

Regulatory Circular No. RG95-78

Date: September 27, 1995

To: Members and Member Organizations

Attention: Chief Executive Officers, Managing Partners, Compliance Directors,
Senior Registered Options Principals and Compliance Registered
Options Principals

From: Capital Markets Division
Division of Regulatory Services

Re: Adoption of Rules Concerning Stock Index and Currency Warrants

On August 29, 1995, the Securities and Exchange Commission ("Commission") approved revisions to the rules of the Chicago Board Options Exchange ("Exchange") concerning customer transactions in stock index and currency warrants.¹ The amended rules revise the listing criteria for stock index and currency warrants, specify the customer margin for the purchase and short sale of stock index and currency warrants, and clarify the extent that Rules in Chapter 9 are made applicable to the trading of stock index and currency warrants. Attached as Exhibit A is the text of the new rules. [See Rule Change File No. SR-CBOE-94-34, printed below.]

All currency and index warrants traded on any exchange before the Commission's approval of the new rules shall continue to be governed by the rules and policies of the Exchange as in effect at the time of their listing.

This Regulatory Circular summarizes the most significant aspects of the new stock index and currency rules.

1. Account Approval, Trading and Advertising Rules

New Rule 30.52, Special Requirements for Stock Index Warrants, Currency Index Warrants and Currency Warrants, sets out various customer protection rules applicable to stock index, currency index and currency warrants. In addition, Rule 30.52 makes existing options customer protection rules in Chapter 9 applicable to stock index, currency and currency index warrants. Where Rules in Chapter 9 are made applicable by Rule 30.52 to such warrants, the term "option" shall be deemed to include a stock index, currency index or currency warrant.

¹ The Commission has simultaneously approved similar rule amendments for the American Stock Exchange, the New York Stock Exchange, the Pacific Stock Exchange and the Philadelphia Stock Exchange.

Rule 30.52(c) states that no member organization shall accept an order from a customer to purchase or sell a stock index, currency index or currency warrant unless the customer's account has been approved for options trading pursuant to Exchange Rule 9.7.

Rule 30.52(d)-(f) applies the options rules for suitability (Rule 9.9), discretionary accounts (Rule 9.10) and supervision of accounts (Rule 9.8) to stock index and currency warrants.

Rule 30.52(g) generally applies the standards applicable to written communications regarding listed options (Rule 9.21) to stock index and currency warrants. The provisions of Rule 9.21 as applied to stock index and currency warrants require that all advertisements, sales literature and educational material issued by a member or member organization pertaining to stock index and currency warrants be approved by a Compliance Registered Options Principal, and all advertisements and educational materials pertaining to stock index warrants be approved either by the Exchange or by another self-regulatory organization.

The Exchange cautions its member firms that any time they provide information to a customer regarding stock index warrants, they should provide the customer with information regarding the unique characteristics and risks of these instruments. In addition, any written communications to customers regarding stock index and currency warrants should state that these warrants share many of the risks of standardized options but, unlike standardized options, they are backed only by the credit of the issuer (not The Options Clearing Corporation) and each issue of warrants contains its own terms and conditions which may differ from those of other warrants, even other warrants on the same underlying index or issued by the same issuer.

Rule 30.52(h) generally applies the standards applicable to customer complaints to stock index and currency warrants.

Rule 30.35(a) provides that position limits for stock index warrants on the same index with original issue prices of ten dollars or less will be fifteen million warrants covering all such warrant issues, except that for warrants on the Russell 2000 Index with an original issue price of ten dollars or less, the position limit will be twelve million five hundred thousand warrants covering all such issues. The Rule provides that warrants with an original issue price in excess of ten dollars will be weighted more heavily than warrants with an original issue price of ten dollars or less in calculating position limits.

Rule 30.35(b) provides for exercise limits on stock index warrants.

Rule 30.35(d) requires members to report stock index warrant positions exceeding 100,000 warrants covering the same underlying index to the Exchange.

