

Regulatory Circular RG95-96

Date: November 6, 1995

To: The Membership

From: Department of Financial Compliance

Subject: Capital and Margin Requirements for Standard & Poors ("S&P")/Barra Growth Index and S&P/Barra Value Index.

On November 6, 1995 the Chicago Board Options Exchange ("CBOE") will begin to trade two index options based on S&P\Barra Value and Growth Indexes ("Barra Indexes"). The Barra Indexes will be broad based, cash-settled, European-style index options. Both indexes are 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 Barra Index options.

MARGIN

Barra 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, Barra Index options will be treated as broad-based 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 +6%/-8% of the underlying index value for non-clearing market makers and +(-)10% for all

other broker-dealers.¹ 80% of the profits from one Barra index can offset losses on the other Barra index at the same valuation points. Further, an 85% offset of gains versus losses is available between the Barra indexes and the indexes in the U.S. product group². Additionally, there is a minimum charge of \$25 per contract. 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 Barra 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. However, good faith credit for Barra securities baskets is prohibited.

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

¹Risk-based haircuts are applied pursuant to a 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.

²The U.S. product group consists of the following indexes: S&P 100 Index, S&P 500 Index, Major Market Index, NYSE Composite Index, Institutional Index, Big Cap Index and U.S. Top 100 Index.