February 25, 2020

VIA ELECTRONIC SUBMISSION

Carolyn Rogers
Secretary General
Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland

Re: Credit Valuation Adjustment Risk

Dear Secretary General:

The Basel Committee on Banking Supervision (the "Committee") is exploring potential revisions to the credit valuation adjustment ("CVA") risk framework.[1] Cboe Global Markets, Inc. ("Cboe"), as a global exchange operator and a leader in exchange-traded derivatives,[2] and The Options Clearing Corporation ("OCC"), as the world's largest equity derivatives clearing organization,[3] welcome the opportunity to provide feedback on the consultation. We commend the Committee for seeking revisions that will enhance regulatory consistency and incentivize central clearing. Cboe and OCC encourage the Committee to also consider revisions that will incentivize the offering of client clearing services as such services are critical to the central clearing model. Specifically, we recommend the Committee exclude clearing member ("CM") exposures to clients from the CVA framework in the same manner that derivatives transacted directly with a qualified central counterparty ("QCCP") are excluded.

[1] BCBS, Consultative Document, *Credit Valuation Adjustment risk: targeted final revisions*, November 2019, *available at,* https://www.bis.org/bcbs/publ/d488.pdf.

[2] Cboe operates four U.S. options exchanges (CBOE, C2, BZX, and EDGX), four U.S. equities exchanges (BYX, BZX, EDGX, and EDGA), the largest pan-European stock Exchange (Cboe Europe), a futures exchange (CFE), and a foreign exchange-trading platform (Cboe FX).

[3] In addition to clearing other products, OCC clears listed options as the sole clearing agency for all national securities exchanges listing and trading such products. OCC operates under the jurisdiction of both the Securities and Commission and the Commodity Futures Trading Commission. In July 2012, the Financial Stability Oversight Council designated OCC as a systemically important financial market utility ("SIFMU") under Title VIII of the Dodd-Frank Act. As a SIFMU, OCC is also subject to oversight by the Board of Governors of the Federal Reserve System.

As noted by the Committee, during the financial crisis, the value of outstanding derivative assets was written down as it became clear that counterparties were less likely than expected to meet their obligations.[4] Banks incurred significant counterparty credit risk losses from this fair value adjustment (i.e., CVA) on derivative portfolios. However, the counterparty credit risk framework at the time was designed to capitalize for default risk rather than the risk of valuation losses occurring prior to a counterparty's default. Thus, post-crisis, the Committee introduced a CVA charge designed to capitalize the risk of future changes in CVA.

The CVA capital charge, as proposed, applies to all derivative transactions except those transacted directly with a QCCP.[5] In practice, this means that when a CM acts as a principal and enters into a derivative transaction cleared through a QCCP, the CM's exposure to the QCCP is not subject to the CVA framework as such exposures do not give rise to CVA risk. However, a CM's exposure to its client where the CM acts as an agent or intermediary[6]remains subject to the CVA framework, albeit with a lower proposed margin period of risk of five days.[7] While the ultimate counterparty is the client and not a QCCP in such a transaction, the CM's exposure to its client similarly does not give rise to CVA risk as the exposure is not recorded on a bank's balance sheet and therefore no CVA is marked. The CM's exposure to its client would only expose the CM to losses when a client defaults, which is captured through the separate counterparty credit risk default charge.

Cboe and OCC therefore encourage the Committee to exclude CM exposures to clients from the CVA framework in the same manner that derivatives transacted directly with a QCCP are excluded. As previously noted, for cleared transactions a CM's exposure to the client and QCCP does not give rise to CVA risk. In addition, in the case of the CM's exposure to its client, the risk presented is solely counterparty default risk, not counterparty CVA risk, and default risk is separately accounted for in the Basel III counterparty credit risk framework. Excluding CM exposures to clients from the CVA framework would also be consistent with the Committee's goal of aligning the CVA framework with industry practices for accounting purposes.[8]

Another of the Committee's goals in revising the CVA framework is to further incentivize central clearing. OCC and Cboe strongly believe that incentivizing client clearing services goes hand in glove with incentivizing central clearing; thus, as a policy matter, prudential requirements should be designed to encourage the offering of client clearing services. However, as noted by the Committee,

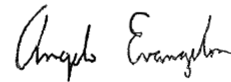
---

[4] BCBS, Consultative Document, *Review of the Credit Valuation Adjustment Risk Framework,* October 2015, *available at,* https://www.bis.org/bcbs/publ/d325.pdf.
[5] *See* MAR50.5, *available at*, https://www.bis.org/basel_framework/chapter/MAR/50.htm?inforce=20220101.
[6] CCPs operate under different "clearing models." Essentially, two main models co-exist in the derivatives markets. The most common model in use in Europe is known as the "principal-to-principal model." In this model, the CM acts as intermediary and is the sole counterparty to the CCP. The financial rights and obligations arising under the cleared transaction are "passed" to the CM's client via a back-to-back transaction. U.S. CCPs, however, generally operate under an "agency model," whereby the CM merely acts as an agent for its client who is the sole legal counterparty to the CCP under the cleared transaction.
[7] *See* CRE54.12, *available at*, https://www.bis.org/basel_framework/chapter/CRE/54.htm?inforce=20220101.
[8] *See* note 4 at 2.

post-crisis reforms have negatively impacted the ability of firms to access client clearing services.[9] Excluding CM exposures to clients from the CVA framework helps incentivize the offering of client clearing services by aligning the CVA capital charge with the risk presented by these exposures.

Cboe and OCC greatly appreciate the opportunity to provide views on the CVA framework. Incentivizing client clearing services is a critical component of incentivizing central clearing. As such, Cboe and OCC encourage the Committee to adopt this policy recommendation and exclude CM exposures to clients from the CVA framework.

Sincerely,



Chief Policy Officer
Cboe Global Markets, Inc.

Janet Angstadt,
EVP and General Counsel
The Options Clearing Corporation

[9] BCBS, CPMI, FSB and IOSCO, *Incentives to centrally clear over-the-counter (OTC) derivatives: A post-implementation evaluation of the effects of the G20 financial regulatory reforms*, August 2018, *available at*, www.fsb.org/wp-content/uploads/P070818.pdf.