

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-52032; File No. SR-CBOE-2002-03)

July 14, 2005

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order Approving a Proposed Rule Change and Amendment Nos. 1 and 2 Thereto Relating to Customer Portfolio and Cross-Margining Requirements

I. Introduction

On January 15, 2002, the Chicago Board Options Exchange, Incorporated (“CBOE” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4² thereunder, a proposed rule change seeking to amend its rules, for certain customer accounts, to allow member organizations to margin listed, broad-based, market index options, index warrants, futures, futures options and related exchange-traded funds according to a portfolio margin methodology. The CBOE seeks to introduce the proposed rule as a two-year pilot program that would be made available to member organizations on a voluntary basis.

The proposed rule change was published in the Federal Register on March 29, 2002.³ The Commission received two comment letters in response to the March 29, 2002 Federal Register notice.⁴ On April 2, 2004, the Exchange filed Amendment No. 1 to the

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 45630 (March 22, 2002), 67 FR 15263 (March 29, 2002).

⁴ See letter from Carl E. Vander Wilt, Federal Reserve Bank of Chicago, to Jonathan G. Katz, Secretary, Commission, dated July 18, 2002 (“Vander Wilt

proposed rule change.⁵ The proposed rule change and Amendment No. 1 were published in the Federal Register on December 27, 2004.⁶ The Commission received eleven comment letters in response to the December 27, 2004 Federal Register notice.⁷

Letter”); and e-mail from Mike Ianni, Private Investor to rule-comments@sec.gov, dated November 7, 2002 (“Ianni E-mail”).

⁵ See letter from Richard Lewandowski, Vice President, Division of Regulatory Services, CBOE, to Michael A. Macchiaroli, Associate Director, Division of Market Regulation (“Division”), Commission, dated April 1, 2004 (“Amendment No. 1”). The CBOE proposed Amendment No. 1 to make corrections or clarifications to the proposed rule, or to reconcile differences between the proposed rule and a parallel filing by the NYSE. See Securities Exchange Act Release No. 46576 (October 1, 2002), 67 FR 62843 (October 8, 2002) (File No. SR-NYSE-2002-19).

⁶ See Securities Exchange Act Release No. 50886 (December 20, 2004), 69 FR 77275 (December 27, 2004); see also Securities Exchange Act Release No. 50885 (December 20, 2004), 69 FR 77287 (December 27, 2004).

⁷ See letter from Anthony J. Saliba, President, LiquidPoint, LLC, to Jonathan G. Katz, Secretary, Commission, dated January 21, 2005 (“Saliba Letter”); letter from Barbara Wierzynski, Executive Vice President and General Counsel, Futures Industry Association (“FIA”), and Gerard J. Quinn, Vice President and Associate General Counsel, Securities Industry Association (“SIA”), to Jonathan G. Katz, Secretary, Commission, dated January 14, 2005 (“Wierzynski/Quinn Letter”); letter from Craig S. Donohue, Chief Executive Officer, Chicago Mercantile Exchange, to Jonathan G. Katz, Secretary, Commission, dated January 18, 2005 (“Donohue Letter”); letter from Robert C. Sheehan, Chairman, Electronic Brokerages Systems, LLC, to Jonathan G. Katz, Secretary, Commission, dated January 19, 2005 (“Sheehan Letter”); letter from William O. Melvin, Jr., President, Acorn Derivatives Management, to Jonathan G. Katz, Secretary, Commission, dated January 19, 2005 (“Melvin Letter”); letter from Margaret Wiermanski, Chief Operating & Compliance Officer, Chicago Trading Company, to Jonathan G. Katz, Secretary, Commission, dated January 20, 2005 (“Wiermanski Letter”); e-mail from Jeffrey T. Kaufmann, Lakeshore Securities, L.P., to Jonathan G. Katz, Secretary, Commission, dated January 24, 2005 (“Kaufmann Letter”); letter from J. Todd Weingart, Director of Floor Operations, Mann Securities, to Jonathan G. Katz, Secretary, Commission, dated January 25, 2005 (“Weingart Letter”); letter from Charles Greiner III, LDB Consulting, Inc., to Jonathan G. Katz, Secretary, Commission, dated January 26, 2005 (“Greiner

On April 15, 2005, the Exchange filed Amendment No. 2⁸ to the proposed rule change. The proposed rule change and Amendment Nos. 1 and 2 were published in the Federal Register on May 3, 2005.⁹ The Commission received one comment in response to the May 3, 2005 Federal Register notice.¹⁰

