



DIVISION OF
MARKET REGULATION

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

January 19, 1999

Mr. Richard Lewandowski
Vice President
Department of Financial and Sales Practice Compliance
Regulatory Division
The Chicago Board Options Exchange
400 South LaSalle Street
Chicago, Illinois 60605

Re: Computation of Equity by Broker-Dealers Carrying Market-Maker
Accounts of Listed Options Specialists

Dear Mr. Lewandowski:

This is in response to your letter dated January 11, 1999, in which you request that broker-dealers, in computing equity in specialist market-maker accounts for purposes of Rule 15c3-1 of the Securities Exchange Act of 1934 ("Exchange Act") (17 CFR 240.15c3-1), be permitted to adjust the value of options positions to reflect substantial price movements of the underlying common stock when closing price information for the common stock is reported after closing quotations for the options series are established.

Based on your letter and subsequent discussions with the staff of the Division of Market Regulation ("Division"), I understand the following facts to be pertinent to your request. A specialist in listed options on The Chicago Board Options Exchange ("CBOE" or "Exchange") maintains in a market-maker account, carried by a broker-dealer, positions in listed equity options and common stock underlying those options. In certain situations, last sale information for the common stock is reported after closing quotations and last sale information for the options series overlying the common stock are established.¹ In

¹ CBOE Rule 6.1 Interpretation .01 permits transactions in options on individual stocks to be effected on the Exchange until two minutes after the normal time set for the close of trading of the underlying stock on its primary exchange. See File No. SR-CBOE-96-71 approved in Securities Exchange Act Release No. 34-38543 (May 14, 1997), 62 FR 28082 (May 22, 1997). CBOE has discovered that when news of a stock underlying a CBOE option is disseminated near the close, heavy trading often results in dissemination of last sale information for the common stock well after the overlying options stop trading.

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these situations, the closing price of the common stock may not be reflected in the closing quotation information for the options series. Because of the discrepancy between the last sale price of the underlying common stock and the closing quotations of the options series, the net liquidating equity in the specialist's market-maker account may be valued at a liquidating deficit.

Pursuant to Rule 15c3-1(c)(2)(x)(D), a broker-dealer guaranteeing, endorsing, or carrying listed options transactions in a specialist market-maker account is prohibited from extending any further credit if at any time there is a liquidating deficit in the account. The broker-dealer is also required to take steps to liquidate promptly existing positions in the account and to transmit telegraphic facsimile notice of the deficit and its amount by the close of business of the following business day to its Designated Examining Authority and the Designated Examining Authority of the specialist, if different from its own. The broker-dealer, upon approval by the broker-dealer's Designated Examining Authority, is permitted to enter into hedging positions in the specialist's market-maker account.

Rule 15c3-1(c)(2)(x)(B)(2) provides the formula for computing equity in market-maker accounts for listed option specialists. Broker-dealers carrying accounts of listed options specialists must (i) mark all securities positions long or short in the account to their respective current market values; (ii) add (deduct in the case of a debit balance) the credit balance carried in such specialist's market-maker account; and (iii) add (deduct in the case of short positions) the market value of positions long in such account.

Recalculation of the closing price would be done by the carrying broker-dealer using the same methodology as that used by the Options Clearing Corporation to reprice options assuming different prices for the underlying securities. You believe that it is unduly harsh to use a closing price for the option which does not reflect the strong market movement of the underlying stock when there was a reporting delay in that price.

Based upon the facts set forth above, the Division will not recommend enforcement action to the Securities and Exchange Commission ("Commission") if, for the purpose of determining whether a net liquidating deficit exists in a specialist market-maker account under Rule 15c3-1(c)(2)(x)(D), a broker-dealer carrying market-maker accounts for listed options specialists adjusts the value of options positions in the specialist market-maker account, long or short, to reflect substantial price movement of the underlying common stock when the closing price of the common stock is reported after closing prices for the options series are established and a liquidating deficit results. Any broker-dealer adjusting equity in a specialist market-maker account must provide documentation to the Exchange for such adjustments before the opening of trading the

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next business day (or before the broker-dealer may extend credit for opening transactions). In situations where the deficit is eliminated by the adjustment and the adjustment is approved by the Exchange's Department of Financial and Sales Practice Compliance, the specialist will be permitted to continue trading.

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,

A handwritten signature in cursive script, appearing to read "Michael A. Macchiaroli".

Michael A. Macchiaroli
Associate Director