



DIVISION OF
TRADING AND MARKETS

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

May 4, 2012

Timothy H. Thompson
Senior Vice President and Chief Regulatory Officer
Chicago Board Options Exchange, Inc.
400 South LaSalle Street
Chicago, IL 60605

Grace B. Vogel
Executive Vice President, Member Regulation
Risk Oversight and Operational Regulation
Financial Industry Regulatory Authority, Inc.
One World Financial Center
200 Liberty Street
New York, NY 10005

Re: Security Futures under Appendix A to Exchange Act Rule 15c3-1

Dear Mr. Thompson and Ms. Vogel:

This responds to your letter dated May 1, 2012, wherein you request that the staff of the Division of Trading and Markets (the "Division") provide you with written assurance that it will not recommend enforcement action to the Securities and Exchange Commission (the "SEC" or "Commission") if broker-dealers, when calculating net capital using a theoretical option pricing model pursuant to Appendix A of Rule 15c3-1 ("Appendix A") under the Securities Exchange Act of 1934 (the "Exchange Act"),¹ group U.S.-listed security futures contracts on individual stocks with equity options on, and positions in, the same underlying instrument under paragraph (b)(1)(ii)(A) of Appendix A.

In 1997, the Commission adopted amendments to Appendix A to permit broker-dealers to employ theoretical option pricing models when calculating net capital for listed options and related positions that hedge those options.² Under the amendments, broker-dealers are allowed to group long and short positions in listed options into specified "portfolio types," and, within each portfolio type, offset a position's gain at any one valuation point with another position's loss at the same valuation point. Paragraph (b)(1)(ii)(A) of Appendix A allows broker-dealers to group long and short listed options positions into a portfolio type that includes "equity options on the same underlying instrument and positions in that underlying instrument."

¹ 17 CFR 240.15c3-1a.

² See Net Capital Rule, Exchange Act Release No. 38248 (Feb. 6, 1997), 62 FR 6474 (Feb. 12, 1997).

When the Commission allowed broker-dealers to use theoretical option pricing models to calculate net capital, security futures trading was prohibited in the United States. This prohibition was repealed, however, by the Commodity Futures Modernization Act of 2000 (the "CFMA"), which established a framework for the joint regulation of security futures products by the SEC and the Commodity Futures Trading Commission.³ Because SEC-registered broker-dealers were prohibited from trading security futures when Appendix A was amended as described above, security futures contracts on individual stocks were not included within the portfolio type specified in paragraph (b)(1)(ii)(A) of Appendix A. Consequently, offsets for purposes of applying net capital deductions to listed options on individual stocks under the theoretical option pricing model provisions of Appendix A are only recognized to the extent they include other equity options on the same underlying stock and the underlying stock, itself.

Security futures contracts on individual stocks represent legally binding agreements between two parties to purchase or sell in the future a specific quantity of shares of a security at a certain price. You represent that trading strategies in the stock market are generally transferable to the stock futures market and that security futures contracts on individual stocks are used by broker-dealers for a variety of portfolio management needs, including hedging positions in equity options on, and positions in, the same underlying instrument. You also represent that the current market value of a security futures contract on an individual stock typically tracks the price of the underlying stock, and, at expiration, the price of the security futures contract equals the price of the underlying stock.

To more accurately measure the risk in a broker-dealer's portfolio, and, concomitantly, the amount of net capital a broker-dealer should maintain with respect to the portfolio, you request that broker-dealers using theoretical option pricing models to calculate net capital under Appendix A be allowed to treat a security futures contract on an individual stock as a position in the "underlying instrument," as that term is defined in paragraph (a)(4) of Appendix A.⁴ As you recognize, had security futures trading not been prohibited when Appendix A was amended in 1997, it is likely that security futures contracts on individual stocks would have been included in the portfolio type described in paragraph (b)(1)(ii)(A) of Appendix A. You contend that treating a security futures contract on an individual stock as if it were an "underlying instrument" would achieve the same result and is not inconsistent with the CFMA or the intended purpose of Appendix A.⁵

³ Pub. L. No. 106-554, 114 Stat. 2763 (2000). The term "security futures product" includes both a security future and any option on a security future. The term "security future" is defined in Exchange Act Section 3(a)(55), and, in general, includes futures contracts on single securities and on narrow-based security indexes.

