Regulatory Circular RG03-22

To:	The Membership
From:	Division of Regulatory Services
Date:	March 27, 2003
Subject:	Margin and Net Capital Requirements for Options on the CBOE Euro 25 Index and CBOE Asia 25 Index

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KEY POINTS

- The Chicago Board Options Exchange ("CBOE") will list and trade options on the CBOE Euro 25 Index and CBOE Asia 25 Index beginning on March 31, 2003.
- For margin purposes, both indices are considered broad-based.
- For net capital purposes, both indices are considered broad-based. The CBOE Euro 25 Index is considered a high capitalization index. However, the CBOE Asia 25 Index is considered a non-high capitalization index.

DISCUSSION

On March 31, 2003, the Chicago Board Options Exchange ("CBOE") will list and begin trading options on the CBOE Euro 25 Index (symbol "EOR") and the CBOE Asia 25 Index (symbol "EYR"). The options on both indices will be cash-settled and European-style exercise.

The EOR is a diversified, capitalization weighted index of 25 American Depository Receipts ("ADRs"), New York Registered Shares ("NYSs") or New York Stock Exchange ("NYSE") Global Shares® that are traded on the NYSE, NASDAQ or American Stock Exchange. The ADRs, NYSs and NYSE Global Shares that compose the index are issued on behalf of companies domiciled in one of 11 member countries of the European Union.

The EYR is a diversified, capitalization weighted index of 25 ADRs, NYSs or NYSE Global Shares that are traded on the NYSE, NASDAQ or American Stock Exchange. The ADRs, NYSs and NYSE Global Shares that compose the index are issued on behalf of companies domiciled in one of 8 Asian-Pacific countries.

Both indices will be rebalanced quarterly following the expiration of the index option contracts. The base date for both indices is January 2, 2002, when their values were set equal to 100.

MARGIN

In accordance with CBOE Rule 12.3(c)(4), for purchases of puts or calls with more than 9 months until expiration, it is required that 75% of the total cost (option current market value) be deposited (maintained). When time to expiration reaches 9 months, the option no longer has value for margin purposes. Purchases of puts or calls with 9 months or less until expiration must be paid for in full.

Both the EOR and EYR are considered broad–based for margin purposes and option writers are subject to the margin requirements specified in CBOE Rule 12.3 (c)(5). The initial and maintenance margin requirement for a short put or call on a broad-based index is 100% of the option proceeds* plus 15% of the aggregate contract value (current index level x $100) minus the amount by which the option is out-of-the-money, if any, subject to a minimum for calls of option proceeds* plus 10% of the aggregate contract value and a minimum for puts of option proceeds* plus 10% of the aggregate exercise price amount. (*For calculating maintenance margin, use current market value instead of option proceeds.)

In a margin account, no margin need be required in respect of an EOR or EYR call option carried in a short position which is covered by a long position in equivalent units of a “underlying stock basket” as defined in CBOE Rule 12.3(a)(7). Correspondingly, no margin need be required in respect of an EOR or EYR put option carried in a short position which is offset by a short position in equivalent units of an underlying stock basket. In computing margin on the underlying stock basket, the current market value used shall not be greater than the exercise price in the case of a short call. In the case of a short put, in computing margin on the underlying stock basket, margin shall be the amount required by CBOE Rule 12.3(b)(2), plus any amount by which the exercise price of the put exceeds the current market value of the underlying stock basket.

Where a short option contract is covered by an “escrow agreement” meeting the requirements of CBOE Rule 12.3(d)(2), no margin need be required on the short put or call.

Spreads and straddles are permitted for options covering the same number of shares of the same underlying index. Members should be aware that due to their exercise feature, it is possible for European–style options to trade at a discount to their intrinsic values. It is possible that the spread margin held by the carrying broker could become insufficient to cover the assignment obligation on the short option if the customer is unable to exercise the long option and it is trading at a discount to its intrinsic value.

OPTION MARKET–MAKER MARGIN REQUIREMENTS

Pursuant to CBOE Rule 12.3(f), market–makers in EOR or EYR are allowed “permitted offset” treatment for qualified stock baskets. In the case of both indices, the basket must contain no less than 50% of the capitalization in the index, in order to qualify as a permitted offset.

NET CAPITAL

Both the EOR and EYR are considered broad–based for net capital purposes. EOR is considered a high capitalization index. However, EYR is considered a non-high capitalization index.

EOR. Under risk–based haircuts, the haircut is equal to the maximum potential loss for all EOR option positions calculated over a range of index movements of -8% /+6% for options market-makers, and –10%/+10% for all other all broker–dealers. All positions are subject to a minimum charge of $25 per contract.[1] A new product group will be established for EOR options.

EYR. Under risk–based haircuts, the haircut is equal to the maximum potential loss for all EYR option positions calculated over a range of index movements of -10% /+10% for options market-makers, and –15%/+15% for all other all broker–dealers. All positions are subject to a minimum charge of $25 per contract.[1] A new product group will be established for EYR options.

Under risk-based haircuts, an offset is permitted between the options and a qualified stock basket. The stock basket must represent not less than 50% of the capitalization of the index. A 95% offset between the qualified stock basket and the options will be applied with a minimum charge equal to 5% of the market value of a qualified EOR basket and 7.5% of the market value of a qualified EYR basket.

For those firms not utilizing risk–based haircuts, the haircut will be calculated pursuant to SEC Rule 15c3–1a(b).

Questions regarding the margin and capital treatment of EOR and EYR options should be directed to James Adams at (312) 786–7718 or Rich Lewandowski at (312) 786–7183.

Footnotes

[1] Risk–based haircuts may be applied pursuant to SEC Rule 15c3-1a (Appendix A).