

Regulatory Circular RG92-53

Date: **October 8, 1992**

To: **The Membership**

From: **Department of Financial Compliance**

Subject: **Capital and Margin Requirements for BioTech Index Options**

On October 9, 1992 the CBOE will begin to trade options on an industry index of securities from the biotechnology sector ("BioTech Index"). The BioTech Index will be a cash-settled, narrow-based, price-weighted index comprised of 20 biotechnology companies. The 20 underlying securities trade on either the American Stock Exchange or the National Association of Securities Dealers Automated Quotations System. The purpose of this circular is to explain the Exchange margin and capital treatment for BioTech options.¹

MARGIN

Exchange Requirements

The BioTech Index is an industry index and, therefore, options on the index are subject to the margin requirements specified in CBOE Rule 24.11(b)(ii). A long option position must be paid for in full. The margin requirement for a short put or call is 100% of the current market value plus 20% of the product of the current index value times the index multiplier (100), less the out-of-the-money amount, if any, to a minimum of 100% of the current market value plus 10% of the product of the current index value times the index multiplier. Spreads and straddles are permitted for options covering equivalent units of the same underlying index.

Options Market Maker Margin on Biotech Index Stock Baskets

With the concurrence of the staff of the Board of Governors of the Federal Reserve System ("FRB"), the Securities and Exchange Commission has issued a no-action position allowing good faith credit to be extended to transactions of options market makers in securities underlying the Biotech Index, where all twenty Index stocks are in the correct proportion as represented in the Index, in accordance with the "permitted offset" provisions of FRB Regulation T Section 220.12.

CAPITAL

¹Exchange options margin requirements are applicable to all public customer positions and the non-market maker positions of non-clearing broker-dealers. Capital requirements ("haircuts") are applicable to the positions of all broker-dealers as described herein.

Because the BioTech Index is narrow-based, the haircuts associated with individual stock options are generally applicable. For example, the haircut on a short Biotech option position is:

- 75% of the current market value with a minimum haircut of \$75 per contract for market maker positions.
- 100% of the current market value with a minimum of \$150 per contract for firms utilizing the proprietary haircuts described in the SEC October 23, 1985 no action letter to the Securities Industry Association Capital Committee.
- 30% of the underlying index value, less the out-of-the-money amount, plus the prescribed net worth adjustment which is an add back equal to the time value of the short contract, for firms computing haircuts under Appendix A of SEC Rule 15c3-1. The minimum haircut is \$250 per contract less the aforementioned net worth adjustment.

Additionally, at the request of the Exchange the SEC has agreed that basket haircut treatment is applicable to BioTech options and offsetting securities baskets, when the broker-dealer holds positions in all of the component securities in equal proportion as represented in the index.²

Questions regarding the margin and capital treatment of BioTech options should be directed to Diane Malley at 312-786-7924 or Rich Lewandowski at 312-786-7183 in the Exchange's Department of Financial Compliance.

² Basket haircut treatment is provided in a February 27, 1986 no action letter from Michael Macchiaroli of the SEC to David Marcus of the New York Stock Exchange. The haircut for a BioTech basket offset by options is the greater of a) the haircut pursuant to paragraph (c) (2) (x) of SEC Rule 15c3-1 or b) 5% of the value of the securities basket position. Any excess value of the basket must be haircut as a naked stock position.