent broker/dealers who would sell such programs would not be engaged in transacting a general securities business.

(c) In response to a specific view recently expressed, the Board agrees that under Regulation T:

* * * a broker/dealer dealing in special insurance premium funding products can only extend credit in connection with such products or in connection with the sale of shares of registered investment companies under the cash accounts * * * (and) cannot engage in the general securities business or sell any securities other than shares * * * (in) registered investment companies through a cash account or any other manner involving the extension of credit.

(d) There is a way, of course, as has been indicated, that an independent broker/dealer might be able to sell other than shares of registered investment companies without creating any conflict with the regulation. Such sales could be executed on a "funds on hand" basis and in the case of payment by check, would have to include the collection of such check. It is understood from industry sources, however, that few if any independent broker/dealers engage solely in a "fund on hand" type of operation.

[38 FR 11066, May 4, 1973]