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January 16, 2019

**VIA ELECTRONIC SUBMISSION**

Basel Committee on Banking Supervision  
Bank for International Settlements  
Attn: Chairman Stefan Ingves  
CH-4002 Basel  
Switzerland

Re: Leverage ratio treatment of client cleared derivatives

Chairman Ingves:

The Basel Committee on Banking Supervision (the “Committee”) is in the process of reviewing the impact of its post-crisis Basel III reforms. To aid its review, on October 18, 2018, the Committee published a consultative document seeking views of stakeholders on whether a targeted and limited revision of the leverage ratio's treatment of client cleared derivatives may be warranted (the “Consultation”).<sup>1</sup> As a global exchange operator and a leader in exchange-traded derivatives, Cboe Global Markets, Inc. (“Cboe”)<sup>2</sup> welcomes the opportunity to provide feedback on the Consultation and encourages the Committee to not only consider limited amendments to the leverage ratio's treatment of client cleared derivatives, but also consider broader amendments that reduce disincentives for firms to offer client clearing services.

The Consultation highlights two key policy objectives of the Committee's post-crisis Basel III reforms: 1) to strengthen regulatory frameworks, prevent excessive leverage and improve the quality and quantity of capital in the banking system and 2) to promote central clearing of standardized derivatives contracts as part of mitigating systemic risk and making derivatives markets safer.<sup>3</sup> The Committee is reviewing the impact of its post-crisis reforms in light of those objectives. As noted, the Consultation seeks feedback on potential amendments to the leverage ratio's treatment of client cleared derivatives, more precisely, feedback on potential amendments to allow offsets for client margin collateral. The Consultation sets forth three options:

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<sup>1</sup> BCBS, Consultative Document, *Leverage Ratio Treatment of Client Cleared Derivatives*, October 2018, available at, <https://www.bis.org/bcbs/publ/d451.htm>.

<sup>2</sup> 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).

<sup>3</sup> See *id.*

Option 1. Maintain the current approach, which prevents banks from taking into account physical or financial collateral, guarantees or other credit risk mitigation techniques to reduce the leverage ratio exposure measure.

Option 2. Amend the current approach to permit cash and non-cash initial margin received from a client to offset the potential future exposure of derivatives centrally cleared on the client's behalf.

Option 3. Amend the current approach to permit cash and non-cash initial and variation margin received from a client to offset replacement cost and potential future exposure for client cleared derivatives, which is consistent with how the standardized approach to counterparty credit risk ("SA-CCR") treats client cleared derivatives for purposes of risk-based capital requirements.

In arriving at these options the Committee states it has considered, among other things, the insights gained from the joint evaluation conducted by the Committee, the Financial Stability Board, the Committee on Payments and Market Infrastructures, and the International Organization of Securities Commissions (the "Derivatives Assessment Team" or "DAT") on the effects of post-crisis reforms on incentives to centrally clear over-the-counter derivatives (the "DAT Report").<sup>4</sup> The DAT Report demonstrates that post-crisis reforms have negatively impacted the ability of firms to access client clearing services: a significant percentage of firms are having difficulty establishing accounts with client clearing service providers or are being declined new accounts; firms that do have access to clearing services are seeing their clearing service providers place limitations on their derivatives activity; and some firms have been off-boarded entirely by their clearing service providers.<sup>5</sup> A driving force behind this troubling trend to off-board clients – according to clearing service providers – are the constraints caused by one or more of the measures introduced under the Basel III capital framework.

In light of these insights it is clear to Cboe that a concerted effort to increase incentives to offer client clearing services is appropriate. Limited access to client clearing services has reduced access to hedging products for end users, leading to increased systemic risk as a result.<sup>6</sup> Allowing banks to take into account exposure reducing client margin collateral, as described in Options 2 and 3, will reduce a significant disincentive to offer client clearing services and thereby further the policy objective of promoting central clearing and mitigating systemic risk.

However, as Cboe noted in its response to the DAT Report<sup>7</sup>, another part of the Basel III capital framework has been, and continues to be, a substantial constraint on the ability of clearing service providers to provide client clearing services – the use of the current exposure method ("CEM") to

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<sup>4</sup> 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](http://www.fsb.org/wp-content/uploads/P070818.pdf).

<sup>5</sup> *Id.* at 47-48.

<sup>6</sup> See World Federation of Exchanges Response to 'the Committees' (BCBS, CPMI, FSB, IOSCO): Incentives to clear OTC derivatives (September 2018), available at, <http://www.fsb.org/wp-content/uploads/World-Federation-of-Exchanges-2.pdf>.

<sup>7</sup> Letter from Angelo Evangelou, Chief Policy Officer, Cboe Global Markets., Inc., to the FSB, BCBS, CPMI, and IOSCO in response to the consultation on incentives to centrally clear over-the-counter (OTC) derivatives (September 7, 2018), available at, <http://www.cboe.com/aboutcboe/government-relations/pdf/fsb-comment.pdf>.

compute the potential future exposure of exchange-traded derivatives in leverage-based and risk-based ratios. As commenters noted in the DAT Report, CEM's flaws "cause clearing service providers to hold capital well in excess of their estimates of the actual risk" posed by a clients' positions.<sup>8</sup> Requiring a disproportionate amount of capital for a particular risk in turn causes clearing service providers to constrain or eliminate their derivatives clearing services. **This has led to significant, unintended consequences for derivatives markets, such as reductions in liquidity, increased costs to customers, and increased possibility of market dislocation.**

Reductions in client clearing services have been particularly impactful to the centrally-cleared exchange-listed options market where options market-makers are relied on to provide critical liquidity to institutional and retail investors. Client clearing service providers have begun to set limits on their market-maker clients' derivatives activity. This has caused reductions in liquidity and led to the aforementioned increases in investor costs and heightened possibility of market dislocation during volatile environments.

Cboe understands that CEM is intended to be replaced by SA-CCR; yet, authorities in many important jurisdictions have not taken the necessary steps to implement SA-CCR in a timely manner. Implementing SA-CCR and allowing segregated client margin collateral to reduce the leverage exposure measure will positively impact derivatives markets by reducing a profound disincentive for firms to offer client clearing services. Increasing access to client clearing services fully supports the policy objective to promote central clearing of standardized derivatives contracts as part of mitigating systemic risk and making derivatives markets safer.

Cboe implores the Committee to encourage jurisdictions to promptly adopt SA-CCR and allow segregated client margin collateral to reduce the leverage exposure measure. Cboe also encourages the Committee to explore and consider additional policy amendments that would increase incentives to offer clearing services. Access to client clearing services is a critical component of centrally-cleared derivatives markets. Increasing incentives to offer client clearing services will help market liquidity, encourage client clearing, and help G20 Leaders achieve their post-crisis goals.

Sincerely,



Angelo Evangelou  
Chief Policy Officer  
Cboe Global Markets, Inc.

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<sup>8</sup> *Id.* at 72.