

RECEIVED  
O.C.C.O.

2005 MAR 11 AM 9:03

Page 1 of 18

File No. SR-OCC-2004-08

**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

---

Form 19b-4

Proposed Rule Change  
by

**THE OPTIONS CLEARING CORPORATION**

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

**Item 1. Text of the Proposed Rule Change**

In order to clear and settle futures on the “variance” of certain measures and instruments (“reference variables”), The Options Clearing Corporation (“OCC” or “the Corporation”) proposes to amend Articles I, VI, and XII of its By-Laws and Chapters VI and XIII of its Rules as set forth below. Material to be added to OCC’s By-Laws and Rules as currently in effect is underlined. Material to be deleted is enclosed in bold brackets. OCC also proposes to amend the Agreement for Clearing and Settling Security Futures and Futures Options on Broad-Based Indexes (the “Clearing Agreement”) entered into between OCC and CFE that was filed for immediate effectiveness in SR-OCC-2003-06. The proposed First Amendment to the Clearing Agreement (the “Amendment”) is attached as Exhibit A.

**THE OPTIONS CLEARING CORPORATION**

**BY-LAWS**

**ARTICLE I**

**Definitions**

**Definitions**

**SECTION 1.** Unless the context requires otherwise (or except as otherwise specified in the By-Laws), the terms defined herein shall, for all purposes of these By-Laws and the Rules of the Corporation, have the meanings herein specified.

**A. – L.** [unchanged]

**M.**

(1) – (7) [unchanged]

**Multiplier**

(8) The term “multiplier” as used in reference to an index option contract or index futures of any series means an index multiplier and as used in reference to a variance futures contract of any series means the dollar amount (as specified by the futures market on

which a series of variance futures is traded) by which the final settlement price in respect of such futures contract is to be multiplied to obtain the final variation payment.

N. – Q. [unchanged]

R.

(1) [unchanged]

### **Reference Variable**

(2) The term “reference variable” means the price or value of a security, commodity, future, currency, asset, index, or other thing, the variance or other measure of variability of which is used as the underlying interest for a cleared contract.

(2) – (5) [The defined term “Return” is proposed to be added as (5) in SR-OCC-2003-11, which also proposes to renumber (5) as (6). Because this rule change will take effect before 2003-11 is approved, (2) – (5) will be renumbered as (3) – (6), “Return” will be proposed to be numbered (6), and when SR-OCC-2003-11 is approved, (6) will be renumbered as (7).]

S – T. [unchanged]

U.

(1) – (3) [unchanged]

### **Underlying Variance**

(4) The term “underlying variance” or “variance” means the variability of a reference variable over a specified period as measured by the futures market on which the overlying variance future is traded or as measured by a reporting authority designated by that futures market.

(4) [renumbered as (5) but otherwise unchanged]

V.

(1) [unchanged]

### **Variance Future**

(2) The term “variance future” means a commodity future for which the underlying interest is a variance.

(2) [renumbered as (3), but otherwise unchanged]

W. – Z. [unchanged]

\* \* \*

## ARTICLE VI

### Clearance of Exchange Transactions

\* \* \*

#### Terms of Cleared Contracts

##### SECTION 10. (a) – (c) [no change]

(d) Except to the extent provided otherwise in the By-Laws and Rules with respect to transactions in flexibly structured futures, the variable terms of each series of futures shall be determined by each Exchange, futures market or security futures market at the time such series is first opened for trading on that Exchange, futures market or security futures market. The unit of trading of each series of stock futures shall be designated by the Corporation prior to the time such series of stock futures is first opened for trading. In the absence of such designation for a series of stock futures, the unit of trading shall be 100 shares. The [index] multiplier for each series of index futures and variance futures shall be determined by each Exchange, futures market or security futures market at the time such series is first opened for trading on such Exchange, futures market or security futures market. The unit of trading and settlement price established for a series of stock futures are subject to adjustment in accordance with Section 4 of Article XII of the By-Laws. The [index] multiplier established for a series of index futures or variance futures is subject to adjustment in accordance with Sections 3 and 4 of Article XII of the By-Laws.

(e) – end [unchanged]

\* \* \*

## ARTICLE XII

### Futures and Futures Options

\* \* \*

#### Adjustments to Futures and Futures Options

SECTION 3. (a) Section 11 of Article VI of the By-Laws shall not apply to futures or futures options. Determinations as to whether and how to adjust the terms of futures to reflect events affecting underlying interests shall be made by the Corporation based on its judgment as to what is appropriate for the protection of investors and the public interest, taking into account such factors as fairness to the buyers and sellers of such futures and futures options, the maintenance of a fair and orderly market in futures on the underlying interest, consistency of interpretation and practice (including consistency with the actions of the Securities Committee in making adjustments to options on the same underlying interest), efficiency of settlement of

delivery obligations arising from physically-settled stock futures, and the coordination with other clearing agencies of the clearance and settlement of transactions in the underlying interest. The Corporation may, in addition to determining adjustments to futures and futures options on a case-by-case basis, adopt statements of policy or interpretations having general application to specified types of events. Every determination by the Corporation in respect of futures or futures options pursuant to this Section 3, or to Section 4 or Section 4A of this Article shall be within the sole discretion of the Corporation and shall be conclusive and binding on all investors and not subject to review. The following paragraphs of this Section 3 apply to stock futures only. Special rules for adjustment of index futures and futures options and variance futures and futures options are set out in Section 4. Special rules for adjustment of cash-settled foreign currency futures are set out in Section 4A.

(b) – end [unchanged]

\* \* \*

#### **Adjustments to Index Futures and Variance Futures and Options on [Index] Such Futures**

**SECTION 4.** (a) No adjustments will ordinarily be made in the terms of index futures or in the terms of variance futures that have an index as their reference variable in the event that [underlying] securities are added to or deleted from the index or when the relative weight of one or more [underlying] securities in the index is changed. However, if the Corporation shall determine in its sole discretion that any such addition, deletion or change causes significant discontinuity in the level of the index, the Corporation may adjust the terms of the affected index futures by adjusting the index multiplier with respect to such contracts or by taking such other action as the Corporation in its sole discretion deems fair to both the buyers and sellers of such contracts. Similarly, the Corporation may use its discretion to adjust variance futures if necessary to correct for any impact such an event could have on an underlying variance.