The comment letters and the Exchange's responses to the comments¹¹ are

Letter"); letter from Jack L. Hansen, Chief Investment Officer and Principal, The Clifton Group, to Jonathan G. Katz, Secretary, Commission, dated February 1, 2005 ("Hansen Letter"); and letter from Barbara Wierzynski, Executive Vice President and General Counsel, Futures Industry Association, and Ira D. Hammerman, Senior Vice President and General Counsel, Securities Industry Association, to Jonathan G. Katz, Secretary, Commission, dated March 4, 2005 ("Wierzynski/Hammerman Letter").

⁸ See Partial Amendment No. 2 ("Amendment No. 2"). The Exchange submitted this partial amendment, pursuant to the request of Commission staff, to remove the paragraph under which any affiliate of a self-clearing member organization could participate in portfolio margining, without being subject to the \$5 million equity requirement.

⁹ See Securities Exchange Act Release No. 34-51614 (April 26, 2005), 70 FR 22935 (May 3, 2005); see also Securities Exchange Act Release No. 34-51615 (April 26, 2005), 70 FR 22953 (May 3, 2005).

¹⁰ See letter from William H. Navin, Executive Vice President, General Counsel, and Secretary, The Options Clearing Corporation, to Jonathan G. Katz, Secretary, Commission, dated May 27, 2005 ("Navin Letter").

¹¹ See letter from Timothy H. Thompson, Senior Vice President, Chief Regulatory Officer, Regulatory Services Division, CBOE, to Michael A. Macchiaroli, Associate Director, Division of Market Regulation, Commission, dated May 2, 2005 ("CBOE Response"). The Commission received the CBOE Response on June 1, 2005; see also letter from Timothy H. Thompson, Senior Vice President, Chief Regulatory Officer, Regulatory Services Division, CBOE, to Michael A. Macchiaroli, Associate Director, Division of Market Regulation, Commission, dated June 29, 2005.

summarized below. This Order approves the proposed rule, as amended.¹²

II. Description

a. Summary of Proposed Rule Change

The CBOE has proposed to amend its rules, for certain customer accounts, to allow member organizations to margin listed broad-based securities index options, warrants, futures, futures options and related exchange-traded funds according to a portfolio margin methodology. The CBOE seeks to introduce the proposed rule as a two-year pilot program that would be made available to member organizations on a voluntary basis.

b. Overview - Portfolio Margin Computation

(1) Portfolio Margin

Portfolio margining is a methodology for calculating a customer's margin requirement by "shocking" a portfolio of financial instruments at different equidistant points along a range representing a potential percentage increase and decrease in the value of the instrument or underlying instrument in the case of a derivative product. For example, the calculation points could be spread equidistantly along a range bounded on one end by a 10% increase in market value of the instrument and at the other end by a 10% decrease in market value. Gains and losses for each instrument in the portfolio are

¹² By separate orders, the Commission also is approving a parallel rule filing by the NYSE [SR-NYSE-2002-19], and a related rule filing by the Options Clearing Corporation ("OCC") [SR-OCC-2003-04]. See Securities Exchange Act Release No. 52031 (July 14, 2005) and Securities Exchange Act Release No. 52030 (July 14, 2005). In addition, the staff of the Division of Market Regulation is issuing certain no-action relief related to the OCC's rule filing. See letter from Bonnie Gauch, Attorney, Division of Market Regulation, Commission, to William H. Navin, General Counsel, OCC, dated July 14, 2005.

netted at each calculation point along the range to derive a potential portfolio-wide gain or loss for the point. The margin requirement is the amount of the greatest portfolio-wide loss among the calculation points.

Under the Exchange's proposed rule, a portfolio would consist of, and be limited to, financial instruments in the customer's account within a given broad-based US securities index class (e.g., the S&P 500 or S&P 100).¹³ The gain or loss on each position in the portfolio would be calculated at each of 10 equidistant points ("valuation points") set at and between the upper and lower market range points. The range for non-high capitalization indices would be between a market increase of 10% and a decrease of 10%. High capitalization indices would have a range of between a market increase of 6% and a decrease of 8%.¹⁴ A theoretical options pricing model would be used to derive position values at each valuation point for the purpose of determining the gain or loss. The amount of margin (initial and maintenance) required with respect to a given portfolio would be the larger of: (1) the greatest loss amount among the valuation point calculations; or (2) the sum of \$.375 for each option and future in the portfolio multiplied by the contract's or instrument's multiplier. The latter computation establishes a minimum margin requirement to ensure that a certain level of margin is required from the

¹³ A "portfolio" is defined in the rule as "options of the same options class grouped with their underlying instruments and related instruments."

