



Regulatory Circular RG12-043

To: Trading Permit Holders and
Clearing Trading Permit Holders

From: Division of Regulatory Services

Date: March 6, 2012

Subject: Product Description, Margin and Net Capital Requirements
- Options on the CBOE Brazil ETF Volatility Index

Exchange	Bill Speth (Product Description)	(312) 786-7141
Contacts:	James Adams (Margin)	(312) 786-7718
	Robert Gardner (Net Capital)	(312) 786-7937

KEY POINTS

- On March 6, 2012, the Chicago Board Options Exchange (the “CBOE” or “Exchange”) plans to commence trading of options on the CBOE Brazil ETF Volatility Index. Options will trade under the ticker symbol “VXEWZ.”
- VXEWZ options are cash-settled, European style and have a \$100 multiplier.
- The CBOE Brazil ETF Volatility Index represents an up-to-the-minute estimate of the expected 30-day volatility of the iShares MSCI Brazil Index Fund (EWZ) and is derived by applying the CBOE Volatility Index (VIX) methodology to EWZ options traded on CBOE.
- For strategy-based customer margin requirements, narrow-based index option margin requirements apply to **short** VXEWZ options (20% basic / 10% minimum).
- Net capital treatment for VXEWZ options will be similar to narrow-based index options. Margin and net capital requirements are described in detail below.

DISCUSSION

PRODUCT DESCRIPTION

The CBOE will list cash-settled, European-style option contracts on the CBOE Brazil ETF Volatility Index (Ticker: VXEWZ) on or about March 6, 2012.

VXEWZ is an up-to-the-minute market estimate of the expected 30-day volatility of the iShares MSCI Brazil Index Fund (EWZ). Calculation of the index is based on the CBOE Volatility Index (VIX) methodology, applied to CBOE listed options on EWZ. VXEWZ uses real-time bid/ask quotes of nearby and second nearby options with at least 8 days left to expiration, and weights these options to yield a constant, 30-day measure of expected volatility.

The contract multiplier for VXEWZ options will be \$100. The minimum tick for VXEWZ option series trading below \$3 is 0.05 (\$5.00); above \$3 is 0.10 (\$10.00).

VXEWZ option series may be listed with minimum strike price intervals of not less than 1 point, subject to certain conditions that are described in Rule 24.9.01(i). Initially, in-, at- and out-of-the-money strike prices will be listed. New strikes can be added as the calculated forward value of the index moves up or down and upon request.

Initially, CBOE plans to list VXEWZ options expiring in April, May and June. CBOE may list up to six VXEWZ options contract months, provided that the time to expiration is not greater than 12 months.

VXEWZ options have European-style exercise; options generally may be exercised only on the Expiration Date.

The last day to trade expiring VXEWZ options will be the business day prior to the Expiration Date. The Expiration Date for VXEWZ options will be the Wednesday that is thirty days prior to the third Friday of the calendar month immediately following the month in which the contract expires. If the third Friday of the month immediately following the month in which the contract expires is a CBOE holiday, the last day to trade and the Expiration Date for the contract shall be thirty days prior to the CBOE business day immediately preceding that Friday.

VXEWZ options are A.M.-settled; the exercise-settlement value for options on VXEWZ shall be a Special Opening Quotation ("SOQ") of VXEWZ (Ticker – VXEST) calculated from the sequence of opening prices, as traded on CBOE, of a single strip of EWZ options expiring 30 days after the VXEWZ settlement date. The opening price for any series in which there is no trade shall be the average of that option's bid price and ask price as determined at the opening of trading. Exercise will result in delivery of cash on the business day following expiration. The exercise-settlement amount is equal to the difference between the exercise-settlement value and the exercise price of the option, multiplied by \$100. If the exercise-settlement value is not available or the normal settlement procedure cannot be utilized due to a trading disruption or other unusual circumstance, the final settlement value will be determined in accordance with the rules and bylaws of The Options Clearing Corporation.

Please note that the "time to expiration" used to calculate the SOQ of the VXEWZ Index on the Expiration Date is 30 days *plus* 390 minutes. This adjustment is intended to reflect the fact that EWZ options are P.M.-settled.

The position limit for VXEWZ options is 50,000 contracts on either side of the market with no more than 30,000 contracts in the nearest expiration month.

Trading hours for VXEWZ options are 8:30 a.m. to 3:15 PM Central Time (Chicago time).

Questions regarding product specifications should be directed to Bill Speth, Research Department, at (312) 786-7141.

