

**REGULATORY CIRCULAR RG98-61**

June 5, 1998

TO: Members and Member Organizations

ATTENTION: Chief Executive Officers/Managing Partners/  
Compliance Officers/Senior Registered Options Principals

FROM: Capital Markets Division

SUBJECT: TARGETS TRUST I

*Please note two changes on page three of this Regulatory Circular, which is a revision of Regulatory Circular No. 98-56 issued on May 28, 1998. 1) Relating to haircut offsets in paragraph three under Margin and Capital Requirements. 2) Eliminating the need for special account approval in paragraph two under sales practices.*

The following Securities are the subject of a Preliminary Prospectus and will commence trading on a date to be announced (Ticker Symbol: TCX; CUSIP: 87612V108).

Targeted Growth Enhanced Term Securities ("TARGETS")  
With Respect to the Common Stock of Cisco Systems, Inc.  
Due on   \*  .

Holders of the TARGETS will receive periodic cash distributions of   \*   per security on each   \*     \*     \*  , beginning   \*  , 1998. At maturity, Holders are entitled to an amount equal to the sum of (A) the product of (i) the Current Market Price\*\* of Cisco common stock as of the Maturity Date multiplied by (ii) the "Exchange Rate" and (B) any previously unpaid "Yield Enhancement Payments". The Exchange Rate shall be one-half (0.5) if the Current Market Price\*\* of the Common Stock on the Maturity Date is less than or equal to the Appreciation Threshold Price\*. If the Current Market Price is greater than the Appreciation Threshold Price, then the Exchange Rate shall be a fraction -- the numerator being the Appreciation Threshold Price times 0.5 and the denominator being the Current Market Price of the Common Stock as of the Maturity date.

TARGETS represent preferred undivided beneficial ownership interests in the assets of TARGETS Trust 1, a statutory business trust formed under the laws of the State of Delaware ("Trust"). The Trust exists for the sole purpose of issuing the Trust Securities and will utilize approximately 85-90% of the proceeds from the sale of the Trust Securities to purchase from Salomon Smith Barney, a forward contract with respect to the common stock of Cisco Systems, Inc. Approximately 10-15% of the proceeds from the sale of the Trust Securities will be used to purchase certain Treasury Securities.

The purpose of this circular is to provide basic information to Members and Member Organizations regarding a proposed new issue of Equity Linked Notes based upon Cisco Systems, Inc. Common Stock and to advise of certain compliance responsibilities when handling transactions in these securities. This is not a sales document and is not intended to be distributed to customers.

\* To be announced

\*\* As more fully described in the Prospectus, the Current Market Price will generally be based on the average price of Cisco common stock during the 10 days prior to maturity.

## **CERTAIN RISK FACTORS**

- The terms of the TARGETS differ from most types of trust preferred securities in that the payment that a Holder of the TARGETS will receive at maturity is not fixed, but rather will be based on the Market Price of Cisco Common Stock. There can be no assurance that the amount of such payment will be equal to or greater than the amount an investor initially paid for the TARGETS. Therefore, investors in the TARGETS bear the full risk of a decline in the value of the Common Stock prior to maturity of the TARGETS.
- The opportunity for equity appreciation afforded by an investment in the TARGETS is less than the opportunity for appreciation afforded by a direct investment in Cisco Common Stock. As a result of the limitation provided by the Appreciation Threshold Price, holders of the TARGETS will only be entitled to receive at maturity, an amount representing a maximum of   \*   % of any appreciation of the value of the Common Stock.
- The market price at any time will be affected primarily by changes in the price of Cisco Common Stock. It is impossible to predict whether the price of the Common Stock will rise or fall. Trading prices of the Common Stock will be influenced by Cisco's results of operations and by complex and interrelated political, economic, financial and other factors that can affect the capital markets.
- Although the yield on the TARGETS will be higher than the current dividend on Cisco Common Stock, there can be no assurance that this difference will remain throughout the life of the instrument.
- Upon the occurrence of an Acceleration Event, the maturity of the Trust Securities will be accelerated. An Acceleration Event will generally occur upon the occurrence of (i) certain adverse tax consequences of the Trust (ii) the Trust being considered an "investment company" under the Investment Company Act of 1940 or (iii) the bankruptcy of Salomon Smith Barney. As a result, the Treasury Proceeds and the Accelerated Maturity Payment will be distributed to the holders of the TARGETS on the Accelerated Maturity Date.

## **OTHER IMPORTANT INFORMATION:**

- Investors should consider the tax consequences of investing in TARGETS. See "Uncertainty of Federal Income Tax Consequences" in the Prospectus.
- The Securities are backed only by Salomon Smith Barney Holdings, Inc.
- Cisco is not in any way involved with TARGETS and has no obligation with respect to these securities.
- Holders of TARGETS will not be entitled to any rights with respect to Cisco Common Stock including, without limitation, voting rights, and dividends or other distributions.
- TCX will be quoted and traded in round lots of 100, and will trade "flat" without accrued interest.

The foregoing information has been excerpted from the Preliminary Prospectus, and the Exchange assumes no responsibility for the accuracy or completeness of such information. Members and associated persons of member organizations are advised to read both the Preliminary Prospectus and the final Prospectus.

## **REGULATORY CONSIDERATIONS**

## MARGIN AND CAPITAL REQUIREMENTS

For margin and capital purposes, TCX will be considered an equity security. A long TCX position will have an initial and maintenance margin requirement equal to 50% and 25% of market value, respectively.

TCX does not qualify as an options hedge under the Securities and Exchange Commission's Rule 15c3-1 (the "Net Capital Rule") or the Exchange's margin rules. Therefore, members should be aware that making markets in or trading TCX, or any structured product that does not qualify as an options hedge, will subject the member to the provisions of the Net Capital Rule. Members should refer to Regulatory Circular RG 97-40 for further information regarding capital requirements and structured products.

For capital purposes, TCX positions will be subject to a haircut equal to 15% of market value. Currently, there are no haircut offsets for related derivative securities. It should be noted, however, that the CBOE believes that this may soon change, as the SEC is reviewing a proposal to allow haircut offsets for related derivatives with regards to equity linked products in general and for TCX in particular. Further information will be forthcoming as it becomes available.

## SALES PRACTICES

TCX is considered an equity security and is subject to the provisions of Rule 30.50. A customer's account is not required to be options approved. Members and associated persons of member organizations should take such steps as may be reasonably necessary to assure that prospective purchasers of TCX reach an investment decision only after carefully considering the suitability of the security in light of their particular financial circumstances and objectives.

Members and Member Organizations should not recommend purchases or sales in TCX unless they have reason to believe that the recommended transaction is suitable for such customer in light of the customer's financial circumstances and objectives.

SEC Rule 10a-1 ("short sales") applies to TCX as do "front-running" prohibitions.

\* \* \*

Questions regarding suitability of customers transactions in these securities should be directed to Larry Bresnahan (312) 786-7713 and questions regarding marginability should be directed to Jim Adams (312) 786-7718. General product questions should be directed to Nick Parcharidis of the Capital Markets Division (212) 803-1411.