

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-97019; File No. SR-CBOE-2022-058)

March 2, 2023

Self-Regulatory Organizations; Cboe Exchange, Inc.; Order Approving a Proposed Rule Change to Amend Rule 10.3 Regarding Margin Requirements

I. Introduction

On November 14, 2022, Cboe Exchange, Inc. (the “Exchange” or “Cboe”) filed with the Securities and Exchange Commission (the “Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend Cboe Rule 10.3 regarding margin requirements related to cash-settled index options written against exchange-traded funds (“ETF(s)”) that track the same index underlying the option. The proposed rule change was published for comment in the Federal Register on December 2, 2022.<sup>3</sup> On January 10, 2023, the Exchange consented to an extension of the time period in which the Commission must approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to approve or disapprove the proposed rule change to March 2, 2023. The Commission received no comment letters on the proposal. This order approves the proposed rule change.

II. Description of the Proposed Rule Change

The Exchange proposed to amend Cboe Rule 10.3, which sets forth margin requirements, and certain exceptions to those requirements, applicable to security positions

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Exchange Act Release No. 96395 (Nov. 28, 2022), 87 FR 74199 (Dec. 2, 2022) (“Notice”).

of Trading Permit Holders' ("TPHs") customers. Specifically, the Exchange stated that Cboe Rule 10.3(c)(5) generally requires TPHs to obtain from a customer, and maintain, a margin deposit for short cash-settled index options in an amount equal to 100% of the current market value of the option plus 15% (if overlying a broad-based index) or 20% (if overlying a narrow-based index) of the amount equal to the index value multiplied by the index multiplier minus the amount, if any, by which the option is out-of-the-money.<sup>4</sup> The minimum margin required for such an option is 100% of the option current market value plus 10% of the index value multiplied by the index multiplier for a call or 10% of the exercise price multiplied by the index multiplier for a put.<sup>5</sup>

By contrast, Rule 10.3(c)(5)(C)(iii) provides that no margin is required for a call (put) option contract or warrant carried in a short position where there is carried in the same account a long (short) position in equivalent units of the underlying security,<sup>6</sup> and no margin is required for a call (put) index option contract or warrant carried in a short position where there is carried in the same account a long (short) position in an (1) underlying stock basket,<sup>7</sup>

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<sup>4</sup> See Notice at 74201. According to the Exchange, the out-of-the-money amount for a call is any excess of the aggregate exercise price of the option or warrant over the product of the current (spot or cash) index value and the applicable multiplier. The out-of-the-money amount for a put is any excess of the product of the current (spot or cash) index value and the applicable multiplier over the aggregate exercise price of the option or warrant. See *id.* at 74201, n.8.

<sup>5</sup> See *id.* at 74201.

<sup>6</sup> The Exchange states that in computing margin on a position in the underlying security, (a) in the case of a call, the current market value to be used must not be greater than the exercise price and (b) in the case of a put, margin will be the amount required by Cboe Rule 10.3(b)(2), plus the amount, if any, by which the exercise price of the put exceeds the current market value of the underlying. See *id.* at 74201, n.3.

<sup>7</sup> The Exchange defines "underlying stock basket" to mean a group of securities that includes each of the component securities of the applicable index and which meets the following conditions: (a) the quantity of each stock in the basket is

(2) index mutual fund, (3) index portfolio receipt (“IPR”),<sup>8</sup> or (4) index portfolio share (“IPS”),<sup>9</sup> that is based on the same index underlying the index option or warrant and having a market value at least equal to the aggregate current index value.

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proportional to its representation in the index, (b) the total market value of the basket is equal to the underlying index value of the index options or warrants to be covered, (c) the securities in the basket cannot be used to cover more than the number of index options or warrants represented by that value and (d) the securities in the basket shall be unavailable to support any other option or warrant transaction in the account. See Cboe Rule 10.3(a)(7). See also Notice at 74201, n.4.

