



Regulatory Circular RG11-039

To: Trading Permit Holders and
Clearing Trading Permit Holders

From: Division of Registration and Regulatory Services

Date: March 2, 2011

Subject: Margin and Net Capital Requirements
- CBOE Credit Event Binary Options

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KEY POINTS

- On March 8, 2011, the Chicago Board Options Exchange (the “CBOE” or “Exchange”) plans to commence trading of Credit Event Binary Options.
- Credit Event Binary Option (“CEBO”) is another term for Credit Default Option. Credit Default Options are covered in Chapter 29 – Credit Option Contracts, of the Exchange’s rules.
- A Credit Event Binary Option (“CEBO”) is a binary call option that automatically settles by paying a holder (and charging a writer) \$1,000 in cash upon the confirmation of a designated Credit Event (e.g., bankruptcy) in respect of the Reference Entity (i.e., debt issuer or guarantor) underlying the CEBO, and pays nothing if there is no Credit Event prior to or on the last trading day.
- For information concerning CEBO contract specifications and Reference Entities for which the Exchange initially expects to list CEBOs, see CBOE Regulatory Circular RG11-037, which was issued contemporaneously. For information concerning system settings, see CBOE Regulatory Circular RG11-038.
- CEBOs may be purchased on margin, and the initial and maintenance margin requirement is a percentage of the settlement amount. The percentage scales up as the credit default swap spread for the underlying Reference Entity and/or the time until expiration increase.
- The margin requirements for writers of CEBO’s are calculated in a similar manner, but different percentage tables apply. (See tables later in this Regulatory Circular).

- For net capital purposes, a risk-based haircut is not available for CEBOs. A strategy-based haircut methodology must be applied. Margin and net capital requirements are described in detail below.

CUSTOMER MARGIN¹

CBOE Rule 12.3(l) requires that Trading Permit Holders monitor the risk of customer and broker-dealer accounts with exposure to CEBOs, and implement and maintain a comprehensive written risk analysis methodology for assessing the potential risk to the Trading Permit Holder's capital over a specified range of possible market movements over a specified time period. Refer to Rule 12.3(l) for information regarding what to include in risk monitoring procedures and guidelines.

The requirements given below are Exchange minimums. **Trading Permit Holders shall, based on the risk monitoring procedures and guidelines required by Rule 12.3(l), determine whether the margin requirements given below are adequate with respect to their customer and broker-dealer accounts and, where appropriate, increase such requirements.**

LONG POSITIONS – SINGLE-NAME

CEBOs may be purchased on margin. The amount of margin required (both initial and maintenance) is a percentage, specified in the table below, of the CEBO's **settlement value**.

Credit Default Swap ("CDS") Spread* for the Reference Entity Underlying the Credit Default Option	Length of Time Until Expiration of the Option			
	1 Year or Less	Greater than 1 Year / Less Than or Equal to 3 Years	Greater Than 3 Years / Less Than or Equal to 7 Years	Greater Than 7 Years
0 – 100	.5%	1%	2%	3.5%
100 – 300	1%	2.5%	3.5%	5%
300 – 500	2.5%	5%	7.5%	10%
500 – 700	5%	7.5%	10%	12.5%
700 & above	7.5%	10%	12.5%	15%

* Over LIBOR, in basis points.

¹ Customer margin requirements (strategy-based) for CEBOs are set-forth in Exchange Rule 12.3(l)(3).

SHORT POSITIONS – SINGLE-NAME

The initial and maintenance margin requirement for a short position is a percentage, specified in the table below, of the CEBO's **settlement value**.

Credit Default Swap (“CDS”) Spread* for the Reference Entity Underlying the Credit Default Option	Length of Time Until Expiration of the Option			
	1 Year or Less	Greater than 1 Year / Less Than or Equal to 3 Years	Greater Than 3 Years / Less Than or Equal to 7 Years	Greater Than 7 Years
0 – 100	1%	2%	4%	7%
100 – 300	2%	5%	7%	10%
300 – 500	5%	10%	15%	20%
500 – 700	10%	15%	20%	25%
700 & above	15%	20%	25%	30%

* Over LIBOR, in basis points.

Spreads. If an account is short a CEBO and is also long a CEBO with the same underlying Reference Obligation(s), and the long option is paid for in full and does not expire before the short option, no margin is required.

Debt Security Offset. If an account is short a CEBO and also has a short position in a debt security issued by the Reference Entity underlying the CEBO, and the principal amount of the debt security is equal to: the cash settlement amount of the option multiplied by 1.33, no margin is required on the short single-name CEBO.

Where a short CEBO is covered by an “escrow agreement” meeting the requirements of CBOE Rule 12.3(d)(2), no margin need be required.

CEBOs are not eligible for portfolio margining.

OPTION MARKET-MAKER MARGIN REQUIREMENTS

Pursuant to CBOE Rule 12.3(f), CEBOs may be margined on a basis that is satisfactory to the market-maker and carrying broker-dealer.

Questions regarding the margin treatment of options should be directed to James Adams, Department of Member Firm Regulation, at (312) 786-7718.

NET CAPITAL REQUIREMENTS

The following net capital haircut requirements were established through consultation with staff of the Securities and Exchange Commission (the “Commission”) as to how to apply the Commission’s Net Capital Rule (Rule 15c3-1) to CEBOs.

Risk-based haircuts are not available for CEBOs. For each CEBO, Trading Permit Holders must deduct from net capital an amount equal to the margin requirement that applies to the CEBO, as specified above.

In addition to the spread and short debt security offsets (as provided above in reference to margin requirements), a long equity put option offset is available to Trading Permit Holders. Where a Trading Permit Holder has a short position in a CEBO and also has an offsetting long position in put options overlying the equity security of the issuer or guarantor whose debt security is the Reference Obligation for the CEBO, and the aggregate exercise price of the puts is equal to \$1,000 (or as close to \$1,000 as is possible with whole option contracts), the deduction for the short CEBO and long put options may be reduced by 50%.

Concentration Charge. If, across all accounts, the maximum exposure in CEBOs overlying any single Reference Entity exceeds the Trading Permit Holder's tentative net capital, the Trading Permit Holder must deduct from net capital an amount equal to the aggregate customer margin requirement (as specified in this Regulatory Circular) for all such accounts on the CEBOs (including Basket CEBOs having the subject Reference Entity as a component) overlying such single Reference Entity. This deduction from net capital may be reduced by the amount of excess margin held in all customer and broker-dealer accounts.

Questions regarding the net capital treatment of CEBOs should be directed to Robert Gardner, Department of Member Firm Regulation, at (312) 786-7937.

[Supersedes CBOE Regulatory Circular RG07-067]