Regulatory Circular RG97-131

Date: October 3, 1997

To: The Membership

From: Department of Financial Compliance

Subject: Capital and Margin Requirements for Dow Jones Transportation and Utility Indexes

On October 6, 1997 the Chicago Board Options Exchange ("CBOE") will begin to trade two options based on the Dow Jones Transportation ("Transportation") and Utility ("Utility")indexes. The options will be narrow-based, cash-settled, price-weighted, European-style contracts. The securities underlying the indexes trade on either the New York Stock Exchanges or the National Association of Securities Dealers. This circular explains the margin and capital treatment applicable to transactions in Dow Jones Transportation and Utility index options.

<u>MARGIN</u>

The Transportation and Utility index options are considered narrow-based options for margin purposes and are subject to the margin requirements specified in CBOE Rule 24.11(b)(ii). The margin requirement for a short contract will be 100% of the option premium plus 20% 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 for call contracts and 100% of the premium plus 10% of the aggregate exercise price for put contracts. Exchange rules require a long option position to be paid for in full. Spreads and straddles will be permitted for options covering the same number of shares of the same underlying index. <u>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.</u> 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.

<u>OPTION MARKET-MAKER MARGIN REQUIREMENTS</u>

As of June 2, 1997, CBOE rules allow option market makers to consider an offsetting stock basket a permitted offset position entitled to good faith margin. The basket of securities must represent at least 95% of the index capitalization.

CAPITAL

For capital purposes, the Transportation and Utility index options will be treated as narrow-based index options. Under risk-based haircuts, the haircut shall be equal to the maximum potential loss for each index calculated over a range of market movements of +/-15% of the underlying index value for all broker-dealers. There is a minimum charge of $25 per short contract and the lesser of $25 or the current market value for long contracts. Additionally, an 85% offset of gains versus losses at the same valuation point will be allowed between the Dow Jones Utility Index and the Philadelphia Stock Exchange's utility index ("UTY"). Further, a 90% offset will also be permitted between the Dow Jones Transportation Index and the CBOE's transportation index ("TRX"). For those firms not utilizing risk based haircuts, the haircut on option positions must be calculated pursuant to the alternative methodology under SEC Rule 15c3-1, Appendix A.

Basket haircut treatment will be available to Transportation and Utility index options and offsetting securities baskets. The baskets must represent 95% of the composition of the underlying indexes. A 95% offset between the basket and the options will be applied with a minimum haircut equal to 5% of the aggregate underlying index value.

Questions regarding the margin and capital treatment of Dow Jones Transportation and Utility index options should be directed to Doug Beck at (312) 786-7959 or Rich Lewandowski at (312) 786-7183.