



Statement for the Record from Cboe Global Markets, Inc.
U.S. House of Representatives
Committee on Financial Services
Subcommittee on Capital Markets, Securities, and Investment
“Legislative Proposals Concerning Derivatives”
February 14, 2018

Cboe Global Markets, Inc. (“Cboe”), on behalf of Cboe Options, C2 Options, BZX Options, and EDGX Options, appreciates Chairman Huizenga, Ranking Member Maloney and Members of the Subcommittee holding a hearing on legislative proposals concerning derivatives and is grateful for the opportunity to raise important issues impacting the listed options market. Cboe is a leader in centrally-cleared, exchange-listed options, and we applaud the Subcommittee’s efforts to consider legislative proposals that will strengthen the derivatives markets and our financial system. In particular, we support the legislative language of H.R. 4659, which would address the significant defects of the current regulatory regime governing the capital treatment of initial margin for centrally cleared derivatives by exempting initial margin from the supplemental leverage ratio (“SLR”) denominator. In doing so, H.R. 4659 would further the post-crisis goal of promoting centralized clearing.

Cboe also would like to take this opportunity to bring to the Subcommittee’s attention another issue with current bank capital rules that inhibits central clearing—the capital treatment for listed options. In its October 2017 Report on Capital Markets (“Treasury Report”), the Department of the Treasury identified the SLR as a risk-insensitive capital rule that is discouraging central clearing and increasing costs to customers. The Treasury Report noted two particular problems with the SLR. The first—the treatment of initial margin—is addressed by H.R. 4659. The second—the current approach for calculating the exposure for cleared options—should also be addressed by the Subcommittee.

As the Treasury Report explained, current regulations require banks to calculate charges for cleared options using the Current Exposure Method (“CEM”). Unfortunately, CEM is risk-insensitive and “requires options contracts to be sized on their notional face value rather than allowing for a risk adjustment to notional to reflect the actual exposure associated with these derivatives.”¹

CEM’s failure to account for the actual risk of listed options positions forces firms using CEM to grossly overstate actual economic exposure to listed options. As a result, bank holding companies (“BHCs”) with affiliate clearing firms are required to hold capital that is disproportionate to the actual risks posed by an affiliate clearing firm’s listed options business. Thus, CEM constrains the ability of options market-makers to accumulate positions (even off-setting positions), which hinders their ability to provide liquidity. We believe that because options market-makers are responsible for nearly all liquidity in the options industry, the knock-on effects of reduced liquidity are increased costs to investors, an increased possibility of market dislocation during volatile environments, and an illogical bias against centrally-cleared products that limit systemic risk.

Given the demonstrably negative impact that CEM has on the options marketplace, it is unsurprising that the Treasury Report recommended moving to a “risk-adjusted approach for valuing options for purposes of the capital rules to better reflect the exposure, such as potentially weighting options by their delta.”² Accordingly, we urge the Subcommittee² to consider targeted legislation that allows BHCs to risk-adjust their listed options exposures, thereby alleviating the harmful effects described above, while promoting central clearing and aligning the exposure calculation with the economic reality of cleared options transactions.

Cboe appreciates the Subcommittee’s efforts to develop legislative solutions that benefit investors, and we welcome further discussions on these important issues.

¹ Treasury Report on Capital Markets, at page 136.

² Treasury Report on Capital Markets, at page 138.