¹⁴ These are the same ranges applied to options market makers under Appendix A to Rule 15c3-1 (17 CFR 240.15c3-1a), which permits a broker-dealer when computing net capital to calculate securities haircuts on options and related positions using a portfolio margin methodology. See 17 CFR 240.15c3-1a(b)(1)(iv)(A); Letter from Michael Macchiaroli, Associate Director, Division of Market Regulation, Commission, to Richard Lewandowski, Vice President, Regulatory Division, The Chicago Board Options Exchange, Inc. (Jan. 13, 2000).

customer. The margin for all other portfolios of broad based US securities index instruments within an account would be calculated in a similar manner.

Certain portfolios would be allowed offsets such that, at the same valuation point, for example, 90% of a gain in one portfolio may reduce or offset a loss in another portfolio.¹⁵ The amount of offset allowed between portfolios would be the same as permitted under Rule 15c3-1a for computing a broker-dealer's net capital.¹⁶

Under the Exchange's proposed rule, the theoretical prices used for computing profits and losses must be generated by a theoretical pricing model that meets the requirements in Rule 15c3-1a.¹⁷ These requirements include, among other things, that the model be non-proprietary, approved by a Designated Examining Authority ("DEA") and available on the same terms to all broker-dealers.¹⁸ Currently, the only model that qualifies under Rule 15c3-1a is the OCC's Theoretical Intermarket Margining System ("TIMS").

(2) Cross-Margining

The Exchange's proposed rule permits futures and futures options on broad-based US securities indices to be included in the portfolios. Consequently, futures and futures options would be permitted offsets to the securities positions in a given portfolio.

¹⁵ These offsets would be allowed between portfolios within the High Capitalization, Broad Based Index Option product group and the Non-High Capitalization, Broad Based Index product group.

¹⁶ 17 CFR 240.15c3-1a.

¹⁷ See 17 CFR 240.15c3-1a(b)(1)(i)(B).

¹⁸ Id.

Operationally, these offsets would be achieved through cross-margin agreements between the OCC and the futures clearing organizations holding the customer's futures positions. Cross-margining would operate similar to the cross-margin program that the Commission and the Commodity Futures Trading Commission ("CFTC") approved for listed options market-makers and proprietary accounts of clearing member organizations.¹⁹ For determining theoretical gains and losses, and resultant margin requirements, the same portfolio margin computation program will be applied to portfolio margin accounts that include futures. Under the proposed rule, a separate cross-margin account must be established for a customer.

c. Margin Deficiency

Under the Exchange's proposed rule, account equity would be calculated and maintained separately for each portfolio margin account and a margin call would need to be met by the customer within one business day (T+1), regardless of whether the deficiency is caused by the addition of new positions, the effect of an unfavorable market movement, or a combination of both. The portfolio margin methodology, therefore, would establish both the customer's initial and maintenance margin requirement.

d. \$5.0 Million Equity Requirement

The Exchange's proposed rule would require a customer (other than a broker-dealer or a member of a national futures exchange) to maintain a minimum account equity of not less than \$5.0 million. This requirement can be met by combining all securities and futures accounts owned by the customer and carried by the broker-dealer

¹⁹ See Securities Exchange Act Release 26153 (Oct. 3, 1988), 53 FR 39567 (Oct. 7, 1988).

(as broker-dealer and futures commission merchant), provided ownership is identical across all combined accounts. The proposed rule would require that, in the event account equity falls below the \$5 million minimum, additional equity must be deposited within three business days (T+3).

e. Net Capital

The Exchange's proposed rule would provide that the gross customer portfolio margin requirements of a broker-dealer may at no time exceed 1,000 percent of the broker-dealer's net capital (a 10:1 ratio), as computed under Rule 15c3-1.²⁰ This requirement is intended to place a ceiling on the amount of portfolio margin a broker-dealer can extend to its customers.

f. Internal Risk Monitoring Procedures

The Exchange's proposed rule would require a broker-dealer that carries portfolio margin accounts to establish and maintain written procedures for assessing and monitoring the potential risks to capital arising from portfolio margining.

g. Margin at the Clearing House Level

The OCC will compute clearing house margin for the broker-dealer using the same portfolio margin methodology applied at the customer level. The OCC will continue to require full payment for all customer long option positions. These positions, however, would be subject to the OCC's lien. This would permit the long options positions to offset short positions in the customer's portfolio margin account. In conjunction with the Exchange's rule proposal, the OCC proposed amending OCC Rule

²⁰ 17 CFR 240.15c3-1.

