March 31, 2000

Katherine A. England, Esq.
Assistant Director
Division of Market Regulation
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-1001

Re: **File No. SR-NASD-00-15** - Margin Rule Amendments Relating to Options Positions

Dear Ms. England:

Pursuant to Rule 19b-4, enclosed is the above-numbered rule filing. Also enclosed is a 3-l/2" disk containing the rule filing in Microsoft Word 7.0 to facilitate production of the Federal Register release.

If you have any questions, please contact Stephanie M. Dumont, Office of General Counsel, NASD Regulation, Inc., at (202) 728-8176, e-mail Stephanie.Dumont@nasd.com. The fax number of the Office of General Counsel is (202) 728-8264.

Very truly yours,

Patrice Gliniecki
Vice President and
Deputy General Counsel

Enclosures

File No. SR-NASD-00-15
Consists of 48 Pages

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C.

Form 19b-4

Proposed Rule Change

by

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

Pursuant to Rule 19b-4 under the
Securities Exchange Act of 1934

1. Text of Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(1) under the Securities Exchange Act of 1934 (“Act”), the National Association of Securities Dealers, Inc. (“NASD” or “Association”), through its wholly owned subsidiary, NASD Regulation, Inc. (“NASD Regulation”), is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change to Rules 2520 and 2522 that will revise the margin requirements to: (1) expand the types of short options positions that would be considered "covered" in a cash account, specifically, certain short positions that are components of limited risk spread strategies, provided that any potential risk to the carrying broker/dealer is paid for in full and retained in the account; (2) allow an escrow agreement that conforms to NASD standards to serve in lieu of cash for certain spread positions held in a cash account; (3) permit "butterfly" and "box" spreads to be recognized as strategies for purposes of margin treatment, when such strategies result in a lower risk position; (4) recognize various hedging strategies involving stock paired with options positions and provide for lower maintenance margin requirements on the security component of these hedged positions; (5) permit extension of credit on certain long-term options and warrants with over nine months until expiration and on certain long box spreads; and (6) permit minimum margin requirements for a short put on a listed option to be the current value of the put plus a specified percentage of the put option’s exercise price, and for a short put on an over-the-counter (“OTC”) option to be a specified percentage of the put option’s exercise price.

The text of the proposed rule change is set forth in Exhibit 2. Proposed new language is underlined; proposed deletions are in brackets.

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

(a) The proposed rule change was approved by the Board of Directors of NASD Regulation at its meeting on January 27, 2000, which authorized the filing of the rule change with the SEC. The Nasdaq Stock Market has been provided an opportunity to consult with respect to the proposed rule change, pursuant to the Plan of Allocation and Delegation of Functions by the NASD to its Subsidiaries. The NASD Board of Governors had an opportunity to review the proposed rule change at its meeting on January 28, 2000. No other action by the NASD is necessary for the filing of the proposed rule change. Section 1(a)(ii) of Article VII of the NASD By-Laws permits the NASD Board of Governors to adopt amendments to NASD Rules without recourse to the membership for approval.

The NASD will announce the effective date of the proposed rule change in a Notice to Members to be published no later than 60 days following Commission approval. The effective date will be 30 days following publication of the Notice to Members announcing Commission approval.

(b) Questions regarding this rule filing may be directed to Stephanie M. Dumont, Assistant General Counsel, NASD Regulation, Office of General Counsel, at (202) 728-8176.

3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(a) Purpose

Background

Until several years ago, the margin requirements governing listed options were set forth in Regulation T. However, Federal Reserve Board amendments to Regulation T that became effective on June 1, 1997 modified or deleted certain margin requirements regarding options transactions in favor of rules to be adopted by the self-regulatory organizations ("SROs"), subject to approval by the Commission.[1]

The NASD currently regulates the options activities of its members, which includes margin requirements for options-related positions. The proposed rule change is consistent with recent margin rule amendments by the New York Stock Exchange ("NYSE"), which were approved by the SEC.[2] These amendments were based on recommendations by the 431 Committee[3] and its Options Subcommittee. In addition, the proposed rule change is substantially similar to Chicago Board Options Exchange ("CBOE") margin amendments, which also were approved by the SEC.[4]

Specifically, the NASD is proposing to amend Rule 2520 to:

(1) expand the types of short options positions that would be considered "covered" in a cash account, specifically, certain short positions that are components of limited risk spread

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1 See Board of Governors of the Federal Reserve System Docket No. R-0772 (April 24, 1996), 61 FR 20386 (May 6, 1996) (permitting the adoption of margin requirements “deemed appropriate by the exchange that trades the option, subject to the approval of the Securities and Exchange Commission”).

2 See Securities Exchange Act Release No. 42011 (October 14, 1999).

3 After the Board of Governors of the Federal Reserve System extensively amended Regulation T, an informal ad hoc committee (the "431 Committee") was formed to consider changes to the NYSE’s and NASD’s margin rules (NYSE Rule 431 and NASD Rule 2520, respectively). The 431 Committee also was formed to ensure that the NYSE’s and NASD’s margin rules were consistent in order to prevent confusion and to avoid conferring advantages on members that are required to comply with one rule and not the other. The 431 Committee is composed of NYSE staff, attorneys from the NYSE’s outside counsel, NASD staff, Federal Reserve staff, and representatives from several clearing firms and broker/dealers.

4 See Securities Exchange Act Release No. 41658 (July 27, 1999), 64 FR 42736 (August 5, 1999) (order approving File No. SR-CBOE-97-67) (hereinafter referred to as “CBOE Approval Order”).

strategies, provided that any potential risk to the carrying broker/dealer is paid for in full and retained in the account;

(2) allow an escrow agreement that conforms to NASD standards to serve in lieu of cash for certain spread positions held in a cash account;

(3) permit "butterfly" and "box" spreads to be recognized as strategies for purposes of margin treatment, when such strategies result in a lower risk position;

(4) recognize various hedging strategies involving stock paired with options positions and provide for lower maintenance margin requirements on the security component of these hedged positions;

(5) permit the extension of credit on certain long-term options and warrants with over nine months until expiration and on certain long box spreads; and

(6) permit minimum margin requirements for a short put on a listed option to be the current value of the put plus a specified percentage of the put option's exercise price, and for a short put on an OTC option to be a specified percentage of the put option's exercise price.

In addition, the NASD is proposing to amend Rule 2522 to include definitions relating to the proposed rule change described above.

Permissible Cash Account Transactions

Under recent Regulation T amendments, certain limited risk spread strategies are permissible in a cash account.[5] Under the proposed rule change, these limited risk strategies will be permitted in the cash account, provided the potential risk is paid for in full. These strategies include: Long and Short Box Spreads and Long and Short Butterfly Spreads.

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[5] See Regulation T, Section 220.2 – "Definitions."

The proposed rule change will permit butterfly and box spreads in cash-settled European-style[6] options in cash accounts. To qualify to be carried in the cash account, such butterfly and box spreads must meet the specifications contained in the proposed definitions[7] of each strategy and must be comprised of options that are listed or guaranteed by the carrying broker/dealer. In addition, the long options must be held in, or purchased for, the account on the same day.

The proposed rule change requires that any debit incurred when a long butterfly or long box spread strategy is established must be paid in cash, covering any potential risk to the carrying broker/dealer. As a European-style spread, the contracts cannot be exercised until the expiration date, so there is no market risk once any debit incurred is paid in full.[8]

Short butterfly spreads generate a credit balance when established (i.e. the proceeds from the sale of short option components exceed the cost of purchasing long option components). However, in the worst case scenario where all options are exercised, a debit (loss) would be

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6 A European-style option may be exercised only at its expiration.

7 The term "box spread" is defined in proposed new paragraph 2522(a)(8) as: "An aggregation of positions in a long call option and short put option with the same exercise price ("buy side") coupled with a long put option and a short call option with the same exercise price ("sell side"), all of which have the same underlying component or index and time of expirations, and are based on the same aggregate current underlying value, and are structured as either: (A) a "long box spread" in which the sell side exercise price exceeds the buy side exercise price, or (B) a "short box spread" in which the buy side exercise price exceeds the sell side exercise price."

The term "butterfly spread" is defined in proposed new paragraph 2522(a)(9) as "An aggregation of positions in three series of either put or call options all having the same underlying component or index and time of expiration, and based on the same aggregate current underlying value, where the interval between the exercise price of each series is equal, which positions are structured as either (A) a "long butterfly spread" in which two short options in the same series are offset by one long option with a higher exercise price and one long option with a lower exercise price, or (B) a "short butterfly spread" in which two long options in the same series offset one short option with a higher exercise price and one short option with a lower exercise price."

