THE FOUNDATION FOR SECURE MARKETS

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July 1, 2024

VIA CFTC PORTAL
Christopher J. Kirkpatrick
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: Rule Certification by The Options Clearing Corporation Concerning the Modification of its Margin Methodology, System for Theoretical Analysis and Numerical (STANS), to Conform its Margin Model to the Contract Specifications for a New Exchange Product Based on the Expected Realized Variance of the Underlying.

Dear Secretary Kirkpatrick:

Pursuant to Section 5c(c)(1) of the Commodity Exchange Act, as amended ("Act"), and Commodity Futures Trading Commission ("CFTC") Regulation 40.6, The Options Clearing Corporation ("OCC") hereby certifies a rule change concerning the modification of its margin model to the product specifications for a new exchange-traded futures contracts based on the expected realized variance of an underlying interest (such contracts being "variance futures," and such model being the "Variance Futures Model") that the Cboe Future Exchange ("CFE") intends to list. The date of implementation of the rule is at least 10 business days following receipt of the certification by the CFTC. The proposal will also be submitted to the Securities and Exchange Commission ("SEC") under Section 19(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 19b-4 thereunder. The change will not be implemented until OCC has obtained all necessary regulatory approvals.

In conformity with the requirements of Regulation 40.6(a)(7), OCC states the following:

Explanation and Analysis

The purpose of this rule certification concerns a proposed rule change to modify OCC's margin methodology, the System for Theoretical Analysis and Numerical Simulations ("STANS"), to conform its margin model to the contract specifications for a new exchange-traded futures contract based on the expected realized variance of an underlying interest (such contracts being "variance futures," and such model being the "Variance Futures Model") that the CFE intends to list. The proposed changes to the STANS Methodology Description are contained in confidential Exhibit A. Amendments to the existing text are underlined and material proposed to be deleted is marked by strikethrough text. The proposed changes are described in detail below. Replacement text specific to the proposed input descriptions of the daily settlement price calculation in Section 2.1.6 (Variance Futures), is presented without marking. The proposed rule change does not require any changes to the text of OCC's By-Laws or Rules. All terms with initial capitalization that are not otherwise defined herein have the same meaning as set forth in the OCC By-Laws and Rules[1].

Overview

In its capacity as a derivatives clearing organization ("DCO") registered with the CFTC, OCC clears certain futures products on behalf of CFTC-registered designated contract markets ("DCMs"), including CFE. Such futures products included CFE-listed variance futures based on the realized variance in the S&P 500 Index. To support this product, OCC developed and implemented a Variance Futures Model as part of STANS,[2] OCC's proprietary risk management system for measuring the exposure of portfolios of options and futures cleared by OCC, including variance futures.[3] OCC most recently updated that model in 2022.[4] CFE delisted its variance futures the same year, with the intent of relisting such futures at a future date.[5]

CFE now intends to re-list its S&P 500 variance futures product with a different product design.[6] As discussed in more detail below, OCC proposes to amend its STANS Methodology Description to conform the description of the Variance Futures Model with the new product design. Specifically, OCC would simplify the description of the daily settlement of variance futures products

[1] OCC's By-Laws and Rules can be found on OCC's public website: https://www.theocc.com/Company-Information/Documents-and-Archives/By-Laws-and-Rules.

[2] See Exchange Act Release No. 91079 (Feb. 8, 2021), 86 FR 9410, 9411 (Feb. 12, 2021) (File No. SR-OCC-2020-016) (noting the model to price variance futures as among the model components addressed by the STANS Methodology Description). OCC makes its STANS Methodology description available to Clearing Members. An overview of the STANS methodology is on OCC's public website: https://www.theocc.com/Risk-Management/Margin-Methodology.

[3] Pursuant to OCC Rule 601(e)(1), OCC also calculates initial margin requirements for segregated futures accounts on a gross basis using the Standard Portfolio Analysis of Risk Margin Calculation System ("SPAN"). CFTC Rule 39.13(g)(8), requires, in relevant part, that a DCO collect initial margin for customer segregated futures accounts on a gross basis. While OCC uses SPAN to calculate initial margin requirements for segregated futures accounts on a gross basis, OCC believes that margin requirements calculated on a net basis (i.e., permitting offsets between different customers' positions held by a Clearing Member in a segregated futures account using STANS) affords OCC additional protections at the clearinghouse level against risks associated with liquidating a Clearing Member's segregated futures account. As a result, OCC calculates margin requirements for segregated futures accounts using both SPAN on a gross basis and STANS on a net basis, and if at any time OCC staff observes a segregated futures account where initial margin calculated pursuant to STANS on a net basis exceeds the initial margin calculated pursuant to SPAN on a gross basis, OCC collateralizes this risk exposure by applying an additional margin charge in the amount of such difference to the account. See Exchange Act Release No. 72331 (June 5, 2014), 79 FR 33607 (June 11, 2014) (File No. SR-OCC-2014-13).

[4] See Exchange Act Release No. 95319 (July 19, 2022), 87 FR 44167, 44170 (July 25, 2022) (SR-OCC-2022-001).

[5] See Cboe, Update – CFE April 2022 Contract Listing Changes (Apr. 14, 2022), https://cdn.cboe.com/resources/product_update/2022/Update-New-CFE-Contracts-Added-in-April-2022.pdf

[6] See Cboe, Variance Futures (last updated Mar. 6, 2024), https://cdn.cboe.com/resources/participant_resources/New_Cboe_Variance_Futures_Product_Overview.pdf.

to include configurable parameters to reflect changes in CFE's standardized formula for calculating the final settlement value for the new product. OCC does not believe this change would have any impact on Clearing Members because there is no open interest in variance futures currently. Rather, this change would serve to ensure that CFE's new product aligns with OCC's rules related to the clearance and settlement of variance futures.