(b) If (i) an Exchange, futures market or security futures market shall increase or decrease the [index] multiplier for any index futures contract or variance futures contract, (ii) the reporting authority shall change the method of calculation of an index that is an underlying [index] interest or reference variable so as to create a discontinuity or change in the level of the index that does not reflect a change in the prices or values of the constituent securities in the index, or (iii) the Corporation shall substitute one [underlying] index for another pursuant to paragraph (c) of this Section, the Corporation shall make such adjustments in the number of outstanding affected futures or the contract prices of such futures or such other adjustments, if any, as the Corporation in its sole discretion deems fair to both the buyers and the sellers of such contracts.

(c) In the event the Corporation determines that: (i) publication of an index that is an underlying [index] interest or reference variable has been discontinued; (ii) such an [underlying] index has been replaced by another index; or (iii) the composition or method of calculation of such an [underlying] index is so materially changed since its selection as an underlying [index] interest or reference variable that it is deemed to be a different index, the

Corporation may substitute another index (a “successor index”) as the underlying [index] interest or reference variable. A successor index shall be reasonably comparable, as determined by the Corporation in its discretion, to the original [underlying] index for which it is substituted. An index may be created specifically for the purpose of becoming a successor index.

(d) If a futures market or its reporting authority shall change the method of calculation of an underlying variance so as to create a discontinuity or change in the underlying variance that does not reflect a change in the variability of the reference variable, the Corporation shall make such adjustments in the number of outstanding affected variance futures or the contract prices of such futures or such other adjustments, if any, as the Corporation in its sole discretion deems fair to both the buyers and the sellers of such contracts.

(e) (i) In the event the Corporation, acting pursuant to paragraph (a) of this Section, adjusts an index futures contract or variance futures contract underlying a futures option, such futures option will ordinarily be adjusted to provide, upon exercise, for delivery of the futures contract as adjusted by the Corporation. (ii) In the event the Corporation, acting pursuant to paragraph (b) or (d) of this Section, adjusts (A) the number of outstanding index futures or variance futures in a series of futures underlying a futures option, (B) the contract price of index futures or variance futures underlying a futures option, or (C) the index futures or variance futures underlying a futures option in any other manner, the futures option ordinarily will be adjusted in a manner corresponding to the adjustment in the underlying futures contract (e.g., if the number of outstanding index futures or variance futures in a series of futures underlying a futures option is adjusted, the number of futures options on the adjusted underlying index future or variance future will be similarly adjusted; if the contract price of the underlying index future or variance future is adjusted, the exercise price of the futures options will be similarly adjusted; etc.).

#### **Unavailability or Inaccuracy of Final Settlement Price**

**SECTION 5.** (a) If the Corporation shall determine (i) that the primary market(s) (as determined by the Corporation) (A) for the underlying security in respect of a maturing stock future or cash-settled foreign currency future, or (B) for one or more component securities of (I) the underlying index in respect of a maturing index future or (II) the index that is the reference variable in respect of a maturing variance future, did not open or remain open for trading (or that any such security or securities or foreign currency did not open or remain open for trading on such market(s)) at or before the time when the final settlement price for such futures would ordinarily be determined, or (ii) that a price, variance or other value to be used as, or to determine, the final settlement price (a “required value”) is otherwise unreported, inaccurate, unreliable, unavailable or inappropriate for such use, then, in addition to any other action that the Corporation may be entitled to take under the By-Laws and Rules, the Corporation shall be empowered to do any or all of the following with respect to such maturing futures (“affected futures”):

(1) [no change]

(2) The Corporation may fix the final settlement price for affected futures, based on its judgment as to what is appropriate for the protection of investors and the public interest, taking into account such factors as fairness to buyers and sellers of affected futures, the maintenance of a fair and orderly market in such futures, consistency of interpretation and practice, and consistency with actions taken in related futures or other markets. Without limiting the generality of the foregoing, the Corporation may fix the final settlement price using: (i) the reported price or value for the relevant security, [or] securities, [or] index or variance at the close of regular trading hours (as determined by the Corporation) on the last preceding trading day for which such a price or value was reported by the reporting authority; (ii) the reported price or value for the relevant security, [or] securities, [or] index or variance at the opening of regular trading hours (as determined by the Corporation) on the next trading day for which such an opening price or value is reported by the reporting authority; or (iii) a price or value for the relevant security, [or] securities, [or] index or variance at such other time, or representing a combination or average of prices or values at such time or times, as the Corporation deems appropriate.

(b) Every determination of the Corporation pursuant to this Section shall be within the sole discretion of the Corporation and shall be conclusive and binding on all investors and not subject to review. Unless the Corporation directs otherwise, the price of an underlying security, [and] the current index value of an underlying index, and the variance of a reference variable as initially reported by the relevant exchange or other reporting authority shall be conclusively presumed to be accurate and shall be deemed final for the purpose of determining settlement prices and the final settlement price, even if such price or value is subsequently revised or determined to have been inaccurate.

**... Interpretations and Policies:**

**.01** The Corporation will not adjust officially reported stock prices, variances or current index values for final settlement purposes, even if those prices or values are subsequently found to have been erroneous, except in extraordinary circumstances. Such circumstances might be found to exist where, for example, the closing price or current index value as initially reported is clearly erroneous and inconsistent with prices or values reported earlier in the same trading day, or, in the case of an underlying variance, clearly erroneous and inconsistent with variances reported on prior trading days and a corrected closing price, variance or current index value is promptly announced by the reporting authority. In no event will a completed settlement be adjusted due to errors in officially reported stock prices, variances or current index values.

