



DIVISION OF
MARKET REGULATION

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

February 25, 1999

Mr. Steven A. O'Malley
Chairman
Clearing Procedures Committee
The Chicago Board of Options Exchange, Inc.
400 South La Salle Street
Chicago, Illinois 60605

Re: Short Futures Options Value Charge

Dear Mr. O'Malley:

This responds to your letter dated December 7, 1998, on behalf of the Clearing Procedures Committee (Regulatory Sub-Committee) ("Committee") of the Chicago Board of Options Exchange ("CBOE"). The Committee requests that the Division of Market Regulation ("Division") not recommend enforcement action to the Securities and Exchange Commission ("Commission") if certain clearing broker-dealers do not take the four percent (4%) charge on short futures options positions carried for the accounts of market makers and specialists when computing net capital pursuant to the Securities Exchange Act of 1934 ("Exchange Act") Rule 15c3-1 (17 CFR 240.15c3-1).

Based on your letter and discussions with the Division staff, I understand the following facts to be pertinent to the Committee's request. A broker-dealer is permitted, pursuant to Appendix A of Rule 15c3-1, to use an approved theoretical options pricing model to calculate capital charges for listed options and related futures and futures options positions. In addition to the capital charges calculated by the model, a broker-dealer is required to deduct from its net worth four percent (4%) of the market value of commodity options sold by option customers, including market-makers and specialists, on or subject to the rules of a contract market in accordance with Rule 15c3-1(b)(a)(3)(x). The four percent (4%) deduction is known as the Short Option Value Charge ("SOVC").

The Committee has requested that a clearing broker-dealer that calculates its capital charges on listed options and related positions pursuant to Appendix A of Rule 15c3-1 not be required to take an SOVC charge for the accounts of market-makers and

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specialists when the market maker or specialist holds a securities index option position and hedges that position with an option on a future in the same index product group.¹ The Committee reasons that the SOVC is unnecessary because the market maker's or specialist's short futures option positions are hedge-positions and because the capital charges calculated pursuant to Appendix A of Rule 15c3-1 adequately address the risks associated with the short futures option positions. In addition, you state that the SOVC creates the risk that a significant increase in the market value of a market maker's or specialist's short futures options positions could force a clearing broker-dealer to liquidate positions in order to avoid a net capital violation without an accompanying actual risk to the clearing broker-dealer.

Based on the foregoing, the Division will not recommend enforcement action if a clearing broker-dealer does not take an SOVC charge for short futures options positions carried for the accounts of market makers or specialists if the clearing broker-dealer calculates its capital charges on listed options and related positions in accordance with paragraph (c)(2)(x) and Appendix A of Rule 15c3-1.

You should be aware that this is a staff position with respect to enforcement only and does not purport to express any legal conclusions. This position is based solely on the foregoing description. Factual variations could warrant a different response, and any material change in the facts must be brought to the Division's attention. This position may be withdrawn or modified if the staff determines that such action is necessary for the protection of investors, in the public interest, or otherwise in furtherance of the purposes of the securities laws.

Sincerely,



Michael A. Macchiaroli
Associate Director

¹ The term "product group" is defined in 17 CFR 240.15c3-1a(a)(6).