

would be measured by the closing price reported in the primary market in which the underlying security is traded. The Exchange believes that a "look back" period of five consecutive days would provide a sufficient measure of protection from any attempts to manipulate the market price of the underlying security.

The Exchange also believes that the proposed rule change would encourage the delisting of inactive option classes, particularly those classes in which the market price of the underlying security is below \$7.50. Currently, a Designated Primary Market Maker ("DPM") on the Exchange to whom an option class has been allocated may be reluctant to delist an inactive option class if the market price of the underlying security is below \$7.50 because once delisted, the Exchange's current initial listing criteria must be met to re-list the option class, including the requirement that the market price per share of the underlying security be at least \$7.50 for the majority of business days during the preceding three months. The Exchange also notes that the Commission recently granted CBOE approval to list additional series on an option class even though the market price of the underlying security is below \$3, provided that at least one other options exchange trades the series to be added, and at the time the other options exchange added that series, it met the requirements to add new series, including the \$3 price requirement.<sup>6</sup>

The proposed \$3 price standard and the five-day look-back period would provide a reliable test for stability and, at the same time, presents a more reasonable time period for qualifying the price of an underlying security. The Exchange further believes that this proposed abbreviated qualification period, in combination with CBOE's existing quarterly delisting program,<sup>7</sup> would contribute to reducing unnecessary quote traffic.

Finally, for the purposes of consistency within CBOE Rules, the Exchange proposes to amend Interpretation and Policy .05(d)(ii) to CBOE Rule 5.3. Currently, Interpretation .05(d)(ii) to CBOE Rule 5.3 provides a method to certify that the market price of a Restructure Security satisfies the

pricing requirement of Interpretation and Policy .01(b)(2) to CBOE Rule 5.3 and specifically references the \$7.50 market price per share. In order to make Interpretation .05(d)(ii) to CBOE Rule 5.3 consistent with the pricing standard change to Interpretation .01(b)(2) to CBOE Rule 5.3, the amended rule would reflect that the market price standard for Restructure Securities also shall be reduced from \$7.50 to \$3.00 as long as the Restructure Security is a Covered Security.

## 2. Statutory Basis

The Exchange believes that the current proposal will allow the Exchange to provide investors with those options that are most useful and demanded by them without sacrificing any investor protection. As such, the Exchange believes that the proposed rule change is consistent with section 6(b) of the Act<sup>8</sup> in general and furthers the objectives of section 6(b)(5)<sup>9</sup> in particular in that it will promote just and equitable principles of trade; facilitate transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system; and protect investors and the public interest.

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

The Exchange 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 Exchange 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, including whether the proposed rule change is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. 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 at the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the Exchange. All submissions should refer to File No. SR-CBOE-2002-62 and should be submitted by January 6, 2003.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>10</sup>

**Margaret H. McFarland,**  
Deputy Secretary.

[FR Doc. 02-31550 Filed 12-13-02; 8:45 am]

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-46971; File No. SR-CBOE-2002-67]

### Self-Regulatory Organizations; Notice of Filing of a Proposed Rule Change and Amendment No. 1 Thereto by the Chicago Board Options Exchange, Inc. Amending the Margin Rule 12.3 to Incorporate Security Futures

December 9, 2002.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on November 1, 2002, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") filed with the Securities and Exchange Commission ("Commission" or "SEC") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the CBOE. On November 21, 2002, the CBOE filed an

<sup>6</sup> See Securities Exchange Act Release No. 46501 (September 16, 2002), 67 FR 59585 (September 23, 2002) (SR-CBOE-2002-52). The Exchange represents that these rules are consistent with similar rules regarding listing and maintenance standards of the Amex, International Securities Exchange, Inc., Pacific Exchange, Inc., and the Philadelphia Stock Exchange, Inc.

<sup>7</sup> CBOE states that it maintains an active delisting program which requires the quarterly delisting of multiply listed option classes that do not trade more than 20 contracts per day on the Exchange.

<sup>8</sup> 15 U.S.C. 78f(b).

<sup>9</sup> 15 U.S.C. 78f(b)(5).

<sup>10</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

amendment to the proposed rule change.<sup>3</sup> The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

The Exchange proposes to amend its margin rules under CBOE Rule 12.3 to incorporate security futures. Below is the text of the proposed rule change, as amended. Proposed new language is italicized; proposed deletions are bracketed.

