**Section 1075.570 Financial Options**

a) Definitions as used in this Section apply unless the context otherwise requires.

1) "Call" means an option which gives the holder the right to purchase a financial instrument at a price and on or before the expiration date specified in the option contract.

2) "Deliverable Instrument" means a financial instrument whose terms satisfy the requirements for fulfilling delivery obligations of an option.

3) "Effective Exercise Price" means the yield equivalent price of an instrument whose coupon rate differs from the standard instrument specified in the option,

4) "Financial Options Contract" means an agreement (other than an optional delivery forward commitment contract to purchase and sell mortgages or mortgage-backed securities when used as part of the mortgage loan origination process) to make or take delivery of a financial instrument upon demand by the holder of the contract at any time before the expiration date specified in the agreement, under terms established either by:

A) a board of trade designated as a contract market for the trading of option contracts by the CFTC or a national securities exchange registered with the Securities Exchange Commission (SEC); or

B) the savings bank and a "permissible counterparty," as defined in subsection (a)(10), that are counterparties in an over-the-counter option transaction (other than an over-the-counter commodity optional transaction subject to the jurisdiction of the CFTC that is not otherwise authorized under the Commodity Exchange Act (7 USC 1) and the regulations under that Act).

5) "Financial Options Transaction" means the purchase or sale of a financial options contract.

6) "Immediate Exercise Value" means the market value gained by exercising an option with the lowest cost deliverable instrument at its effective exercise price compared to purchasing (or selling) an identical instrument with the same coupon rate in the cash market.

7) "Long Position" means the holding of a financial options contract with the option to make or take delivery of a financial instrument.

8) "Option Commitment Fee" means the option premium minus the immediate exercise value of the option.

9) "Option Premium" means the price paid or received for establishing an option position.

10) "Permissible Counterparty" means any entity that is:

A) a primary dealer as defined in subsection (a)(11) of this Section;

B) a bank subject to the regulation and supervision of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, or the Board of Governors of the Federal Reserve System and that is in compliance with applicable regulatory capital requirements;

C) a savings bank that is subject to the regulation and supervision of the Division and is in compliance with applicable regulatory capital requirements or subject to the regulation and supervision of the Division;

D) a broker or dealer registered with the Securities and Exchange Commission (SEC) and subject to regulation and supervision by a Registered Securities Association (registered pursuant to section 15A of the Securities and Exchange Act of 1934 (15 USC 78(o)) (Exchange Act) or a National Securities Exchange (registered pursuant to sections 6 and 19(a) of the Exchange Act) and that is in compliance with applicable capital requirements;

E) a government securities broker or dealer registered with the SEC that is subject to examination and supervision by a Registered Securities Association (registered pursuant to section 15A of the Exchange Act) or National Securities Exchange (registered pursuant to sections 6 and 19(a) of the Exchange Act) and that is in compliance with applicable capital requirements;

F) a futures commission merchant registered with the CFTC and that is in compliance with applicable capital requirements;

G) the Federal Home Loan Banks;

H) the Federal Home Loan Mortgage Corporation, the Federal National Mortgage Association, or the Government National Mortgage Association or the Government National Mortgage Association; or

I) any other entity that the Director , upon application, determines to be adequately regulated, capitalized, and audited or examined such that acting as a counterparty in an over-the-counter options transaction with a savings bank would not entail substantial credit risks for the savings bank.

11) "Primary Dealer in Government Securities" means any member of the Association of Primary Dealers in United States Government Securities and any parent, subsidiary, or affiliated entity of such primary dealer: provided, that the member guarantees (to the satisfaction of the Division) the over-the-counter financial options transactions between its parent, subsidiary, or affiliated entity with a savings bank, and provided further that the parent, subsidiary, or affiliated entity is substantially engaged in similar activities.

12) "Put" means an option that gives the holder the right to sell a financial instrument at a price on or before the expiration date specified in the financial options contract.

13) "Short Position" means a commitment through a financial options contract to stand ready during the term of the contract to make or take delivery of a financial instrument.

b) Permitted Transactions – to the extent that it has legal power to do so, a savings bank may engage in financial options transactions as follows:

1) Long Positions – a savings bank may enter into long positions without numerical limit.

2) Short Positions – a savings bank may enter into short call positions without numerical limit. If a savings bank meets its capital requirement, it may enter into short put options to the extent that the aggregate amount of its short put options and forward commitments to purchase securities does not exceed 15% of total assets. If capital requirements are not met, the savings bank may enter into short put options only with prior written approval from the Director. Permission shall be granted if the Director finds the investment is not for speculative purposes and that the investment is made in accordance with a well-defined hedging program adopted by the savings bank board of directors.

c) Authorized Contracts – a savings bank may engage in financial options transactions using any financial options contracts either:

1) designated by the CFTC or approved by the SEC; or

2) entered into with a "permissible counter-party", as defined in subsection (a)(10), and based upon a financial instrument that the savings bank has authority to invest in or to issue.

