Regulatory Circular RG95-66

Date: July 20, 1995

To: The Membership

From: Department of Financial Compliance

Subject: Capital and Margin Requirements for CBOE Latin 15™ Index Options

On July 24, 1995 the Chicago Board Options Exchange ("CBOE") will begin to trade an index option ("Latin 15", symbol "LTX") composed of fifteen (15) stocks or closed-end, country funds of four Latin American countries: Argentina, Brazil, Chile, and Mexico. The Latin 15 is a narrow-based cash settled index, with European-style exercise. The underlying index securities trade on the New York Stock Exchange. This circular explains the margin and capital treatment applicable to transactions in the Latin 15 options.

MARGIN

The Latin 15 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 put or call 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. 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.

Option Market-Maker Margin Requirements

With the concurrence of the staff of the Board of Governors of the Federal Reserve System, the Securities and Exchange Commission ("SEC") has taken a no-action position allowing good faith credit to be extended to Latin 15 option market-makers on a basket of securities underlying the Latin 15 index in accordance with the "permitted offset" provisions of Regulation T, Section 220.12. For a basket to qualify as a permitted offset position, it must be comprised of all of the securities in the underlying index in exact proportion to the index.

<u>CAPITAL</u>

For capital purposes, Latin 15 options will be treated as narrow-based options. Under risk-based haircuts the haircut shall be equal to the maximum potential loss on the Latin 15 portfolio calculated over a range of market movement of +(-) 15% of the underlying index value. The minimum haircut charge are $25 per short contract and for the long contract , the lesser of $25 or the current market value of a long option.[1] 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.

-15% 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 Latin 15 options and offsetting securities baskets. The basket must represent 100% of the composition of the index. 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 Latin 15 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.