\* \* \* \* \*

#### Chicago Board Options Exchange, Incorporated

##### Rules

\* \* \* \* \*

#### Chapter XII

##### Margins

Rule 12.1 No change

Rule 12.2 Time Margin Must Be Obtained

(a) *Securities Other Than Security Futures Contracts.* The amount of initial margin, or payment in respect of cash account transactions, required by this Rule shall be obtained as promptly as possible and in any event within one payment period as defined in Section 220.2 of Regulation T of the Board of Governors of the Federal Reserve System. The amount of maintenance margin required by this Rule shall be obtained as promptly as possible and in any event within 15 *business* days.

Rule 12.3 Margin Requirements

(a) No change

(b) Customer Margin Accounts—General Rule. Subject to the exceptions set forth in parts (c) and (k) hereof, the minimum amount of margin which must be maintained in margin accounts of customers having positions in securities shall be as follows:

(1) No change

(2) No change

(c)–(e) No Change

(f) Market maker and specialist accounts.

(1) *Definitions.* For purposes of this section (f), the following terms shall have the meanings specified below.

(A) The term “related instrument” within an option class or product group

means any related derivative product, *including security futures contracts*, that meets the offset level requirements for product groups under Rule 15c3–1 of the Exchange Act, or any applicable SEC staff interpretations or no-action positions (hereinafter referred to as SEC Rule 15c3–1).

(B) The term “product group” means two or more option classes, related instruments, and qualified stock baskets for which it has been determined that a percentage of offsetting profits may be applied to losses in the determination of net capital as set forth in SEC Rule 15c3–1.

(C) The term “option class” refers to all option contracts covering the same underlying instrument.

(D) The term “underlying instrument” refers to long and short positions covering the same security, or a security which is exchangeable for or convertible into the underlying security within a period of 90 days. The term underlying instrument shall not be deemed to include securities options, futures contracts, options on futures contracts, *security futures contracts*, qualified stock baskets, or unlisted instruments.

(E) The term “qualified stock basket” shall have the meaning as defined in SEC Rule 15c3–1.

(F) The term “net liquidating equity” shall mean the sum of positive cash balances and long securities positions less negative cash balances and short securities positions held in the accounts.

(2) The following positions of members may be carried upon a margin basis that is satisfactory to the member and the carrying broker or dealer:

(A) positions in which the member makes a market and permitted offset transactions as defined below[.] and  
(B) *positions in security futures contracts that qualify for exclusion from the margin requirements of SEC and Commodity Futures Trading Commission (“CFTC”) regulations pursuant to SEC Rule 400(c)(2)(v) under the Exchange Act and CFTC Rule 41.42(c)(2)(v), and any permitted offset transactions designated by the exchange or association upon which the member trades the security futures contract.*

Notwithstanding the other provisions of this paragraph (f), a member organization may clear and carry the market-maker permitted offset positions of one or more registered specialists, registered market-makers, or Designated Primary Market-Makers pursuant to the rules of a national securities exchange (all of which are deemed specialists for all purposes under the [Securities] Exchange Act [of 1934]) (hereinafter

referred to as “market-maker(s)”) upon a margin basis satisfactory to the concerned parties. The amount of any deficiency between the equity maintained by the market-maker and the haircuts specified in SEC Rule 15c3–1 shall be considered as a deduction from net worth in the net capital computation of the carrying broker or dealer.

(3) *Permitted Offset Transactions.*

(A) For purposes of this subparagraph (f)(3), a permitted offset position means, 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 permitted offset positions:

(i) A long position in the underlying instrument or *security futures contract* offset by a short option position which is “in or at the money”;

(ii) A short position in the underlying instrument or *security futures contracts* 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 option position *or delivery in respect of a short security futures contract*;

(iv) A stock position resulting from the exercise of a market-maker long option position *or taking delivery in respect of a long security futures contract*;

(v) A net long position in a security (other than an option) in which a market-maker makes a market;

(vi) A net short position in a security (other than an option) in which the market-maker makes a market; or

(vii) An offset position as defined in SEC Rule 15c3–1, including its appendices, or any applicable SEC staff interpretation or no-action position

Permitted offset transactions must be effected for market-making purposes such as hedging, risk reduction, rebalancing of positions, liquidation, or accommodation of customer orders, or other similar market-maker purpose.

