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September 30, 2022

Re: FIA Supplemental Comments in Response to the Second Consultation on the Prudential Treatment of Cryptoasset Exposures

The Futures Industry Association ("FIA") appreciates the opportunity to comment on the Basel Committee on Banking Supervision's (Basel Committee) *Second consultation on the prudential treatment of cryptoasset exposures* (Consultation). FIA is the primary industry association for centrally cleared futures, options, and swaps. Its core members are clearing members to central counterparties (CCPs), many of which are banking organizations. FIA's membership also includes the major global futures exchanges, clearinghouses, trading platforms, technology vendors, and legal services firms that make central clearing possible.

FIA also is pleased to join the Global Financial Markets Association, the Financial Services Forum, the Institute of International Finance, the International Swaps and Derivatives Association, the Bank Policy Institute and the International Securities Lending Association (collectively, the "Associations") comprehensive joint response to the Consultation.

FIA supports the Association's overall position that Group 2 cryptoasset exposure limit should be modified to reflect that only positions with direct price risk to Group 2 cryptoassets, i.e. where the bank is long or short, are included and not exposures where there is no direct price risk. As such, client clearing where the bank acts as clearing member to clear trades for clients as well as other counterparty credit risk related exposures, in particular securities financing transaction ("SFT") referencing Group 2 cryptoassets would not be in scope for the exposure limit. It is also worth noting that the large exposure framework already captures an institution's counterparty credit risk exposure where there is no direct price risk. Therefore, there is no need to account for the same exposure through a new crypto framework.

To supplement the Association's joint response, FIA is pleased to provide more detail about aspects of the Consultation related to client clearing, and specifically why the Group 2 cryptoasset exposure limit should clarify that client clearing is out of scope to ensure it does not penalize that activity.

We welcome the Basel Committee's prior efforts to preserve incentives for central clearing in support of the G20 mandate to clear centrally all standardised over-the counter-derivatives and urge the Basel Committee to ensure that the overall framework for cryptoassets is not overly conservative, so that it does not preclude regulated bank involvement to clear trades for clients.

The Scope of Exposures Subject to the Group 2 Cryptoasset Exposure Limit should be Clarified to Exclude Client Clearing to be Consistent with the Existing Basel Committee Principle that the Same Risk/Same Activity Receive the same Treatment.

FIA urges the Basel Committee to recognize the benefits of client clearing by excluding client cleared exposures, where the bank acts as clearing member to clear trades for clients, from the Group 2 cryptoasset exposure limit.

We believe the exposure limit should reflect the economic reality that client cleared transactions are the exposure of the client, not the clearing member bank, which clears on behalf of the client.

Supporting this is the fact that the client has direct exposure to the changes in value of the underlying position, not the clearing member bank. FIA recognizes that a clearing member bank has some exposure to the client because the bank guarantees the client's performance to the CCP if the client defaults. However, this exposure is dramatically reduced by margin and other safeguards required for client cleared derivatives, described below.

Currently, CME, a regulated exchange and CCP in the US that trades and clears cryptoassets, is regulated by the US market regulator, the Commodity Futures Trading Commission (CFTC). All intermediaries on CME, including banks that execute client cleared derivatives, are also regulated by the CFTC.

Central clearing of derivatives was a key pillar of the G20 countries response to the post-2008 financial crisis reforms, intended to reduce risk, increase transparency, and promote market integrity within the financial system through a range of important structural features, including:

- CCPs demand initial margin from their clearing members on both sides of the derivative position, both those they clear for themselves and on behalf of their clients. Initial margin is typically collected in the form of cash or low risk, highly liquid securities, and clearing members are required to demand the same from their clients. These requirements reduce counterparty exposure of clearing members to their clients, mitigate close-out risk in the event of a client's non-performance, and reduce counterparty exposure of the CCP to its clearing members.
- In addition to initial margin, CCPs require their clearing members, and clearing members in turn require their clients, to post daily maintenance or variation margin in the form of cash. Variation margin is determined based on the mark-to market value of the cleared portfolio and eliminates exposure in the market. If the client defaults, clearing members of the CCP are permitted promptly to liquidate the client's position, typically with little impact to the clearing member or the CCP.
- Clearing members and CCPs are required to hold customer margin at all times in segregated accounts, and in accordance with local requirements, only with permitted depositories, only in specifically denominated accounts, and subject to the segregated custodian's undertaking that no lien will be asserted against the margin by the custodian.
- Clearing members and CCPs are typically subject to significant restrictions on their use of customer margin, which effectively prohibit the use of such margin except for the purpose of meeting customer obligations at the CCP and for investment in certain highly liquid assets.
- CCPs also maintain default funds to cover any residual losses incurred as a result of the default of a clearing member (i.e., losses that are not covered by margin).

For these reasons, the exposure limit should exclude client cleared exposures. Without this exclusion the framework would undermine consensus reforms and discourage banks from facilitating the central clearing of crypto-asset linked derivatives, thereby limit the risk-reducing effect on crypto-asset markets that central clearing has on other derivative markets, and limiting hedging opportunities for market participants.

The Group 2a Cryptoasset Risk Factor Structure Should be Modified to Remove the Maturity Dimension

FIA also supports the Association's overall position that the Group 2a crypotasset risk factor structure should be modified to remove and the maturity dimension from the delta (vega) risk factor structure under SCO60.79(2). As noted by the Association's, transactions relating to Group 2 cryptoassets are generally based on the spot price rather than the forward price. Storage costs and the associated convenience yields that may drive forward prices for commodities are not relevant to cryptoassets. CME Bitcoin futures are based on the CME Crypto Facilities (CF) Bitcoin Reference Rate (BRR), which reflects the USD price of one Bitcoin in major Bitcoin spot exchanges.[1] Like the delta risk factors for FX and equity, cryptoasset spot prices do not have a tenor dimension. Any funding-related risk factors as a result of buying or selling the cryptoasset forward would be captured through a bank's assessment of GIRR. This funding risk is not inherent in the cryptoasset price, unlike commodities where—as mentioned above—storage costs and convenience yields can influence forward prices. Therefore, CME futures, and other similar Group 2a cryptoassets, that reference the same underlying price, but have different settlement dates, should net. Additionally, clearinghouses process daily settlement which extinguishes exposures on a daily basis (and therefore all contracts, regardless of final expiration date, are within the same 0-1 day maturity bucket). Ultimately, this supports removal of maturity dimension.

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FIA appreciates your consideration of our comments and look forward to engaging with the Basel Committee on the matters discussed in this letter.

Most respectfully,

Walt L. Lukken

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President and CEO

[1] CME Bitcoin futures are based on the CME CF Bitcoin Reference Rate (BRR), which aggregates bitcoin trading activity across major bitcoin spot exchanges between 3:00 p.m. and 4:00 p.m. London time

(https://www.cmegroup.com/education/bitcoin/cme-bitcoin-futures-frequently-asked-questions.html)