611 and establishing a new type of omnibus account to be carried at the OCC and known as the “customer’s lien account.”²¹ In order to unsegregate the long option positions, the Commission staff would have to grant certain relief from some requirements of Commission Rules 8c-1, 15c2-1, and 15c3-3.²² The OCC requested such relief on behalf of its members.²³

h. Risk Disclosure Statement and Acknowledgement

The Exchange’s proposed rule would require a broker-dealer to provide a portfolio margin customer with a written risk disclosure statement at or prior to the initial opening of a portfolio margin account. This disclosure statement would highlight the risks and describe the operation of a portfolio margin account. The disclosure statement would be divided into two sections, one dealing with portfolio margining and the other with cross-margining. The disclosure statement would note that additional leverage is possible in an account margined on a portfolio basis in relation to existing margin requirements. The disclosure statement also would describe, among other things, eligibility requirements for opening a portfolio margin account, the instruments that are

²¹ See SR-OCC-2003-04, Securities Exchange Act Release No. 51330 (March 8, 2005). As noted above, the Commission is approving the OCC’s rule filing. See Securities Exchange Act Release No. 52030 (July 14, 2005).

²² 17 CFR 240.8c-1, 17 CFR 240.15c2-1 and 17CFR 240.15c3-3, respectively.

²³ See Letter from William H. Navin, Executive Vice President, General Counsel, and Secretary, The Options Clearing Corporation, to Michael A. Macchiaroli, Associate Director, Division of Market Regulation, Commission, dated January 13, 2005. As noted above, the staff of the Division of Market Regulation is issuing a no-action letter providing such relief. See letter from Bonnie Gauch, Attorney, Division of Market Regulation, Commission, to William H. Navin, General Counsel, OCC, dated July 14, 2005.

allowed in the account, and when deposits to meet margin and minimum equity requirements are due. Further, there would be a summary list of the special risks of a portfolio margin account, including the increased leverage, time frame for meeting margin calls, potential for involuntary liquidation if margin is not received, inability to calculate future margin requirements because of the data and calculations required, and the OCC lien on long option positions. The risks and operation of the cross-margin account are outlined in a separate section of the disclosure statement.

Further, at or prior to the time a portfolio margin account is initially opened, the broker-dealer would be required to obtain a signed acknowledgement concerning portfolio margining from the customer. A separate acknowledgement would be required for cross-margining. The acknowledgements would contain statements to the effect that the customer has read the disclosure statement and is aware of the fact that long option positions in a portfolio margin account are not subject to the segregation requirements under the Commission's customer protection rules, and would be subject to a lien by the OCC.

An additional acknowledgement form would be required for a cross-margin account. It would contain similar statements as well as statement to the effect that the customer is aware that futures positions are being carried in a securities account, which would make them subject to the Commission's customer protection rules, and Securities Investor Protection Act of 1970 ("SIPA")²⁴ in the event the broker-dealer becomes financially insolvent. The Exchange would prescribe the format of the written disclosure

²⁴ 15 U.S.C. 78aaa et seq.

statements and acknowledgements, which would allow a broker-dealer to develop its own format, provided the acknowledgement contains substantially similar information and is approved by the Exchange in advance.

i. Rationale For Portfolio Margin

Theoretical options pricing models have become widely utilized since Fischer Black and Myron Scholes first introduced a formula for calculating the value of a European style option in 1973.²⁵ Other formulas, such as the Cox-Ross-Rubinstein model have since been developed. Option pricing formulas are now used routinely by option market participants to analyze and manage risk. In addition, as noted, a portfolio margin methodology has been used by broker-dealers since 1994 to calculate haircuts on option positions for net capital purposes.²⁶

The Board of Governors of the Federal Reserve System (the “Federal Reserve Board” or “FRB”) in its amendments to Regulation T in 1998 permitted SROs to implement portfolio margin rules, provided they are approved by the Commission.²⁷

²⁵ See Securities Exchange Act Release No. 34-38248 (Feb. 6, 1997), 62 FR 6474 (Feb. 12, 1997) (discussing the development of the options pricing approach to capital); see also Securities Exchange Act Release No. 33761 (March 15, 1994), 59 FR 13275 (March 21, 1994).

