

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-38502; File No. SR-CBOE-97-18]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Chicago Board Options Exchange, Incorporated Relating to Changes to its Margin Rules

April 14, 1997.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on March 21, 1997, the Chicago Board Options Exchange, Incorporated ("CBOE" or the "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II and III below, which Items have been prepared by the CBOE. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The CBOE proposes to make revisions to its rules governing margin that will: (i) Permit a market-maker to receive market-maker margin treatment on transactions in options and other securities and (ii) allow certain defined strategies involving options to be carried in a cash account. The text of the proposed rule change is available at the Office of the Secretary, CBOE and at the Commission.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the CBOE included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The CBOE has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, Proposed Rule Change

The purpose of the proposed rule change is to make revisions to the Exchange's rules governing margin that

will: (i) Permit a market-maker to receive market-maker margin treatment on transactions in options and other securities,³ and (ii) allow certain defined strategies involving options to be carried in a cash account. The Exchange is also submitting concurrently separate changes to its margin rules in a separate rule filing. That other filing proposes to make significant changes to the CBOE's margin rules in order to: (i) Establish CBOE rules to govern areas of margin regulation that will no longer be addressed by Regulation T ("Regulation T") of the Board of Governors of the Federal Reserve System ("Federal Reserve Board" or "Board"), and (ii) conform certain CBOE margin provisions to those of the New York Stock Exchange. That other filing will be referred to herein as the "First Margin Filing." See SR-CBOE-97-17. The present filing will be referred to as the "Second Margin Filing."

CBOE Rule 24.11A currently permits a debit put spread to be carried in a cash account.⁴ The Exchange is proposing to allow also (as more fully described below) credit put spreads and both debit and credit call spreads in European, cash settled options to be carried in a cash account because such strategies are substantially similar to the presently permitted debit put spread and fully meet the criteria established by Regulation T. The Federal Reserve Board decided to defer to the options exchanges' determination of the allowable specific options related strategies to be effected in the cash account, provided that the risk of the strategy is defined and the account contains the securities and/or cash required to fully cover the exposure.⁵ The proposed provision would permit a customer to hold short European-style options offset by long European-style options on the same underlying component or index in a cash account. In order to qualify for the cash account, the long position would have to be held in the account, or be purchased for the account on the same day as the short position is established. In addition, the option premium would have to be held in the account until full cash payment for the long option is received; the long option must expire with the short

³ Market-maker margin treatment provides that the member carrying a market-maker's account ("Clearing Firm") may extend credit to a market-maker on specified market-maker and permitted offset transactions on a basis that is mutually satisfactory.

⁴ The Commission notes that CBOE Rule 24.11A relates to debit put spreads in cash account transactions, and not Rule 24.11 as inadvertently referred to in the rule filing.

⁵ See 61 FR 20386 (May 6, 1996).

option, and the account must hold cash or cash equivalents of not less than any amount by which the aggregate exercise price of a long call (short put) exceeds the aggregate exercise price of a short call (long put). In the near future, the CBOE intends to propose inclusion in the cash account of other strategies meeting the criteria established by the Federal Reserve Board.

The Exchange is proposing to add these new provisions to Rule 12.3. Although most of the provisions governing the margin of index options are contained in Rule 24.11, the Exchange intends ultimately to move most of the margin provisions to Chapter 12 of its rules and so is proposing to add the index option cash account provision to Rule 12.3.

Market Maker and Specialist Accounts

The CBOE rules and the rules of the other regulatory bodies have always distinguished the margin treatment for market-makers and specialists from that applicable to customers and other broker-dealers because of the unique position of market-makers and specialists in maintaining liquid markets. The rules recognize that options market-makers and specialists must engage in various hedging transactions to manage the risk involved in fulfilling their role. Specific provisions governing permitted offset treatment for market-makers and specialists are being deleted from Regulation T, which as a result will defer to the rules of the self-regulatory organizations ("SROs").