⁴ The term "underlying instrument" in paragraph (a)(4) of Appendix A refers to "long and short positions, as appropriate, covering the same foreign currency, the same security, or a security which is exchangeable for or convertible into the underlying security within a period of 90 days. If the exchange or conversion requires the payment of money or results in a loss upon conversion at the same time when the security is deemed an underlying instrument for purposes of this Appendix A, the broker or dealer will deduct from net worth the full amount of the conversion loss. The term underlying instrument shall not be deemed to include securities options, futures contracts, options on futures contracts, qualified stock baskets, or unlisted instruments."

⁵ The CFMA amended the definition of the term "security" under Exchange Act Section 3(a)(10) to include security futures.

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Based on the foregoing, the staff of the Division will not recommend enforcement action to the Commission if a broker-dealer, when calculating net capital using a theoretical option pricing model pursuant to Appendix A, treats a U.S.-listed security futures contract on an individual stock as a position in the underlying instrument for purposes of paragraph (b)(1)(ii)(A) of Appendix A. This position is conditioned, however, on the broker-dealer applying the minimum charge specified under paragraph (b)(1)(v)(C)(2) of Appendix A to the security futures contract when such amount exceeds the deduction, if any, required by paragraph (b)(1)(v)(C)(1) of Appendix A.

You should be aware that this is a staff position with respect to enforcement only and does not purport to express any legal conclusions regarding the application of the federal securities laws. 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 securities laws.

Sincerely,



Michael A. Macchiaroli
Associate Director

cc: James Adams, Chicago Board Options Exchange, Inc.
Yui Chan, Financial Industry Regulatory Authority, Inc.
David Downey, OneChicago, LLC
Kathy Mahoney, Financial Industry Regulatory Authority, Inc.



May 1, 2012

Mr. Michael A. Macchiaroli
Associate Director
Division of Trading and Markets
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-7010

RE: Security Futures Contracts Under
Appendix A to Exchange Act Rule 15c3-1

Dear Mr. Macchiaroli,

The Chicago Board Options Exchange, Inc. ("CBOE") and the Financial Industry Regulatory Authority ("FINRA") hereby jointly request that Staff of the Division of Trading and Markets ("Division") confirm that it will not recommend enforcement action to the Securities and Exchange Commission (the "SEC" or "Commission") against broker-dealers, if, when computing net capital using a theoretical options pricing model pursuant to Appendix A of Rule 15c3-1 ("Appendix A") under the Securities Exchange Act of 1934 (the "Exchange Act"), broker-dealers were to include security futures contracts on single stocks in the portfolio type provided under paragraph (b)(1)(ii)(A) of Appendix A.

When the Commission allowed broker-dealers to use theoretical options pricing models to calculate net capital, security futures trading was prohibited. Now that security futures trading is permitted, CBOE and FINRA seek the ability to include security futures in the theoretical options pricing model methodology used to calculate net capital pursuant to Appendix A.

I. Background

In 1997, the Commission adopted amendments to Appendix A to permit broker-dealers to employ theoretical option pricing models when calculating net capital for listed options and related positions that hedge those options.¹ Under the amendments, broker-dealers are allowed to group long and short positions in

¹ See Net Capital Rule, Exchange Act Release No. 38248 (Feb. 6, 1997), 62 FR 6474 (Feb. 12, 1997).

listed options into specified "portfolio types," and, within each portfolio type, offset a position's gain at any one valuation point with another position's loss at the same valuation point. Paragraph (b)(1)(ii)(A) of Appendix A allows broker-dealers to group long and short listed options positions within a portfolio type that includes "Equity options on the same underlying instrument and positions in that underlying instrument."