²⁶ See letter from Brandon Becker, Director, Division, Commission, to Mary Bender, First Vice President, Division of Regulatory Services, CBOE, and Timothy Hinkes, Vice President, OCC, dated March 15, 1994; see also “Net Capital Rule,” Securities Exchange Act Release No. 38248 (February 6, 1997), 62 FR 6474 (February 12, 1997).

²⁷ See Federal Reserve System, “Securities Credit Transactions; Borrowing by Brokers and Dealers”; Regulations G, T, U and X; Docket Nos. R-0905, R-0923 and R-0944, 63 FR 2806 (January 16, 1998). More recently, the FRB encouraged the development of a portfolio margin approach in a letter to the Commission and the CFTC delegating authority to the agencies to jointly prescribe margin

Portfolio margining brings a more risk sensitive approach to establishing margin requirements. For example, in a diverse portfolio some positions may appreciate and others depreciate in response to a given change in market prices. The portfolio margin methodology recognizes offsetting potential changes among the full portfolio of related instruments. This links the margin required to the risk of the entire portfolio as opposed to the individual positions on a position-by-position basis.

Professional investors frequently hedge listed index options with futures positions. Cross-margining would better align their margin requirements with the actual risks of these hedged positions. This could reduce the risk of forced liquidations. Currently, an option (securities) account and futures account of the same customer are viewed as separate and unrelated. Moreover, an option account currently must be liquidated if the risk in the positions has increased dramatically or margin calls cannot be met, even if gains in the customer's futures account offset the losses in the options account. If the accounts are combined (i.e., cross-margined), unnecessary liquidation may be avoided. This could lessen the severity of a period of high volatility in the market by reducing the number of liquidations.

III. Summary of Comments Received and CBOE Response

The Commission received a total of fourteen comment letters to the proposed rule.²⁸ The comments, in general, were supportive. One commenter stated that “portfolio

regulations for security futures products. See letter from the FRB to James E. Newsome, Acting Chairman, CFTC, and Laura S. Unger, Acting Chairman, Commission, dated March 6, 2001.

²⁸ See supra notes 4, 7 and 10.

marginng would enable CBOE to more accurately reflect the risk exposure of options and related positions-potentially reducing the trading costs of market participants and increasing the liquidity and efficiency of the market.”²⁹ Some commenters, however, recommended changes to specific provisions of the proposed rule change.

Seven of the comment letters specifically objected to the \$5.0 million equity requirement.³⁰ Three commenters noted that the requirement blocks certain large institutions from participating in portfolio margining because these institutions hold assets at a custodian bank and, consequently, would not hold \$5.0 million in an account with a broker-dealer.³¹ Five commenters raised the issue that securities index options will be at a disadvantage compared with economically similar CFTC regulated index futures, because futures accounts have no minimum equity requirement.³²

The Exchange believes that the comments directed at the \$5.0 million equity requirements have merit, particularly with respect to certain types of accounts that must hold assets at a custodial bank.³³ The Exchange, however, stated that these comments should not delay implementation of the proposed rule change and noted that it intends to file a proposed rule amendment that would offer alternative methods for meeting the

²⁹ See Vander Wilt Letter.

³⁰ See Ianni Letter; Weingart Letter; Wiermanski Letter; Hansen Letter; Greiner Letter; Saliba Letter; and Melvin Letter.

³¹ See Weingart Letter; Wiermanski Letter; and Melvin Letter.

³² See Weingart Letter, Wiermanski Letter; Hansen Letter; Saliba Letter; and Sheehan Letter.

³³ See CBOE Response.

minimum equity requirement after the industry becomes acclimated to the portfolio margin methodology and its operational aspects.

Several commenters stated that other products should be eligible for portfolio margining,³⁴ such as equities,³⁵ as well as OCC-cleared equity derivatives.³⁶ One commenter stated that other risk-based algorithms, such as SPAN,³⁷ that are recognized by other clearing organizations should be permitted for calculating the portfolio margin requirement, in addition to the OCC's TIMS.³⁸

In addition, one commenter stated that the Securities Investor Protection Corporation ("SIPC") would need to amend its rules in order to provide SIPA protection to futures and options on futures in a securities account.³⁹ The Exchange disagrees and notes that the proposed rule change was amended, at the request of Commission staff, to require the immediate transfer to another broker-dealer or the liquidation of a cross-margin account in the event that a broker-dealer becomes insolvent. In addition, the Exchange believes that amendments to Commission Rule 15c3-3 could provide customers holding both securities and futures with protection under SIPA.