8 For example, to create a long butterfly spread, which is comprised of call options, an investor may be long 1 XYZ Jan 45 Call @ 6, short 2 XYZ Jan 50 Calls @ 3 each, and long 1 XYZ Jan 55 Call @ 1. The maximum risk for this long butterfly spread is the net debit incurred to establish the strategy ((3+3)-(6+1)=net debit of 1). Under the proposed rule change, the investor would be required to pay the net debit, or $100 (1x100). See CBOE Approval Order at footnote 25.

created that is greater than the initial credit balance received. To eliminate the risk to the broker/dealer carrying the short butterfly spread, the proposed rule change requires that an amount equal to the maximum risk be held or deposited in the account in the form of cash or cash equivalents. The maximum potential risk in a short butterfly spread composed of call options is the aggregate difference between the two lowest exercise prices.[9] For short butterfly spreads composed of put options, the maximum potential risk is the aggregate difference between the two highest exercise prices. The net credit received from the sale of the short option components could be applied towards the requirement. Because this debit or loss is quantifiable, the proposed rule change requires, in addition to the initial credit balance, the deposit of an amount equal to the difference between the initial credit and the total risk in the form of cash or cash equivalents to cover the risk to the broker/dealer.[10]

Short box spreads also generate a credit balance when established, but unlike the butterfly spread, this credit is nearly equal to the total debit (loss) that will accrue to the account if held to expiration. The proposed rule change will require that cash or cash equivalents covering the

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9 For example, an investor may be short 1 XYZ Jan 45 Call @ 6, long 2 XYZ Jan 50 Calls @ 3 each, and short 1 XYZ Jan 55 Call @ 1. Under the proposed rule change, the maximum risk for this short butterfly spread, which is comprised of call options, is equal to the difference between the two lowest exercise prices (50-45=5). If the net credit received from the sale of short option components ((6+1)-(3+3)=1) is applied, the investor is required to deposit an additional $400 (4x100). Otherwise, the investor would be required to deposit $500 (5x100). See CBOE Approval Order at footnote 27.

10 Under the proposed rule change, an escrow agreement could be used as a substitute for cash or cash equivalents if the agreement satisfies certain criteria. For short butterfly spreads, the escrow agreement must certify that the bank holds for the account of the customer as security for the agreement (1) cash, (2) cash equivalents, or (3) a combination thereof having an aggregate market value at the time the positions are established of not less than the amount of the aggregate difference between the two lowest exercise prices with respect to short butterfly spreads comprised of call options or the aggregate difference between the two highest exercise prices with respect to short butterfly spreads comprised of put options and that the bank will promptly pay the member such amount in the event the account is assigned an exercise notice on the call (put) with the lowest (highest) exercise price.

maximum risk, which is equal to the aggregate difference in the two exercise prices involved, be held or deposited.[11] The net credit received from the sale of the short option components may be applied towards the requirement; if applied, only a small fraction of the total requirement need be held or deposited.[12]

In addition to butterfly spreads and box spreads, the proposed rule change will permit investors to hold in their cash accounts other spreads made up of European-style, cash-settled stock index options or stock index warrants. A short position would be considered covered, and thus eligible for the cash account, if a long position in the same European-style, cash-settled index option or stock index warrant was held in, or purchased for, the account on the same day.[13] The long and short positions making up the spread must expire concurrently, and the long position must be paid in full.

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[11] As a substitute for cash or cash equivalents, an escrow agreement could be used if it satisfies certain criteria. For short box spreads, the escrow agreement must certify that the bank holds for the account of the customer as security for the agreement (1) cash, (2) cash equivalents, or (3) a combination thereof having an aggregate market value at the time the positions are established of not less than the amount of the aggregate difference between the exercise prices, and that the bank will promptly pay the member such amount in the event the account is assigned an exercise notice on either short option.

[12] For example, to create a short box spread, an investor may be short 1 XYZ Jan 60 Put @ 5 1/2 and long 1 XYZ Jan 60 Call @ 2 ("buy side"), and short 1 XYZ Jan 50 Call @ 7 and long 1 XYZ Jan 50 Put @ 1 ("sell side"). As required by the proposed definition of "short box spread," the buy side exercise price exceeds the sell side exercise price. In this example, the maximum risk for the short box spread is equal to the difference between the two exercise prices (60-50=10). If the net credit received from the sale of short option components ((5 1/2 + 7)-(2+1)= net credit of 9 1/2) is applied, the investor is required to deposit an additional $50 (1/2 x 100). Otherwise, the investor would be required to deposit $1,000 (10 x 100). See CBOE Approval Order at footnote 29.

[13] Under the proposed rule change, a long warrant may offset a short option contract and a long option contract may offset a short warrant provided they have the same underlying component or index and equivalent aggregate current underlying value.

The proposed rule change also would permit a member to use an escrow agreement that conforms with standards set forth in the proposed rule change[14] in lieu of the cash or cash equivalents required to carry short butterfly and box spreads in the cash account.

Margin Requirements for Butterfly and Box Spreads

The NASD's margin rules currently do not recognize butterfly spreads for margin purposes. Under current margin rules, the components of butterfly spreads must be margined separately. As a result, current margin requirements would not recognize that the risk of each spread offsets the risk of the other. Under the proposed rule change, the two spreads can be viewed in combination, such that investors will receive the benefit of lower margin requirements commensurate with the lower combined risk.

The proposed rule change would recognize as a distinct strategy butterfly spreads held in margin accounts, and specify requirements that are the same as the cash account requirements for butterfly spreads. The margin requirements would apply to butterfly spreads where all option positions are listed or guaranteed by the carrying broker/dealer. In the case of a long butterfly spread, the net debit must be paid in full. For short butterfly spreads comprised of call options, the initial and maintenance margin must equal at least the aggregate difference between the two lowest exercise prices. For short butterfly spreads comprised of put options, the initial and maintenance margin must equal at least the aggregate difference between the two highest

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[14] The proposed rule change defines an "escrow agreement," when used in connection with cash settled calls, puts, currency warrants, currency index warrants or stock index warrants, carried short, as any agreement issued in a form acceptable to the NASD under which a bank holding cash, cash equivalents, one or more qualified equity securities or a combination thereof is obligated (in the case of an option) to pay the creditor the exercise settlement amount in the event an option is assigned an exercise notice or (in the case of a warrant) the funds sufficient to purchase a warrant sold short in the event of a buy-in.

exercise prices. The net credit received from the sale of the short option components may be applied towards the margin requirement for short butterfly spreads.

The proposed requirements for box spreads held in a margin account, where all option positions making up the box spread are listed or guaranteed by the carrying broker/dealer, also are the same as those applied to the cash account. With respect to long box spreads, where the component options are not European-style, the proposed rule change would require full payment of the net debit that is incurred when the spread strategy is established. For short box spreads held in the margin account, the proposed rule change would require that cash or cash equivalents covering the maximum risk, which is equal to the aggregate difference in the two exercise prices involved, be deposited and maintained. The net credit received from the sale of the short option components may be applied towards the requirement. Generally, long and short box spreads would not be recognized for margin equity purposes; however, the proposed rule change would allow loan value for one type of long box spread where all component options have a European-style exercise provision and are listed or guaranteed by the carrying broker/dealer.

Maintenance Margin Requirements for Stock Positions Held with Options Positions

The proposed rule change would allow for a reduction in the maintenance margin requirement[15] for the stock component of the following five hedging strategies: (1) Long Put/Long Stock; (2) Long Call/Short Stock; (3) Conversions; (4) Reverse Conversions; and (5) Collars. Although the five strategies are summarized below in terms of stock positions held in conjunction with an overlying option (or options), the proposal is structured also to apply to

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[15] Generally, Rule 2520(c) requires maintenance margin of 25% for all securities "long" in the account and 30% of the current market value of all securities "short" in the account.

components that underlie index options and warrants. For example, these same maintenance margin requirements will apply when these strategies are used with a stock basket underlying index options or warrants. The proposed rule change will define the five strategies and set forth the respective maintenance margin requirements for the stock component of each strategy.

1. Long Put/Long Stock

The Long Put/Long Stock hedging strategy requires an investor to carry in an account a long position in the component underlying the put option and a long put option specifying equivalent units of the underlying component. This strategy is designed to limit downside risk in the underlying stock while the put is held. The put holder retains the right to sell stock at the strike price through the expiration of the put.

Under the proposed rule change, the maintenance margin requirement for the Long Put/Long Stock combination would be the lesser of: (a) 10% of the put option exercise price, plus 100% of any amount by which the put option is out-of-the-money; or (b) 25% of the current market value of the long stock position.[16]

2. Long Call/Short Stock

The Long Call/Short Stock strategy requires an investor to carry in an account a short position in the component underlying the call option, and a long call option specifying the equivalent units of the underlying components. This strategy is designed to limit the risk

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[16] For example, if an investor is long 100 shares of XYZ @ 52 and long one XYZ Jan 50 Put @ 2, the required margin would be the lesser of ((10% x 50) + (100% x 2) = 7) or (25% x 52 = 13). Therefore, the investor would be required to maintain margin equal to at least $700 (7 x 100). See CBOE Approval Order at footnote 34.

associated with upside appreciation in the underlying stock during the life of the call. The call holder retains the right to buy the stock at the strike price through the expiration of the call.

