

I. Description of the Proposed Rule Change

CBOE has proposed to amend its margin rules, in a manner consistent with the joint margin regulations of the Commission and the Commodity Futures Trading Commission ("CFTC")⁵ to incorporate security futures. Specifically, the proposed rule change adds a new provision (k) to CBOE Rule 12.3 to address margin for security futures contracts. Proposed Rule 12.3(k) 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.

CBOE's proposed margin requirement for security futures contracts would adopt the applicable provisions of the Joint Regulations of the SEC and CFTC ("Joint Regulations").⁶ In particular, CBOE Rule 12.3(k) 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 Federal Reserve Board. Accordingly, 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.⁷

Proposed CBOE Rules 12.3(k)(2) and 12.3(k)(3) would set a time limit for obtaining required margin by incorporating by reference the same time frame that the SEC's Net Capital

Rule⁸ permits maintenance margin calls to remain unsatisfied before the member organization must deduct the maintenance margin deficiency in computing its net capital. As a result, if a customer did not satisfy an initial or maintenance margin call on a security futures contract for five days, the proposed rule change would require 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 has noted that the Joint Regulations do not include a day trading margin requirement.

The proposed rule change includes lower margin requirements for a security futures contract held in conjunction with an offsetting position in another security futures contract, an underlying security, or an option on an underlying security.⁹ Specifically, the proposed rule change would incorporate the offsets identified in the **Federal Register** release announcing the adoption of the Joint Regulations, except for the offset involving a broad-based index future (No. 17) because a broad-based index future may not be carried in a securities account. In addition, the proposed rule change includes a definition of the term "underlying basket" as pertains to security futures contracts,¹⁰ which would require that the composition of the basket match the composition of the index being offset.

The proposed rule change also would amend CBOE Rule 12.3(f) ("Market-Maker and Specialist Accounts") to permit options market-makers to receive good faith margin treatment from a CBOE member for certain transactions in security futures contracts that are based on the same underlying security as the options in which they make markets. In addition, the proposed rule change provides that security futures contracts that qualify for the "security futures dealer" exclusion from margin under the Joint Regulations¹¹ would be subject to margin that is satisfactory to the member and the carrying broker or dealer.

Proposed changes to CBOE Rule 12.5 ("Determination of Value for Margin Purposes") 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 would also make necessary conforming changes to other margin provisions,¹² and other changes for consistency purposes.

II. Discussion

After careful review, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.¹³ In particular, the Commission believes that the proposed rule change is consistent with the requirements of section 6(b)(5) of the Act,¹⁴ which requires, among other things, that the rules of the Exchange be designed to promote just and equitable principles of trade and, in general, to protect investors and the public interest.¹⁵ In addition, the Commission believes that the proposed rule change is consistent with section 7(c)(2)(B) of the Act,¹⁶ which provides, among other things, that the margin requirements for security futures must preserve the financial integrity of markets trading security futures, prevent systemic risk, be consistent with the margin requirements for comparable exchange-traded options, and provides that the margin levels for security futures may be no lower than the lowest level of margin, exclusive of premium, required for any comparable exchange-traded option.

The Commission believes that the rule change is generally consistent with the customer margin rules for security futures adopted by the Commission and the CFTC. In particular, the Commission notes that, CBOE's proposed rule change provides that, with respect to security futures contracts, its members must collect proper and adequate margin in accordance with the Joint Regulations. As a result, the proposed rule change requires a minimum margin level of 20% of current market value for positions in security futures, which the Commission believes is the minimum margin level necessary to satisfy the

⁵ See Securities Exchange Act Release No. 46292 (August 1, 2002), 67 FR 53146 (August 14, 2002).

⁶ 17 CFR 242.400 through 242.406 and 17 CFR 41.42 through 41.49.

⁷ The current market value of the contract would be calculated on a market-to-market basis at the conclusion of each trading day. Based on the market-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.

⁸ 17 CFR 240.15c3-1(c)(2)(xii).

⁹ In some cases only lower maintenance margin levels are proposed.

¹⁰ See proposed CBOE Rule 12.3(k)(5)(D).

¹¹ SEC Rule 400(c)(2)(v); CFTC Rule 41.42(c)(2)(v).

¹² 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).

¹³ 15 U.S.C. 78s(b)(2).

¹⁴ 15 U.S.C. 78f(b)(5).

¹⁵ In approving the proposed rule, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

¹⁶ 15 U.S.C. 78g(c)(2)(B).