For purposes of this subparagraph (f)(3), the term “in- or at-the-money” means the current market price of the underlying security is not more than two standard exercise intervals below (with respect to a call option) or above (with respect to a put option) the exercise price of the option; the term “in the money” means the current market price of the underlying instrument or index is not below (with respect to a call option) or above (with respect to a put option) the exercise price of the option; and, the term “overlying option” means

<sup>3</sup> See letter from Madge M. Hamilton, Senior Attorney, CBOE, to Theodore R. Lazo, Senior Special Counsel, Division of Market Regulation (“Division”), Commission, dated November 20, 2002 (“Amendment No. 1”). Amendment No. 1 makes technical changes to the proposed rule text.

a put option purchased or a call option written against a long position in an underlying instrument, or a call option purchased or a put option written against a short position in an underlying instrument.

(B) Reserved

(C)(1) Reserved

(2) For any member which acts as a Market-Maker on the Exchange, the carrying member organization may combine all Market-Maker accounts in which the Market-Maker or its nominee(s) participates, with the exception of joint accounts in which the Market-Maker or its nominee are not the sole participants, for purpose of computing its requirements as prescribed by SEC Rule 15c3-1.

(3) On any business day on which positive net liquidating equity is not maintained in the account(s), the carrying member organization must make a call to the member for additional equity at least equal to the deficit and must notify the Exchange's Department of Financial Compliance of the deficit. The carrying member organization may extend no further credit in the account(s) until the account(s) maintains a positive net liquidating equity and, if the member organization's call for additional equity is not met, steps should be taken promptly to liquidate the positions in the account(s). If the deficit is not resolved by noon of the following business day the carrying member organization must send telegraphic notice to the Exchange as well as the regional and national offices of the Securities and Exchange Commission. However, nothing in this subparagraph (C) shall prohibit the carrying firm from effecting hedging transactions in the deficit account with the prior written approval of the carrying firm's SEC designated examining authority.

(4) In the case of a joint account carried by a member organization for a Market-Maker or specialist in which the Member Organization participates, the margin deposited by the other participants may be in any amount which is mutually satisfactory.

(g)(i) Broker-Dealer Account. A member organization may carry the proprietary account of another broker-dealer, which is registered with the SEC, upon a margin basis which is satisfactory to both parties, provided the requirements of Regulation T of the Board of Governors of the Federal Reserve System *and, in respect of security futures contracts, SEC Rules 400 through 406 under the Exchange Act and CFTC Rules 41.42 through 41.48* are adhered to and the account is not carried in a deficit equity condition.

The amount of any deficiency between the equity maintained in the account and the margin required by the other provisions of this Rule shall be deducted in computing the Net Capital of the member organization under Rule 15c3-1 of the Exchange Act.

(ii) Requirements for Joint Back Office Participants. A member organization may carry the accounts of joint back office ("JBO") participants upon a margin basis which is satisfactory to both parties, provided the requirements of Regulation T Section 220.7 and CBOE Rule 13.4 are adhered to and the account has a minimum equity of not less than \$1,000,000. If equity is below \$1,000,000 the carrying organization must issue a call for additional funds or securities which shall be obtained within five business days.

(h) Notwithstanding any provisions of paragraphs (b) through (g) and (k) hereof, the Exchange may at any time impose higher margin requirements in respect of positions in any security (including any series of options dealt in on an exchange) when it deems such higher margin requirements to be advisable in light of the price of the security or in light of existing market conditions pertaining generally or with respect to such security.

(i) For the purpose of effecting new securities transactions and commitments, the customer shall be required to deposit margin or have equity in cash and/or securities in the account which shall be at least the greater of:

(1) The amount specified in Regulation T of the Board of Governors of the Federal Reserve System[,] *and, in respect of security futures contracts, SEC Rules 400 through 406 under the Exchange Act and CFTC Rules 41.42 through 41.48, or*

(2) The amount specified in paragraphs (b), [and] (c) *and (k)* of this Rule, or

(3) Such greater amount as the Exchange may from time to time require for specific securities, or

(4) Equity of at least \$2,000 except that cash need not be deposited in excess of the cost of any security purchased (this equity and cost of purchase provision shall not apply to "when distributed" securities in a cash account).

