EXECUTE SUCCESS℠

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January 28, 2016

Mr. Robert deV. Frierson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Re: Docket No. R-1523; RIN 7100 AE-37

Dear Mr. Frierson:

The Chicago Board Options Exchange, Incorporated ("CBOE") supports the Board of Governors of the Federal Reserve System ("Board") on its continued efforts to promote the financial stability of major financial companies by adopting enhanced capital, liquidity, leverage, and other prudential requirements.

As the world's first options exchange, CBOE's leadership role in options trading is recognized worldwide. CBOE is the largest U.S. options exchange and one of the largest options exchanges in the world. Our opinions and positions on industry issues are sought by regulators, elected officials, industry and finance leaders, and policy experts worldwide. In addition to being a leading marketplace for standardized, exchange-traded options, CBOE created the world's first index options and has been the source of many other innovations with respect to products, systems and market structure in the options industry.[1]

CBOE commends the Board's proposal to further improve the resiliency and resolvability of certain major financial companies through, among other things, enhanced prudential standards imposing total loss-absorbing capacity and separate long-term debt requirements.[2] Major

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[1] More information about CBOE is available at http://www.cboe.com/.

[2] See Total Loss-Absorbing Capacity, Long-Term Debt, and Clean Holding Company Requirements for Systemically Important U.S. Bank Holding Companies and Intermediate Holding Companies of Systemically Important Foreign Banking Organizations; Regulatory Capital Deduction for Investments in Certain Unsecured Debt of Systemically Important U.S. Bank Holding Companies, 80 FR 74926 (Nov. 30, 2015), at https://www.gpo.gov/fdsys/pkg/FR-2015-11-30/pdf/2015-29740.pdf.

financial companies covered by the rule would be required to maintain sizeable financial cushions, in amounts based on a percentage of the company's risk-weighted assets, which are designed to absorb losses as a financial company is failing. CBOE is concerned, however, that absent further action by the Board, the proposal could result in severe unintended consequences by destabilizing the nation's largest and most liquid securities exchange-traded derivatives markets. This concern arises from the calculations proposed by the Board to determine the size of the financial cushion – i.e., utilizing risk-weighted assets as a component – without taking into account risk mitigating strategies when determining risk weights for exchange-traded derivatives, such as listed options. As discussed below, the Board could alleviate this concern by adopting – on an expedited basis – an approach for assessing risk for risk-based capital purposes that provides a more meaningful recognition of netting benefits for exchange-traded derivatives, such as the Basel Committee on Banking Supervision's standardized approach for measuring counterparty credit risk exposures ("SA-CCR").[3]

A number of CBOE's largest trading permit holders would be subject to the Board's proposal. These trading permit holders play an essential and central role in facilitating efficient price discovery in the global markets. They use their own proprietary capital to provide market liquidity, even in the absence of public participation, and guarantee and clear transactions of other trading permit holders. CBOE trading permit holders are the backbone of our exchange-traded derivatives marketplace.

Although CBOE supports requirements designed to strengthen the financial and operational wherewithal of its trading permit holders, CBOE does not support capital, leverage, and other requirements that fail to recognize risk reducing positions and transactions. Options are powerful risk mitigating tools that are used day after day by investors large and small to manage volatility and safeguard capital. For example, certain options trading strategies, such as box spreads and long call spreads, are comprised of multiple options positions that, together, are limited in risk (e.g., the maximum potential loss is limited to the amount paid to enter into the strategy).[4] Under the Board's capital adequacy framework, however, each options position that

[3] See Basel Committee on Banking Supervision, The standardised approach for measuring counterparty credit risk exposures (Mar. 2014; rev. Apr. 2014), at http://www.bis.org/publ/bcbs279.pdf.

[4] Call options and put options are financial contracts between two parties. In general, the buyer of a call option has the right, but not the obligation, to buy an agreed quantity of a particular underlying instrument from the seller of the option at a certain time (the expiration date) for a certain price (the strike price). The seller of the option (or writer) is obligated to sell the underlying instrument to the buyer if the buyer so decides. The buyer pays a fee (called a premium) for this right. The buyer of a put option has the right, but not the obligation, to sell an agreed quantity of a particular underlying instrument to the seller of the option at a certain time for a certain price. The seller of the option is obligated to buy the underlying instrument from the buyer of the put if that buyer so decides. For a call option, when the option's strike price is below the market price of the underlying instrument, the option is in the money. When the option's strike price is above the market price of the underlying asset, the option is out of the money. For a put option, when the option's strike price is below the market price of the underlying instrument, the option is out of the money. When the option's strike price is above the market price of the underlying instrument, the option is in the money.