\* \* \*

**CHAPTER VI**

**Margins**

\* \* \*

**Margin on Positions in Non-Equity Options and Stock Loan Baskets and Stock Borrow**

**Baskets; Risk Margin on Positions in Non-Equity Futures**

**RULE 602.** (a) – (e) [unchanged]

(f) Notwithstanding the foregoing provisions of this Rule:

(1) – (5) [unchanged]

(6) The risk margin requirement for variance futures will be calculated by the Corporation using such measures of risk as the Corporation deems appropriate.

**. . . . Interpretations and Policies:** [unchanged]

\* \* \*

**Daily Margin Report**

**RULE 605.** [no change]

**. . . . Interpretations and Policies:**

.01 The Daily Margin Report will not include the amount of margin required by the Corporation on the Clearing Member's positions in variance futures. Instead, the Corporation will advise Clearing Members of such margin requirement separately, but in any event before 9:00 A.M. Central Time. For all purposes of the By-Laws and Rules, including Rule 605, the margin requirement with respect to variance futures will be treated as if it were included in the Daily Margin Report.

\* \* \*

**CHAPTER XIII**

**Futures and Futures Options**

**Introduction**

The Rules in this Chapter are applicable only to security futures, cash-settled foreign currency futures, broad-based stock index futures, [and] futures options on underlying broad-based stock index futures, variance futures and futures options on variance futures (as defined in the By-Laws). In addition, the Rules in Chapters I through XII are also applicable to the foregoing cleared contracts[security futures, cash-settled foreign currency futures, broad-based index futures and futures options on underlying broad-based stock index futures], in some cases supplemented by one or more Rules in this Chapter, except for Rules that have been replaced in respect of futures or futures options by one or more Rules in this Chapter and except where the context otherwise requires. Whenever a Rule in this Chapter supplements or, for purposes of this Chapter, replaces one or more of the By-Laws or Rules in Chapters I through XII, that fact is indicated in this Chapter.



### Variation Payments

**RULE 1301.** (a) At each settlement time for variation payments as set forth below, the Corporation shall determine the amount of the variation payment to be paid or received by buyers and sellers in respect of each outstanding contract in each series of futures. The amount of the variation payment for each such contract shall be equal to the relevant unit of trading (in the case of stock futures and cash-settled foreign currency futures) or [index] multiplier (in the case of index futures or variance futures) multiplied by: (i) in the case of a contract that was opened since the most recent variation settlement, the current settlement price less the contract price at which such contract was opened, (ii) in the case of a contract that was closed since the most recent settlement of variation payments was effected, the contract price at which such contract was closed less the previous settlement price, (iii) in the case of a contract that was neither opened nor closed since the most recent variation settlement, the current settlement price less the previous settlement price, and (iv) in the case of a contract that was both opened and closed since the most recent variation settlement, the contract price at which such contract was closed less the contract price at which it was opened. If the result of the foregoing calculation is positive, the variation payment shall be owed by the Clearing Member that is, or represents, the seller to the Corporation and by the Corporation to the Clearing Member that is, or represents, the buyer. If the result is negative, the variation payment shall be owed by the Clearing Member that is, or represents, the buyer to the Corporation and by the Corporation to the Clearing Member that is, or represents, the seller.

(b) -- end [unchanged]

**Item 2.        Procedures of the Self-Regulatory Organization**

The proposed rule change was approved by the Board of Directors of OCC at a meeting held on May 10, 2004.

Questions regarding the proposed rule change should be addressed to Jean M. Cawley, First Vice President and Deputy General Counsel, at (312) 322-6269.

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

The purpose of this rule change is to permit OCC to clear and settle futures contracts ("variance futures") on the variance over a set time period of a reference variable selected by the futures market proposing to trade the contracts. OCC's rules would permit it to

clear and settle options on variance futures as well. A variance is a statistical measure of the variability of price returns relative to an average (mean) price return.

CBOE Futures Exchange, LLC (“CFE”) has proposed to trade variance futures for which the reference variable would be the S&P 500 Index. The underlying variance will be calculated by CFE (or its agent) using a standard formula that uses continuously compounded daily returns on the reference variable for a specified time period. The calculated variance is then annualized assuming 252 business days per year. CFE currently proposes futures on the one month variance and three month variance of the S&P 500 Index, although CFE may list variance futures on other variance measurement periods for the S&P 500 Index, or on other reference variables, in the future. The variance measurement period for each series of variance futures traded on CFE will begin on the first business day following the maturity date of the previously maturing series and continue to (and include) the maturity date of the subject series. CFE may open trading in a series of variance futures prior to the beginning of the measurement period for the underlying variance. For example, CFE may open a future on the one month variance of the S&P 500 Index four months before its maturity date, and the measurement period for the variance underlying that variance future would be the one month prior to the maturity date of the future.

Futures on variance differ from futures on volatility indexes currently traded on CFE and cleared and settled by OCC in that underlying variance is calculated using only historical daily closing values of the reference variable while an underlying volatility index represents the implied volatility component of bid and ask premium quotations for options on a reference variable.

An underlying variance is clearly a “commodity” within the definition of Section

1a(4) of the Commodity Exchange Act (“CEA”), which includes “all . . . rights, and interests in which contracts for future delivery are presently or in the future dealt in.” A variance as proposed to be traded by CFE is clearly not a “security” as defined in Section 3(a)(10) of the Securities Exchange Act of 1934 (the “Act”), nor is it a “narrow-based security index” as defined in Section 3(a)(55)(B) of the Act. Accordingly, a futures contract on such a variance is not a “security future” within the meaning of Section 3(a)(55)(A) of the Act, and would therefore be within the exclusive jurisdiction of the Commodity Futures Trading Commission. OCC therefore proposes to clear this product in its capacity as a “derivatives clearing organization” registered under Section 5b of the CEA.