Withdrawals of cash or securities may be made from any account which has a debit balance, "short" position or commitments, provided the account is in compliance with Regulation T of the Board of Governors of the Federal Reserve System *and the security futures contract margin requirements pursuant*

*to SEC Rules 400 through 406 under the Exchange Act and CFTC Rules 41.42 through 41.48, and after such withdrawal the equity in the account is at least the greater of \$2,000 or an amount sufficient to meet the maintenance margin requirements of this Rule.*

(j) Reserved

(k) *Security Futures Contracts. Nothing in this paragraph (k) or other rules of this Chapter XII shall be applicable to security futures contract transactions and positions in a futures account.*

(1) *General Rule. In relation to security futures contracts, no member organization may effect a transaction or carry an account for a customer, whether a member or nonmember of the Exchange, without proper and adequate margin in accordance with this Chapter XII, all other applicable rules of the Exchange, SEC Rules 400 through 406 under the Exchange Act and CFTC Rules 41.42 through 41.48. No transaction in a security futures contract may be effected, nor may a position in a security futures contract be carried, in a securities cash account.*

(2) *Time Allowed for Obtaining Margin. If initial or maintenance margin owed is not obtained prior to the day on which the account is deemed undermargined for purposes of SEC Rule 15c3-1(c)(2)(xii), member organizations must comply with the provisions of paragraph (k)(3) below. Extensions of time shall be unavailable.*

(3) *Net Capital. In computing its net capital, a member organization shall deduct any initial or maintenance margin deficiency attributable to security futures contracts in accordance with the undermargined account provision of SEC Rule 15c3-1(c)(2)(xii).*

(4) *Day Trading. Day trading rules shall not be applicable to security futures contracts.*

(5) *Definitions. For the purposes of this paragraph (k), the following terms shall have the meanings specified below.*

(A) *The term "security futures contract" means a "security future" as defined in Section 3(a)(55) of Exchange Act.*

(B) *The term "current market value", with respect to security futures contracts, means "current market value" as defined in SEC Rule 401(4)(i)(A) or (4)(i)(B), whichever is applicable, under the Exchange Act and CFTC Rule 41.43(4)(i)(A) or (4)(i)(B), whichever is applicable.*

(C) *The term "underlying security" means, in the case of physically settled security futures contracts, the security that is delivered upon expiration of the*

contract, and, in the case of cash settled security futures contracts, the security or securities index the price or level of which determines the final settlement price for the security futures contract upon its expiration. The term "underlying security" also means, in the case of a securities index, an underlying stock basket, or equivalent units of a registered investment company meeting the criteria set forth in CBOE Rule 5.3 and the Interpretations and Policies there under.

(D) The term "underlying basket" means, in the case of a securities index, a group of securities futures contracts where the underlying securities as defined in paragraph (C) above include

each of the component securities of the applicable index and which meets the following conditions (i) the quantity of each underlying security is proportional to its representation in the index, (ii) the total market value of the underlying securities is equal to the aggregate value of the applicable index, (iii) the basket cannot be used to offset more than the number of contracts or warrants represented by its total market value, and (iv) the security futures contracts shall be unavailable to support any other contract or warrant transaction in the account.

(6) Exceptions. For the offsetting positions specified in the table below, member organizations may apply the

corresponding initial and maintenance margin requirement minimums, notwithstanding the margin required on a security futures contract pursuant to paragraph (k)(1) above, or on other securities pursuant to paragraphs (b) and (c) of this Rule.

All options referred to mean options on the underlying security, not the security futures contract.

All requirements that are expressed in terms of an option's exercise price, in-the-money amount, and out-of-the-money amount mean the aggregate amount (i.e., multiply by number of shares per contract or the contract multiplier).