Proposed Changes

Variance futures are commodity futures for which the underlying interest is a variance.[7] The underlying variance is calculated using historical daily closing values of the reference variable. When a variance futures contract is listed, it defines the initial variance strike. This initial variance strike represents the estimated future variance at contract expiration. The final settlement value is determined based on a standardized formula for calculating the realized variance of the S&P 500 measured from the time of initial listing until expiration of the contract. At maturity, the buyer of the contract pays the amount of predefined strike to the seller and the seller pays the realized variances. Therefore, the buyer profits if the realized variance at maturity exceeds the predefined variance strike. S&P 500 variance futures are exchange-traded futures contracts based on the realized variance of the S&P 500.

CFE's proposed S&P 500 Variance Futures have a final settlement value that will be determined by a standardized formula for calculating the realized variance of the S&P 500. Compared to the previous variance futures delisted by CFE in April 2022, the proposed contract has a simpler settlement definition:

1. Rather than the previous contract's settlement being based on the difference of the realized variance from a fixed delivery variance strike, the proposed variance future settlement is based only on the realized variance – equivalent to setting the delivery variance strike to 0.
2. Rather than using an interest rate-based factor to discount the variance, the proposed variance future settlement has no scaling – equivalent to scaling by 1.
3. Rather than including a term for the accumulation of interest on daily variation margin, the proposed variance future settlement has no term included – equivalent to setting the term to 0.
4. Rather than recentering the value around 1000, the proposed variance future settlement does not recenter – equivalent to setting this term to 0.

[7] A variance is a statistical measure of the variability of price returns relative to an average (mean) price return. Accordingly, OCC believes that an underlying variance is a "commodity" within the definition of Section 1a(4) of the Act, which defines "commodity" to include "all . . . rights, and interests in which contracts for future delivery are presently or in the future dealt in." 7 U.S.C. 1a(9). OCC believes a variance is neither a "security" nor a "narrow-based security index" as defined in Section 3(a)(10) and Section 3(a)(55)(A) of the Exchange Act, respectively, and therefore is within the exclusive jurisdiction of the CFTC. OCC clears this product in its capacity as a DCO registered under Section 5b of the CEA. See Exchange Act Release No. 49925 (June 28, 2004), 69 FR 40447 (July 2, 2004) (File No. SR-OCC-2004-08).

5. Rather than scale the variance calculation by 10,000, the proposed variance future settlement does not scale the variance – equivalent to scaling by 1.

The current STANS Methodology Description explicitly details the terms and specific values of these parameters based on product specifications for the variance futures that CFE delisted in 2022. OCC proposes to instead define these terms as parameters within the STANS Methodology Description that would be determined by the specifications of the products that the applicable DCM is authorized to list, rather than as set values in the STANS Methodology Description. As amended, the STANS Methodology Description would ensure that OCC's Variance Futures Model is consistent with CFE's new product design. In addition, by setting the values as configurable parameters based on the DCM's contract specifications, OCC would be able to accommodate potential variance futures products that may be listed in the future with different contract specifications. Other than allowing OCC to conform the settlement calculation to the DCM's contract specification, the change would have no effect on OCC's Variance Futures Model, as addressed in detail in the 2022 filing that established OCC's current model approach for such products.[8]

Consistency with DCO Core Principles

OCC reviewed the DCO core principles ("Core Principles") as set forth in the Act, the regulations thereunder, and the provisions applicable to a DCO that elects to be subject to the provisions of 17 CFR Subpart C ("Subpart C DCO"). During this review, OCC identified the following as potentially being impacted:

Risk Management OCC believes that the proposed changes are consistent with Core Principle D and the CFTC Regulations thereunder, which require in relevant part that a DCO's models and parameters used in setting margin requirements be risk based and reviewed on a regular basis.[9] Some inputs used in the current Variance Futures Model for the calculation of the contract daily settlement were set in the STANS Methodology Description using specific values based on CFE's previous contract specifications for the variance futures it delisted in April 2022. The proposed changes would allow OCC to align those values with the contract specifications for CFE's new product, thereby ensuring that OCC may clear and settle the new variance futures CFE intends to list based on the updated contract specifications. For these reasons, OCC believes that the proposed changes are consistent with the requirements of the DCO Core Principles and the CFTC Regulations thereunder.

Opposing Views

No substantive opposing views were expressed related to the rule amendments by OCC's Board members, Clearing Members or market participants. Public comments on the proposed rule

[8] See Exchange Act Release No. 94165 (Feb. 7, 2022), 87 FR 8072, 8077-8078 (Feb. 11, 2022) (SR-OCC-2022-001).

[9] See 7 US 7a-1(c)(2)(D)(v); 17 CFR 39.13(g)(1).

change filed with the SEC, if any, and any OCC response to such comments may be viewed on the SEC's public website.[10]

Notice of Pending Rule Certification

OCC hereby certifies that notice of this rule filing has been given to Clearing Members of OCC in compliance with Regulation 40.6(a)(2) by posting a copy of this certification on OCC's website concurrently with the filing of this submission.

Certification

OCC hereby certifies that the rule set forth at Exhibit A of the enclosed filing complies with the Act and the CFTC's regulations thereunder.

Should you have any questions regarding this matter, please do not hesitate to contact me.

Sincerely,

/s/ Karen deGroot
Karen deGroot
Associate General Counsel
The Options Clearing Corporation

Enclosure: Exhibit A

[10] See Options Clearing Corporation (OCC) Rulemaking, https://www.sec.gov/rules-regulations/self-regulatory-organization-rulemaking/occ.