**A. Rule Changes**

In order to provide for the clearance of variance futures, OCC proposes to add four new defined terms to Article I of OCC’s By-Laws. The more general term “multiplier” is added to encompass the already defined term “index multiplier” as well as the multiplier that will be applied to a variance future to determine the final settlement price. Adding the multiplier definition simplifies other amendments to the By-Laws and Rules, described below. The term “reference variable” is defined to mean the price or value of a security, commodity, future, currency, asset, index, or other thing, the variance or other measure of variability of which is used as the underlying interest for a cleared contract. The term is needed to describe contracts, such as variance futures, that have as their underlying a measure of the variability of the price or level of an index or instrument. “Underlying variance” or “variance” is defined as the variability of the reference variable over a specified time period as measured by the futures market on which the variance future is traded or that market’s designated reporting authority, and a “variance future” is defined as a future on a variance.

Article VI, Section 10(d) of the By-Laws currently provides that the index multiplier for an index future is set by a market at the time a series is opened and may be adjusted under Article XII, Sections 3 and 4. The rule change would make Section 10(d) applicable to variance futures by replacing the term “index multiplier” with the new term “multiplier” and by specifically referring to variance futures as well as index futures. Likewise, Article XII, Sections 3 and 4 (relating to “Adjustments”) and Section 5 (“Unavailability or Inaccuracy of Final Settlement Price”) are made applicable to variance futures and options on such futures. In order to determine the variance of a variance future that has a stock index as its reference variable, the level of the stock index must be accurate and available. Therefore, OCC requires similar authority to adjust variance futures for changes in the index that is the reference variable, or the unavailability of such index, as OCC has in the case of indexes underlying index futures. Additionally, a new Section 4(d) is added to Article XII to account for the fact that variance futures may also need to be adjusted for changes in the calculation of the underlying variance itself.

Variance futures are non-equity futures (*see* the definition of “future” in Article I of OCC’s By-Laws) and will therefore be margined under Chapter VI, Rule 602. Rule 602(a)-(e) describes OCC’s current automated margining system, TIMS. However, TIMS is not currently configured to calculate appropriate margin levels for variance futures. Thus, the appropriate risk margin levels for variance futures cannot be determined through the application of Rule 602(a)-(e), and it is necessary to add variance futures to those instruments that are exempted from the provisions of 602(a)-(e) by Rule 602(f). New Rule 602(f)(6) would direct that risk margin for variance futures be calculated using such measures of risk as OCC deems

appropriate. Because the margin requirements for variance futures will not be set through TIMS, those margin requirements will not appear on the Daily Margin Report provided for in Rule 605, which is a report of the TIMS calculations applied to a Clearing Member's positions. OCC is adding an interpretation and policy to Rule 605 advising Clearing Members that risk margin in respect of variance futures will not be included in the Daily Margin Report, and that notifications to Clearing Members of their risk margin requirement in respect of variance futures will be given before 9:00 a.m. Central Time, which is the same deadline that applies to delivery of the Daily Margin Report. Clearing Members will be required to make settlement of variance futures risk margin as if it were included in the Daily Margin Report.

The "Introduction" to Chapter XIII is amended to include variance futures among those futures contracts that OCC is approved to clear and settle. Rule 1301(a) is, like Article VI, Section 10(d), made applicable to variance futures by simply replacing "index multiplier" with "multiplier" and adding references to variance futures where index futures are referenced.

**B. Amendment to Clearing Agreement**

The Amendment makes several changes to the Clearing Agreement in anticipation of the clearance of variance futures. Only certain of those changes are substantive. Section 3(b) of the Clearing Agreement currently identifies the permissible underlying interests for futures contracts that CFE may clear through OCC. The Amendment amends Section 3(b) to permit the parties to agree on additional underlyings by completion and execution of a schedule in the form attached to the Amendment as Schedule C. *See* Amendment Section 5. The parties have also agreed upon, and included with the Amendment, a Schedule C-1 for variance futures. *See* Amendment Schedule C-1. The Amendment also amends Section 3(e) to extend the established procedure for selecting underlying interests to an underlying interest listed on a Schedule C. *See* Amendment Section 10.

Section 3(c)(i) of the Clearing Agreement currently states that broad-based index futures are the only acceptable underlying for options to be cleared under the Clearing Agreement. The Amendment would change this language so that any future other than a security future may be an underlying for such an option. *See* Amendment Section 6.

The Clearing Agreement currently requires CFE to indemnify OCC in certain circumstances. The Amendment would add a provision clarifying, among other things, the applicability of the indemnification provisions to certain currently pending litigation against CBOE and CFE and similar litigation or claims that may be brought in the future. *See* Amendment Section 11. The Amendment makes CBOE a party to the Clearing Agreement for the purpose of assuming joint and several liability to OCC in the event that OCC is entitled to indemnification in respect of such litigation or claims. *See id.*

\* \* \*

The proposed changes to OCC's By-Laws and Rules and the Amendment are consistent with the purposes and requirements of Section 17A of the Securities Exchange Act of 1934, as amended, because they are designed to promote the prompt and accurate clearance and settlement of derivative transactions, to foster cooperation and coordination with persons engaged in the clearance and settlement of such transactions, to remove impediments to and perfect the mechanism of a national system for the prompt and accurate clearance and settlement of such transactions, and, in general, protect investors and the public interest.

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

OCC does not believe that the proposed rule change would impose any burden on competition.

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

Written comments were not and are not intended to be solicited with respect to the proposed rule change and none have been received.

**Item 6. Extension of Time Period for Commission Action**

Not applicable.

