March 18, 2019

Via Electronic Filing

Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Robert E. Feldman
Executive Secretary
Attention: Comments/RIN 3064-AE80
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
400 7th Street, SW
Suite 3E-218
Washington, DC 20219

Re: <u>Capital Adequacy: Standardized Approach for Calculating the Exposure Amount of Derivative Contracts (FRB Docket No. R-1629 and RIN 7100-AF22; FDIC RIN 3064-AE80; OCC Docket ID OCC-2018-0030)</u>

Dear Ladies and Gentlemen:

CTC Trading Group, LLC ("CTC"), is a major market making firm providing liquidity in the listed equity, index, and futures options markets. Founded in 1995, CTC has over 370 employees and makes markets across multiple asset classes and geographies. We appreciate the opportunity to comment on the proposal of the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency to update the standards for how firms measure counterparty credit risk posed by derivative contracts under the agencies' regulatory capital rule. We are encouraged by your proposal and applaud your efforts to align regulation to support the liquidity and stability of the centrally-cleared listed options market.

The options market is an important complement to the equities market that enables investors to hedge risk and efficiently adjust exposures while providing for price discovery and execution certainty. This allows for heightened liquidity in the underlying stock market and thus plays a direct role in supporting capital formation and broader U.S. economic growth. Unfortunately, the regulatory burden imposed by the leverage capital ratio requirements on the banks that clear options trades negatively impacts the health of these markets. These requirements force banks to direct capital away from the exchange-listed, centrally-cleared options market, thereby hindering options market makers' ability to provide liquidity.

For some time, we have voiced our concern that the current method for calculating exposures for centrally-cleared listed options transactions for purposes of determining related capital charges – the Current Exposure Method ("CEM") – lacks appropriate risk sensitivity, results in excessive capital charges that are not commensurate with risk, and ultimately is impairing the centrally-cleared listed options market. We believe the proposed rulemaking and adoption of the Standard Approach to the Counterparty Credit Risk ("SA-CCR") would ensure that the calculation for centrally-cleared listed options exposures more accurately captures clearing member credit risk and is more consistent with the revised framework set forth by the Basel Committee on Banking Supervision.

We would also encourage you to refine the proposed rulemaking to allow for the use of risk-reducing netting sets to recognize practices that are standard today. For example, futures on the S&P 500 Index traded on the CME have been a long-standing natural hedge for S&P 500 index options ("SPX options") traded on Cboe. The current proposal would fail to recognize this natural and risk-reducing hedge because of the netting requirements of section 132(c)(9)(iv)(C), which would effectively prevent margined and un-margined positions from netting against one another. This would appear to be an unintended consequence of the proposal, and we would hope this can be resolved in the final rule. Similarly, we would seek to ensure that the currently commonplace netting of other highly-correlated products also would not go unrecognized by the proposal. Just as options and futures on the S&P 500 Index can offset each other, it is also natural to offset SPX options with options on ETFs that also track the S&P 500 Index (such as the SPDR S&P 500 ETF Trust, or "SPY"). In the final rule it will be important to prevent these unintended consequences from disrupting the important longstanding, risk-reducing hedging of these products with their highly-correlated, natural counterparts.

We consider this proposed rulemaking and the adoption of SA-CCR to be an urgent matter. While it is impossible to determine the full impact of CEM, we believe CEM is contributing to wider spreads, increased liquidity premiums (a larger difference between a trade price and theoretical price), smaller quote sizes, fewer market-makers with increased volume concentrations, and changes in behavior that increase the risk of a significant market event and market makers exiting the options market. Fewer firms making markets results in reduced liquidity and increased concentration of liquidity, increasing risk in the system and ultimately harming end users, investors, and the general public. We believe this proposed rulemaking would prevent a similar result in centrally-cleared listed options, where market makers are vital to the health and quality of the overall market.

In the last three months of 2018, we saw increased market volatility that posed significant constraints on option liquidity providers because of the CEM calculation. As long as that calculation is in place, the liquidity constraints imposed by CEM significantly increase the risk that a sell-off near the end of the month (when banks apply heightened scrutiny to internal capital allocations) will accelerate in a precipitous way. Should a severe price dislocation event occur, especially near the end of any calendar month, it is clear to us that end users will not find the liquidity they are accustomed to in the options market, creating risk of a liquidity vacuum in instruments generally used to manage risk – and therefore heightened potential for a flash crash and/or severe market sell-off.

This risk will persist as long as CEM is the required calculation method, so we urge the agencies to issue a final rule as soon as possible, so that this risk can be mitigated by using SACCR. We strongly support the proposal’s intent to allow banks to adopt SACCR upon the final rule and hope that many do. We also urge the agencies to keep the backstop of July 2020 in place and not let that date slip.

Therefore, we encourage the agencies to finalize the proposed rulemaking expeditiously, as it is essential to supporting liquidity and would address the unintended adverse impact of CEM on the listed options market and ultimately on investors nationwide. Finalizing this rulemaking represents a powerful and straightforward improvement for the markets and furthers the cause of sensible, impactful regulatory reform. We urge you to bring about this much-needed progress as soon as possible.

We appreciate the opportunity to comment on the proposal. If you have any questions, please contact my Chief Legal Officer, Mel Williams, Jr.

Respectfully submitted,

[redacted]

Eric Chern
Chief Executive Officer
Chicago Trading Company