Regulatory Circular RG95-43

Date: May 16, 1995

To: The Membership

From: Department of Financial Compliance

Subject: Capital and Margin Requirements for Standard & Poors ("S&P") SmallCap Index.

On June 5, 1995 the Chicago Board Options Exchange ("CBOE") will begin to trade an option based on the S&P SmallCap 600 Index ("SmallCap Index"). The SmallCap will be a broad based, cash-settled, European-style index option. The index is price-weighted. The underlying index securities trade on either the New York or American stock exchanges or the National Association of Securities Dealers Automated Quotations System. This circular explains the margin and capital treatment applicable to transactions in SmallCap Index options.

MARGIN

SmallCap 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, SmallCap Index options will be treated as non-high cap broad-based options. Under risk-based haircuts the haircut shall be equal to the maximum potential loss on the portfolio calculated over a range of market movements of +(-) 10% of the underlying index value for non-clearing market makers and

+(-) 15% for all other broker-dealers.[1] There is a minimum charge of $25 per contract. Additionally, a 75% offset will be allowed with options on the Russell 2000, Wilshire, Value Line and S&P MidCap indexes.
For those firms not utilizing risk based haircuts, the haircut on a short position calculated pursuant to the current methodology under SEC Rule 15c3-1 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.

Basket haircut treatment will be available to SmallCap options and offsetting securities baskets. The basket must represent 90% of the composition of the index. A 95% offset between the basket and the options will be applied with a minimum haircut equal to 10% of the aggregate underlying index value.

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

[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.