

[Release No. 34-35806; International Series Release No. 817; File No. SR-CBOE-95-12]

Self-Regulatory Organizations; Order Approving a Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval of Amendment Nos. 2 and 3 to the Proposed Rule Change by the Chicago Board Options Exchange, Inc. Relating to the Listing of Currency Warrants Based on the Mexican Peso

June 5, 1995.

On January 27, 1995, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² filed with the Securities and Exchange Commission ("Commission") a proposed rule change to permit the listing of foreign currency warrants based on the value of the U.S. dollar in relation to the Mexican peso ("Peso Warrants"). Notice of the proposal appeared in the **Federal Register** on February 8, 1995.³ The Exchange subsequently filed Amendment No. 1 to the proposal on March 6, 1995. Notice of Amendment No. 1 to the proposal appeared in the **Federal Register** on March 15, 1995.⁴ No comment letters were received on the original proposed rule change or on Amendment No. 1. The Exchange then filed Amendment No. 2 to the proposal on May 1, 1995,⁵ and Amendment No. 3 on May 24, 1995.⁶ This order approves the CBOE proposal, as amended by Amendment Nos. 2 and 3.

Pursuant to CBOE Rule 31.5(E), the Exchange is now proposing to list and trade currency warrants based upon the

value of the U.S. dollar in relation to the Mexican peso. Peso Warrants will be unsecured obligations of their issuers and will be cash-settled in U.S. dollars. Peso Warrants will be exercisable either throughout their life (*i.e.*, American-style) or only immediately prior to their expiration date (*i.e.*, European-style). Upon exercise, the holder of Peso Warrant structured as a "put" will receive payment in U.S. dollars to the extent that the value of the Mexican peso in relation to the U.S. dollar has declined below a pre-stated base level. Conversely, upon exercise, holders of a Peso Warrant structured as a "call" will receive payment in U.S. dollars to the extent that the value of the Mexican peso in relation to the U.S. dollar has increased above a pre-stated level. Peso Warrants that are "out-of-the-money" at the time of expiration will expire worthless.

Any issue of Peso Warrants will conform to the listing guidelines under CBOE Rule 31.5(E) which provide that: (1) The issuer will have assets in excess of \$100,000,000 and otherwise substantially exceed the size and earnings requirements in CBOE Rule 31.5(A); (2) the term of the warrants will be from one to five years from the date of issuance; and (3) the minimum public distribution of such issues will be one million warrants, with a minimum of 400 public holders, and an aggregate market value of at least \$4 million.⁷

The CBOE will also require that Peso Warrants be sold only to customers whose accounts have been approved for options trading pursuant to Exchange Rule 9.7. The suitability standards of Exchange Rule 9.9 will apply to recommendations for opening transactions in Peso Warrants. Additionally, the standards of Rule 9.10(a), regarding discretionary orders, will also be applied to Peso Warrants. Moreover, the Exchange will require members and member organizations to report to the CBOE any positions of 100,000 or more Peso Warrants on the same side of the market.⁸

⁷ On September 28, 1994, the Exchange submitted for Commission approval, proposed rules governing listing requirements, and customer protection and margin requirements for stock index warrants, currency index warrants, and currency warrants. See Securities Exchange Act Release No. 35178 (December 29, 1994), 60 FR 2409 (January 9, 1995) (notice of File No. SR-CBOE-94-34) ("Generic Warrant Listing Proposal"). If ultimately approved by the Commission, Peso Warrants issued subsequent to that approval will be subject to these rules. These rules, however, will not change the customer margin requirements specified herein. See Amendment No. 2, *supra* note 5.

⁸ See Amendment No. 3, *supra* note 6. In connection with the Generic Warrant Listing Proposal, the CBOE intends to impose similar reporting requirements for all currency warrants

For customer margin purposes, the Exchange will set the customer margin "add-on"⁹ percentage for Peso Warrants at 18% for both initial and maintenance margin, with a minimum add-on for out-of-the-money Peso Warrants of 15%.¹⁰ If, as a result of the Exchange's routine monitoring of margin adequacy (*i.e.*, at least quarterly reviews), the CBOE determines that a higher customer margin level would be appropriate, the CBOE will take immediate steps to implement the change.¹¹ If, on the other hand, the Exchange determines that a lower margin percentage would be appropriate as a result of the Exchange's periodic reviews, the Exchange will file a proposal with the Commission pursuant to Section 19(b) of the Act to modify the margin add-on percentages applicable to Peso Warrants.¹² Anytime that the customer margin levels for Peso Warrants are changed, the Exchange will promptly notify the Exchange's membership and the public.

Prior to the commencement of trading of Peso Warrants, the Exchange will distribute a circular to its membership calling attention to certain compliance responsibilities when handling transactions in Peso Warrants.¹³

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange, and, in particular, the requirements of Section 6(b)(5)¹⁴ in that

listed by the Exchange. See Generic Warrant Listing Proposal, *supra* note 7.

⁹ For these purposes, "add-on" is the percentage of the current market value of the Mexican pesos underlying each Peso Warrant that the holder of a "short" position must pay in addition to the current market value of each Peso Warrant.

¹⁰ See Amendment No. 2, *supra* note 5.

¹¹ Prior to increasing the customer margin levels, the Exchange should immediately contact the Commission for a determination as to whether a rule filing pursuant to Section 19(b) of the Act will be required.

¹² Specifically, the Exchange will review, on at least a quarterly basis, the frequently distributions reflecting the percentage price returns for the Mexican peso in relation to the U.S. dollar for all seven day periods during the preceding two year period. If the current margin add-on is not sufficient to cover at least 97.5% of all such seven day price returns, the Exchange will take steps to increase the margin level to one that will cover at least 97.5% of all such instances. See Amendment No. 3, *supra* note 6. In no event, however, will the Exchange reduce the margin levels provided in Amendment No. 2 without the prior approval of the Commission. See Amendment No. 2, *supra* note 5.

¹³ The circular should highlight: (1) That Peso Warrants may be sold only to customers with options approved accounts; (2) the applicable suitability requirements; (3) the standards regarding discretionary orders; (4) the reporting requirements for positions of 100,000 or more Peso Warrants on the same side of the market; and (5) the applicable customer margin requirements.

¹⁴ 15 U.S.C. 78f(b)(5) (1988).

¹ 15 U.S.C. 78s(b)(1) (1988).

² 17 CFR 240.19b-4 (1994).

³ See Securities Exchange Act Release No. 35324 (February 2, 1995), 60 FR 7599.

⁴ In Amendment No. 1, the Exchange amended the proposal to specify customer margin levels for the proposed currency warrants. See Securities Exchange Act Release No. 35463 (March 9, 1995), 60 FR 14042.

⁵ Amendment No. 2, as discussed herein, effectively supersedes Amendment No. 1 by specifying higher minimum customer margin levels than those proposed in Amendment No. 1. See Letter from Mary Bender, Senior Vice President, Division of Regulatory Services, CBOE, to Sharon Lawson, Assistant Director, Office of Market Supervision ("OMS"), Division of Market Regulation ("Division"), Commission, dated April 27, 1995 ("Amendment No. 2").

⁶ In Amendment No. 3, as discussed herein, the Exchange: (1) Specified the standards the CBOE will use to ensure continued adequate customer margin levels for short positions in Peso Warrants; and (2) imposed reporting requirements for certain positions in Peso Warrants. See Letter from Mary Bender, Senior Vice President, Division of Regulatory Services, CBOE, to Brad Ritter, Senior Counsel, OMS, Division, Commission, dated May 24, 1995 ("Amendment No. 3").