Under the proposed rule change, for a Long Call/Short Stock combination, the maintenance margin requirement would be the lesser of: (a) 10% of the call option exercise price, plus 100% of any amount by which the call option is out-of-the-money; or (b) the maintenance margin requirement on the short stock position as specified in NASD Rule 2520(c).[17]

3. Conversion (Long Stock/Long Put/Short Call)

A "conversion " is a hedging strategy where the account carries a long stock position in conjunction with a long put and a short call. For a conversion to qualify as hedged, the long put and the short call must have the same expiration and exercise price. The long put/short call acts like a short stock position which offsets the long stock, and the exercise price of the options functions as a predetermined sale price. The short call is covered by the long stock, and the long put is a right to sell the stock at a predetermined price (i.e., the put exercise price). Thus, regardless of any decline in market value, the stock position, in effect, is worth no less than the exercise price of the put.

Current NASD margin rules specify that no maintenance margin would be required on the short call option because it is covered, but the underlying long stock position would be margined according to the current maintenance margin requirement (i.e., 25% of the current market

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[17] For each stock carried short that has a current market value of less than $5 per share, the maintenance margin is $2.50 per share or 100% of the current market value, whichever is greater. For each stock carried short that has a current market value of $5 per share or more, the maintenance margin is $5 per share or 30% of the current market value, whichever is greater. See NASD Rule 2520(c).

The following is an example of the maintenance margin calculation for a Long Call/Short Stock combination. For an investor who is short 100 shares of XYZ @ 48 and long 1 XYZ Jan 50 Call @ 1, the required margin value).[18] Under the proposed rule change, the maintenance margin requirement for a conversion would be 10% of the exercise price.[19]

4. Reverse Conversion (Short Stock/Short Put/Long Call)

A "reverse conversion" is a hedging strategy where the account carries a short stock position in conjunction with a short put and a long call. As with the conversion, the put and call must have the same expiration date and exercise price. The short put is covered by the short stock and the long call is a right to buy the stock at a predetermined price (i.e., the call exercise price). Regardless of any rise in market value, the stock can be acquired for the call exercise price; in effect, the short position is valued at no more than the call exercise price. Under the proposed rule change, the maintenance margin requirement for a reverse conversion would be 10% of the exercise price, plus any in-the-money amount (i.e., the amount by which the exercise price of the short put exceeds the current market value of the underlying stock position).[20]

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would be the lesser of ((10% x 50) + (100% x 2) = 7) or (30% x 48 = 14.4). Therefore, the investor would be required to maintain margin equal to at least $700 (7 x 100). See CBOE Approval Order at footnote 35.

[18] For example, for an investor who is long 100 shares of XYZ @ 48, long one XYZ Jan 50 Put @ 2, and short one XYZ Jan 50 Call @ 1, the current maintenance margin on the long stock position would be $1,200 ((25% x 48) X 100). However, if the price of the stock increased to 60, the NASD currently specifies that the stock may not be valued at more than the short call exercise price. Thus, the maintenance margin on the long stock position would be $1,250 ((25% x 50) x 100). The writer of the call option cannot receive the benefit (i.e., greater loan value) of a market value that is above the call exercise price because, if assigned an exercise, the underlying component would be sold at the exercise price, not the market price of the long position. See CBOE Approval Order at footnote 36.

[19] For the example in the preceding footnote, where the investor was long 100 shares of XYZ, @ 48, long 1 XYZ Jan 50 Put @ 2, and short 1 XYZ Jan 50 Call @ 1, the proposed maintenance margin requirement for the Conversion strategy would be $500 ((10% x 50) x 100). See CBOE Approval Order at footnote 37.

[20] The seller of a put option has an obligation to buy the underlying component at the put exercise price. If assigned an exercise, the underlying component would be purchased (the short position in the reverse conversion effectively closed) at the exercise price, even if the current market price is lower. To recognize the lower market value of a component, the short put in-the-money amount is added to the requirement. For example, an investor holding a reverse conversion may be short 100 shares of XYZ @ 52, long one XYZ Jan 50 Call @ 2 1/2, and short one XYZ Jan 50 Put @ 1 1/2. If the current market value of XYZ stock drops to 30, the maintenance margin would be $2,500 ((10% x 50) + (50-30)) x 100. See CBOE Approval Order at footnote 38.

5. Collar (Long Stock/Long Put/Short Call)

A "collar" is a hedging strategy where the account carries a long stock position held in conjunction with a long put and a short call. In a collar, as compared to a conversion, the exercise price of the long put is lower than the exercise price of the short call. Therefore, the options positions in a collar do not constitute a pure synthetic short stock position. The maintenance margin for a collar under the proposed rule change would be the lesser of: (a) 10% of the long put exercise price, plus 100% of any amount by which the long put is out-of-the-money; or (b) 25% of the short call exercise price.[21] Under the NASD's current margin requirements, the stock may not be valued at more than the call exercise price.

Extension of Credit on Long-Term Options and Warrants and Long Box Spreads

The proposed rule change would allow extensions of credit on certain long listed and OTC[22] options (i.e., put or call options on a stock or stock index) and warrant products (i.e., stock index warrants, but not traditional stock warrants issued by a corporation on its own stock).[23] Only those options or warrants with expirations exceeding nine months ("long-term") will be eligible for credit extension.[24] If the time to expiration is nine months or less, the proposed amendments do not permit options or warrants to have any loan value because of the leverage

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[21] To create a collar, an investor may be long 100 shares of XYZ @ 48, long 1 XYZ Jan 45 Put @ 4, and short 1 XYZ Jan 50 Call @ 3. The maintenance margin requirement would be the lesser of ((10% x 45) + 3=7 1/2) or (25% x 50=12 1/2). Therefore, the investor would need to maintain at least $750 (7 1/2 x 100) in margin. See CBOE Approval Order at footnote 39.

[22] Unlike listed options, OTC options are not issued by the Options Clearing Corporation. OTC options and warrants are not listed or traded on a registered national securities exchange or through the automated quotation system of a registered securities association.

[23] The proposed rule change does not permit long-term foreign currency options to have any loan value.

[24] For any stock option, stock index option, or stock index warrant that expires in nine months or less, initial margin must be deposited and maintained equal to at least 100% of the current market value of the option or warrant.

and volatility associated with such instruments. When the time remaining until expiration for an option or warrant (listed or OTC) on which credit has been extended reaches nine months, the maintenance margin requirement will become 100% of the current market value.

For long-term listed options and warrants, the proposed rule change requires initial and maintenance margin of not less than 75% of the current market value of the option or warrant. Therefore, members would be able to loan up to 25% of the current market value of a long-term listed option or warrant. For example, if an investor purchased a listed call option on stock XYZ that expired in January 2001 for approximately $100 (excluding commissions), the investor would be required to deposit and maintain at least $75. The investor could borrow the remaining $25 from the member. Under the current margin rules, the investor would be required to pay the entire $100.

The proposed rule change also would permit the extension of credit on certain long-term OTC options and warrants. Specifically, the proposed rule change would allow a member firm to extend credit on an OTC put or call option on a stock or stock index, and on an OTC stock index warrant. In addition to being more than nine months from expiration, a marginable OTC option or warrant must: (1) be in-the-money; (2) be guaranteed by the carrying broker/dealer; and (3) have an American-style[25] exercise provision. The proposed rule change requires initial and maintenance margin of 75% of the long-term OTC option's or warrant's in-the-money amount (i.e., intrinsic value), plus 100% of the amount, if any, by which the current market value of the OTC option or warrant exceeds the in-the-money amount.

[25] American-style options are exercisable at any time up to the day before expiration.

Once the time remaining until expiration for an option or warrant on which credit has been extended reaches nine months, the maintenance margin requirement will become 100% of the current market value. Thus, options or warrants expiring in less than nine months would have no loan value under the proposal because of the leverage and volatility of those instruments.

The proposed rule change also provides for the extension of credit on long box spreads composed entirely of European-style options that are listed or guaranteed by the carrying broker/dealer. A long box spread is a strategy composed of four option positions that lock-in the ability to buy and sell the underlying component or index for a profit, after netting the cost of establishing the long box. The two exercise prices of the options in the strategy determine the buy and the sell price.[26]

For long box spreads made up of European-style options, the proposed rule change would require initial and maintenance margin of 50% of the aggregate difference in the two exercise prices (buy and sell), which results in a margin requirement slightly higher than 50% of the debit typically incurred in establishing such a position.[27] Under the proposed rule, a long box spread position would be allowed market value for margin purposes of not more than 100% of the aggregate differential in the exercise prices of the options.

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[26] For example, an investor might be long 1 XYZ Jan 50 Call @ 7 and short 1 XYZ Jan 50 Put @ 1 ("buy side"), and short 1 XYZ Jan 60 Call @ 2 and long 1 XYZ Jan 60 Put @ 5 1/2 ("sell side"). As required by the proposed definition of "long box spread," the sell side exercise price exceeds the buy side exercise price. In this example, the long box spread is a riskless position because the net debit ((2+1)-(7+5 1/2)= net debit of 9 1/2) is less than the exercise price differential (60-50=10). Thus, the investor has locked in a profit of $50 (1/2 x 100).

[27] Using the example in the preceding footnote, the margin required (50% x (60-50) = 5) would be slightly higher than 50% of the net debit (50% x 9 ½ = 4 ¾).

