Regulatory Circular RG13-048

Date: March 15, 2013

To: Trading Permit Holders, Clearing Trading Permit Holders
From: Division of Regulatory Services
RE: Margin Requirements for Mini Options

Chicago Board Options Exchange, Incorporated (CBOE) and C2 Options Exchange, Incorporated (C2) recently adopted rules that permit the listing and trading of options overlying ten shares of SPDR S&P 500 (SPY), Apple, Inc. (AAPL), SPDR Gold Trust (GLD), Google Inc. (GOOG) and Amazon.com Inc. (AMZN) (mini options). Trading is set to begin March 18, 2013. All existing CBOE/C2 rules applicable to regular sized options on equities/ETFs that overlie 100 shares (standard options) will apply to mini-options, except with respect to position and exercise limits. This Regulatory Circular primarily discusses spread margining considerations for spreads involving standard options and mini options.

Spreads. The same spread margin treatment that is applied to spreads involving only standard options is permitted for spreads involving only mini options.

Spreads between standard and mini options are permitted under CBOE rules. However, Trading Permit Holders (TPH) and clearing TPHs are advised that spreads involving long standard options and short mini options require additional position management if less than 10 short mini contracts are assigned, and that a margin requirement may result in certain circumstances. The examples given below highlight potential outcomes.

If a TPH is able to apply a portion of a standard option as a spread with mini options on an **equal underlying aggregate contract value basis** (e.g., 2 mini options vs. four-fifths of a standard option), and properly margin the remaining portion separately, spread margin treatment is permitted. A TPH must have processes and procedures in place to properly compute margin, and document on its books and records that it is properly computing margin, when allowing a portion of a standard option to receive spread margin treatment vs. mini options, both on the spread and un-spread portions of the standard option. As an example, for a short standard option that is spread with 2 long mini options, but is otherwise uncovered, the uncovered margin requirement for the un-spread portion of the standard option is eight-tenths of the uncovered margin requirement for that standard option, if treated as a stand-alone uncovered option.

TPHs and clearing TPHs must implement policies and procedures to provide for the supervision of accounts of market participants that mix standard and mini options in spreads.

Example 1
Bullish (or debit) call spread

Long **1** XYZ MAR2013 45 call
Short **10** mini XYZ MAR2013 50 calls

If the price of XYZ is above 50 and all of the short mini calls are assigned, the long call could be exercised, and the outcome is comparable to a spread involving only standard options in a 1 to 1 ratio. However, if less than 10 mini calls are assigned, and the long call is exercised, a covered call position results. (While it may seem likely that all of the short mini calls would be assigned when the price of XYZ stock is above 50, the possibility exists that they would not.) Margin must be available in the account or deposited to meet the requirement for the stock purchased upon exercise.

For example, if only two 2 of the short mini calls are assigned, the resulting position would be long 1 XYZ MAR2013 45 call, short 8 mini XYZ MAR2013 50 calls and short 20 shares of XYZ. If the long call is exercised upon notice of the assignment, the resulting position would be long 80 shares of XYZ and short 8 mini XYZ MAR2013 50 calls (covered). Margin must be available in the account or deposited to meet the requirement for the net 80 share purchase of XYZ. There would now be the risk of a long stock position.

In the case of a spread that involves only standard options, exercise of the long call upon assignment of the short call would result in no stock position and its attendant risk, and no additional margin requirement.

Alternatively, if only two of the short mini calls are assigned, the long XYZ MAR2013 45 call could continue to be held. There would be no margin requirement under Regulation T for the short stock position provided the long call is held (although Reg. T still requires the short sale proceeds). The limited risk / limited reward profile of a spread would be maintained. One fifth of the long call offsets (hedges) the short stock position and four-fifths would be spread with the remaining short mini calls.

As a second alternative, if less than 10 of the short mini calls are assigned, the long call could be sold, the remaining short calls could be closed (bought) and the resulting short stock position could be closed (bought).

Example 2
Bearish or (credit) call spread

Long **1** XYZ MAR2013 50 call
Short **10** mini XYZ MAR2013 45 calls

If the price of XYZ stock is above 45 (but at or below 50) an assignment of short mini calls could be managed in the same manner as a spread involving only standard options in a 1 to 1 ratio, even if less than ten of the short mini calls are assigned.

For example, if only 2 of the short mini calls are assigned, the resulting position would be long 1 XYZ MAR2013 50 call, short 8 mini XYZ MAR2013 45 calls and short 20 shares of XYZ. The short stock position could either be held or immediately liquidated. If held, margin must be available in the account or deposited to meet the requirement for the short sale of XYZ. The risk would not change. The long call sets a floor on a loss from the short stock.

Except for the number of short shares that would result, this is no different than being assigned on 1 standard option in the case of a spread involving only standard contracts when the price of XYZ is above 45 (but at or below 50).

If the price of XYZ stock is above 50 and all of the short mini calls are assigned, the long call could be exercised, and the outcome is comparable to a spread involving only standard contracts in a 1 to 1 ratio. However, if less than 10 mini calls are assigned, and the long call is exercised, a covered call position results. (While it may seem likely that all of the short mini calls would be assigned when the price of XYZ stock is above 50, the possibility exists that they would not.) Margin must be available in the account or deposited to meet the requirement for the stock purchased upon exercise.

For example, if only two 2 of the short mini calls are assigned, the resulting position would be long 1 XYZ MAR2013 50 call, short 8 mini XYZ MAR2013 45 calls and short 20 shares of XYZ. If the long call is exercised upon notice of the assignment, the resulting position would be long 80 shares of XYZ and short 8 mini XYZ MAR2013 45 calls (covered). Margin must be available in the account or deposited to meet the requirement for the net 80 share purchase of XYZ. There would now be the risk of a long stock position.

