

Regulatory Circular RG91-61

Date: November 7, 1991

To: CBOE Members and Member Organizations

From: Department of Financial Compliance

Subject: Net Capital Requirements for CAPS

This memorandum will outline the net capital requirements for the Capped Index Contracts ("CAPS") on the S&P 100 (CPO) and S&P 500 (CPS) indexes. CAPS have been approved by the Securities and Exchange Commission ("SEC") and are scheduled to begin trading on November 8, 1991.

In general, the Exchange has determined to treat a CAPS contract as an individual index option contract for net capital purposes which would include stock basket offsets¹ and cross-index haircut relief². However, the Exchange believes that certain modifications are warranted which are outlined below.

SHORT CAPS

Since it is possible to define the maximum risk of short CAPS, the haircut is **the lesser of** a) the maximum risk of the position, which is the cap interval (\$3000 per contract) less the current CAPS market value, or b) the standard applicable haircut listed below:

- 75% of the current CAPS market value, with a minimum haircut of \$37.50 per contract for market makers.
- 100% of the current CAPS market value, with a minimum haircut of \$62.50 per contract for firms utilizing the proprietary haircuts described in the October 23, 1985 no action letter to the Securities Industry Association Capital Committee.
- 10% of the underlying index value, less the in-the-money amount, plus the prescribed net worth adjustment which is an add back equal to the time value of the short CAPS

¹The stock basket haircut relief is outlined in a February 27, 1986 letter from the SEC to Mr. David Marcus of the New York Stock Exchange.

²Cross-index haircuts are outlined in an October 4, 1988 letter from the CBOE to Mr. Michael Macchiaroli of the SEC.

contract, for firms computing haircuts under Appendix A of SEC Rule 15c3-1. The minimum short CAPS haircut under Appendix A is \$250 per contract less the aforementioned net worth adjustment.

STOCK BASKET, FUTURES AND OPTIONS OFFSETS

Due to the automatic exercise feature of CAPS, a long CAPS position cannot provide hedging protection beyond the cap price. Therefore, long CAPS hedging stock baskets, index futures and/or index options will not be recognized as haircut offsets. Additionally, box spread haircut treatment will not be available for boxes which contain either long or short CAPS contracts.

It should be noted that long straddles comprised of a CAPS contract and an index option will receive straddle haircuts and that spread, conversion, reversal and covered haircuts can be utilized if the CAPS is a short position.

CAPS SPREADS

It is permissible to have spread haircuts if both legs are CAPS contracts. As mentioned previously, CAPS cannot be used as any leg of a box spread.

Any questions regarding the net capital treatment of CAPS can be directed to Diane Malley at (312) 786-7924, in the Exchange's Department of Financial Compliance.

malley\regcir.hc