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

OCC is filing the proposed rule change for immediate effectiveness pursuant to Section 19(b)(3) of the Securities Exchange Act of 1934 and Rule 19b-4(f)(4) thereunder. Pursuant to Rule 19b-4(f)(4), a rule change may take effect upon filing with the Commission if it effects a change in an existing service of OCC that does not (i) adversely affect the safeguarding of securities or funds in OCC's custody or control or for which OCC is responsible or (ii) significantly affect the respective rights or obligations of OCC or persons using the service. Variance futures are commodity futures within the exclusive jurisdiction of the CFTC, and OCC will therefore clear variance futures in its capacity as a registered derivatives clearing organization under the CFTC's regulatory jurisdiction. Accordingly, although this rule change represents a change in OCC's existing service of clearing commodity futures contracts, that service is not otherwise within the jurisdiction of the Commission. This rule change will not affect the safeguarding of funds or securities in OCC's possession because OCC will apply the same procedures and safeguards to the clearing of these contracts that it does to the clearing of securities options and security futures over which the Commission has direct regulatory authority. The respective rights and obligations of OCC and Clearing Members with respect to matters within the Commission's jurisdiction will be unaffected.

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

Not applicable.



**Item 9.**      **Exhibits**

- Exhibit 1.      Completed Notice of Proposed Rule Change for publication in the Federal Register.
  
- Exhibit A.      First Amendment to Agreement for Clearing and Settling Security Futures and Futures and Futures Options on Broad-Based Indexes.

**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, The Options Clearing Corporation has caused this filing to be signed on its behalf by the undersigned hereunto duly authorized.

**THE OPTIONS CLEARING CORPORATION**

By: \_\_\_\_\_  
**William H. Navin**  
**Executive Vice President and**  
**General Counsel**

**EXHIBIT 1**

**SECURITIES AND EXCHANGE COMMISSION**

**(Release No. 34-\_\_\_\_\_ ; File No. SR-OCC-2004-08**

**SELF-REGULATORY ORGANIZATION**

Proposed Rule Change By  
The Options Clearing Corporation

Relating to Clearing and Settling  
Futures on the Variance of Certain  
Measures and Instruments

Comments requested within \_\_\_\_ days  
after the date of this publication.

---

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934, 15 U.S.C. '78s(b)(1), notice is hereby given that on \_\_\_\_\_, 2004, The Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission the proposed rule change as described in Items I, II and III below, which Items have been prepared by the self-regulatory organization. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

**I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change**

The proposed rule change is to permit OCC to clear and settle futures contracts ("variance futures") on the variance over a set period of time of a reference variable, and to clear and settle options on variance futures as well.

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

In its filing with the Commission, the self-regulatory organization 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. The self-regulatory organization 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**

The purpose of this rule change is to permit OCC to clear and settle futures contracts (“variance futures”) on the variance over a set time period of a reference variable selected by the futures market proposing to trade the contracts. OCC’s rules would permit it to clear and settle options on variance futures as well. A variance is a statistical measure of the variability of price returns relative to an average (mean) price return.

CBOE Futures Exchange, LLC (“CFE”) has proposed to trade variance futures for which the reference variable would be the S&P 500 Index. The underlying variance will be calculated by CFE (or its agent) using a standard formula that uses continuously compounded daily returns on the reference variable for a specified time period. The calculated variance is then annualized assuming 252 business days per year. CFE currently proposes futures on the one month variance and three month variance of the S&P 500 Index, although CFE may list variance futures on other variance measurement periods for the S&P 500 Index, or on other reference variables, in the future. The variance measurement period for each series of variance

futures traded on CFE will begin on the first business day following the maturity date of the previously maturing series and continue to (and include) the maturity date of the subject series. CFE may open trading in a series of variance futures prior to the beginning of the measurement period for the underlying variance. For example, CFE may open a future on the one month variance of the S&P 500 Index four months before its maturity date, and the measurement period for the variance underlying that variance future would be the one month prior to the maturity date of the future.

Futures on variance differ from futures on volatility indexes currently traded on CFE and cleared and settled by OCC in that underlying variance is calculated using only historical daily closing values of the reference variable while an underlying volatility index represents the implied volatility component of bid and ask premium quotations for options on a reference variable.

An underlying variance is clearly a “commodity” within the definition of Section 1a(4) of the Commodity Exchange Act (“CEA”), which includes “all . . . rights, and interests in which contracts for future delivery are presently or in the future dealt in.” A variance as proposed to be traded by CFE is clearly not a “security” as defined in Section 3(a)(10) of the Securities Exchange Act of 1934 (the “Act”), nor is it a “narrow-based security index” as defined in Section 3(a)(55)(B) of the Act. Accordingly, a futures contract on such a variance is not a “security future” within the meaning of Section 3(a)(55)(A) of the Act, and would therefore be within the exclusive jurisdiction of the Commodity Futures Trading Commission. OCC therefore proposes to clear this product in its capacity as a “derivatives clearing organization” registered under Section 5b of the CEA.

## **A. Rule Changes**

In order to provide for the clearance of variance futures, OCC proposes to add four new defined terms to Article I of OCC's By-Laws. The more general term "multiplier" is added to encompass the already defined term "index multiplier" as well as the multiplier that will be applied to a variance future to determine the final settlement price. Adding the multiplier definition simplifies other amendments to the By-Laws and Rules, described below. The term "reference variable" is defined to mean the price or value of a security, commodity, future, currency, asset, index, or other thing, the variance or other measure of variability of which is used as the underlying interest for a cleared contract. The term is needed to describe contracts, such as variance futures, that have as their underlying a measure of the variability of the price or level of an index or instrument. "Underlying variance" or "variance" is defined as the variability of the reference variable over a specified time period as measured by the futures market on which the variance future is traded or that market's designated reporting authority, and a "variance future" is defined as a future on a variance.

Article VI, Section 10(d) of the By-Laws currently provides that the index multiplier for an index future is set by a market at the time a series is opened and may be adjusted under Article XII, Sections 3 and 4. The rule change would make Section 10(d) applicable to variance futures by replacing the term "index multiplier" with the new term "multiplier" and by specifically referring to variance futures as well as index futures. Likewise, Article XII, Sections 3 and 4 (relating to "Adjustments") and Section 5 ("Unavailability or Inaccuracy of Final Settlement Price") are made applicable to variance futures and options on such futures. In order to determine the variance of a variance future that has a stock index as its

reference variable, the level of the stock index must be accurate and available. Therefore, OCC requires similar authority to adjust variance futures for changes in the index that is the reference variable, or the unavailability of such index, as OCC has in the case of indexes underlying index futures. Additionally, a new Section 4(d) is added to Article XII to account for the fact that variance futures may also need to be adjusted for changes in the calculation of the underlying variance itself.

