REGULATORY CIRCULAR RG97-164

Date: December 5, 1997

To: Members and Member Organizations

From: Department of Financial and Sales Practice Compliance

Subject: Lipper Analytical / Salomon Brothers
Growth Funds Index Options (LGO) and

Lipper Analytical / Salomon Brothers
Growth and Income Funds Index Options (LIO)

On December 8, 1997, the Chicago Board Options Exchange ("CBOE") will commence trading options on two indexes; the Lipper Analytical / Salomon Brothers Growth Funds Index ("LGO") and the Lipper Analytical / Salomon Brothers Growth and Income Funds Index ("LIO"). LGO is calculated based on the net asset values of the 30 largest mutual funds with a "growth" investment objective. LIO is calculated based on the net asset values of the 30 largest mutual funds having a "growth and income" investment objective. Both indexes are equal-weighted and are deemed broad-based. The options will be cash-settled and have a European style exercise.

This circular explains the margin and capital treatment applicable to transactions in LGO and LIO options.

<u>MARGIN REQUIREMENTS (Initial and Maintenance)</u>

Long put or call. Long positions must be paid for in full.

Short put or call. 100% of the option premium plus 15% of the aggregate underlying index value, less the aggregate out-of-the-money amount, if any, to a minimum of 100% of the option premium plus 10% of the aggregate underlying index value for short calls, and 100% of the option premium plus 10% of the aggregate put strike price amount for short puts [CBOE Rule 24.11(b)(i)].

Spreads and straddles are permitted for options having the same underlying index and linked to the same current aggregate underlying index value.

Members should be aware that, due to their European style exercise feature, it is possible for LGO and LIO options to trade at a discount to their intrinsic values. Thus, if the long option component of a spread cannot be exercised and is trading at a discount to its intrinsic value, the proceeds from the sale of the long option combined with any spread margin being held by the carrying broker may not cover the assignment obligation on the short option.

CAPITAL REQUIREMENTS

For capital purposes, LGO and LIO options are treated as a non-high capitalization, broad based index product. Under risk-based haircuts, the haircut is equal to the maximum potential loss for a position calculated over a range of +/- 10% of movement in the underlying index value for non-clearing market-makers and +/- 15% for all other broker-dealers.[1] LGO and LIO options will be included in the U.S. Market Mutual Fund Product Group and entitled to a 75% offset of gains on one index versus losses on another index at the same valuation point within the product group.[2] In addition, the Mutual Fund Product Group will receive a 50% offset with the High-Cap and Non-High Cap, Broad Based U.S. Market Product Groups. For those firms not utilizing risk-based haircuts, the haircut will be calculated pursuant to the alternative strategy-based method described in SEC Rule 15c3-1 Appendix A.

Questions regarding the margin and capital treatment of LGO and LIO index options should be directed to Jim Adams at (312) 786-7718 or Rich Lewandowski (312) 786-7183.

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

[2] The U.S. Market Mutual Fund Product Group is a new group under the Non-High Capitalization Broad Based Indices category. Currently, LGO and LIO are the only components of the U.S. Market Mutual Fund Product Group.