Detailed product specifications may be found on the CBOE website at the following URL:

www.cboe.com/VXEWZ

CUSTOMER MARGIN

Narrow-based index option margin requirements apply to VXEWZ options [CBOE Rule 12.3(c)(5)], except that the current (“cash”) index value is **not** used to compute the requirements for short options. VXEWZ options are expected to price in relation to the price of the securities futures contract having a settlement month that coincides with the expiration month of the option. Therefore, the price of the securities futures contract (traded on the CBOE Futures Exchange, ticker symbol VXEW) with a settlement month that matches the expiration month of the option must be used. If there is no futures contract with a settlement month that matches the expiration month of the option, use the next futures contract settlement month that is available going forward. If there is no futures contract settlement month going forward, use the last futures contract settlement month available chronologically.

Purchases of VXEWZ options must be paid for in full. For purchases of options with more than 9 months until expiration, Exchange rules permit a minimum margin requirement of 75% of the total cost (option current market value) to be deposited (maintained). When time to expiration reaches 9 months, the option no longer has value for margin purposes.

The initial and maintenance margin requirement for a short put or call is 100% of the option proceeds* plus 20% of the aggregate contract value (current index value x \$100) minus the amount by which the option is out-of-the-money, if any, subject to a minimum for calls of option proceeds* plus 10% of the aggregate contract value and a minimum for puts of option proceeds* plus 10% of the aggregate put exercise price amount. (*For calculating maintenance margin, use current market value instead of option proceeds.)

Spreads and straddles are permitted for VXEWZ options having equivalent aggregate underlying values. In respect of calendar spreads, member organizations are reminded that VXEWZ options are European style. It is possible that the spread margin requirement could be, or become, insufficient to cover the assignment obligation on the short option if the long option cannot be exercised and it is trading at less than its intrinsic value in relation to the price of the futures contract or current index value that determines the intrinsic value of the short option. Therefore, member organizations must apply “house” margin requirement policies and procedures for calendar spreads with European style options in order to insure that sufficient margin is held to cover the risk.

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

VXEWZ options are eligible for portfolio margining. A new Product Group will be created (Emerging Markets Volatility). At this time, no offsets with other classes are allowed. The portfolio margin requirement will be equal to the maximum potential loss over a range of market movements covering +/-15%. VXEW security futures contract prices will be utilized to compute theoretical option prices rather than the current (“cash”) index value. All positions are subject to a minimum charge of \$37.50 per contract, except that the minimum charge for long options will not exceed the market value. These requirements are Exchange minimums. House portfolio margin requirements may be greater.

OPTION MARKET-MAKER MARGIN REQUIREMENTS

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

VXEWS options and VXEWS security futures positions of a VXEWS options market-maker are eligible for cross-margin treatment in a cross-margin account carried for the options market-maker by a clearing trading permit holder. If cross-margining is accommodated in a futures account, a futures account must be used exclusively for carrying CBOE and CFE products that are cross-marginable. The SPAN file will be updated to take any risk offsets between VXEWS options and VXEWS security futures into consideration and render a margin requirement accordingly. Additionally, a risk-based haircut ("RBH") must be computed on the cross-margin account positions. If the RBH is greater than the SPAN margin requirement, the RBH must be used as the margin requirement in lieu of the SPAN margin requirement.

VXEWS security futures may be carried in a securities account. If a clearing firm is capable of accommodating security futures in a securities account, VXEWS security futures that hedge market-making positions in VXEWS options may be carried in a VXEWS options market-maker account on a good-faith margin basis.

It should be noted that at OCC, VXEWS options are eligible for a market professional cross-margin account, in which offsetting positions in VXEWS options and VXEWS security futures may be combined. A cross-margin account for a market professional must be set-up exclusively for carrying CBOE and CFE products that are cross-marginable. OCC currently requires that both VXEWS options and VXEWS security futures be cleared and carried by the same OCC clearing member (i.e., a dual broker-dealer / FCM) in order to establish market professional cross-margin accounts at OCC.

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

For risk-based haircuts, a new Product Group will be created for VXEWS options.¹ The risk-based haircut will be equal to the maximum potential loss calculated over a range of market movements covering +/-15% for options market-makers and all other broker-dealers. VXEWS security futures contract prices will be utilized to compute theoretical option prices rather than the current ("cash") index value.¹ All positions are subject to a minimum charge of \$25 per contract, except that the minimum charge for long positions will not exceed the market value. VXEWS security futures will be included in the same Product Group with a 100% offset.

For those firms not utilizing risk-based haircuts, the haircut will be calculated pursuant to the alternative strategy based method of SEC Rule 15c3-1a.

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

¹ Risk-based haircuts may be applied pursuant to SEC Rule 15c3-1a (Appendix A).