Minimum Margin Requirements for Short, Uncovered Put Options

NASD Rule 2520(f)(2)(D) currently provides that the minimum required margin for a short listed put option is an amount equal to the option premium plus a percentage of the current value of the underlying instrument. The minimum required margin for a short OTC put option is an amount equal to a percentage of the current value of the underlying component. As a result, the current provisions create a margin requirement for a short put option even when the price of the underlying instrument rises above the exercise price of the put and the risk associated with the put option has decreased because the option is out-of-the money. The proposed rule change would amend the margin requirement for short put options to provide a minimum margin requirement more in line with the risk associated with the option. Specifically, the proposed rule change would provide that the minimum margin requirement for a short listed put option be an amount equal to the current value of the option plus a percentage of the option's exercise price. The minimum margin required for a short OTC put option will be an amount equal to a specified percentage of the option's exercise price.

(b) Statutory Basis

NASD Regulation believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, which requires, among other things, that the Association’s rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. The NASD believes that the proposed rule change will promote the safety and soundness of member firms and is consistent with the rules and regulations of the FRB for the purpose of preventing the excessive use of credit for the purchase or carrying of securities.

4. Self-Regulatory Organization's Statement on Burden on Competition

NASD Regulation does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

6. Extension of Time Period for Commission Action

NASD Regulation does not consent at this time to an extension of the time period for Commission action specified in Section 19(b)(2) of the Act.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

NASD Regulation requests the Commission to find good cause pursuant to Section 19(b)(2) for approving the proposed rule change prior to the 30th day after its publication in the Federal Register. As described herein, the proposed rule change is consistent with rule changes by the NYSE and CBOE, both of which have been approved by the SEC. Because NASD Regulation believes it is important that the NASD's margin rules be consistent with other SRO’s margin rules in order to avoid subjecting firms that are members of more than one SRO to conflicting margin requirements, NASD Regulation requests the Commission to accelerate the effectiveness of the proposed rule change prior to the 30th day after its publication in the Federal Register.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

The provisions of the proposed rule change are consistent with the proposed rule changes by the NYSE and CBOE, both of which have been approved by the SEC. Except where NASD Regulation may not agree with a specific margin proposal of another SRO, NASD Regulation generally believes it is important that the NASD's and other SRO's margin rules be consistent in order to avoid subjecting firms that are members of more than one SRO to conflicting margin requirements.

9. Exhibits

1. Completed notice of proposed rule change for publication in the Federal Register.

2. Text of Proposed Rule Change.

Pursuant to the requirements of the Securities Exchange Act of 1934, NASD Regulation has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

NASD REGULATION, INC.

BY:____

Patrice Gliniecki
Vice President and Deputy General Counsel

Date: March 31,2000

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-NASD-00-15)

Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to Margin Requirements for Options

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")[1] and Rule 19b-4 thereunder,[2] notice is hereby given that on , the National Association of Securities Dealers, Inc. ("NASD"), through its wholly owned subsidiary, NASD Regulation, Inc. ("NASD Regulation") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by NASD Regulation. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons. For the reasons discussed below, the Commission is granting accelerated approval of the proposed rule change.

I. SELF-REGULATORY ORGANIZATION'S STATEMENT OF THE TERMS OF SUBSTANCE OF THE PROPOSED RULE CHANGE

NASD Regulation is proposing to amend NASD Rules 2520 and 2522 to revise the margin requirements to: (1) expand the types of short options positions that would be considered "covered" in a cash account, specifically, certain short positions that are components of limited risk spread strategies, provided that any potential risk to the carrying broker/dealer is paid for in full and retained in the account; (2) allow an escrow agreement that conforms to NASD standards to serve in lieu of cash for certain spread positions held in a cash account; (3) permit "butterfly"

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[1] 15 U.S.C. 78s(b)(1).

and "box" spreads to be recognized as strategies for purposes of margin treatment, when such strategies result in a lower risk position; (4) recognize various hedging strategies involving stock paired with options positions and provide for lower maintenance margin requirements on the security component of these hedged positions; (5) permit extension of credit on certain long-term options and warrants with over nine months until expiration and on certain long box spreads; and (6) permit minimum margin requirements for a short put on a listed option to be the current value of the put plus a specified percentage of the put option's exercise price, and for a short put on an over-the-counter ("OTC") option to be a specified percentage of the put option's exercise price.

The text of the proposed rule change is set forth in Exhibit 2. Proposed new language is underlined; proposed deletions are in brackets.

II. SELF-REGULATORY ORGANIZATION'S STATEMENT OF THE PURPOSE OF, AND STATUTORY BASIS FOR, THE PROPOSED RULE CHANGE

In its filing with the Commission, NASD Regulation included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. NASD Regulation has prepared summaries, set forth in Sections (A), (B), and (C) below, of the most significant aspects of such statements.

(A) Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(a) Purpose

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[2] 17 CFR 240.19b-4.

Background

Until several years ago, the margin requirements governing listed options were set forth in Regulation T. However, Federal Reserve Board amendments to Regulation T that became effective on June 1, 1997 modified or deleted certain margin requirements regarding options transactions in favor of rules to be adopted by the self-regulatory organizations ("SROs"), subject to approval by the Commission.[3]

The NASD currently regulates the options activities of its members, which includes margin requirements for options-related positions. The proposed rule change is consistent with recent margin rule amendments by the New York Stock Exchange ("NYSE"), which were approved by the SEC.[4] These amendments were based on recommendations by the 431 Committee[5] and its Options Subcommittee. In addition, the proposed rule change is substantially similar to Chicago Board Options Exchange ("CBOE") margin amendments, which also were approved by the SEC.[6]

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[3] See Board of Governors of the Federal Reserve System Docket No. R-0772 (April 24, 1996), 61 FR 20386 (May 6, 1996) (permitting the adoption of margin requirements “deemed appropriate by the exchange that trades the option, subject to the approval of the Securities and Exchange Commission”).

[4] See Securities Exchange Act Release No. 42011 (October 14, 1999).

[5] After the Board of Governors of the Federal Reserve System extensively amended Regulation T, an informal ad hoc committee (the "431 Committee") was formed to consider changes to the NYSE’s and NASD’s margin rules (NYSE Rule 431 and NASD Rule 2520, respectively). The 431 Committee also was formed to ensure that the NYSE’s and NASD’s margin rules were consistent in order to prevent confusion and to avoid conferring advantages on members that are required to comply with one rule and not the other. The 431 Committee is composed of NYSE staff, attorneys from the NYSE’s outside counsel, NASD staff, Federal Reserve staff, and representatives from several clearing firms and broker/dealers.

[6] See Securities Exchange Act Release No. 41658 (July 27, 1999), 64 FR 42736 (August 5, 1999) (order approving File No. SR-CBOE-97-67) (hereinafter referred to as “CBOE Approval Order”).

Specifically, the NASD is proposing to amend Rule 2520 to:

(1) expand the types of short options positions that would be considered "covered" in a cash account, specifically, certain short positions that are components of limited risk spread strategies, provided that any potential risk to the carrying broker/dealer is paid for in full and retained in the account;

(2) allow an escrow agreement that conforms to NASD standards to serve in lieu of cash for certain spread positions held in a cash account;

(3) permit "butterfly" and "box" spreads to be recognized as strategies for purposes of margin treatment, when such strategies result in a lower risk position;

(4) recognize various hedging strategies involving stock paired with options positions and provide for lower maintenance margin requirements on the security component of these hedged positions;

(5) permit the extension of credit on certain long-term options and warrants with over nine months until expiration and on certain long box spreads; and

(6) permit minimum margin requirements for a short put on a listed option to be the current value of the put plus a specified percentage of the put option's exercise price, and for a short put on an OTC option to be a specified percentage of the put option's exercise price.

In addition, the NASD is proposing to amend Rule 2522 to include definitions relating to the proposed rule change described above.

Permissible Cash Account Transactions

Under recent Regulation T amendments, certain limited risk spread strategies are permissible in a cash account.[7] Under the proposed rule change, these limited risk strategies will be permitted in the cash account, provided the potential risk is paid for in full. These strategies include: Long and Short Box Spreads and Long and Short Butterfly Spreads.

The proposed rule change will permit butterfly and box spreads in cash-settled European-style[8] options in cash accounts. To qualify to be carried in the cash account, such butterfly and box spreads must meet the specifications contained in the proposed definitions[9] of each strategy and must be comprised of options that are listed or guaranteed by the carrying broker/dealer. In addition, the long options must be held in, or purchased for, the account on the same day.

The proposed rule change requires that any debit incurred when a long butterfly or long box spread strategy is established must be paid in cash, covering any potential risk to the

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[7] See Regulation T, Section 220.2 – "Definitions."

[8] A European-style option may be exercised only at its expiration.

[9] The term "box spread" is defined in proposed new paragraph 2522(a)(8) as: "An aggregation of positions in a long call option and short put option with the same exercise price ("buy side") coupled with a long put option and a short call option with the same exercise price ("sell side"), all of which have the same underlying component or index and time of expirations, and are based on the same aggregate current underlying value, and are structured as either: (A) a "long box spread" in which the sell side exercise price exceeds the buy side exercise price, or (B) a "short box spread" in which the buy side exercise price exceeds the sell side exercise price."