<sup>8</sup> The Exchange defines IPRs as securities that (a) represent an interest in a unit investment trust (“UIT”) which holds the securities that comprise an index on which a series of IPRs is based; (b) are issued by the UIT in a specified aggregate minimum number in return for a “Portfolio Deposit” consisting of specified numbers of shares of stock plus a cash amount; (c) when aggregated in the same specified minimum number, may be redeemed from the UIT, which will pay to the redeeming holder the stock and cash then comprising the Portfolio Deposit; and (d) pay holders a periodic cash payment corresponding to the regular cash dividends or distributions declared and paid with respect to the component securities of the stock index on which the IPRs are based, less certain expenses and other charges as set forth in the UIT prospectus. IPRs are “UIT interests” within the meaning of the Cboe’s rules. See Cboe Rule 1.1. See also Notice at 74201, n.5. The Exchange defines a UIT Interest as any share, unit, or other interest in or relating to a unit investment trust, including any component resulting from the subdivision or separation of such an interest. See Cboe Rule 1.1. See also Notice at 74201, n.5.

<sup>9</sup> The Exchange defines IPSs as securities that (a) are issued by an open-end management investment company based on a portfolio of stocks or fixed income securities designed to provide investment results that correspond generally to the price and yield performance of a specified foreign or domestic stock index or fixed income securities index; (b) are issued by such an open-end management investment company in a specified aggregate minimum number in return for a deposit of specified number of shares of stock and/or a cash amount, or a specified portfolio of fixed income securities and/or a cash amount, with a value equal to the next determined net asset value; and (c) when aggregated in the same specified minimum number, may be redeemed at a holder’s request by such open-end management investment company, which will pay to the redeeming holder stock and/or cash, or a specified portfolio of fixed income securities and/or cash with a value equal to the next determined net asset value. See Cboe Rule 1.1. See also Notice at 74201, n.6.

The Exchange stated that, in order for these exceptions to apply, in computing margin on positions in the underlying security, underlying stock basket, index mutual fund, IPR or IPS, as applicable, (1) in the case of a call, the current market value to be used must not be greater than the exercise price, and (2) in the case of a put, margin is the amount required by subparagraph (b)(2) of Rule 10.3, plus the amount, if any, by which the exercise price exceeds the current market value.<sup>10</sup>

The Exchange proposed to amend this exception to margin requirements applicable to short option positions or warrants on indexes that are offset by positions in an underlying stock basket, non-leveraged index mutual fund, or non-leveraged ETF (each, the “protection”) that is based on the same index as the option, as well as move it within Cboe Rule 10.3 to Rule 10.3(c)(5)(C)(iv)(e).

Specifically, the proposed rule change provides that the margin requirement for an uncovered, short index option or warrant does not apply to a “protected option or warrant position.” The proposed rule change identifies a “protected option” as a strategy of writing an index option against a holding in an ETF based on the same index as the index option, and differentiates it from a “covered call,” which is a strategy of writing an option against a position in an underlying security.<sup>11</sup> The proposed rule change also limits the margin exception to index options written against an underlying stock basket, non-leveraged index mutual fund or non-leveraged ETF (compared to underlying stock basket, index mutual fund, IPR, or IPS under the current rule). The Exchange stated that it proposed to add the non-leveraged limitation to clarify that the exception is not

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<sup>10</sup> See Notice at 74201.

<sup>11</sup> See *id.* at 74201, n.12.

intended to, and does not apply to leveraged instruments.<sup>12</sup> Additionally, the Exchange proposed to not include specific references to IPRs and IPSs in the proposed margin exception for protected options and warrants.<sup>13</sup>

The Exchange also proposed certain conditions that must be met in order for the proposed margin exception to apply. The first proposed condition to qualify for the exception is that the TPH must carry or establish in the same account as the protected option or warrant position protection with an absolute value of not less than 100% of the aggregate underlying index value at either the time the order that created the protected option or warrant position was entered or executed, or the close of business on the trading day the protected option or warrant position was created.<sup>14</sup> The Exchange stated that the aggregate underlying index value used would be that which existed at the same point in time that the clearing broker selects to value the protection.<sup>15</sup> According to the Exchange, this first condition corresponds to the concept of covered writing (such as writing a covered call).<sup>16</sup>

The second proposed condition to qualify for the exception is that the absolute value of the protection must at no time be less than 95% of the aggregate underlying index value associated with the protected option or warrant position.<sup>17</sup> According to the Exchange, this second proposed condition is intended to correspond to covered writing

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<sup>12</sup> See id. at 74201, n.11.

<sup>13</sup> See id. According to the Exchange, IPRs and IPSs are commonly referred to as ETFs. See id. at n.7.

<sup>14</sup> See proposed Cboe Rule 10.3(c)(5)(C)(iv)(e)(1).

<sup>15</sup> See Notice at 74202.

<sup>16</sup> See id.