In the case of a spread that involves only standard options, exercise of the long call upon assignment of the short call would result in no stock position and its attendant risk, and no additional margin requirement.

Alternatively, if only two of the short mini calls are assigned, the long XYZ MAR2013 50 call could continue to be held. There would be no margin requirement under Regulation T for the short stock position provided the long call is held (although Reg. T still requires the short sale proceeds). The limited risk / limited reward profile of a spread would be maintained. One fifth of the long call offsets (hedges) the short stock position and four-fifths would be spread with the remaining short mini calls.

As a second alternative, if less than 10 of the short mini calls are assigned, the long call could be sold, the remaining short calls could be closed (bought) and the resulting short stock position could be closed (bought).

Example 3
Bullish (credit) put spread

Long **1** XYZ MAR2013 45 put
Short **10** mini XYZ MAR2013 50 puts

If the price of XYZ stock is below 50 (but at or above 45) an assignment of short mini puts could be managed in the same manner as a spread involving only standard options in a 1 to 1 ratio, even if less than ten of the short mini puts assigned.

For example, if only 2 of the short mini puts are assigned, the resulting position would be long 1 XYZ MAR2013 45 put, short 8 mini XYZ MAR2013 50 puts and long 20 shares of XYZ. The long shares would either be held or immediately liquidated. If held, margin must be available in the account or deposited to meet the requirement for the purchase of XYZ. The risk would not change. The long put sets a floor on a loss from the long stock.

Except for the number of long shares that would result, this is no different than being assigned on 1 standard option in the case of a spread involving only standard contracts when the price of XYZ is below 50 (but at or above 45).

If the price of XYZ is below 45, and all of the short mini puts are assigned, the long put could be exercised, and the outcome is comparable to a spread involving only standard options in a 1 to 1 ratio. However, if less than 10 mini puts are assigned, and the long put is exercised, a covered put position results. (While it may seem likely that all of the short mini puts would be assigned when the price of XYZ stock is below 45, the possibility exists that they would not.) Margin must be available in the account or deposited to meet the requirement for the stock sold short upon exercise.

For example, if only two 2 of the short mini puts are assigned, the resulting position would be long 1 XYZ MAR2013 45 put, short 8 mini XYZ MAR2013 50 puts and long 20 shares of XYZ. If the long put is exercised upon notice of the assignment, the resulting position would be short 80 shares of XYZ and short 8 mini XYZ MAR2013 50 puts (covered). Margin must be available in the account or deposited to meet the requirement for the net 80 share short sale of XYZ. There would now be the risk of a short stock position.

In the case of a spread that involves only standard options, exercise of the long put upon assignment of the short put would result in no stock position and its attendant risks, and no additional margin requirement.

Alternatively, if only two of the short mini puts are assigned, the long XYZ MAR2013 45 put could continue to be held. The limited risk / limited reward profile of a spread would be maintained, but margin must be available in the account or deposited to meet the requirement for the 20 share purchase of XYZ stock. One fifth of the long put offsets (hedges) the long stock position and four-fifths would be spread with the remaining short mini puts.

As a second alternative, if less than 10 of the short mini puts are assigned, the long put could be sold, the remaining short puts could be closed (bought) and the resulting long stock position could be closed (sold).

Example 4
Bearish or (debit) put spread

Long **1** XYZ MAR2013 50 put
Short **10** mini XYZ MAR2013 45 puts

If the price of XYZ stock is below 45 and all of the short mini puts are assigned, the long put could be exercised, and the outcome is comparable to a spread involving only standard options in a 1 to 1 ratio. However, if less than 10 mini puts are assigned, and the long put is exercised, a covered put position results. (While it may seem likely that all of the short mini puts would be assigned when the price of XYZ stock is below 45, the possibility exists that they would not.) Margin must be available in the account or deposited to meet the requirement for the stock sold short upon exercise.

For example, if only two 2 of the short mini puts are assigned, the resulting position would be long 1 XYZ MAR2013 50 put, short 8 mini XYZ MAR2013 45 puts and long 20 shares of XYZ. If the long put is exercised upon notice of the assignment, the resulting position would be short 80 shares of XYZ and short 8 mini XYZ MAR2013 45 puts (covered). Margin must be available in the account or deposited to meet the requirement for the net 80 share short sale of XYZ. There would now be the risk of a short stock position.

In the case of a spread that involves only standard options, exercise of the long put upon assignment of the short put would result in no stock position and its attendant risks, and no additional margin requirement.

Alternatively, if only two of the short mini puts are assigned, the long XYZ MAR2013 50 put could continue to be held. The limited risk / limited reward profile of a spread would be maintained, but margin must be available in the account or deposited to meet the requirement for the 20 share purchase of XYZ stock. One fifth of the long put offsets (hedges) the long stock position and four-fifths would be spread with the remaining short mini puts.

As a second alternative, if less than 10 of the short mini puts are assigned, the long put could be sold, the remaining short puts could be closed (bought) and the resulting long stock position could be closed (sold).

Covered writing. The same covered writing margin treatment that is applied to short standard options is permitted for mini options written against an equivalent or greater position in the underlying security.

Straddles. Short straddle (and strangle and combination) margin treatment is permitted for short put and short call positions that combine standard and mini options, provided that the put(s) and call(s) have equal underlying aggregate contract values. Either the put or the call position (or both) can be composed of mini contracts. Only the portion of a standard option that corresponds equally to mini options may be treated as a straddle. Any portion for which there is not a standard or mini option counterpart must be margined separately.

Additional Information:
Please contact the Regulatory Interpretations and Guidance team at reginterps@cboe.com and (312) 786-8141 for additional information.