The term "butterfly spread" is defined in proposed new paragraph 2522(a)(9) as "An aggregation of positions in three series of either put or call options all having the same underlying component or index and time of expiration, and based on the same aggregate current underlying value, where the interval between the exercise price of each series is equal, which positions are structured as either (A) a "long butterfly spread" in which two short options in the same series are offset by one long option with a higher exercise price and one long option with a lower exercise price, or (B) a "short butterfly spread" in which two long options in the same series offset one short option with a higher exercise price and one short option with a lower exercise price."

carrying broker/dealer. As a European-style spread, the contracts cannot be exercised until the expiration date, so there is no market risk once any debit incurred is paid in full.[10]

Short butterfly spreads generate a credit balance when established (i.e. the proceeds from the sale of short option components exceed the cost of purchasing long option components). However, in the worst case scenario where all options are exercised, a debit (loss) would be created that is greater than the initial credit balance received. To eliminate the risk to the broker/dealer carrying the short butterfly spread, the proposed rule change requires that an amount equal to the maximum risk be held or deposited in the account in the form of cash or cash equivalents. The maximum potential risk in a short butterfly spread composed of call options is the aggregate difference between the two lowest exercise prices.[11] For short butterfly spreads composed of put options, the maximum potential risk is the aggregate difference between the two highest exercise prices. The net credit received from the sale of the short option components could be applied towards the requirement. Because this debit or loss is quantifiable, the proposed rule change requires, in addition to the initial

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[10] For example, to create a long butterfly spread, which is comprised of call options, an investor may be long 1 XYZ Jan 45 Call @ 6, short 2 XYZ Jan 50 Calls @ 3 each, and long 1 XYZ Jan 55 Call @ 1. The maximum risk for this long butterfly spread is the net debit incurred to establish the strategy ((3+3)-(6+1)=net debit of 1). Under the proposed rule change, the investor would be required to pay the net debit, or $100 (1x100). See CBOE Approval Order at footnote 25.

[11] For example, an investor may be short 1 XYZ Jan 45 Call @ 6, long 2 XYZ Jan 50 Calls @ 3 each, and short 1 XYZ Jan 55 Call @ 1. Under the proposed rule change, the maximum risk for this short butterfly spread, which is comprised of call options, is equal to the difference between the two lowest exercise prices (50-45=5). If the net credit received from the sale of short option components ((6+1)-(3+3)=1) is applied, the investor is required to deposit an additional $400 (4x100). Otherwise, the investor would be required to deposit $500 (5x100). See CBOE Approval Order at footnote 27.

credit balance, the deposit of an amount equal to the difference between the initial credit and the total risk in the form of cash or cash equivalents to cover the risk to the broker/dealer.[12]

Short box spreads also generate a credit balance when established, but unlike the butterfly spread, this credit is nearly equal to the total debit (loss) that will accrue to the account if held to expiration. The proposed rule change will require that cash or cash equivalents covering the maximum risk, which is equal to the aggregate difference in the two exercise prices involved, be held or deposited.[13] The net credit received from the sale of the short option components may be applied towards the requirement; if applied, only a small fraction of the total requirement need be held or deposited.[14]

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12 Under the proposed rule change, an escrow agreement could be used as a substitute for cash or cash equivalents if the agreement satisfies certain criteria. For short butterfly spreads, the escrow agreement must certify that the bank holds for the account of the customer as security for the agreement (1) cash, (2) cash equivalents, or (3) a combination thereof having an aggregate market value at the time the positions are established of not less than the amount of the aggregate difference between the two lowest exercise prices with respect to short butterfly spreads comprised of call options or the aggregate difference between the two highest exercise prices with respect to short butterfly spreads comprised of put options and that the bank will promptly pay the member such amount in the event the account is assigned an exercise notice on the call (put) with the lowest (highest) exercise price.

13 As a substitute for cash or cash equivalents, an escrow agreement could be used if it satisfies certain criteria. For short box spreads, the escrow agreement must certify that the bank holds for the account of the customer as security for the agreement (1) cash, (2) cash equivalents, or (3) a combination thereof having an aggregate market value at the time the positions are established of not less than the amount of the aggregate difference between the exercise prices, and that the bank will promptly pay the member such amount in the event the account is assigned an exercise notice on either short option.

14 For example, to create a short box spread, an investor may be short 1 XYZ Jan 60 Put @ 5 1/2 and long 1 XYZ Jan 60 Call @ 2 ("buy side"), and short 1 XYZ Jan 50 Call @ 7 and long 1 XYZ Jan 50 Put @ 1 ("sell side"). As required by the proposed definition of "short box spread," the buy side exercise price exceeds the sell side exercise price. In this example, the maximum risk for the short box spread is equal to the difference between the two exercise prices (60-50=10). If the net credit received from the sale of short option components ((5 1/2 + 7)-(2+1)= net credit of 9 1/2) is applied, the investor is required to deposit an additional $50 (1/2 x 100). Otherwise, the investor would be required to deposit $1,000 (10 x 100). <u>See</u> CBOE Approval Order at footnote 29.

In addition to butterfly spreads and box spreads, the proposed rule change will permit investors to hold in their cash accounts other spreads made up of European-style, cash-settled stock index options or stock index warrants. A short position would be considered covered, and thus eligible for the cash account, if a long position in the same European-style, cash-settled index option or stock index warrant was held in, or purchased for, the account on the same day.[15] The long and short positions making up the spread must expire concurrently, and the long position must be paid in full.

The proposed rule change also would permit a member to use an escrow agreement that conforms with standards set forth in the proposed rule change[16] in lieu of the cash or cash equivalents required to carry short butterfly and box spreads in the cash account.

Margin Requirements for Butterfly and Box Spreads

The NASD's margin rules currently do not recognize butterfly spreads for margin purposes. Under current margin rules, the components of butterfly spreads must be margined separately. As a result, current margin requirements would not recognize that the risk of each spread offsets the risk of the other. Under the proposed rule change, the two spreads can be

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[15] Under the proposed rule change, a long warrant may offset a short option contract and a long option contract may offset a short warrant provided they have the same underlying component or index and equivalent aggregate current underlying value.

[16] The proposed rule change defines an "escrow agreement," when used in connection with cash settled calls, puts, currency warrants, currency index warrants or stock index warrants, carried short, as any agreement issued in a form acceptable to the NASD under which a bank holding cash, cash equivalents, one or more qualified equity securities or a combination thereof is obligated (in the case of an option) to pay the creditor the exercise settlement amount in the event an option is assigned an exercise notice or (in the case of a warrant) the funds sufficient to purchase a warrant sold short in the event of a buy-in.

viewed in combination, such that investors will receive the benefit of lower margin requirements commensurate with the lower combined risk.

The proposed rule change would recognize as a distinct strategy butterfly spreads held in margin accounts, and specify requirements that are the same as the cash account requirements for butterfly spreads. The margin requirements would apply to butterfly spreads where all option positions are listed or guaranteed by the carrying broker/dealer. In the case of a long butterfly spread, the net debit must be paid in full. For short butterfly spreads comprised of call options, the initial and maintenance margin must equal at least the aggregate difference between the two lowest exercise prices. For short butterfly spreads comprised of put options, the initial and maintenance margin must equal at least the aggregate difference between the two highest exercise prices. The net credit received from the sale of the short option components may be applied towards the margin requirement for short butterfly spreads.

The proposed requirements for box spreads held in a margin account, where all option positions making up the box spread are listed or guaranteed by the carrying broker/dealer, also are the same as those applied to the cash account. With respect to long box spreads, where the component options are not European-style, the proposed rule change would require full payment of the net debit that is incurred when the spread strategy is established. For short box spreads held in the margin account, the proposed rule change would require that cash or cash equivalents covering the maximum risk, which is equal to the aggregate difference in the two exercise prices involved, be deposited and maintained. The net credit received from the sale of the short option components may be applied towards the requirement. Generally, long and short box spreads would not be recognized for margin equity purposes; however, the proposed rule change would allow loan value for one type of long box spread where all component options have a European-style exercise provision and are listed or guaranteed by the carrying broker/dealer.

Maintenance Margin Requirements for Stock Positions Held with Options Positions

The proposed rule change would allow for a reduction in the maintenance margin requirement[17] for the stock component of the following five hedging strategies: (1) Long Put/Long Stock; (2) Long Call/Short Stock; (3) Conversions; (4) Reverse Conversions; and (5) Collars. Although the five strategies are summarized below in terms of stock positions held in conjunction with an overlying option (or options), the proposal is structured also to apply to components that underlie index options and warrants. For example, these same maintenance margin requirements will apply when these strategies are used with a stock basket underlying index options or warrants. The proposed rule change will define the five strategies and set forth the respective maintenance margin requirements for the stock component of each strategy.

1. Long Put/Long Stock

The Long Put/Long Stock hedging strategy requires an investor to carry in an account a long position in the component underlying the put option and a long put option specifying equivalent units of the underlying component. This strategy is designed to limit downside

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[17] Generally, Rule 2520(c) requires maintenance margin of 25% for all securities "long" in the account and 30% of the current market value of all securities "short" in the account.

risk in the underlying stock while the put is held. The put holder retains the right to sell stock at the strike price through the expiration of the put.