Variance futures are non-equity futures (*see* the definition of “future” in Article I of OCC’s By-Laws) and will therefore be margined under Chapter VI, Rule 602. Rule 602(a)-(e) describes OCC’s current automated margining system, TIMS. However, TIMS is not currently configured to calculate appropriate margin levels for variance futures. Thus, the appropriate risk margin levels for variance futures cannot be determined through the application of Rule 602(a)-(e), and it is necessary to add variance futures to those instruments that are exempted from the provisions of 602(a)-(e) by Rule 602(f). New Rule 602(f)(6) would direct that risk margin for variance futures be calculated using such measures of risk as OCC deems appropriate. Because the margin requirements for variance futures will not be set through TIMS, those margin requirements will not appear on the Daily Margin Report provided for in Rule 605, which is a report of the TIMS calculations applied to a Clearing Member’s positions. OCC is adding an interpretation and policy to Rule 605 advising Clearing Members that risk margin in respect of variance futures will not be included in the Daily Margin Report, and that notifications to Clearing Members of their risk margin requirement in respect of variance futures will be given before 9:00 a.m. Central Time, which is the same deadline that applies to delivery of the Daily Margin Report. Clearing Members will be required to make settlement of variance futures risk

margin as if it were included in the Daily Margin Report.

The “Introduction” to Chapter XIII is amended to include variance futures among those futures contracts that OCC is approved to clear and settle. Rule 1301(a) is, like Article VI, Section 10(d), made applicable to variance futures by simply replacing “index multiplier” with “multiplier” and adding references to variance futures where index futures are referenced.

**B. Amendment to Clearing Agreement**

The Amendment makes several changes to the Clearing Agreement in anticipation of the clearance of variance futures. Only certain of those changes are substantive. Section 3(b) of the Clearing Agreement currently identifies the permissible underlying interests for futures contracts that CFE may clear through OCC. The Amendment amends Section 3(b) to permit the parties to agree on additional underlyings by completion and execution of a schedule in the form attached to the Amendment as Schedule C. *See* Amendment Section 5. The parties have also agreed upon, and included with the Amendment, a Schedule C-1 for variance futures. *See* Amendment Schedule C-1. The Amendment also amends Section 3(e) to extend the established procedure for selecting underlying interests to an underlying interest listed on a Schedule C. *See* Amendment Section 10.

Section 3(c)(i) of the Clearing Agreement currently states that broad-based index futures are the only acceptable underlying for options to be cleared under the Clearing Agreement. The Amendment would change this language so that any future other than a security future may be an underlying for such an option. *See* Amendment Section 6.

The Clearing Agreement currently requires CFE to indemnify OCC in certain circumstances. The Amendment would add a provision clarifying, among other things, the



applicability of the indemnification provisions to certain currently pending litigation against CBOE and CFE and similar litigation or claims that may be brought in the future. *See* Amendment Section 11. The Amendment makes CBOE a party to the Clearing Agreement for the purpose of assuming joint and several liability to OCC in the event that OCC is entitled to indemnification in respect of such litigation or claims. *See id.*

\* \* \*

The proposed changes to OCC's By-Laws and Rules and the Amendment are consistent with the purposes and requirements of Section 17A of the Securities Exchange Act of 1934, as amended, because they are designed to promote the prompt and accurate clearance and settlement of derivative transactions, to foster cooperation and coordination with persons engaged in the clearance and settlement of such transactions, to remove impediments to and perfect the mechanism of a national system for the prompt and accurate clearance and settlement of such transactions, and, in general, protect investors and the public interest.

**B. Self-Regulatory Organization's Statement on Burden on Competition**

OCC does not believe that the proposed rule change would impose any burden on competition.

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

Written comments were not and are not intended to be solicited with respect to the proposed rule change and none have been received.

### **III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action**

OCC is filing the proposed rule change for immediate effectiveness pursuant to Section 19(b)(3) of the Securities Exchange Act of 1934 and Rule 19b-4(f)(4) thereunder. Pursuant to Rule 19b-4(f)(4), a rule change may take effect upon filing with the Commission if it effects a change in an existing service of OCC that does not (i) adversely affect the safeguarding of securities or funds in OCC's custody or control or for which OCC is responsible or (ii) significantly affect the respective rights or obligations of OCC or persons using the service. Variance futures are commodity futures within the exclusive jurisdiction of the CFTC, and OCC will therefore clear variance futures in its capacity as a registered derivatives clearing organization under the CFTC's regulatory jurisdiction. Accordingly, although this rule change represents a change in OCC's existing service of clearing commodity futures contracts, that service is not otherwise within the jurisdiction of the Commission. This rule change will not affect the safeguarding of funds or securities in OCC's possession because OCC will apply the same procedures and safeguards to the clearing of these contracts that it does to the clearing of securities options and security futures over which the Commission has direct regulatory authority. The respective rights and obligations of OCC and Clearing Members with respect to matters within the Commission's jurisdiction will be unaffected.

### **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 Section, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of such filing will also be available for inspection and copying at the principal office of the above-mentioned self-regulatory organization. All submissions should refer to the file number in the caption above and should be submitted by \_\_\_\_\_.