Rule 30.36 requires that the trading halt provisions in Rule 24.7 shall be applied to the trading of stock index warrants.

2. Margin

New Rule 30.53 applies the margin required for broad-based index options and currency options to index warrants and currency warrants. For example, the purchase of a stock index warrant will require payment in full, and the short sale of a stock index warrant will require margin of (i) 100 percent of the current value of the warrant plus (ii) 15 percent of the current value of the underlying index less the amount by which the warrant is out of the money (but not less than ten percent of the index value). The new warrant margin requirements generally will permit offset treatment for spread and straddle positions as well as positions covered by qualifying escrow receipts.

3. Listing Standards

The Exchange has substantially revised Rule 31.5E. First, the Exchange has amended Rule 31.5E.(1) and (4) to provide alternative standards for issuers of index and currency warrants. Issuers now will be expected to have either (i) a minimum tangible net worth of \$250,000,000 or (ii) a minimum tangible net worth of \$150,000,000 and not to have outstanding listed index or currency warrants where the aggregate original issue price of all such warrants (combining the issuer's warrants with those of its affiliates) exceed 25% of the issuer's net worth. Second, Rule 31.5E.(6) requires each warrant issuer to provide for automatic exercise of listed warrants on expiration (or on any earlier delisting). Third, 31.5E.(5) now provides that, for stock index warrants for which more than 25% of the value is represented by securities traded primarily in the U.S., in the case of warrants that are exercised on the expiration date or on either of the two business days preceding the day on which the final settlement value is to be determined, the value of the stocks underlying the warrants shall be determined by reference to the opening prices of the underlying securities.

4. Reporting Changes in the Number of Warrants Outstanding.

Exchange Rule 31.5E.(8) requires issuers of stock index warrants (for which more than 25% of the value of the underlying index is represented by securities traded primarily in the United States) to make arrangements with the warrant transfer agent to notify the Exchange of any early exercises by no later than 3:30 pm. Chicago time on the day that the settlement value for the warrants is determined. Such notice shall be filed in such form and manner as may be prescribed by the Exchange from time to time.

5. Reporting the Execution of Hedging Transactions Due to Early Exercise.

The Exchange will require any issuer of a stock index warrant (for which 25% or more of the value of the underlying index is represented by securities traded primarily in the United States) to file a report with the Exchange concerning certain trades the issuer effects as a result of the early exercise of a stock index warrant in order to adjust a hedge that the issuer has established in connection with the issuance of such warrants. The threshold reporting level for issuer hedge transactions in stock will be set at the reporting level of the New York Stock Exchange's Daily Program Trading Report (or "DPTR"), *i.e.*, a program trade involving at least 15 stocks of \$1 million or more in value. Any issuer hedge transaction effected in another market (*e.g.*, options market, futures market, OTC derivatives market) must be reported regardless of its size.

Such reports shall be submitted to the Exchange by the close of business on the second business day following the trade date of the transaction subject to the report. All such reports shall be filed in such manner and form as may be required by the Exchange from time to time and shall include the following information with respect to each reportable trade: (i) order entry time, (ii) product type (e.g., stock, stock option, futures contract, futures option), (iii) order type (e.g., market, market on close, limit), (iv) market action (i.e., buy/open, buy/close, sell/open, sell/close), (v) account identifier, (vi) size (e.g., total number of shares or contracts), (vii) total dollar value of trade, (viii) market where executed, and (ix) the warrant issue hedged.

6. Additional Information

Questions regarding the new rules applicable to stock index and currency warrants may be directed to the following persons:

General Product Information	Nick Parcharidis	212-803-1411 (effective 9/29/95)
Membership Requirements	Pamela Purdy	312-786-7452
Rules of Trading Procedure and ITS	Edward Provost	312-786-7717
Trade Processing and Clearing	Patrick Fay	312-786-7520
Margin and Capital Requirements	Diane Malley	312-786-7924
Sales Practice and Suitability	Lawrence Bresnahan	312-786-7713
Position and Exercise Limits	Patricia Cerny	312-786-7722

Attachments