	Security futures contract type	Margin account initial requirement	Margin account maintenance requirement
Long and Short Security Futures Contract. same underlying different expiration months same or different market(s)	Single Stock, Narrow-Based Index.	5% of the current market value of the long or short security futures contract, whichever is greater.	Same as initial.
	Single Stocks vs. Narrow-Based Index 1.	5% of the current market value of the long or short security futures contract(s), whichever is greater.	Same as initial.
Long and Short Security Futures Contract. same underlying same expiration month different markets 2	Single Stock Narrow-Based Index	3% of the current market value of the long or short security futures contract, whichever is greater.	Same as initial.
Long Security Futures Contract and Short Underlying. same underlying	Single Stock .....	None required on long security futures contract. Short sale proceeds plus 50% requirement on short stock position.	None required on long security futures contract. Short stock requirement is 105% of stock market value.
	Narrow-Based Index .....	None required on long security futures contract. Short sale proceeds plus 50% requirement on short stock basket.3.	None required on long security futures contract. Short stock basket requirement is 105% of basket market value.
Long Security Futures Contract and Short Call. same underlying	Single Stock, Narrow-Based Index.	20% of the current market value of the long security futures contract plus any call in-the-money amount. None required on short call. Proceeds from the call sale may be applied.	20% of the current market value of the long security futures contract plus any call in-the money amount.
	Single Stocks 4 vs. Narrow-Based Index Call Option. Narrow-Based Indices 4 vs. Broad-Based Index Call Option.	20% of the current market value of the long basket of security futures contracts plus any call in-the-money amount. None required on short index call. Proceeds from the call sale may be applied.	20% of the current market value of the long basket of security futures contracts plus any call in-the-money amount.
Long Security Futures Contract and Long Put. same underlying	Single Stock, Narrow-Based Index.	20% of the current market value of the long security futures contract Pay for long put in full.	10% of the put exercise price plus any put out-of-the-money amount or 20% of the current market value of the long security futures contract, whichever is lower.
	Single Stocks 4 vs. Narrow-Based Index Call Option. Narrow-Based Indices 4 vs. Broad-Based Index Put Option.	20% of the current market value of the long basket of security futures contracts. Pay for long index put in full.	10% of the index put exercise price plus any put out-of-the-money amount or 20% of the current market value of the long basket of security futures contracts, whichever is lower.
Short Security Futures Contract and Long Underlying. same underlying	Single Stock .....	None required on the short security futures contract. 50% requirement on long stock position.	5% of the current market value of the long stock position.

	Security futures contract type	Margin account initial requirement	Margin account maintenance requirement
Short Security Futures Contract and Long Marginable Convertible 5. same underlying	Narrow-Based Index .....	None required on the short narrow-based security futures contract. 50% requirement on long stock basket. <sup>4</sup>	5% of the current market value of the long stock basket 4
	Single Stock .....	None required on the short security futures contract. 50% requirement on long convertible security.	10% of the current market value of the long convertible security.
	Single Stock .....	20% of the current market value of the short security futures contract. Pay for long call in full.	10% of the call exercise price plus any call out-of-the-money amount or 20% of the current market value of the short security futures contract, whichever is lower.
Short Security Futures Contract and Long Call 6. same underlying	Single Stocks 4 vs. Narrow-Based Index Call Option. Narrow-Based Indices 4 vs. Broad-Based Index Call Option.	20% of the current market value of the short basket of security futures contracts. Pay for long index call in full.	10% of the index call exercise price plus any call out-of-the-money amount or 20% of the current market value of the short basket of security futures contracts, whichever is lower.
	Single Stock .....	20% of the current market value of the short security futures contract plus any put in-the-money amount. None required on short put. Proceeds from the put sale may be applied.	20% of the current market value of the short security futures contract plus any put in-the-money amount.
	Single Stocks 4 vs. Narrow-Based Index Put Option. Narrow-Based Indices 4 vs. Broad-Based Index Put Option.	20% of the current market value of the short basket of security futures contracts plus any put in-the-money amount. None required on short index put. Proceeds from the index put sale may be applied.	20% of the current market value of the short basket of security futures contracts plus any put in-the-money amount.
Short Security Futures Contract and Short Put. same underlying	Single Stock .....	20% of the current market value of the short security futures contract plus any put in-the-money amount. None required on short put. Proceeds from the put sale may be applied.	20% of the current market value of the short security futures contract plus any put in-the-money amount.
	Single Stocks 4 vs. Narrow-Based Index Put Option. Narrow-Based Indices 4 vs. Broad-Based Index Put Option.	20% of the current market value of the short basket of security futures contracts plus any put in-the-money amount. None required on short index put. Proceeds from the index put sale may be applied.	20% of the current market value of the short basket of security futures contracts plus any put in-the-money amount.
Long Security Futures Contract, Short Call and Long Put. same underlying put and call must have same exercise price	Single Stock .....	20% of the current market value of the long security futures contract(s) plus any call in-the-money amount. Pay for long put in full. None required on short call. Proceeds from call sale may be applied.	10% of the exercise price plus any call in-the-money amount.
	Narrow Based Index. Single Stocks 4 vs. Narrow-Based Index Options. Narrow-Based Indices 4 vs. Broad-Based Index Options.	20% of the current market value of the long security futures contract(s) plus any call in-the-money amount. Pay for long put in full. None required on short call. Proceeds from call sale may be applied.	10% of the exercise price plus any call in-the-money amount.
Long Security Futures Contract, Short Call and Long Put. same underlying put exercise price must be below call exercise price	Single Stock .....	20% of the current market value of the long security futures contract(s) plus any call in-the-money amount. Pay for long put in full. None required on short call. Proceeds from call sale may be applied.	10% of the put exercise price plus any put out-of-the-money amount, or 20% of the call exercise price plus any call in-the-money amount, whichever is lower.
	Narrow Based Index. Single Stocks 4 vs. Narrow-Based Index Options. Narrow-Based Indices 4 vs. Broad-Based Index Options.	20% of the current market value of the long security futures contract(s) plus any call in-the-money amount. Pay for long put in full. None required on short call. Proceeds from call sale may be applied.	10% of the put exercise price plus any put out-of-the-money amount, or 20% of the call exercise price plus any call in-the-money amount, whichever is lower.
Short Security Futures Contract, Long Call and Short Put. same underlying put and call must have same exercise price	Single Stock .....	20% of the current market value of the short security futures contract(s) plus any call in-the-money amount. Pay for long put in full. None required on short put. Proceeds from put sale may be applied.	10% of the exercise price plus any put in-the-money amount.
	Narrow Based Index. Single Stocks 4 vs. Narrow-Based Index Options. Narrow-Based Indices 4 vs. Broad-Based Index Options.	20% of the current market value of the short security futures contract(s) plus any call in-the-money amount. Pay for long put in full. None required on short put. Proceeds from put sale may be applied.	10% of the exercise price plus any put in-the-money amount.

