CHICAGO BOARD OPTIONS EXCHANGE

Regulatory Circular RG08-074

To:	Members, Member Organizations
From:	Division of Member and Regulatory Services
Date:	June 23, 2008
Subject:	Product Description & Margin and Net Capital Requirements - CBOE Binary Options on the S&P 500, CBOE Volatility Indexes

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KEY POINTS

- The Chicago Board Options Exchange expects to list and trade binary options on the S&P 500 Index and the CBOE Volatility Index beginning on July 1, 2008.
- Initially, CBOE will list only binary call options. Binary call options pay either 1) $100, if the underlying index settles **at or above** the strike price at expiration; or 2) nothing at all, if the underlying index settles below the strike price at expiration.
- While broad-based for margin and net capital purposes, there are differences in customer margin requirements for these binary options compared to standard broad-based index options.

PRODUCT DESCRIPTION

CBOE Binary Options are contracts that have an “all-or-nothing” payout depending on the settlement value of the underlying broad-based index relative to the strike price of the binary option. In the case of S&P 500 Binary Options, the final settlement value used to determine the cash payout at expiration - either $100 or $0 - will be the same as the settlement value for standard S&P 500 options (“SET”). In the case of VIX Binary Options, the final settlement value will be the same as the settlement value for standard VIX options (“VRO”).

Ticker symbols for the S&P 500 Index and CBOE Volatility Index Binary Options are “BSZ” and “BVZ,” respectively. Both are European style and cash-settled. The last trading and expiration dates for S&P 500 Binary Options will be the same as the last trading and expiration dates for standard S&P 500 options. Likewise, the last trading and expiration dates for VIX Binary Options will be the same as the last trading and expiration dates for standard VIX.

Initially, CBOE plans to list only binary call options. It is important to note that S&P 500 Binary

Call Options pay either 1) $100, if SET is **equal to or greater than** the strike price at expiration; or 2) $0, if SET is less than the strike price at expiration. VIX Binary Call Options pay either 1) $100, if VRO is **equal to or greater than** the strike price at expiration; or 2) $0, if VRO is less than the strike price at expiration.

On July 1, CBOE plans to list a limited number of S&P 500 and VIX Binary Option series in only three (3) consecutive near-term expirations. Additional series may be added based on market movement and customer demand. Strike prices for S&P 500 Binary Options may be listed in $5 intervals; VIX Binary Options may be listed in $1 intervals.

Both S&P 500 and VIX Binary Options will be quoted in pennies over a range of 0.00 to 1.00. The contract multiplier is $100.

Margin and net capital requirements are described in detail below.

Detailed product specifications may be found on the CBOE website at the following URL:

www.cboe.com/binaries

CUSTOMER MARGIN

Margin requirements for binary options are set-forth in CBOE Rule 12.3(m). Purchases of binary options must be paid for in full. For purchases of binary options with more than 9 months until expiration, Exchange rules permit a minimum margin requirement of 75% of the total cost (option current market value) to be deposited (maintained). When time to expiration reaches 9 months, the option no longer has value for margin purposes.

Writers of binary options are required to deposit and maintain 100% of the option's exercise settlement amount as defined in Exchange rules for each binary option. The exercise settlement amount for BSZ and BVZ options is $100 per contract.

Spread margin requirements for binary options differ significantly from standard options. For binary options, the long and short must expire at the same time, and the exercise price of the long must be less than the exercise price of the short in the case of calls, and greater than the exercise price of the short in the case of puts. As with any spread, the long and short must have the same underlying security or instrument and the long must be paid for in full. If these conditions are met, no margin is required. If not, each position must be margined separately. Binary option spreads meeting the above conditions may be carried in a cash account.

Short straddle/combination margin requirements for binary options also differ from standard options. For binary options, the short call and put must expire at the same time, and the exercise price of the put must be less than the exercise price of the call. As with any short straddle/combination, both options must have the same underlying security or instrument. If these conditions are met, margin (100% of the exercise settlement amount) is required for one side only (put or call). If not, each position must be margined separately.

Where a short binary option contract is covered by an "escrow agreement" meeting the requirements of CBOE Rule 12.3(m), no margin need be required.

BSZ and BVZ options are eligible for portfolio margining. BSZ will be grouped with options in the S&P 500 Index (SPX) class group with a 100% offset. BVZ will be grouped with options in the CBOE Volatility Index (VIX) class group with a 100% offset. Offsets between other class groups remain the same. The portfolio margin requirement will be equal to the maximum potential loss over a range of market movements covering –8%/+6% (the Exchange minimum). All positions are subject to a minimum charge of $37.50 per contract. House requirements may be greater.

OPTION MARKET–MAKER MARGIN REQUIREMENTS

Pursuant to CBOE Rule 12.3(f), binary options may be margined on a basis that is satisfactory to the market-maker and carrying broker-dealer.

Questions regarding the margin treatment of binary options should be directed to James Adams, Department of Member Firm Regulation, at (312) 786–7718.

NET CAPITAL REQUIREMENTS

For risk-based haircuts, BSZ will be grouped with options on the S&P 500 Index (SPX) class group with a 100% offset. BVZ will be grouped with options on the CBOE Volatility Index (VIX) class group with a 100% offset.[1] The Options Clearing Corp. will compute theoretical values in the same manner as for Fixed Return Options[SM].[2] Offsets between other class groups remain the same. The risk–based haircut will be equal to the maximum potential loss calculated over a range of market movements covering -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.

At this time, BSZ options are not eligible for cross-margin accounts governed by the OCC/CBOE/CME cross-margining program. Therefore, margin required on any CME index futures contracts intended as a hedge of BSZ options will be the full amount required by CME.

In respect of BVZ options, in order to have a cross-margining capability, a clearing firm must establish a separate OCC/CBOE/CFE[3] cross-margin account for customers as well as separate clearing accounts at OCC. BVZ options may be combined with VIX futures in the OCC/CBOE/CFE cross-margin account. The CFE SPAN file will handle the margin computation; providing for a reduction in the full margin requirement on VIX futures when offsetting BVZ options are present.

For those firms not utilizing risk–based haircuts, the haircut will be calculated pursuant to SEC Rule 15c3–1(c)(2)(vi)(J).

Questions regarding the net capital treatment of binary options should be directed to Robert Gardner, Department of Member Firm Regulation, at (312) 786–7937.

Footnote

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

[2] Fixed Return Options is a service mark of the American Stock Exchange LLC.

[3] CFE – CBOE Futures Exchange.