Under the proposed rule change, the maintenance margin requirement for the Long Put/Long Stock combination would be the lesser of: (a) 10% of the put option exercise price, plus 100% of any amount by which the put option is out-of-the-money; or (b) 25% of the current market value of the long stock position.[18]

2. Long Call/Short Stock

The Long Call/Short Stock strategy requires an investor to carry in an account a short position in the component underlying the call option, and a long call option specifying the equivalent units of the underlying components. This strategy is designed to limit the risk associated with upside appreciation in the underlying stock during the life of the call. The call holder retains the right to buy the stock at the strike price through the expiration of the call.

Under the proposed rule change, for a Long Call/Short Stock combination, the maintenance margin requirement would be the lesser of: (a) 10% of the call option exercise price, plus 100% of any amount by which the call option is out-of-the-money; or (b) the maintenance margin requirement on the short stock position as specified in NASD Rule 2520(c).[19]

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18 For example, if an investor is long 100 shares of XYZ @ 52 and long one XYZ Jan 50 Put @ 2, the required margin would be the lesser of ((10% x 50) + (100% x 2) = 7) or (25% x 52 = 13). Therefore, the investor would be required to maintain margin equal to at least $700 (7 x 100). See CBOE Approval Order at footnote 34.

19 For each stock carried short that has a current market value of less than $5 per share, the maintenance margin is $2.50 per share or 100% of the current market value, whichever is greater. For each stock carried

3. Conversion (Long Stock/Long Put/Short Call)

A "conversion " is a hedging strategy where the account carries a long stock position in conjunction with a long put and a short call. For a conversion to qualify as hedged, the long put and the short call must have the same expiration and exercise price. The long put/short call acts like a short stock position which offsets the long stock, and the exercise price of the options functions as a predetermined sale price. The short call is covered by the long stock, and the long put is a right to sell the stock at a predetermined price (i.e., the put exercise price). Thus, regardless of any decline in market value, the stock position, in effect, is worth no less than the exercise price of the put.

Current NASD margin rules specify that no maintenance margin would be required on the short call option because it is covered, but the underlying long stock position would be margined according to the current maintenance margin requirement (i.e., 25% of the current

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short that has a current market value of $5 per share or more, the maintenance margin is $5 per share or 30% of the current market value, whichever is greater. See NASD Rule 2520(c).

The following is an example of the maintenance margin calculation for a Long Call/Short Stock combination. For an investor who is short 100 shares of XYZ @ 48 and long 1 XYZ Jan 50 Call @ 1, the required margin would be the lesser of ((10% x 50) + (100% x 2) = 7) or (30% x 48 = 14.4). Therefore, the investor would be required to maintain margin equal to at least $700 (7 x 100). See CBOE Approval Order at footnote 35.

market value).[20] Under the proposed rule change, the maintenance margin requirement for a conversion would be 10% of the exercise price.[21]

4. Reverse Conversion (Short Stock/Short Put/Long Call)

A "reverse conversion" is a hedging strategy where the account carries a short stock position in conjunction with a short put and a long call. As with the conversion, the put and call must have the same expiration date and exercise price. The short put is covered by the short stock and the long call is a right to buy the stock at a predetermined price (i.e., the call exercise price). Regardless of any rise in market value, the stock can be acquired for the call exercise price; in effect, the short position is valued at no more than the call exercise price. Under the proposed rule change, the maintenance margin requirement for a reverse conversion would be 10% of the exercise price, plus any in-the-money amount (i.e., the amount by which the exercise price of the short put exceeds the current market value of the underlying stock position).[22]

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20 For example, for an investor who is long 100 shares of XYZ @ 48, long one XYZ Jan 50 Put @ 2, and short one XYZ Jan 50 Call @ 1, the current maintenance margin on the long stock position would be $1,200 ((25% x 48) X 100). However, if the price of the stock increased to 60, the NASD currently specifies that the stock may not be valued at more than the short call exercise price. Thus, the maintenance margin on the long stock position would be $1,250 ((25% x 50) x 100). The writer of the call option cannot receive the benefit (i.e., greater loan value) of a market value that is above the call exercise price because, if assigned an exercise, the underlying component would be sold at the exercise price, not the market price of the long position. See CBOE Approval Order at footnote 36.

21 For the example in the preceding footnote, where the investor was long 100 shares of XYZ, @ 48, long 1 XYZ Jan 50 Put @ 2, and short 1 XYZ Jan 50 Call @ 1, the proposed maintenance margin requirement for the Conversion strategy would be $500 ((10% x 50) x 100). See CBOE Approval Order at footnote 37.

22 The seller of a put option has an obligation to buy the underlying component at the put exercise price. If assigned an exercise, the underlying component would be purchased (the short position in the reverse conversion effectively closed) at the exercise price, even if the current market price is lower. To recognize the lower market value of a component, the short put in-the-money amount is added to the requirement. For example, an investor holding a reverse conversion may be short 100 shares of XYZ @ 52, long one XYZ Jan 50 Call @ 2 1/2, and short one XYZ Jan 50 Put @ 1 1/2. If the current market value of XYZ stock

5. Collar (Long Stock/Long Put/Short Call)

A "collar" is a hedging strategy where the account carries a long stock position held in conjunction with a long put and a short call. In a collar, as compared to a conversion, the exercise price of the long put is lower than the exercise price of the short call. Therefore, the options positions in a collar do not constitute a pure synthetic short stock position. The maintenance margin for a collar under the proposed rule change would be the lesser of: (a) 10% of the long put exercise price, plus 100% of any amount by which the long put is out-of-the-money; or (b) 25% of the short call exercise price.[23] Under the NASD's current margin requirements, the stock may not be valued at more than the call exercise price.

Extension of Credit on Long-Term Options and Warrants and Long Box Spreads

The proposed rule change would allow extensions of credit on certain long listed and OTC[24] options (i.e., put or call options on a stock or stock index) and warrant products (i.e., stock index warrants, but not traditional stock warrants issued by a corporation on its own stock).[25] Only those options or warrants with expirations exceeding nine months ("long-

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drops to 30, the maintenance margin would be $2,500 ((10% x 50) + (50-30)) x 100. See CBOE Approval Order at footnote 38.

[23] To create a collar, an investor may be long 100 shares of XYZ @ 48, long 1 XYZ Jan 45 Put @ 4, and short 1 XYZ Jan 50 Call @ 3. The maintenance margin requirement would be the lesser of ((10% x 45) + 3=7 1/2) or (25% x 50=12 1/2). Therefore, the investor would need to maintain at least $750 (7 1/2 x 100) in margin. See CBOE Approval Order at footnote 39.

[24] Unlike listed options, OTC options are not issued by the Options Clearing Corporation. OTC options and warrants are not listed or traded on a registered national securities exchange or through the automated quotation system of a registered securities association.

[25] The proposed rule change does not permit long-term foreign currency options to have any loan value.

term") will be eligible for credit extension.[26] If the time to expiration is nine months or less, the proposed amendments do not permit options or warrants to have any loan value because of the leverage and volatility associated with such instruments. When the time remaining until expiration for an option or warrant (listed or OTC) on which credit has been extended reaches nine months, the maintenance margin requirement will become 100% of the current market value.

For long-term listed options and warrants, the proposed rule change requires initial and maintenance margin of not less than 75% of the current market value of the option or warrant. Therefore, members would be able to loan up to 25% of the current market value of a long-term listed option or warrant. For example, if an investor purchased a listed call option on stock XYZ that expired in January 2001 for approximately $100 (excluding commissions), the investor would be required to deposit and maintain at least $75. The investor could borrow the remaining $25 from the member. Under the current margin rules, the investor would be required to pay the entire $100.

The proposed rule change also would permit the extension of credit on certain long-term OTC options and warrants. Specifically, the proposed rule change would allow a member firm to extend credit on an OTC put or call option on a stock or stock index, and on an OTC stock index warrant. In addition to being more than nine months from expiration, a marginable OTC option or warrant must: (1) be in-the-money; (2) be guaranteed by the

[26] For any stock option, stock index option, or stock index warrant that expires in nine months or less, initial margin must be deposited and maintained equal to at least 100% of the current market value of the option or warrant.

carrying broker/dealer; and (3) have an American-style[27] exercise provision. The proposed rule change requires initial and maintenance margin of 75% of the long-term OTC option's or warrant's in-the-money amount (i.e., intrinsic value), plus 100% of the amount, if any, by which the current market value of the OTC option or warrant exceeds the in-the-money amount.

Once the time remaining until expiration for an option or warrant on which credit has been extended reaches nine months, the maintenance margin requirement will become 100% of the current market value. Thus, options or warrants expiring in less than nine months would have no loan value under the proposal because of the leverage and volatility of those instruments.

The proposed rule change also provides for the extension of credit on long box spreads composed entirely of European-style options that are listed or guaranteed by the carrying broker/dealer. A long box spread is a strategy composed of four option positions that lock-in the ability to buy and sell the underlying component or index for a profit, after netting the cost of establishing the long box. The two exercise prices of the options in the strategy determine the buy and the sell price.[28]

For long box spreads made up of European-style options, the proposed rule change would require initial and maintenance margin of 50% of the aggregate difference in the two

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27 American-style options are exercisable at any time up to the day before expiration.

