

Regulatory Circular RG96-86

Date: October 3, 1996
To: The Membership
From: Department of Financial Compliance
Subject: Capital and Margin Requirements for the Goldman Sachs Technology Indexes ("GSTI")

On September 27, 1996 the Chicago Board Options Exchange ("CBOE") began trading seven index options based on the Goldman Sachs Technology Indexes. The GSTI consists of one composite index and six subindexes¹. The GSTI Composite is a broad based, capitalization-weighted contract and the GSTI Subindexes are narrow-based, modified-capitalization weighted contracts. All the indexes are cash settled, European style contracts. The underlying index securities trade on either the New York or American stock exchanges or the National Association of Securities Dealers Automated Quotations System. This circular explains the margin and capital treatment applicable to transactions in GSTI options.

MARGIN

The GSTI Composite is considered a broad-based option for margin purposes and subject to the margin requirements specified in CBOE Rule 24.11(b)(i). The margin requirement for a broad-based short index put or call is 100% of the option premium plus 15% of the underlying index value, less the out-of-the-money dollar amount, if any, to a minimum of 100% of the premium plus 10% of the underlying index value. The GSTI Subindexes are considered narrow-based options for margin purposes and are subject to the margin requirements specified in CBOE Rule 24.11(b)(ii). The margin requirement for a narrow-based short index put or call is 100% of the option premium plus 20% of the underlying index value, less the out-of-the-money dollar amount, if any, to a minimum of 100% of the premium plus 10% of the underlying index value. Pursuant to Regulation T Section 220.18, a long option position must be paid for in full. Spreads and straddles are permitted for options covering the same number of shares of the same underlying index. Members should be aware that due to their

¹The six subindexes are GSTI Hardware, GSTI Internet, GSTI Multimedia Networking, GSTI Semiconductor, GSTI Services and GSTI Software.

exercise feature, it is possible for European-style options to trade at a discount to their intrinsic values. It is possible that the spread margin held by the carrying broker could become insufficient to cover the assignment obligation on the short option if the customer is unable to exercise the long option and it is trading at a discount to its intrinsic value.

OPTION MARKET-MAKER MARGIN REQUIREMENTS

With the concurrence of the staff of the Board of Governors of the Federal Reserve System, the Securities and Exchange Commission ("SEC") has taken a no-action position allowing good faith credit to be extended to GSTI Index market-makers on a basket of underlying securities in accordance with the "permitted offset" provisions of Regulation T, Section 220.12. For a basket to qualify as a permitted offset position, it must be comprised of all of the securities in the underlying index in exact proportion to the index.

CAPITAL

For capital purposes, GSTI options are treated as narrow-based options. Under risk-based haircuts, the haircut is equal to the maximum potential loss for each index calculated over a range of market movements of $\pm 15\%$ for all broker-dealers.² All the GSTI options, with the exception of the GSTI Services, are included in a product group for haircut purposes³. Within each product group a 75% offset of gains versus losses at the same valuation point is available. Additionally, there is a minimum charge of \$25 per contract. For those firms not utilizing risk-based haircuts, the haircut will be calculated pursuant to SEC Rule 15c3-1(c)(2)(x) or Appendix A.

²Risk-based haircuts are applied pursuant to a SEC staff no-action letter dated March 15, 1994 from Brandon Becker, Director, SEC Division of Market Regulation, to Mary L. Bender, CBOE, and Timothy Hinkes, OCC.

³ There are three technology product groups.

1. Technology Product Group - CBOE Technology 30 (TXX), PSE High Technology (PSE), AMEX Computer Technology (XCI) and Morgan Stanley High Technology (MSH), CBOE Computer Software Index (CWX), GSTI Composite (GTC), GSTI Hardware (GHA), GSTI Software (GSO) and GSTI Multimedia Networking (GIP).
2. Internet Product Group - GSTI Internet (GIN), CBOE Internet Index (INX) and AMEX Interactive Index (IIX).
3. Semiconductor Product Group - GSTI Semiconductor (GSM) and PHLX Semiconductor Index (SOX).

Basket haircut treatment is available to GSTI options and offsetting securities baskets. The basket must represent 100% of the composition of the index. A 95% offset between the basket and the options will be applied with a minimum haircut equal to 5% of the aggregate underlying index value.

Questions regarding the margin and capital treatment of GSTI options should be directed to Diane Malley at (312) 786-7924 or Rich Lewandowski at (312) 786-7183.