A prohibition against security futures trading was repealed by the Commodity Futures Modernization Act of 2000 (the "CFMA"), which established a framework for the joint regulation of security futures products by the SEC and the Commodity Futures Trading Commission.² Because SEC-registered broker-dealers were prohibited from trading security futures when Appendix A was amended as described above, security futures contracts on individual stocks were not included within the portfolio type specified in paragraph (b)(1)(ii)(A) of Appendix A. Consequently, offsets for purposes of applying net capital deductions to listed options on individual stocks under the theoretical option pricing model provisions of Appendix A are only recognized to the extent they include other equity options on the same underlying stock and the underlying stock itself.

II. Discussion

Security futures contracts on individual stocks (including ETFs) represent legally binding agreements between two parties to, in the future, buy (in the case of a long position) and sell (in the case of a short position) a specific quantity of shares of a security at a certain price.

Trading strategies in the stock market are generally transferable to the security futures market and security futures contracts on individual stocks are used by broker-dealers for a variety of portfolio management needs, including hedging positions in equity options on the same underlying stock, and positions in the underlying stock. Also, the current market value of a security futures contract on an individual stock typically tracks the price of the underlying stock, and, at expiration of a security futures contract, the price of the security futures contract equals the price of the underlying stock.

To more accurately measure the risk in a broker-dealer's portfolio, and, concomitantly, the amount of net capital a broker-dealer should maintain with respect to the portfolio, CBOE and FINRA believe that broker-dealers using

² Pub. L. No. 106-554, 114 Stat. 2763 (2000). The term "security futures product" includes both a security future and any option on a security future. The term "security future" is defined in Exchange Act Section 3(a)(55), and, in general, includes futures contracts on single securities and on narrow-based security indexes.

theoretical option pricing models to calculate net capital under Appendix A should be allowed to treat a security futures contract on an individual stock as a position in the "underlying instrument," as that term is defined in paragraph (a)(4) of Appendix A.³ Additionally, CBOE and FINRA contend that interpreting the term "underlying instrument" to include a security futures contract on an individual stock would achieve the same result and is not inconsistent with the CFMA or the intended purpose of Appendix A.⁴

CBOE and FINRA assert that, had security futures trading not been prohibited when Appendix A was amended in 1997, CBOE and FINRA would have supported including security futures contracts within the portfolio type described in paragraph (b)(1)(ii)(A) of Appendix A.

III. Request for No-Action Relief

Based on the foregoing, CBOE and FINRA jointly request that the staff of the Division not recommend enforcement action to the Commission if a broker-dealer, when calculating net capital using a theoretical option pricing model pursuant to Appendix A, includes a U.S.-Listed security futures contract on a single stock with equity options on the same underlying stock and positions in the underlying stock under paragraph (b)(1)(ii)(A) of Appendix A.

As is currently required under Appendix A for an option or futures contract, a security futures contract would be subject to the minimum charge specified under paragraph (b)(1)(v)(C)(2) of Appendix A when such amount exceeds the deduction, if any, required by paragraph (b)(1)(v)(C)(1) of Appendix A.

If you have any questions or require further information, please do not hesitate to contact James Adams, Chicago Board Options Exchange, at (312) 786-7718, or Yui Chan, Financial Industry Regulatory Authority, at (646) 315-8426. Thank you for your attention to this request.

³ The term "underlying instrument" in paragraph (a)(4) of Appendix A refers to "long and short positions, as appropriate, covering the same foreign currency, the same security, or a security which is exchangeable for or convertible into the underlying security within a period of 90 days. If the exchange or conversion requires the payment of money or results in a loss upon conversion at the same time when the security is deemed an underlying instrument for purposes of this Appendix A, the broker or dealer will deduct from net worth the full amount of the conversion loss. The term underlying instrument shall not be deemed to include securities options, futures contracts, options on futures contracts, qualified stock baskets, or unlisted instruments."

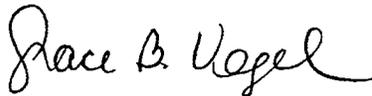
⁴ The CFMA amended the definition of the term "security" under Exchange Act Section 3(a)(10) to include security futures.

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cc: Mark Attar, SEC
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