28 For example, an investor might be long 1 XYZ Jan 50 Call @ 7 and short 1 XYZ Jan 50 Put @ 1 ("buy side"), and short 1 XYZ Jan 60 Call @ 2 and long 1 XYZ Jan 60 Put @ 5 1/2 ("sell side"). As required by the proposed definition of "long box spread," the sell side exercise price exceeds the buy side exercise price. In this example, the long box spread is a riskless position because the net debit ((2+1)-(7+5 1/2)= net debit of 9 1/2) is less than the exercise price differential (60-50=10). Thus, the investor has locked in a

exercise prices (buy and sell), which results in a margin requirement slightly higher than 50% of the debit typically incurred in establishing such a position.[29] Under the proposed rule, a long box spread position would be allowed market value for margin purposes of not more than 100% of the aggregate differential in the exercise prices of the options.

Minimum Margin Requirements for Short, Uncovered Put Options

NASD Rule 2520(f)(2)(D) currently provides that the minimum required margin for a short listed put option is an amount equal to the option premium plus a percentage of the current value of the underlying instrument. The minimum required margin for a short OTC put option is an amount equal to a percentage of the current value of the underlying component. As a result, the current provisions create a margin requirement for a short put option even when the price of the underlying instrument rises above the exercise price of the put and the risk associated with the put option has decreased because the option is out-of-the money. The proposed rule change would amend the margin requirement for short put options to provide a minimum margin requirement more in line with the risk associated with the option. Specifically, the proposed rule change would provide that the minimum margin requirement for a short listed put option be an amount equal to the current value of the option plus a percentage of the option's exercise price. The minimum margin required for a short OTC put option will be an amount equal to a specified percentage of the option's exercise price.

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profit of $50 (1/2 x 100).

[29] Using the example in the preceding footnote, the margin required (50% x (60-50) = 5) would be slightly higher than 50% of the net debit (50% x 9 ½ = 4 ¾).

(b) Statutory Basis

NASD Regulation believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, which requires, among other things, that the Association's rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. The NASD believes that the proposed rule change will promote the safety and soundness of member firms and is consistent with the rules and regulations of the FRB for the purpose of preventing the excessive use of credit for the purchase or carrying of securities.

(B) Self-Regulatory Organization's Statement on Burden on Competition

NASD Regulation does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

(C) Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

III. DATE OF EFFECTIVENESS OF THE PROPOSED RULE CHANGE AND TIMING FOR COMMISSION ACTION

NASD Regulation has requested that the Commission find good cause pursuant to Section 19(b)(2) for approving the proposed rule change prior to the 30th day after publication in the Federal Register. The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to the NASD and, in particular, the requirements of Section 15A and the rules and regulations thereunder. The Commission finds good cause for approving the proposed rule change prior to the 30th day after the date of publication of notice of filing thereof in that accelerated approval will benefit NASD members by making the NASD margin rules in this area consistent with the margin requirements of other SROs.

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

A. by order approve such proposed rule change, or

B. institute proceedings to determine whether the proposed rule change should be disapproved.

IV. SOLICITATION OF COMMENTS

Interested persons are invited to submit written data, views, and arguments concerning the foregoing. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's

Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to the file number in the caption above and should be submitted by [insert date 21 days from the date of publication].

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change be, and hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority, 17 CFR 200.30-3(a)(12).

Jonathan G. Katz
Secretary

EXHIBIT 2

PROPOSED AMENDMENTS TO THE MARGIN RULE

(Note: New language is underlined; deletions are in brackets)

2520. Margin Requirements

(a) through (e) No Change

(f) Other Provisions

(1) No Change

(2) Puts, Calls, Other Options, Currency Warrants, Currency Index Warrants and Stock Index Warrants

(A) Except as provided below, and in the case of a put, call index stock group option, or stock index warrant with a remaining period to expiration exceeding nine months, no put, call, currency warrant, currency index warrant or stock index warrant carried for a customer shall be considered of any value for the purpose of computing the margin to be maintained in the account of such customer.

(B) No Change

(C) For purposes of this subparagraph [(6)(B)] (f)(2), obligations issued by the United States Government shall be referred to as United States Government obligations. Mortgage pass-through obligations guaranteed as to timely payment of principal and interest by the Government National Mortgage Association shall be referred to as GNMA obligations. [The terms “current market value” or “current market price” of an options, currency warrant, currency index warrant or stock index warrant shall mean the total cost or net proceeds of the option contract or warrant on the day it was purchased or sold and at any other time shall be the preceding business day’s closing price of that option (times the appropriate unit of trading or multiplier) as shown by any regularly published reporting or quotation service. The term “exercise settlement amount” shall mean the difference between the “aggregate exercise price” and the “aggregate current index value” (as such terms are defined in the pertinent By-Laws of the Options Clearing Corporation).]

In the case of any put, call, currency warrant, currency index warrant, or stock index warrant carried "long" in a customer's account that expires in nine months or less, initial margin must be deposited and maintained equal to at least 100% of the purchase price of the option or warrant.

Long Listed Option or Warrant With An Expiration Exceeding Nine Months . In the case of a put, call, index stock group option, or stock index warrant that is issued by a registered clearing agency, margin must be deposited and maintained equal to at least 75% of the current market value of the option or warrant; provided that the option or warrant has a remaining period to expiration exceeding nine months.

Long OTC Option or Warrant With An Expiration Exceeding Nine Months . In the case of a put, call, index stock group option, or stock index warrant carried long that is not issued by a registered clearing agency, margin must be deposited and maintained equal to at least 75% of the option's or warrant's "in the money" amount plus 100% of the amount, if any, by which the current market value of the option or warrant exceeds its "in the money" amount; provided that the option or warrant:

(i) is guaranteed by the carrying broker/dealer,
(ii) has an American-style exercise provision, and
(iii) has a remaining period to expiration exceeding nine months.

(D) The margin required on any put [or call issued], call, currency warrant, currency index warrant, or stock index warrant issued, guaranteed or carried "short" in a customer's account shall be:

(i) In the case of puts and calls issued by a registered clearing agency, 100 percent of the current market value of the option plus the percentage of the current value of the underlying [security or index] component specified in column II of the chart below. In the case of currency warrants, currency index warrants and stock index warrants, 100 percent of the current market value of each such warrant plus the percentage of the warrant's current "underlying component value" (as column IV of the chart below describes) specified in column II of the chart below.

[Notwithstanding the margin required below, t]The [minimum] margin on any put[or call issued], call, currency warrant, currency index warrant, or stock index warrant issued, guaranteed or carried "short" in a customer's account may be reduced by any "out-of-the-money amount" (as defined below), but shall not be less than 100 percent of the current market value of the option or warrant plus the percentage of the current value of the underlying [security or index] component specified in column III, except in the case of any put issued, guaranteed or carried "short" in a customer's account. Margin on such put option contracts shall not be less than the current value of the put option plus the percentage of the put option's exercise price as specified in column III.

* * *

(iii) In the case of puts and calls not issued by a registered clearing agency, the percentage of the current value of the underlying component and the applicable multiplier, if any, specified in column II below, plus any "in-the-money amount" (as defined in this paragraph (f)(2)(D)(iii).)

[Notwithstanding the margin required by this subparagraph] In the case of options not issued by a registered clearing agency, the [minimum] margin on any put or call issued, guaranteed or carried "short" in a customer's account may be reduced by any "out of the money amount" (as defined in paragraph (f)(2)(D)(i)), but shall not be less than the percentage of the current value of the underlying component and the applicable multiplier, if any, specified in column III below, except in the case of any put issued or guaranteed or carried "short" in a customer's account. Margin on such put option contracts shall not be less than the percentage of the put option's exercise price as specified in column III below.

* * *

(D)(iv) through (G)(iv) No Change.

(G)(v) The following requirements set forth the minimum amount of margin that must be maintained in margin accounts of customers having positions in components underlying options, and stock index warrants, when such components are held in conjunction with certain positions in the overlying option or warrant. The option or warrant must be issued by a registered clearing agency or guaranteed by the carrying broker/dealer. In the case of a call or warrant carried in a short position, a related long position in the underlying component shall be valued at no more than the call/warrant exercise price for margin equity purposes.

a. Long Option or Warrant Offset. When a component underlying an option or warrant is carried long (short) in an account in which there is also carried a long put (call) or warrant specifying equivalent units of the underlying component, the minimum amount of margin that must be maintained on the underlying component is 10% of the option/warrant exercise price plus the "out-of-the-money" amount, not to exceed the minimum maintenance required pursuant to paragraph (c) of this Rule.

b. Conversions. When a call or warrant carried in a short position is covered by a long position in equivalent units of the underlying component and there is also carried with a long put or warrant specifying equivalent units of the same underlying component and having the same exercise price and expiration date as the short call or warrant, the minimum amount of margin that must be maintained for the underlying component shall be 10% of the exercise price.

c. Reverse Conversions. When a put or warrant carried in a short position is covered by a short position in equivalent units of the underlying component and is also carried with a long call or warrant specifying equivalent units of the same underlying component and having the same exercise price and expiration date as the short put or warrant, the minimum amount of margin that must be maintained for the underlying component shall be 10% of the exercise price plus the amount by which the exercise price of the put exceeds the current market value of the underlying, if any.

d. Collars. When a call or warrant carried in a short position is covered by a long position in equivalent units of the underlying component and is also carried with a long put or warrant specifying equivalent units of the same underlying component and having a lower exercise price and the same expiration date as the short call/warrant, the minimum amount of margin that must be maintained for the underlying component shall be the lesser of 10% of the exercise price of the put plus the put "out-of-the-money" amount or 25% of the call exercise price.

e. Butterfly Spread. This subparagraph applies to a butterfly spread as defined in Rule 2522 where all option positions are issued by a registered clearing agency or guaranteed by the carrying broker/dealer.