The First Margin Filing proposes to allow various permitted offset positions, which may be cleared and carried by a member on behalf of one or more registered specialists, registered market-makers, or Designated Primary Market-Makers (hereinafter referred to generically as "market-makers"), to be carried upon a margin basis satisfactory to the concerned parties. A permitted offset position is defined to mean, in the case of an option in which a market-maker makes a market, a position in the underlying instrument or other related instrument, and in the case of other securities in which a market-maker makes a market, a position in options overlying the securities in which a market-maker makes a market, if the account holds the following positions: (i) A long position in the underlying instrument offset by a short position which is "in- or at-the-money;" (ii) a short position in the underlying instrument offset by a long option position which is "in- or at-the-money;" (iii) a stock position resulting from the assignment of a market-maker short

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

option position; (iv) a stock position resulting from the exercise of a market-maker long position; (v) a net long position in a security (other than an option) in which a market-maker; or (vii) an offset position as defined in Appendix A of SEC Rule 15c3-1.

In addition to the changes described above which were proposed in the First Margin Filing, the Exchange is also proposing to permit a market-maker to receive market-maker margin treatment on transactions in options or other derivative securities effected on an exchange of which he is not a member and on which he is not registered as a market-maker if the options or other derivative securities are dually listed on the exchange on which he is a registered market-maker, or if the transactions are recognized offsets as defined by Rule 15c3-1.

These transactions may be maintained by a carrying broker-dealer on a margin basis mutually satisfactory to the concerned parties, provided that the member, in the same calendar quarter, executes 80% of his total volume in the options class, product group or other SEC recognized offset group on the exchange where he is registered as a market-maker, and provided that such transactions are effected for the purpose of hedging, reducing the risk of, rebalancing, liquidating open positions of the market-maker, or for the purpose of effecting transactions pursuant to the "trade or fade" rules of any options exchange.⁶ This requirement will ensure that transactions effected by order in markets where the member is not registered as a market-maker are in fact reasonably related to his or her market-making function and are not effected for the purpose of speculation on a margin basis which is applicable only to market-makers and specialists.

A change is also being made to allow facsimile notice of a deficit condition in an account. This change is consistent with the Commission's Rule 15c3-1.

Interpretation to Rule 12.3

Interpretation .04 addresses the manner in which the carrying firm may comply with its responsibility to extend credit properly to market-maker permitted offset transactions effected on an exchange where the market-maker is not registered. If a market-maker fails to specify to which account such an order should be placed and the resulting transaction clears in a market-maker account, and not a customer account, it will be presumed that the market-maker elected market-maker margin treatment

for the position effected on an exchange of which he is not a member. The clearing firm may rely on this in good faith unless the clearing firm knows, or has reason to know, that the market-maker is not or will not be in compliance with the requirement to effect 80% of his transactions in a particular class or product offset group on the exchange where he is registered as a market-maker. Clearing firms are, however, responsible for implementing adequate procedures to ensure that such orders are recorded accurately and cleared into the appropriate accounts.

2. Statutory Basis

The basis under the Act for this proposed rule change is the requirement under Section 6(b)(5) that an exchange have rules that are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to protect and perfect the mechanism of a free and open market and a national market system, and in general, to protect investors and the public interest.

The proposed rule change: (1) Permits a market-maker to receive market-maker margin treatment on transactions in options and other securities and (ii) allows certain defined strategies involving options to be carried in a cash account. The Exchange believes that the proposed rule change is consistent with, and furthers, the objectives of Section 6(b)(5) of the Act, in that it is designed to perfect the mechanisms of a free and open market and to protect investors and the public interest.

B. Self-Regulatory Organization's Statement on Burden on Competition

The CBOE does not believe that the proposed rule change will impose any burden on competition.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants or Others

No written comments were solicited or received with respect to the proposed rule change.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period: (i) As the Commission may designate up to 90 days of such date if it finds such

longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of all such filing will also be available for inspection and copying at the principal office of CBOE. All submissions should refer to file number SR-CBOE-97-18 and should be committed by May 12, 1997.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁷

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-38501; File No. SR-CBOE-97-17]

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April 14, 1997.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on March 21,

¹ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

⁶ CBOE Rule 8.51(b) sets forth the trade or fade requirements applicable to CBOE market-makers.