d) Board of Directors' Authorization – before engaging in financial options transactions, a savings bank's board of directors must authorize such activity. In authorizing options, the board of directors shall consider any plan to engage in writing or purchasing financial options contracts, shall endorse specific written policies, and shall require the establishment of internal control procedures. For options positions that will be matched with cash or forward market positions, policy objectives must be specific enough to outline permissible options contract strategies, taking into account price and yield correlations between assets or liabilities and the financial options contracts; the relationship of the strategies to the savings bank's operations; the rationale for the ratio of the value of options positions to the value of the matched cash market positions; and how the options strategy reduces the savings bank's interest rate risk exposure. For unmatched option positions, policy objectives must specify the relationship of the strategy to the savings bank's operations. Prudent business judgment shall be exercised by participating savings banks engaging in financial options transactions to maintain a safe and sound financial position. Internal control procedures shall include, at a minimum, periodic reports to management, segregation of duties and internal review procedures. In addition, the minutes of the meeting of the board of directors shall set forth limits applicable to financial options transactions, identify personnel authorized to engage in financial options transactions, and set forth the duties, responsibilities and limits of authority of such personnel. The board of directors shall review the position limit, all outstanding options contract positions, and the unrealized gains or losses on those positions at each regular meeting of the board.

e) Notification, Reporting, and Approval

1) A savings bank shall notify the Director immediately following authorization of its board of directors to engage in financial options transactions. The savings bank shall report its outstanding positions, together with the total unrealized gain or loss from those positions to the Director monthly.

2) A savings bank shall not engage in over-the-counter financial option transactions with any permissible counterparty unless the counterparty agrees to notify the Director. A savings bank shall not continue to engage in over-the-counter financial option transactions with any permissible counterparty that has failed to so notify the Director with respect to previous over-the-counter financial option transactions with that savings bank. Notwithstanding the foregoing, no savings bank shall engage in a long over-the-counter financial option transaction with a specific permissible counterparty, without obtaining the prior approval of the Director, whenever the aggregate exercise value of all long over-the-counter financial option positions with the counterparty exceeds the limitations contained in Section 6013 of the Act. The Director may approve any financial option transaction whenever it determines that such transaction does not subject the savings bank to undue risk. In making such determinations, the Director shall consider:

A) the credit worthiness of the specific counterparty;

B) the savings bank's experience with the counterparty and with transacting in financial option and futures contracts generally;

C) the nature of the subject contracts (e.g., matched or unmatched); and

D) any other circumstances considered relevant by the Director. An application to enter into a financial option transaction under this Section shall be considered approved if the Director does not deny the application within 10 calendar days from the date the application was filed.

f) Record Keeping Requirements – a savings bank engaging in financial options transactions shall maintain records of those transactions in accordance with the following requirements.

1) Contract Register – the savings bank shall maintain a contract register adequate to identify and control all financial options contracts and sufficient to indicate at any time the amounts of financial options contracts required to be reported on its monthly report. At a minimum, the register shall list the type, amount, expiration date and the cost of income from each contract.

2) Other Documentation – the savings bank shall maintain as part of the documentation of its financial options strategy a schedule of any cash market or forward commitment position with which the option is matched and the purpose of each contract.

3) Maintenance of Records – the records designated in this Section shall be maintained for all financial options closed out during the preceding 2 years.

g) Accounting

1) Purchase or Sale – upon initial purchase or sale of a financial options contract, a memorandum entry of the information specified in this Section shall be made and appropriate margin accounts shall be established.

2) Option Commitment Fee

A) The option commitment fee paid for a long position or received from the sale of a short put option shall be amortized to income or expense over the term of the option, except as provided in this Section.

B) The option commitment fee received from the sale of a matched short call option shall be deferred until the option position is terminated. The option commitment fee received from the sale of an unmatched short call option shall be amortized to income over the term of the option.

3) Options Contracts

A) Gains or losses on options contracts that are matched with assets or liabilities carried at the lower of cost or market value, or carried at market value shall be considered in determining the market value of the asset or liability.

B) Options positions that are matched with assets or liabilities carried at cost or to be carried at cost shall be accounted for as follows.

i) If a commitment fee will be or has been received with respect to the matched asset, the option commitment fee shall be treated as an adjustment of such fee. The adjusted commitment fee shall then be treated as a fee paid or received in connection with the matched asset.

ii) If a commitment fee has not been received with respect to a matched asset, the option commitment fee (except if received for the sale of a short call option) shall be amortized to income or expense over the commitment period by the straight line method.

iii) Any resulting gain or loss from an option position (except from a short call option) shall be treated as a discount or premium on the matched asset or liability.

iv) Any resulting gain or loss from a short call option position shall be recognized as income or expense upon termination of the option position.

v) If an option position is not matched with a cash-market or forward-commitment position or the cash-market or forward-commitment position with which an option is matched is sold or will not occur, the option shall be marked to market.

C) The immediate exercise value of short puts and other unmatched option positions shall be carried at their current market value.

(Source: Amended at 30 Ill. Reg. 19068, effective December 1, 2006)