<sup>17</sup> See proposed Cboe Rule 10.3(c)(5)(C)(iv)(e)(2).

by requiring a market participant to maintain the protection in an amount close to the aggregate underlying index value associated with the protected option or warrant position.<sup>18</sup> The Exchange stated that because the value of the protection typically will not track exactly the aggregate underlying index value (i.e., tracking error), the 95% threshold will require the absolute value of the protection to remain close to the aggregate underlying index value while effectively imposing a cap of 5% on how much the two values may diverge (i.e., the value of the protection may not be more than 5% less than the value of the aggregate underlying index value).<sup>19</sup> According to the Exchange, if the absolute value of the protection falls below 95% of the aggregate underlying index value associated with the protected option or warrant position, the protected option or warrant position would be deemed uncovered and thus no longer eligible for the exception from the uncovered, short index option margin requirement.<sup>20</sup> When that occurs, the Exchange stated that a clearing broker must either collect the required margin amount for the short index option or warrant position, require that the value of the protection be increased to 100% of the aggregate underlying index value, or liquidate the short index option or warrant position.<sup>21</sup>

The third proposed condition to qualify for the exception is to maintain margin in an amount equal to the greater of: (a) the amount, if any, by which the aggregate underlying index value associated with the protected option or warrant position is above (below) the aggregate exercise price of the protected call (put) option or warrant position;

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<sup>18</sup> See Notice at 74202.

<sup>19</sup> See id.

<sup>20</sup> See id.

<sup>21</sup> See id.

or (b) the amount, if any, by which the absolute value of the protection is below the aggregate current underlying index value associated with the protected option or warrant (which would be subject to the 95% threshold imposed by the second proposed condition, as described above).<sup>22</sup>

The Exchange stated that the proposed margin requirement to cover any difference by which the underlying index value is above (below) the exercise price of a call (put), in aggregate, would capture any amount by which a protected option or warrant position is in-the-money (i.e., the amount the aggregate underlying index value exceeds the aggregate exercise price for a short call).<sup>23</sup> Pursuant to this proposed requirement, margin equivalent to the in-the-money amount of the protected option or warrant position would need to be held in the account with that position, which would then be available to offset any debit to that account in the event of an exercise of the protected option or warrant.<sup>24</sup> The Exchange stated that this corresponds to current Cboe Rule 10.3(c)(5)(C)(iii)(c), which requires the value of the protection or underlying stock to be capped at the exercise price of a covered call for no additional margin to be required for that call position and that both approaches prevent any in-the-money amount from contributing equity to the account and being used to support other positions.<sup>25</sup>

According to the Exchange, the proposed alternative margin requirement to cover any difference by which the absolute value of the protection is below the aggregate underlying index value associated with the protected option or warrant would compensate

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<sup>22</sup> See proposed Cboe Rule 10.3(c)(5)(C)(iv)(e)(3); Notice at 74202.

<sup>23</sup> See Notice at 74202.

<sup>24</sup> See id.

<sup>25</sup> See id.

for any tracking error.<sup>26</sup> Pursuant to this proposed requirement, margin equivalent to the value of the divergence between the absolute value of the protection and the aggregate underlying index value would need to be maintained once a protected option or warrant position is created.<sup>27</sup> However, the Exchange stated that this requirement would be rendered moot if the absolute value of the protection fell below 95% of the aggregate underlying index value associated with the protected option or warrant position, because the position at that point would be considered uncovered.<sup>28</sup> To the extent equity is not available in the margin account to meet this requirement, the Exchange stated that a TPH can require its customer to deposit margin into the account.<sup>29</sup> The Exchange stated that it believes this is more practical than requiring the value of the protection to be maintained at 100% of the aggregate underlying index value in actual shares (or applicable units) of the protection, as this would require continuous small transactions in the protection instrument to offset tracking differences (which are generally no larger than 2% according to the Exchange).<sup>30</sup>

Because there may be instances where margin requirements for the in-the-money amount and the tracking error may be duplicative,<sup>31</sup> the Exchange proposed to require

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<sup>26</sup> See id.

<sup>27</sup> See id.

<sup>28</sup> See id.

<sup>29</sup> See id.

<sup>30</sup> See id.

