CBOE EXECUTE SUCCESS℠

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Bank for International Settlements
Basel Committee on Banking Supervision
Centralbahnplatz 2, CH-4002, Basel, Switzerland

Re: Comments on April 2016 Revision to Consultative Document; Revisions to the Basel III Leverage Ratio Framework ("Revised Framework")

Dear Sir or Madam:

The Chicago Board Options Exchange, Inc. ("CBOE") welcomes the opportunity to comment on the consultative document regarding revisions to the Basel III leverage ratio framework.[1] In particular, we support the proposal to replace the Current Exposure Method ("CEM") with a modified version of the Standard Approach for Counterparty Credit Risk ("SA-CCR"). We agree with the Committee's premise that CEM does not recognize economically meaningful relationships between offsetting derivative positions. We are concerned with the ongoing negative impact that the use of CEM has on the ability of trading permit holders (TPHs) to provide liquidity in the U.S. listed options markets.

The majority of CBOE's TPHs use U.S. bank affiliated clearing members of OCC that are subject to increased capital requirements based on the Basel III leverage ratio framework. These TPHs play an essential role in facilitating efficient price discovery and liquidity in U.S. listed options markets. They use their own proprietary capital to provide market liquidity, even in the absence of public participation. In performing this role, TPHs maintain large, hedged positions in the options contracts for which they make a market.

One of the many beneficial functions performed by TPHs is to facilitate customer trading activity. It is estimated that TPHs are involved in approximately 85% of all customer trades executed in the listed options market. Furthermore, over 45% of CBOE's transaction volume is

[1] Revisions to the Basel III leverage ratio framework – consultative document, April 2016, available at: http://www.bis.org/bcbs/publ/d365.htm.

executed as spread trades – many of which have limited economic exposure.[2] Consider the following table showing year-to-date CBOE spread option volume by product class.

Product	Spread	Outright	Total	ADV (1 side/126 days)	Spread %
Equity Options	93,684,931	240,311,483	333,996,414	1,325,383	28.0%
ETF/ETP	116,128,405	148,837,295	264,965,700	1,051,451	43.8%
S&P 500® Index	152,959,979	99,453,558	252,413,537	1,001,641	60.6%
CBOE VIX® Index	85,178,199	73,797,831	158,976,030	630,857	53.6%
Russell 2000® Index	13,476,666	3,288,398	16,765,064	66,528	80.4%
Other Indexes	6,089,117	4,183,399	10,272,516	40,764	59.3%
Total	467,517,297	569,871,964	1,037,389,261	4,116,624	45.1%

Source: Chicago Board Options Exchange, Inc.

The net economic exposure of much of this spread volume is considerably less than the capital requirement prescribed by the CEM, which is a function of the notional value of the contract. For example, a common spread order is a call spread that is long one call option and short another call option of the same expiration date with a higher strike price. The maximum loss to a TPH who sells this call spread is simply the difference in the strike prices of those options, which is often considerably less than the notional value of the contracts involved. This disparity is particularly large for cash settled index options that tend to have a high notional value. For example, the current notional value of an S&P 500® Index option is approximately $210,000 while the maximum loss for TPH short a 2100-2125 call spread is $2,500.

As demonstrated in a separate comment letter on the Revised Framework in which CBOE has joined, the treatment of a TPH's hedged positions under the SA-CCR method, as compared with the treatment of such positions under the CEM method, is significantly different.[3] That is, the SA-CCR method would take into account the limited risk posed by hedged options positions, and it would therefore recognize the highly limited exposure resulting from such risk limiting

[2] CBOE notes that some of the volume included in the spread data may not be risk limiting. For example, while a call spread would be risk limiting, other spread orders, such as a long call/short put order, would not be risk limited. CBOE notes further, however, that the data on outright orders does not take into account positions in options that are offset by related stock positions, such as a covered call position.

[3] See Figure 1: Impact on CEM, in letter from Jan Bart de Boer, Chief Executive Officer, ABN AMRO Clearing Bank N.V.; Edward T. Tilly, Chief Executive Officer, CBOE Holdings Inc.; et al. to Stefan Ingves, Bank for International Settlements (July 6, 2015).

positions. By contrast, the CEM method would impose costs on the market that far exceed any risk relating to such hedged positions.

Overly burdensome capital requirements – i.e., those that fail to provide meaningful recognition of netting benefits for risk limiting positions – have prompted a number of market participants to exit the exchange-traded derivatives markets.[4] Similarly overly burdensome leverage ratio requirements that do not take into account the limited risk posed by hedged or completely offsetting options positions are likely to harm our capital markets, and thereby the global financial system, by harming liquidity and resulting in larger spreads, lower volume, more volatility, and greater systemic risk.

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CBOE again appreciates this opportunity to present our views concerning the Committee's Revised Framework. Should you have any questions concerning CBOE's comments, please contact Joanne Moffic-Silver, General Counsel, at 312-786-7462 or Sarah Duda, Legal Division, at 312-786-7866.

Sincerely,

Edward T. Tilly
Chief Executive Officer

[4] See letter from Jan Bart de Boer, Chief Commercial Officer, ABN AMRO Clearing Bank N.V.; Edward T. Tilly, Chief Executive Officer, CBOE Holdings Inc.; et al. to Stefan Ingves, Bank for International Settlements (October 27, 2015).