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

Secretary

Dated: \_\_\_\_\_

**FIRST AMENDMENT  
TO  
AGREEMENT FOR CLEARING AND SETTLING  
SECURITY FUTURES AND FUTURES AND  
FUTURES OPTIONS ON BROAD-BASED INDEXES**

**THIS FIRST AMENDMENT** (this “Amendment”) to that certain Agreement for Clearing and Settling Securities Futures and Futures and Futures Options on Broad-Based Indexes (the “Agreement”) dated May 28, 2003 between The Options Clearing Corporation (the “Corporation”) and CBOE Futures Exchange, LLC (the “Market”) is entered into on May \_\_\_\_, 2004 for the purposes of (1) extending Cleared Contracts to include variance futures and options on variance futures, and (2) reflecting the agreement of Chicago Board Options Exchange, Incorporated (“CBOE”), a Delaware corporation, to assume liability jointly and severally with the Market for the indemnification obligations of the Market to the extent set forth in the Agreement as amended by this Amendment. Technical terms (whether or not initially capitalized) used but not defined herein have the meanings they are given in the Agreement, if defined therein. References in the Agreement to a party or the parties shall not include CBOE.

The Agreement is amended as follows:

1. The title of the Agreement is amended to read as follows: “Agreement for Clearing and Settlement Services.”
2. In the fourth line of the first WHEREAS clause, after the words “futures on broad-based security indexes” insert “and on certain other underlying interests that are selected in accordance with Section 3(b).”
3. In the second line of the fourth WHEREAS clause, strike the parenthetical (“futures options”), and in the third line of that clause after the words “futures on broad-based security indexes ” insert “and on certain other underlying interests that are selected in accordance with Section 3(b) (“futures options”).”
4. The title of Section 3(b) is amended to read as follows: “Underlying Interests for Broad-Based Index Futures and Other Futures.”
5. Section 3(b) is amended by adding at the end thereof the following:

The parties may introduce additional types of underlying interests selected by the Market to be the subject of futures to be traded on the Market and cleared by the Corporation by completing and executing a Schedule C in the form attached hereto. The Schedules C shall be numbered sequentially as Schedule C-1, Schedule C-2, etc. The form of Schedule C-1 with respect to variance contracts is attached hereto.

6. Section 3(c) clause (i) is amended to read in its entirety as follows:

(i) each underlying interest so selected shall consist solely of a futures contract, other than a security future, that is traded on the Market and cleared by the Corporation.

7. Section 3(c) is further amended by adding the following sentence at the end of that section:

As used in this Agreement, the term “futures option” shall be limited to an American-style or European-style option on a futures contract.

8. Section 3(d) is amended by adding the following at the end of the first sentence thereof :

; Cleared Contracts with respect to which the underlying interest has been introduced in a Schedule C-[x] are herein referred to as “Schedule C-[x] futures” (where “x” is the sequential number of such Schedule C); all Schedule C-[x] futures are herein referred to collectively as “Schedule C futures”.

9. Section 3(d) is further amended by replacing the fourth and fifth sentences with:

Stock futures, index futures and Schedule C futures are herein referred to collectively, as the context requires, as “futures”. The term “futures” may also refer, as the context requires, to one of stock futures, index futures or Schedule C futures. Options on a futures contract other than a security future are herein referred to as “futures options”.

10. Section 3(e) is amended to read in its entirety as follows:

(e) Procedures for Selection of Underlying Interests. If the Market wishes to list and trade futures or futures options of a class not theretofore listed or traded on the Market, the Market shall notify the Corporation by submitting a certificate as described below (a “Certificate”) (i) in the case of a class of stock futures, no earlier than 12:01 a.m. and no later than 11:00 a.m. (Chicago time) on the trading day before the trading day on which the Market wishes to commence trading such stock futures, (ii) in the case of a class of index futures, no later than ten days before the trading day on which the Market wishes to commence trading such index futures, (iii) in the case of a class of futures options, no earlier than the time at which a Certificate is submitted with respect to the underlying futures contract and no later than 11:00 a.m. (Chicago time) on the trading day before the trading day on which the Market wishes to commence trading, and (iv) in the case of a class of Schedule C futures, as specified in the applicable Schedule C-[x]. (A “trading day” means a day on which U.S. securities markets are open for business.) The Certificate shall set forth the type of contract (future or futures option), the type and complete name of the underlying interest, the maturity cycle of the class, the series marker, if any, and the date on which the Market intends to commence listing and trading contracts in the class. If the type of underlying interest is common stock, the Certificate shall also identify its trading symbol, CUSIP number and the mode of settlement for the futures contracts. If the type of underlying interest is a security index, the Certificate

shall also (1) identify the index, state whether it is a narrow-based security index or a broad-based security index and explain the basis for such statement, (2) identify the securities composing the index by complete name, trading symbol and CUSIP number, (3) identify the reporting authority for the index, (4) set out in detail the method and frequency of calculation of the index, and (5) identify the owner or owners of the index and, if other than the Market, explain the basis for the right of the Market to list and trade futures on the index. If the type of underlying interest is a broad-based index futures contract, the Certificate shall also identify the series by contract price and maturity date. If the type of underlying interest is a Schedule C interest, the Certificate shall contain the information required for an underlying index to the extent applicable to the underlying interest and/or such other information as may be specified in the applicable Schedule C-[x]. Finally, the Certificate shall state that the Market certifies that the specified underlying interest meets the requirements of Section 3(a), 3(b) or 3(c) of this Agreement, whichever is applicable, and the Market has approved the listing and trading of futures or futures options to be cleared by the Corporation on such underlying interest. Subject to Section 3(g) below, the Market may begin listing and trading futures in the specified class on the first trading day (in the case of a class of stock futures), the tenth trading day (in the case of a class of index futures) or the trading day specified in the applicable Schedule C-[x] (in the case of Schedule C futures) after the relevant Certificate has been properly submitted to the Corporation. Trading in a class of futures options may begin on the later of the date when trading in the underlying series of futures begins or the first trading day after the relevant Certificate has been submitted.