1 A long (short) basket of security futures contracts on individual equities offset with a short (long) security futures contract on a narrow-based index. A basket of security futures contracts must qualify as an "underlying basket" in accordance with CBOE Rule 12.3(k)(5)(D).

2 Contract specifications must be substantively identical.

3 The stock basket must qualify as an "underlying stock basket" in accordance with CBOE Rule 12.3(a)(7).

4 A basket of security futures contracts must qualify as an "underlying basket" in accordance with CBOE Rule 12.3(k)(5)(D).

5 The convertible security must be immediately exchangeable for or convertible into, without restriction (including the payment of money), the security underlying the single stock future.

6 A long warrant (issued by the issuer of the underlying security) is also permitted (single stock futures only). The long warrant must be paid for in

full and shall have no value for margin purposes.

\* \* \* Interpretations and Policies:

.01-.15 No change

Rule 12.4 No change

Rule 12.5. Determination of Value for Margin Purposes

Positions in active securities, except security futures contracts, dealt in on a recognized exchange (including option contracts) shall, for margin purposes, be valued at current market value prices; provided that, whether or not dealt in on an exchange, only those options

contracts on a stock or stock index, or a stock index warrant, having an expiration that exceeds 9 months and which are listed or guaranteed by the carrying broker-dealer, may be deemed to have market value for the purposes of Rule 12.3(c). *Security futures contracts shall have no value for margin purposes.* Positions in other securities shall be valued conservatively in the light of current market prices and the amount of anticipated realization upon a liquidation of the entire position. Substantial additional margin must be required in all cases where the securities carried are subject to unusually rapid or violent changes in value, or where the amount carried is such that they cannot be liquidated promptly.