1. With respect to a long butterfly spread as defined in Rule 2522, the net debit must be paid in full.

2. With respect to a short butterfly spread as defined in Rule 2522, margin must be deposited and maintained equal to at least the amount of the aggregate difference between the two lowest exercise prices with respect to short butterfly spreads comprised of calls or the aggregate difference between the two highest exercise prices with respect to short butterfly spreads comprised of puts. The net proceeds from the sale of short option components may be applied to the requirement.

f. Box Spread. This subparagraph applies to box spreads as defined in Rule 2522, where all option positions are issued by a registered clearing agency or guaranteed by the carrying broker/dealer.

1. With respect to a long box spread as defined in Rule 2522 the net debit must be paid in full.

2. With respect to a short box spread as defined in Rule 2522, margin must be deposited and maintained equal to at least the amount of the aggregate difference between the exercise prices. The net proceeds from the sale of the short option components may be applied to the requirement.

g. Long Box Spread in European-Style Options. With respect to a long box spread as defined in Rule 2522, in which all component options have a European-style exercise provision and are issued by a registered clearing agency or guaranteed by the carrying broker/dealer, margin must be deposited and maintained equal to a least 50% of the aggregate difference in the exercise prices. The net proceeds from the sale of short option components may be applied to the requirement. For margin purposes, the long box spread may be valued at an amount not to exceed 100% of the aggregate difference in the exercise prices.

(H) through (f)(2)(L) No Change

(M) Cash account transactions. - A member may make option transactions in a customer's cash account, provided that:

(i) The transaction is permissible under Regulation T, Section 220.8; or

(ii) [The transaction is a debit put spread in listed broad-based index options with European-style exercise comprised of a long put(s) coupled with a short put(s) overlying the same broad-based index with an equivalent underlying aggregate index value and the short put(s) and the long put(s) expire simultaneously, and the strike price of the long put(s) exceed the strike price of the short put(s).] **Spreads.** A European-style cash-settled index stock group option or stock index warrant carried in a short position is deemed a covered position, and eligible for the cash account, provided a long position in a European-style cash-settled stock group index option, or stock index warrant having the same underling component or index that is based on the same aggregate current underlying value, is held in or purchased for the account on the same day, provided that:.

a. the long position and the short position expire concurrently;

b. the long position is paid is full; and

c. there is held in the account at the time the positions are established, or received into the account promptly thereafter:

1. cash or cash equivalents of not less than any amount by which the aggregate exercise price of the long call or call warrant (short put or put warrant) exceeds the aggregate exercise price of the short call or call warrant (long put or put warrant), to which requirement of net proceeds from the sale of the short position may be applied, or

2. an escrow agreement.

The escrow agreement must certify that the bank holds for the account of the customer as security for the agreement i. cash, ii. cash equivalents, or iii. a combination thereof having an aggregate market value at the time the positions are established of not less than any amount by which the aggregate exercise price of the long call or call warrant (short put or put warrant) exceeds the aggregate exercise price of a short call or call warrant (long put or put warrant) and that the bank will promptly pay the member such amount in the event the account is assigned an exercise notice or that the bank will promptly pay the member funds sufficient to purchase a warrant sold short in the event of a buy-in.

d. A long warrant may offset a short option contract and a long option contract may offset a short warrant provided that they have the same underlying component or index and equivalent aggregate current underlying value.

(iii) **Butterfly Spreads.** Put or call options carried in a short position are deemed covered positions and eligible for the cash account provided that the account contains long positions of the same type which in conjunction with the short options, constitute a butterfly spread as defined in Rule 2522 and provided that:

a. all component options are listed, or guaranteed by the carrying broker/dealer;

b. all component options are European-style;

c. all component options are cash settled;

d. the long options are held in, or purchased for the account on the same day;

e. with respect to a long butterfly spread as defined in Rule 2522, the net debit is paid in full; and

f. with respect to a short butterfly spread as defined in Rule 2522, there is held in the account at the time the positions are established or received into the account promptly thereafter:

1. cash or cash equivalents of not less than the amount of the aggregate difference between the two lowest exercise prices with respect to short butterfly spreads comprised of call options or the aggregate difference between the two highest exercise prices with respect to short butterfly spreads comprised or put options, to which requirement the net proceeds from the sale of short option components may be applied; or

2. an escrow agreement.

The escrow agreement must certify that the bank holds for the account of the customer as security for the agreement i. cash, ii. cash equivalents or iii. a combination thereof having an aggregate market value at the time the positions are established of not less than the amount of the aggregate difference between the two lowest exercise prices with respect to short butterfly spreads comprised of calls or the aggregate difference between the two highest exercise prices with respect to short butterfly spreads comprised of puts and that the bank will promptly pay the member such amount in the event the account is assigned an exercise notice on the call (put) with the lowest (highest) exercise price.

(iv) **Box Spreads.** Puts and calls carried in a short position are deemed covered positions and eligible for the cash account provided that the account contains long positions which in conjunction with the short options constitute a box spread as defined in Rule 2522 provided that:

a. all component options are listed, or guaranteed by the carrying broker/dealer;

b. all component options are European-style;

c. all component options are cash settled;

d. the long options are held in, or purchased for the account on the same day;

e. with respect to a long box spread as defined in Rule 2522, the net debit is paid in full; and

f. with respect to a short box spread as defined in Rule 2522, there is held in the account at the time the positions are established, or received into the account promptly thereafter:

1. cash or cash equivalents of not less than the amount of the aggregate difference between the exercise prices, to which requirement the net proceeds from the sale of short option components may be applied; or

2. an escrow agreement.

The escrow agreement must certify that the bank holds for the account of the customer as security for the agreement i. cash, ii. cash equivalents or iii. a combination thereof having an aggregate market value at the time the positions are established of not less than the amount of the aggregate difference between the exercise prices and that the bank will promptly pay the member such amount in the event the account is assigned an exercise notice on either short option.

* * *

2522. Definitions Related to Options Transactions

[(a) Definitions Related to Options Transactions]

(a) The following definitions shall apply to the margin requirements for options transactions:

* * *

(8) Box Spread

The term “box spread” means an aggregation of positions in a long call and short put with the same exercise price (“buy side”) coupled with a long put and short call with the same exercise price (“sell side”) all of which have the same underlying component or index and time of expirations, and are based on the same aggregate current underlying value, and are structured as; (A) a “long box spread” in which the sell side exercise price exceeds the buy side exercise price or (B) a “short box spread” in which the buy side exercise price exceeds the sell side exercise price.

(9) Butterfly Spread

The term "butterfly spread" means an aggregation of positions in three series of either puts or calls all having the same underlying component or index, and time of expiration, and based on the same aggregate current underlying value, where the interval between the exercise price of each series is equal, which positions are structured as either: (A) a "long butterfly spread" in which two short options in the same series are offset by one long option with a higher exercise price and one long option with a lower exercise price or (B) a "short butterfly spread" in which two long options in the same series offset one short option with a higher exercise price and one short option with a lower exercise price.

Paragraphs (8) through (15) are renumbered as Paragraphs (10) through (17).

(18) Current Market Value or Current Market Price

The terms "current market value" or "current market price" of an option, currency warrant, currency index warrant or stock index warrant are as defined in Section 220.2 of Regulation T of the Board of Governors of the Federal Reserve System.

Paragraphs (16) through (19) are renumbered as Paragraphs (20) through (23).

(24) Escrow Agreement

The term "escrow agreement," when used in connection with cash settled calls, puts, currency warrants, currency index warrants or stock index warrants carried short, means any agreement issued in a form acceptable to the Association under which a bank holding cash, cash equivalents, one or more qualified equity securities or combination thereof in the case of a call or warrants or cash, cash equivalents or a combination thereof in the case of a put or warrant is obligated (in case of an option) to pay the creditor the exercise settlement amount in the event an option is assigned an exercise notice or (in the case of a warrant) the funds sufficient to purchase a warrant sold short in the event an option is assigned an exercise notice or (in the case of a warrant) the funds sufficient to purchase a warrant sold short in the event of a buy in.

Paragraphs (20) through (22) are renumbered as Paragraphs (25) through (27).

(28) Exercise Settlement Amount

The term "exercise settlement amount" shall mean the difference between the "aggregate exercise price" and the "aggregate current index value" (as such terms are defined in the pertinent By-Laws of the Options Clearing Corporation).

Paragraphs (23) through (71) are renumbered as Paragraphs (29) through (76).