

Regulatory Circular RG05-60

To: The Membership

From: Division of Regulatory Services

Date: July 7, 2005

Subject: Margin and Net Capital Requirements for
Options on CBOE PowerPacksSM Indices

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KEY POINTS

- The Chicago Board Options Exchange ("CBOE") will list and commence trading options on CBOE PowerPacksSM indices, a family of 12 sector indices, beginning on July 8, 2005.
- For margin and net capital purposes, all of the indices are considered narrow-based.

DISCUSSION

On July 8, 2005, the Chicago Board Options Exchange ("CBOE") will list and commence trading options on the following 12 sector indices:

	<u>Symbol</u>
CBOE PowerPacks SM Bank Index	PVK
CBOE PowerPacks SM Biotechnology Index	PVP
CBOE PowerPacks SM Gold Index	POU
CBOE PowerPacks SM Internet Index	PVL
CBOE PowerPacks SM Iron & Steel Index	PVF
CBOE PowerPacks SM Oil Index	POY
CBOE PowerPacks SM Oil Services Index	PVO
CBOE PowerPacks SM Pharmaceuticals Index	PFU
CBOE PowerPacks SM Retail Index	RPY
CBOE PowerPacks SM Semiconductor Index	PVU
CBOE PowerPacks SM Technology Index	PVC
CBOE PowerPacks SM Telecom Index	POQ

Options on each index will be cash-settled and European-style exercise.

Each index is composed of 25 securities that are among the largest and most actively traded companies in their respective industry groups. The securities composing each index may include U.S. listed common stocks, American Depositary Receipts (ADRs), New York Registered Shares (NYSs) or New York Global Shares (NYGs). The securities composing each index are traded on the New York Stock Exchange, NASDAQ Stock Market or the American Stock Exchange.

Each index is calculated using a "modified" capitalization methodology that limits the weight of individual components to 10% initially, and on subsequent re-balancing dates. Each index will be rebalanced and reconstituted on a quarterly basis (after the close of trading on the third Friday of March, June, September and December) and the composition and/or weighting of the index is subject to change during the interim periods upon occurrence of corporate events or unusual circumstances.

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.

Each index is considered narrow-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 20% 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 a 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 a 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 CBOE PowerPacksSM index options are allowed “permitted offset” treatment for qualified stock baskets. In the case of each index, the basket must contain no less than 95% of the capitalization in the index, in order to qualify as a permitted offset. A CBOE PowerPacksSM futures contract (CBOE Futures Exchange) qualifies as a permitted offset of the corresponding CBOE PowerPacksSM index option.

NET CAPITAL

Each index is considered narrow-based for net capital purposes. Under risk-based haircuts, within each option class, the haircut is equal to the maximum potential loss for all option positions calculated over a range of index movements of +/- 15% for all broker-dealers, including options market-makers. All positions are subject to a minimum charge of \$25 per contract.¹

Under risk-based haircuts, an offset is permitted between the options and a qualified stock basket. The stock basket must represent not less than 95% 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 basket. A 100% offset between a CBOE PowerPacksSM index option and its corresponding CBOE PowerPacksSM futures contract will be applied. An offset between CBOE PowerPacksSM index options and other products within their respective product groups will be applied as follows:

	<u>OCC Product Group</u>	<u>Product Group Offset</u>
CBOE PowerPacks SM Bank Index	Banking	85%
CBOE PowerPacks SM Biotechnology Index	Biotech	90%
CBOE PowerPacks SM Gold Index	Gold & Silver	90%
CBOE PowerPacks SM Internet Index	Internet	80%
CBOE PowerPacks SM Iron & Steel Index	Iron & Steel	New product group
CBOE PowerPacks SM Oil Index	Oil	90%
CBOE PowerPacks SM Oil Services Index	Oil Services	90%
CBOE PowerPacks SM Pharmaceutical Index	Pharmaceutical	90%
CBOE PowerPacks SM Retail Index	Retail	80%
CBOE PowerPacks SM Semiconductor Index	Semiconductor	90%
CBOE PowerPacks SM Technology Index	Technology	80%
CBOE PowerPacks SM Telecom Index	Telecom	New product group

For more information concerning the product groups maintained by The Options Clearing Corp. (“OCC”), contact the OCC help desk at 1 (888) 678-4667.

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 CBOE PowerPacksSM index options should be directed as follows:

Margin: James Adams at (312) 786-7718

Net Capital: Robert Gardner at (312) 786-7937.

Footnotes

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