is part of this conservative strategy is treated separately, and the risk reducing aspects of the strategy are ignored. A perverse result follows, with firms incurring higher capital requirements for positions with limited or no risk. The result will be even more punitive if CBOE trading permit holders are now required to maintain an additional financial cushion to absorb losses that is based on a capital adequacy metric that is insensitive to risk reducing strategies.[5]

As CBOE commented with other leading clearing organizations and market participants in the context of the Basel Committee's leverage ratio requirements, capital requirements that fail to provide meaningful recognition of netting benefits have prompted a number of market participants to exit the exchange-traded derivatives markets.[6] These requirements have proven to be uneconomic for market participants to make markets and provide the necessary liquidity in

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Generally, a box spread is a combination of options positions. For example, a bull call spread (created by purchasing a call and writing a call with a higher strike price) combined with a bear spread (created by purchasing a call and a call at a lower strike price) has a constant payoff of the difference in exercise prices. As long as the price paid for the box is below the combined expiration value of the spreads, a riskless profit can be locked in immediately. A long call spread can be implemented by buying an at-the-money call option while simultaneously writing a high striking out-of-the-money call option of the same underlying security and the same expiration month. The maximum gain is reached for the long call spread when the stock price moves above the higher strike price of the two call options minus the initial debit taken to enter the position. The maximum loss cannot be more than the initial debit taken to enter into the spread position. These two strategies are only examples of the types of transactions that can be structured to minimize risk, but are weighted unfavorably under bank capital requirements.

[5] The Securities and Exchange Commission, which regulates all CBOE trading permit holders, has adopted a risk-based haircut methodology to calculate theoretically-based capital charges. The methodology applies options price theory and portfolio theory to positions involving listed options for the computation of capital charges. Under the risk based method, options price theory is utilized to project portfolio liquidating values under various potential market scenarios. Portfolios may consist of positions in options, stocks, futures and options on futures based on the same underlying instrument or on different highly corrected underlying instructions. Options positions include equity, index and currency products. See 17 CFR 240.15c3-1a.

[6] See Letter from Jan Bart de Boer, Chief Commercial Officer, ABN AMRO Clearing Bank N.V., Kees van Dijkhuizen, Chief Financial Officer, ABN AMRO Bank N.V., Edward T. Tilly, Chief Executive Officer, CBOE Holdings Inc., Bryan Durkin, Chief Commercial Officer, CME Group, Tina Hasenpusch, Chief Executive Officer, CME Clearing Europe, Donald Wilson, Chief Executive Officer, DRW Trading Group, Diederik Dorst, Global Head of Legal and Compliance, Flow Traders B.V., Scott Hill, Chief Financial Officer, Intercontinental Exchange Inc., Jan-Willem Kohne, Managing Director, Head of Europe, IMC Trading B.V., Hans-Ole Jochumsen, President, Nasdaq, Inc., Michael W. McClain, President and Chief Executive Officer, The Options Clearing Corporation, Paul Hilgers, Chief Executive Officer, Optiver, Jonathan B. Galin, Chief Risk Officer, Ronin Trading Europe, Jan Dezort, Group General Counsel, RSJ a.s., to Stefan Ingves, Bank for International Settlements (Oct. 27, 2015), at http://www.cboe.com/framed/PDFframed.aspx?content=/publish/ComLet/20151027.pdf§ion=SEC_ABOUT_CBOE_BOD&title=CBOE%27s+Joint+Comment+Letter+to+the+Basel+Committee+on+Banking+Supervision.

the exchange-traded derivatives market and for clearing members to service them. By failing to adopt risk-sensitive financial responsibility regimes, our trading permit holders are being incentivized to reassess their capital allocations to the exchange-traded derivatives markets and deploy their financial resources to less capital intensive areas of their business models. This is reducing the liquidity of our markets and impeding price discovery which, in turn, makes it harder and more costly for institutions and investors to utilize options to mitigate risk.

Effective risk-sensitive methodologies, such as SA-CCR, provide more meaningful recognition of netting benefits and would address the concerns set forth above. The Basel Committee has scheduled SA-CCR to take effect on January 1, 2017, and for the reasons discussed above, CBOE encourages the Board to move forward on an expedited basis, in conjunction with this proposal or separately, if more efficient, to incorporate an approach similar to SA-CCR into its risk-based capital requirements to avoid further disruption to the exchange-traded derivatives markets.

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CBOE again appreciates this opportunity to present our views concerning the Board's proposal. 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
CBOE Holdings Inc.