³⁴ See Wiermanski Letter; Saliba Letter; and Donohue Letter.

³⁵ See Saliba Letter.

³⁶ See Sheehan Letter.

³⁷ SPAN is the Chicago Mercantile Exchange's Standard Portfolio Analysis System, which is used by many futures exchanges to calculate margin.

³⁸ See Donohue Letter.

³⁹ See Wierzynski/Hammerman Letter.

One commenter, the OCC, strongly urged the Commission to move forward promptly with the approval of the proposed rule changes, and contended that additional regulatory actions are necessary in order to implement the proposed pilot programs.⁴⁰ These other regulatory actions include: Commission approval of SR-OCC-2003-04; a Commission “no-action” letter in connection with SR-OCC-2003-04; an exemptive order from the CFTC; and amendments to Commission Rule 15c3-3. The Exchange agrees with the OCC that approval of the OCC rule filing and issuance of the “no-action” letter are necessary to enable portfolio margining, including cross-margining, to be utilized.⁴¹ The Exchange also urged the Commission to complete all regulatory actions necessary to enable portfolio margining along with the cross-margin component.

IV. Discussion and Commission Findings

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.⁴² In particular, the Commission believes that the proposed rule change is consistent with Section 6(b)(5) of the Act⁴³ in particular, in that it is designed to perfect the mechanism of a free and open market and to protect investors and the public interest. The Commission notes that that the proposed

⁴⁰ See Navin Letter.

⁴¹ See supra notes 21 and 23.

⁴² In approving this proposed rule change, the Commission notes that it has considered the proposed rule’s impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

⁴³ 15 U.S.C. 78f(b)(5).

portfolio margin rule change is intended to promote greater reasonableness, accuracy and efficiency with respect to Exchange margin requirements for complex listed securities index option strategies. The Commission further notes that the cross-margining capability with related index futures positions in eligible accounts may alleviate excessive margin calls, improve cash flows and liquidity, and reduce volatility. Moreover, the Commission notes that approving the proposed rule change would be consistent with the FRB's 1998 amendments to Regulation T, which sought to advance the use of portfolio margining.

Under the proposed rule changes, the Commission notes that a broker-dealer choosing to offer portfolio margining to its customers must employ a methodology that has been approved by the Commission for use in calculating haircuts under Rule 15c3-1a. As stated above, currently, TIMS is the only approved methodology. While some commenters recommended expanding the choice of models, the Commission believes that requiring a broker-dealer to use a model that qualifies for calculating haircuts under Commission Rule 15c3-1a maintains a consistency with the Commission's net capital rule and across potential portfolio margin pricing models. As a result, portfolio margin requirements would vary less from firm to firm. The Commission notes, however, that like Rule 15c3-1a, the proposed rule permits the use of another theoretical pricing model, should one be developed in the future.⁴⁴

⁴⁴ See also Securities Exchange Act Release No. 34-38248 (February 6, 1997), 62 FR 6474 (February 12, 1997)(discussing in Part II.A. the use of TIMS versus other pricing models).

The Commission notes the objections of certain commenters to the \$5 million minimum equity requirement. The Commission believes that the requirement circumscribes the number of accounts able to participate and adds safety in that such accounts are more likely to be of significant financial means and investment sophistication.

Finally, the Commission notes that several commenters recommended expanding the products eligible for portfolio margining. The Exchange's proposed rule limits the instruments eligible for portfolio margining to listed products based on broad-based US securities indices, which tend to be less volatile than narrow-based indices and non-index equities. The Commission believes this limitation is appropriate for the pilot program, which should serve as a first step toward the possible expansion of portfolio margining to other classes of securities.

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,⁴⁵ that the proposed rule change (File No. SR-CBOE-2002-03), as amended, is approved on a pilot basis to expire on July 31, 2007.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁴⁶

Margaret H. McFarland
Deputy Secretary

⁴⁵ 15 U.S.C. 78s(b)(2).

⁴⁶ 17 CFR 200.30-3(a)(12).