12.6 No change

12.7 No change

12.8 No change

#### Rule 12.9. Meeting Margin Calls by Liquidation Prohibited

No Member Organization shall permit a customer to make a practice of effecting transactions requiring initial or additional margin or full cash payment and then furnishing such margin or making such full cash payment by liquidation of the same or other commitments. The provisions of this Rule shall not apply to *margin calls attributable to security futures contract transactions nor to any account maintained for another broker or dealer, exclusive of the partners, officers and directors of such other broker or dealer, provided such other broker or dealer is a Member Organization of the Exchange or has agreed in good faith with the Member Organization carrying the account that he will maintain a record equivalent to that referred to in Rule 12.12 of these Rules.*

\* \* \* \* \*

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

In its filing with the Commission, 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, the Proposed Rule Change

#### 1. Purpose

CBOE is proposing to amend its margin rules, in a manner consistent with the joint margin regulations of the Commission and the Commodity Futures Trading Commission ("CFTC")<sup>4</sup> to incorporate security futures. Specifically, CBOE is proposing to add a new provision (k) to CBOE Rule 12.3 to address margin for security futures contracts. The proposed amendments would: (1) Require the initial and maintenance margin for security futures contracts to be 20 percent unless an offset provision provides for a different margin requirement or the positions are excluded from CBOE Rule 12.3(k); (2) allow for good faith margin of certain positions in security futures contracts; (3) clarify that security futures contracts have no value for margin purposes; (4) make necessary conforming changes to other CBOE margin provisions; and (5) make some non-substantive changes to CBOE margin rules for consistency purposes.

The passage of the Commodity Futures Modernization Act of 2000 (the "CFMA")<sup>5</sup> in December of 2000 enabled futures contracts on individual stocks and narrow-based indexes to be traded in the United States for the first time. The CFMA conferred upon the Board of Governors of the Federal Reserve System (the "FRB") authority to set margin requirements for security futures contracts. The FRB delegated this authority to the SEC and the CFTC jointly, as permitted by the CFMA. The SEC and the CFTC have jointly issued rules and regulations.<sup>6</sup>

CBOE's proposed margin requirements for security futures contracts would adopt the provisions of the joint regulations of the SEC and CFTC ("Joint Regulations").<sup>7</sup> Proposed new provision (k) to CBOE Rule 12.3 would require compliance with the security futures contract margin requirements of the SEC and CFTC, in addition to the Exchange margin rules and Regulation T of the FRB. Therefore, under proposed CBOE Rule 12.3(k)(1), the initial and maintenance margin requirement for a security futures contract would be 20 percent of the current market value of the contract

unless an offset provision enumerated in 12.3(k) or another rule provided for a different margin requirement.

The current market value of the contract would be calculated on a mark-to-market basis at the conclusion of each trading day. Based on the mark-to-market value of a security futures contract, a variation settlement amount could be debited from or credited to a customer's account balance at the conclusion of the trading day. These variation settlement entries represent actual cash withdrawals from, or deposits to, the account that will change its cash balance in the same way as would any other routine cash withdrawal or deposit. When account equity is computed, variation settlement amounts are automatically accounted for in that they can be viewed as integrated into the cash balance, which is a component of the formula for computing equity. Proposed CBOE Rule 12.3(k)(2) would set a time limit for obtaining required margin by incorporating by reference under CBOE Rule 12.3(k)(3) the same time frame that the SEC's Net Capital Rule<sup>8</sup> permits maintenance margin calls to remain unsatisfied before the member organization must deduct the maintenance margin deficiency in computing its net capital. In other words, under the SEC's rules, if a customer did not satisfy an initial or maintenance margin call on a security futures contract for five days, the broker or dealer carrying that customer's security futures positions would be required to take a deduction for the undermargined customer account when computing its own net capital.

CBOE Rule 12.3(k)(4) would expressly state that day trading rules do not apply to security futures contracts. CBOE believes that a level playing field should be maintained between the securities and futures industries. Securities accounts would be at a competitive disadvantage to futures accounts if CBOE, or any other securities self-regulatory organization, were to impose day trading (*i.e.*, intra-day) margin requirements on security futures contract transactions in securities accounts, because futures accounts are not subject to day trading margin requirements. Moreover, the Joint Regulations do not implement a day trading (*i.e.*, intra-day) margin requirement.

Consistent with the Joint Regulations, the Exchange is proposing lower margin requirements for a security futures contract held in conjunction with an offsetting position in another security

<sup>4</sup> See Securities Exchange Act Release No. 46292 (August 1, 2002), 67 FR 53146 (August 14, 2002).

<sup>5</sup> Appendix E of the Pub. L. 106-554, 114 Stat. 2763 (2000).

<sup>6</sup> See note 4, *supra*.

<sup>7</sup> 17 CFR 242.400 through 242.406 and 17 CFR 41.42 through 41.49.