11. Section 16 is amended by adding a new Section 16(f) as follows:

(f) Indemnification with Respect to Certain Volatility and Variance Contracts. For the avoidance of doubt, the indemnification obligations of Market under this Section 16, as amended, shall include, without limitation, all liabilities, judgments, claims, damages, expenses (including reasonable attorneys fees and costs) and amounts paid in settlement in connection with any claim or cause of action that may be asserted against the Corporation and its directors, officers, committee members and employees (including any claim or cause of action asserted against the Corporation by a subcontractor), related to or arising out of: (i) the lawsuit filed on March 29, 2004 by the Chicago Mercantile Exchange, Inc. ("CME") against the Market and CBOE, which lawsuit is pending in the Circuit Court of Cook County, Illinois, Chancery Division and has been assigned Docket Number 04 CH 5395 ("CME Lawsuit"), whether such claim or cause of action is asserted in the CME Lawsuit or in a separate proceeding initiated by CME; or (ii) any legal theory that (X) the Market does not have the right to trade volatility futures or variance futures (as defined in Schedule C-1), or options thereon, where the reference index is the S&P 500 Index or another S&P index, or (Y) the trading in any such contract (and not in contracts generally), or the clearing of any such contract (and not of contracts generally) by the Corporation (including the services of any subcontractor of the Corporation), infringes or interferes with the intellectual property, contract or other rights of a third party (such claims or causes of action being collectively referred to as "S&P Volatility or Variance Claims". Further, with respect to any S&P Volatility or Variance Claim: (x) Market and CBOE shall indemnify and be jointly and severally liable to the Corporation

under the indemnification obligations set forth in Sections 5(b), 16(b), 16(c) and 20, as applicable; and (y) if under Section 16(e) the indemnified party is the Corporation or any person entitled to indemnification under Section 16(b), references to an indemnifying party in such Section shall be references to the Market and CBOE, jointly and severally.

12. Section 28 is amended by replacing the phrase “for security futures and for futures and futures options on broad-based security indexes” with “for futures and futures options (as defined in Section 3(d).”

IN WITNESS WHEREOF, the parties hereto have duly executed this Amendment as of the date first above written.

THE OPTIONS CLEARING CORPORATION

By: \_\_\_\_\_

Name:

Title:

CBOE FUTURES EXCHANGE, LLC

By: \_\_\_\_\_

Name:

Title:

Chicago Board Options Exchange, Incorporated, for good and valuable consideration, is signing this Amendment in order to become a party to the Agreement for the limited purpose of acknowledging, accepting and agreeing to its position as a provider of indemnification, jointly and severally with the Market, to the extent set forth in the Agreement as amended by this Amendment.

CHICAGO BOARD OPTIONS EXCHANGE,  
INCORPORATED

By: \_\_\_\_\_

Name:

Title:

Schedule C-[ ]

INTRODUCTION OF UNDERLYING INTEREST: [identify underlying interest]

[Date]

1. This is one of the Schedules C referred to in Section 3(b) of the Agreement for Clearing and Settlement Services dated May 28, 2003 (as amended, the "Agreement") between the CBOE Futures Exchange, LLC (the "Market") and The Options Clearing Corporation (the "Corporation"). When completed and duly executed by the parties, this Schedule C shall be incorporated into the Agreement and become a part thereof. Terms used herein and defined in the Agreement shall have the meanings they are given in the Agreement.
2. [Insert paragraph in form of Section 3(b) of the Agreement.]
3. [Insert paragraph specifying how far in advance of the start of trading of any class of the Schedule C futures described in this Schedule C the Certificate with respect to such class must be submitted to the Corporation, and other information with respect to such class, if any, described in Section 3(e) of the Agreement.]

IN WITNESS WHEREOF, the parties hereto have duly executed this Schedule as of the date first above written.

CBOE FUTURES EXCHANGE, LLC

THE OPTIONS CLEARING CORPORATION

By: \_\_\_\_\_  
Name:  
Title:

By: \_\_\_\_\_  
Name:  
Title:



Schedule C-1

INTRODUCTION OF UNDERLYING INTEREST: VARIANCES

May \_\_, 2004

1. This is one of the Schedules C referred to in Section 3(b) of the Agreement for Clearing and Settlement Services dated May 28, 2003 (as amended, the "Agreement") between the CBOE Futures Exchange, LLC (the "Market") and The Options Clearing Corporation (the "Corporation"). When completed and duly executed by the parties, this Schedule C shall be incorporated into the Agreement and become a part thereof. Terms used herein and defined in the Agreement shall have the meanings they are given in the Agreement.
2. Pursuant to Section 3(b) of the Agreement, the Market may select the underlying interests that are the subject of variance futures (as defined below) to be traded on the Market and cleared by the Corporation, subject to the following conditions: (i) all underlying interests so selected shall consist solely of variances (as defined below), and (ii) the clearance and settlement by the Corporation of futures on an underlying interest so selected would not, in the opinion of counsel to the Corporation, (1) be unlawful or (2) be likely to subject the Corporation to liability based upon claims that trading of futures on such underlying interest infringes the intellectual property rights of third parties or otherwise. A "variance future" is a futures contract having as its underlying interest a "variance," defined for these purposes as the realized variance of price returns on a specified "reference" index of securities over a specified interval of time relative to an average (mean) price return, calculated pursuant to a standardized statistical formula.
3. Except for variance futures where the reference index is the S&P 500, the Market will submit a Certificate with respect to any class of variance futures no later than ten trading days before the trading day on which the Market wishes to commence trading such class. The Market may begin listing and trading futures in such class on the tenth trading day after the Certificate has been properly submitted to the Corporation. For S&P 500 variance futures, the Market will submit a Certificate no later than 11:00 am (Chicago time) on the trading day before the trading day on which the Market wishes to commence trading such futures, provided the commencement day for trading shall be no earlier than May 18, 2004. The Market may begin listing and trading S&P 500 variance futures on the first trading day after the Certificate has been properly submitted to the Corporation, but in no event earlier than May 18, 2004.

IN WITNESS WHEREOF, the parties hereto have duly executed this Schedule as of the date first above written.

CBOE FUTURES EXCHANGE, LLC

THE OPTIONS CLEARING CORPORATION

By: \_\_\_\_\_

Name:

Title:

By: \_\_\_\_\_

Name:

Title: