Regulatory Circular RG14-058

Date: April 9, 2014

To: Trading Permit Holders and Clearing Trading Permit Holders
From: Division of Regulatory Services
RE: Product Description and Margin and Net Capital Requirements
- Options on the CBOE Short-Term Volatility Index (VXST)

KEY POINTS

- On April 10, 2014, Chicago Board Options Exchange (CBOE or Exchange) plans to commence trading of options on the CBOE Short-Term Volatility Index. Options will trade under the ticker symbol "VXST."
- The CBOE Short-Term Volatility Index represents an up-to-the-minute estimate of the expected 9-day volatility of the S&P 500 Index and is derived by applying the CBOE Volatility Index (VIX) methodology to options on the S&P 500 Index traded on CBOE that expire every week.
- VXST options are cash-settled, have European-style exercise and have a $100 multiplier.
- For strategy-based customer margin requirements, a basic margin requirement of 40% will apply to **short** VXST options, with a 20% minimum (40% basic / 20% minimum).
- Margin, including portfolio margin, requirements and net capital requirements are described in detail below.

DISCUSSION

PRODUCT DESCRIPTION

CBOE expects to list cash-settled option contracts on the CBOE Short-Term Volatility Index (Ticker: VXST) beginning on April 10, 2014. VXST options have European-style exercise; options generally may be exercised only on the Expiration Date.

The VXST Index provides a market estimate of short-term expected (implied) volatility that is calculated by using real-time S&P 500 Index option bid/ask quotes. VXST uses nearby and second nearby options with at least 1 day left to expiration and then weights them to yield a constant, nine-day measure of the expected volatility of the S&P 500 Index. A detailed description of the VXST calculation may be found on the CBOE website at the following URL:

http://www.cboe.com/vxstms/pdf/CBOE506c2-VXST_WP-f.pdf

The contract multiplier for VXST options will be $100. The minimum tick for VXST option series trading below $3 is 0.05 ($5.00); above $3 is 0.10 ($10.00).

Minimum strike price intervals for VXST options are $0.50 or greater where the strike price is $75 or less,

$1 or greater where the strike price is $200 or less and $5 or greater where the strike price is more than $200.

Initially, CBOE plans to list VXST options expiring on April 16, April 23, April 30 and May 7 (2014). CBOE may list up to twelve near-term VXST option expiration weeks.

The last day to trade expiring VXST options will be the business day prior to the Expiration Date of each contract expiration. The Expiration Date for VXST options will be a specific date, usually a Wednesday, identified in the option symbol for the series. If that Wednesday or the Friday in the business week following that Wednesday (i.e., nine days away) is an Exchange holiday, the exercise settlement value would be calculated on the business day immediately preceding the Wednesday.

VXST options are A.M.-settled; the exercise-settlement value for VXST options (Ticker: SVRO) shall be a Special Opening Quotation (SOQ) calculated from the sequence of opening option prices on CBOE used to calculate the index on the Expiration Date. The opening price for any series in which there is no trade shall be the average of that option's bid price and ask price on CBOE as determined at the opening of trading. The "time to expiration" used to calculate the SOQ shall account for the actual number of days and minutes until expiration for the constituent option series. For examples of adjustments to "time to expiration," see the product specifications found at the website address given below.

Exercise will result in delivery of cash on the business day following expiration. The exercise-settlement amount is equal to the difference between the exercise-settlement value and the exercise price of the option, multiplied by $100.

No position and exercise limits are in effect for VXST options. Each Trading Permit Holder (TPH) (other than a market-maker) or TPH organization that maintains an end of day aggregate position in excess of 100,000 VXST contracts for its proprietary account or for the account of a customer, shall report certain information to the Department of Market Regulation. For further information on reporting, see the VXST option product specifications found at the website address given below.

Trading hours for VXST options are 8:30 AM to 3:15 PM (Chicago time).

Detailed product specifications may be found on the CBOE website at the following URL:

http://www.cboe.com/products/indexopts/vxstoptions_spec.aspx

CUSTOMER MARGIN

Purchases of VXST options must be paid for in full.

The initial and maintenance margin requirement for a short put or call is 100% of the option proceeds* plus 40% of the aggregate contract value (current (spot or cash) index value x $100) minus the amount by which the option is out-of-the-money, if any, subject to a minimum for calls of option proceeds* plus 20% of the aggregate contract value and a minimum for puts of option proceeds* plus 20% of the aggregate put exercise price amount.[1] (*For calculating maintenance margin, use current market value instead of option proceeds.)

Spreads and straddles are permitted for VXST options having equivalent aggregate underlying values. In respect of calendar spreads, TPH organizations are reminded that VXST options have European-style exercise. It is possible that the spread margin requirement could be, or become, insufficient to cover the assignment obligation on the short option if the long option cannot be exercised and it is trading at less than its intrinsic value in relation to the SOQ calculated on the Expiration Date. Therefore, TPH

[1] See CBOE Regulatory Circular RG14-040 (Margin Requirements for VXST Options).

organizations must apply "house" margin requirement policies and procedures for calendar spreads with European style options in order to insure that sufficient margin is held to cover the risk.

Where a short option contract is covered by an "escrow agreement" meeting the requirements of CBOE Rule 12.3(d)(2), no margin need be required.

PORTFOLIO MARGIN

VXST options are eligible for portfolio margining. VXST options will be accommodated in The Options Clearing Corporation's (OCC) Broad-Based Index Volatility Indexes Product Group (500), with a 75% offset with the other classes contained in that Product Group. The portfolio margin requirement for VXST options will be equal to the maximum potential loss over a range of market movements covering +/–40%.[2] VXST futures contract prices will be utilized to compute theoretical option prices rather than the current (spot or cash) index value. All positions are subject to a minimum charge of $37.50 per contract, except that the minimum charge for long options will not exceed the market value. These requirements are Exchange minimums. House portfolio margin requirements may be greater.

OPTION MARKET–MAKER MARGIN REQUIREMENTS

Pursuant to CBOE Rule 12.3(f), VXST option positions of a VXST options market-maker may be margined on a basis that is satisfactory to the market-maker and carrying broker-dealer.

VXST options and VXST futures positions of a VXST options market-maker are eligible for cross-margin treatment in a cross-margin account carried for the options market-maker by a Clearing TPH that clears and carries both the VXST options and VXST futures positions. A futures account must be used for cross-margining. Cross-margining of VXST options and VXST futures positions must be undertaken in a cross-margin account that is exclusive to CBOE and CBOE Futures Exchange, LLC (CFE) products. The SPAN file will be updated to take any risk offsets between VXST options and VXST futures into consideration and render a margin requirement accordingly. Additionally, a risk-based haircut (RBH) must be computed on the cross-margin account positions. If the RBH is greater than the SPAN margin requirement, the RBH must be used as the margin requirement in lieu of the SPAN margin requirement.

It should be noted that at OCC, VXST options are eligible for a market professional cross-margin account, in which offsetting positions in VXST options and VXST futures may be combined. A cross-margin account for a market professional must be set-up exclusively for carrying CBOE and CFE products that are cross-marginable. OCC currently requires that both VXST options and VXST futures be cleared and carried by the same OCC clearing member (i.e., a dual broker-dealer / FCM) in order to establish market professional cross-margin accounts at OCC.

NET CAPITAL REQUIREMENTS

For risk-based haircuts, VXST options will be accommodated in the OCC's Broad-Based Index Volatility Indexes Product Group (500), with a 75% offset with the other classes contained in that Product Group.[3] The risk–based haircut will be equal to the maximum potential loss calculated over a range of market movements covering +/-15% for options market-makers and all other broker–dealers. VXST futures contract prices will be utilized to compute theoretical option prices rather than the current (spot or cash) index value. All positions are subject to a minimum charge of $25 per contract, except that the minimum charge for long positions will not exceed the market value. VXST futures will be included in the same Product Group with a 100% offset.

For those firms not utilizing risk–based haircuts, the haircut will be calculated pursuant to the alternative strategy based method of SEC Rule 15c3-1a.

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[2] See CBOE Regulatory Circular RG14-056 (Portfolio Margin Requirements for VXST Options).
[3] Risk–based haircuts may be applied pursuant to SEC Rule 15c3-1a (Appendix A).

Additional Information:

With respect to product specifications, questions regarding this Regulatory Circular should be directed to Dennis O'Callahan, Research Department, at (312) 786 – 7508.

With respect to margin and net capital, questions regarding this Regulatory Circular should be directed to CBOE's Regulatory Interpretations and Guidance team at (312) 786 - 8141 or reginterps@cboe.com