<sup>8</sup> 17 CFR 240.15c3-1(c)(2)(xii).

futures contract, an underlying security, or an option on an underlying security. Such lower margin requirements are appropriate for these offsetting positions since the risk of the combined positions is lower than the risk of the positions viewed separately.<sup>9</sup> Therefore, the Exchange proposes to incorporate all of the offsets identified in the Supplementary Information section of the **Federal Register** release announcing the final Joint Regulations, except for the offset involving a broad-based index future (No. 17), as a broad-based index future cannot be carried in a securities account.<sup>10</sup> Under the enumerated offsets, a person could have a margin requirement for a position in security futures contracts that was lower than 20 percent. For example, a person holding a long and a short securities futures contract in the same underlying security, but having different expiration months, would have a margin requirement of five percent of the current market value of the long or short contract, whichever is greater. Under another offset provision, a person holding long and short security futures contracts in the same underlying security, with the same expiration month, but listed and traded on different markets, would have a three percent margin requirement. The offsets would be listed in table format under proposed CBOE Rule 12.3(k)(6).

A number of offsets involve a basket of security futures contracts. For example, a basket of security futures contracts on individuals stocks may serve as an offset to a security futures contract on a narrow-based index or option on a narrow-based index. Also, a basket of narrow-based security futures contracts may serve as an offset to an option on a broad-based index. A definition of "underlying basket" as pertains to security futures contracts is proposed.<sup>11</sup> The primary purpose of the definition of "underlying basket" is to require that the composition of the basket match the composition of the index being offset.

The Exchange proposes to amend CBOE Rule 12.3(f) (Market-Maker and Specialist Accounts) to permit options market-makers to receive good faith margin treatment for hedging transactions in security futures contracts that are based on the same underlying security as the options in which they make markets. In addition, security futures contracts that qualify for the exclusion from margin under the Joint

Regulations<sup>12</sup> would be subject to margin that is satisfactory to the member and the carrying broker or dealer.

CBOE proposes other amendments to the margin rules. Proposed changes to CBOE Rule 12.5 would clarify that security futures contracts have no value for margin purposes. Proposed amendments to CBOE Rule 12.2, Time Margin Must Be Obtained, and CBOE Rule 12.9, Meeting Margin Calls by Liquidation Prohibited, would clarify that these rules do not apply to security futures contracts. The proposed rule change also makes necessary conforming changes to other margin provisions,<sup>13</sup> and other non-substantive changes being proposed for consistency purposes.

## 2. Statutory Basis

The Exchange believes the proposed rule change is consistent with section 6(b) of the Exchange Act<sup>14</sup> in general and furthers the objectives of section 6(b)(5) of the Exchange Act<sup>15</sup> in particular in that it should promote just and equitable principles of trade, serve to remove impediments to and perfect the mechanism of a free and open market and a national market system, and protect investors and the public interest. CBOE notes that the proposed rules are intended to implement the margin requirements for security futures contracts in the Joint Regulations. CBOE believes that the proposed rule change would remove impediments to trading security future contracts and promote just and equitable principles of trade by incorporating security futures and appropriate offsets into CBOE's margin rules in a manner that will promote competition and permit people to utilize security futures contracts for hedging purposes. As such, 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

This proposed rule change does not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

## 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, including whether the proposed rule change, as amended, is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. 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 Section, 450 Fifth Street, NW., Washington, DC 20549. Copies of such filing will also be available for inspection and copying at the principal office of CBOE. All submissions should refer to the File No. SR-CBOE-2002-67 and should be submitted by January 6, 2003.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>16</sup>

**Margaret H. McFarland,**  
Deputy Secretary.

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<sup>9</sup> In some cases only lower maintenance margin levels are proposed.

<sup>10</sup> See note 4, *supra*.

<sup>11</sup> See proposed CBOE Rule 12.3(k)(5)(D).

<sup>12</sup> SEC Rule 400(c)(2)(v); CFTC Rule 41.42(c)(2)(v).

<sup>13</sup> See Proposed CBOE Rules 12.3(b), (f)(1)(A) and (D), (2)(A), (3)(A)(i), (A)(ii), (A)(iii) and (A)(iv), (g)(i), (h), and (i)(2).

<sup>14</sup> 15 U.S.C. 78f(b).

<sup>15</sup> 15 U.S.C. 78f(b)(5).

<sup>16</sup> 17 CFR 200.30-3(a)(12).