

Regulatory Circular RG96-39

Date: April 29, 1996
To: The Membership
From: Department of Financial Compliance
Subject: Capital and Margin Requirements for CBOE Gold and Oil Indexes

On April 29, 1996 the Chicago Board Options Exchange ("CBOE") will begin to trade two index options based 15 integrated oil ("Oil Index") companies and 10 gold company stocks ("Gold Index"). Both index contracts will be a narrow-based, cash-settled, European-style options. The securities underlying both indexes trade on either the New York or American stock exchanges. This circular explains the margin and capital treatment applicable to transactions in the Gold and Oil Index options.

MARGIN

Both the Gold and Oil 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 Gold and Oil Index market-makers on a basket of underlying securities in accordance with the "permitted offset" provisions of Regulation T, Section 220.12. For a basket to

qualify as permitted offset position, it must be comprised of all of the securities in the underlying index in exact proportion to the index.

CAPITAL

For capital purposes, the Gold and Oil Index options will be treated as narrow-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 $\pm 15\%$ of the underlying index value for all broker-dealers.¹ There is a minimum charge of \$25 per short contract and the lesser of \$25 or the current market value for long contracts. Additionally, a 90% offset of gains versus losses at the same valuation point will be allowed between the Gold Index and the Philadelphia Stock Exchange's gold index ("XAU"). Further, the 90% offset will also be permitted between the Oil Index and the American Stock Exchange's oil index ("XOI"). 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 Gold and Oil options and offsetting securities baskets. The baskets must represent 100% 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 Gold and Oil 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.