Regulatory Circular RG94-54

Date: July 28, 1994

To: The Membership

From: Department of Financial Compliance

Subject: Capital and Margin Requirements for Nikkei 300 Index Options

On July 29, 1994 the Chicago Board Options Exchange ("CBOE") will begin to trade an option (symbol "NIK") composed of 300 major equity securities traded in Japan. The NIK option will be broad-based and cash settled, with European-style exercise. The exercise settlement value will be determined based upon the closing prices of the 300 component stocks on the last trading day for the stocks prior to expiration date. The index is capitalization-weighted. This circular explains the margin and capital treatment applicable to transactions in NIK options.

MARGIN

NIK options are considered broad-based options for margin purposes and are subject to the margin requirements specified in CBOE Rule 24.11(b)(i). The margin requirement for a short put or call will be 100% of the option premium plus 15% of the underlying index value, less the out-of-the-money dollar amount, if any, to a minimum of 100% of the premium plus 10% of the underlying index value. Pursuant to Regulation T Section 220.18 a long option position must be paid for in full. Spreads and straddles will be 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.

CAPITAL

For capital purposes, NIK options will be treated as broad-based options. Under risk-based haircuts the NIK will be treated as a high-cap broad-based market index[1]. The haircut will be equal to the maximum potential loss over a range of market movements of +6%/-8% for non-clearing market makers and +(-) 10% for all other broker-dealers. Additionally, the NIK, the JPN[2] and the Nikkei 225 futures and options on futures will be haircut as a product group with a 90% offset, due to the high level of correlation between the three indexes. As of July 29, 1994 not all market-maker clearing firms will be calculating market-maker haircuts pursuant to the risk-based methodology, although all clearing firms are expected to be operational on the new haircuts in the very near future. For those firms not utilizing risk based haircuts, the haircut on a short position will be:

- 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 October 23, 1985 no action letter to the Securities Industry Association Capital Committee.

- 10% 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.

Questions regarding the margin and capital treatment of NIK options should be directed to Diane Malley at (312) 786-7924 or Rich Lewandowski at (312) 786-7183.

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[1] Risk-based haircuts are applied pursuant to a SEC staff no-action letter dated March 15, 1994 from Brandon Becker, Director, SEC Division of Market Regulation, to Mary L. Bender, CBOE and Timothy Hinkes, OCC.

[2] JPN is an index option contract trading at the American Stock Exchange, which is based on 210 Japanese equity securities.