<sup>31</sup> The Exchange stated that two out of a total of six possible combinations of underlying index value, exercise price and protection value would result in overlapping margin requirements as proposed. For all other combinations, the Exchange stated that one of the proposed margin requirement alternatives would be zero. See id. at 74202, n.13.



only the greater amount of the two to avoid requiring an unnecessarily high amount of margin.<sup>32</sup>

The proposed rule change also deletes Cboe Rule 10.3(c)(5)(C)(iii)(b), as well as the cross-reference to such paragraph and the references to underlying stock basket, index mutual fund, IPR or IPS, as applicable, in current subparagraph (c), as those terms relate specifically to current subparagraph (b). Because this would leave only one section in Cboe Rule 10.3(c)(5)(C)(iii), the proposed rule change deletes subparagraph lettering and combines current subparagraph (iii)(a) and current subparagraph (iii)(c) into a single provision as subparagraph (iii) and makes corresponding conforming changes.<sup>33</sup>

The proposed rule change also makes additional clarifying, non-substantive changes in each subparagraph of Cboe Rule 10.3(c)(5)(C)(iv) to conform language in those subparagraphs to language used throughout Cboe Rule 10.3. Specifically, the proposed rule change amends the provision of each subparagraph to state that the minimum amount of required margin in the circumstances described in each subparagraph applies when the applicable long position is carried “in the same account as” the applicable short position, rather than “also carried.” This language is consistent with the language in, for example, current Cboe Rule 10.3(c)(5)(C)(iii), as margin requirements are determined generally based on positions held in the same account.<sup>34</sup>

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<sup>32</sup> See id. at 74202.

<sup>33</sup> See id. at 74203.

<sup>34</sup> See id.

### III. Commission Discussion and Findings

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>35</sup> In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Exchange Act,<sup>36</sup> which requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest. The Commission also finds that the proposed rule change is consistent with Section 6(c)(3) of the Exchange Act,<sup>37</sup> which authorizes, among other things, a national securities exchange to prescribe standards of financial responsibility or operational capability.

The Commission believes that the proposed rule change would establish a more tailored margin approach for protected options or warrant positions that reflects the differences between protected options and covered options, and that addresses the risks specific to protected options or warrant positions. For example, while both the protected

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<sup>35</sup> In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>36</sup> 15 U.S.C. 78f(b)(5)

<sup>37</sup> 15 U.S.C. 78f(c)(3).

option positions and covered option positions are subject to the risk of exercise where the price or value of the underlying is above (below) the exercise price for a call (put), covered options do not face the risk of “tracking error.” Consequently, by providing for margin requirements that are more tailored to the risks associated with protected options or warrant positions, the Commission believes that the proposed rule change will remove impediments to and perfect the mechanism of a free and open market and a national market system.

More specifically, by revising the margin requirements for protected option or warrant positions, including requiring that certain conditions are met (as described above), and revising the types of products permitted to be used as protection (i.e., permitting only stock baskets, non-leveraged index mutual funds, and non-leveraged ETFs to function as protection), the Commission believes the proposed rule change will facilitate the use of protected options and warrants as the cost and operational burdens associated with these products under the current approach will be reduced. TPHs will no longer be required to purchase and deposit additional shares related to the underlying index, such as additional shares of an ETF, where the protection value is not at least equal to the aggregate underlying index value. Instead, TPHs will be permitted (subject to the requirement that the deficiency not be greater than 5 percent) to post margin in the form of available equity in the margin account or cash or other marginable securities in order to remedy such a deficiency. As a result, TPHs will benefit from a reduction in transaction costs, and to the extent that equity in the margin account is utilized, TPHs will also benefit from a more straightforward process from an operational standpoint with respect to posting required margin.

Lastly, the Commission believes that by imposing the requirement to post margin on protected options or warrant positions that equals the greater of the in-the-money amount of the option or warrant, or the amount by which the aggregate current underlying index value exceeds the absolute value of the protection, while also implementing a requirement that the protection be at all times at least 95% of the aggregate current underlying index value, the proposed rule change addresses the risks associated with protected options or warrant positions (e.g., the risk of exercise of a short position when the option or warrant is in-the-money and tracking error), and appropriately protects investors and the public interest.

Accordingly, for the foregoing reasons, the Commission finds that this proposed rule change is consistent with the Exchange Act.

#### IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Exchange Act,<sup>38</sup> that the proposed rule change (SR-CBOE-2022-058) be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>39</sup>

Sherry R. Haywood,  
Assistant Secretary.

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<sup>38</sup> 15 U.S.C. 78s(b)(2).

<sup>39</sup> 17 CFR 200.30-3(a)(12).