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September 30, 2022

VIA ELECTRONIC SUBMISSION

Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel, Switzerland

Re: Consultative Document: Second consultation on the prudential treatment of cryptoasset exposures

CME Group Inc. ("CME Group"),[1] a corporate holding company, wholly owns Chicago Mercantile Exchange Inc. ("CME"). CME is a CFTC-registered derivatives clearing organization ("DCO") ("CME Clearing"). CME Clearing offers clearing and settlement services for futures and options contracts, including those listed on CME Group's CFTC-registered designated contract markets ("DCMs"), and cleared swap derivatives transactions. These DCMs are CME, Board of Trade of the City of Chicago, Inc. ("CBOT"), New York Mercantile Exchange, Inc. ("NYMEX"), and the Commodity Exchange, Inc. ("COMEX") (collectively, the "CME Group Exchanges" or "Exchanges").

CME Group appreciates the opportunity to comment on the Basel Committee on Banking Supervision's ("BCBS") *Second consultation on the prudential treatment of cryptoasset exposures* ("the Consultation").[2] CME, as a registered DCM, lists futures and options products, including cryptoasset derivative contracts and, as a registered DCO, provides central clearing for those products. The two cryptoassets that CME Group currently offers as exchange-traded derivatives are Bitcoin ("BTC") and Ether ("ETH") futures and options.

We are pleased to see that this Consultation improves the treatment for cryptoassets from the treatment proposed in the original consultation issued in June 2021 but believe that additional improvements are necessary. CME operates as a Qualifying Central Counterparty ("QCCP") and therefore, we are encouraged to see the QCCP methodology incorporated into the new proposal. We recognize that cryptoassets represent a rapidly evolving space and that certain market factors, e.g., liquidity and depth, distinguish the risk profiles of more widely known cryptoassets from developing ones. This distinction should be taken into account in the capital framework. In the sections below we expand on this point and provide our perspective on several aspects of the Consultation where we believe further refinement is needed.

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[1] As a leading and diverse derivatives marketplace, CME Group enables clients to trade futures, cash and OTC markets, optimize portfolios, and analyze data - empowering market participants worldwide to efficiently manage risk and capture opportunities. CME Group exchanges offer the widest range of global benchmark products across all major asset classes based on interest rates, equity indexes, foreign exchange, energy, agricultural products and metals. The company offers futures trading through the CME Globex platform, fixed income trading via BrokerTec and foreign exchange trading on the EBS platform. In addition, it operates one of the world's leading central counterparty clearing providers, CME Clearing.
[2] Basel Committee on Banking Supervision, Consultative Document, *Second consultation on the prudential treatment of cryptoasset exposures* (June 2022).

Group 2 Exposure Limit: 1% Tier 1 Capital Threshold for Group 2 Cryptoassets
We are concerned that the Consultation limits the ability of banks to hold Group 2 cryptoassets on a gross basis to 1% or less of the bank's Tier 1 capital. Our concerns with the proposed limit are related to: (1) the appropriateness and calibration of the 1% threshold; and (2) the treatment of client cleared derivatives in the exposure quantification of the limit.

(1) Calibration of the 1% threshold

To evaluate the appropriateness of this 1% threshold, we compared the total Tier 1 capital held by CME Clearing's bank and bank-affiliated clearing member firms[3] against the market capitalization of the Bitcoin and Ether cryptoassets, which we project would be subject to the Group 2a designation outlined in the Consultation.

- As of June 30, 2022, the total market capitalization of Bitcoin and Ether was:[4]

  $378 Billion (Bitcoin)
  <u>$130 Billion (Ether)</u>
  $508 Billion Market Capitalization for cryptoasset for which CME also offers derivatives products

- As of June 30, 2022, the total Tier 1 capital held by CME Clearing's bank and bank-affiliated clearing member firms was as follows:

  $2 Trillion

- After the application of the 1% capital threshold proposed by the BCBS, the total notional value cap for banks' Group 2a cryptoassets would be **$20 Billion** (i.e., $2 Trillion* 1%).

This severe limitation on banks' cryptoasset exposures would limit CME Clearing's bank and bank-affiliated clearing member firms' access to 4% (i.e., $20 Billion/$508 Billion) of the Bitcoin and Ether cryptoasset market. We are concerned that hard exposure limits often lead to unintended consequences and cliff effects, and we are concerned enforcing a $20B exposure limit to Bitcoin and Ether on a gross basis would effectively force banks out of the cryptoasset markets. Even if bank and bank-affiliated clearing member firms are able to continue to participate in cryptoasset markets there are other concerns to be considered. This hard limit has the potential to negatively impact clearinghouses' default management practices due to concern about breaching these hard limits, which has been recognized by the BCBS in other capital frameworks.[5]

CME Group recommends increasing the exposure limit and allowing for a framework by which netting recognition could be achieved for proprietary exposure limit sizing in the calculation. A higher limit with netting recognition would increase the participation of creditworthy, highly regulated banks in the cryptoasset class, while maintaining conservative limits in the relatively nascent asset class to reduce the risk of negative outcomes. This approach would also reduce the cryptoasset class's reliance on non-regulated institutions which should

[3] *See* https://www.cmegroup.com/clearing/financial-and-regulatory-surveillance/clearing-firms.html
[4] *See* https://coinmarketcap.com/historical/20220630/
[5] *See* https://www.bis.org/press/p190626.htm

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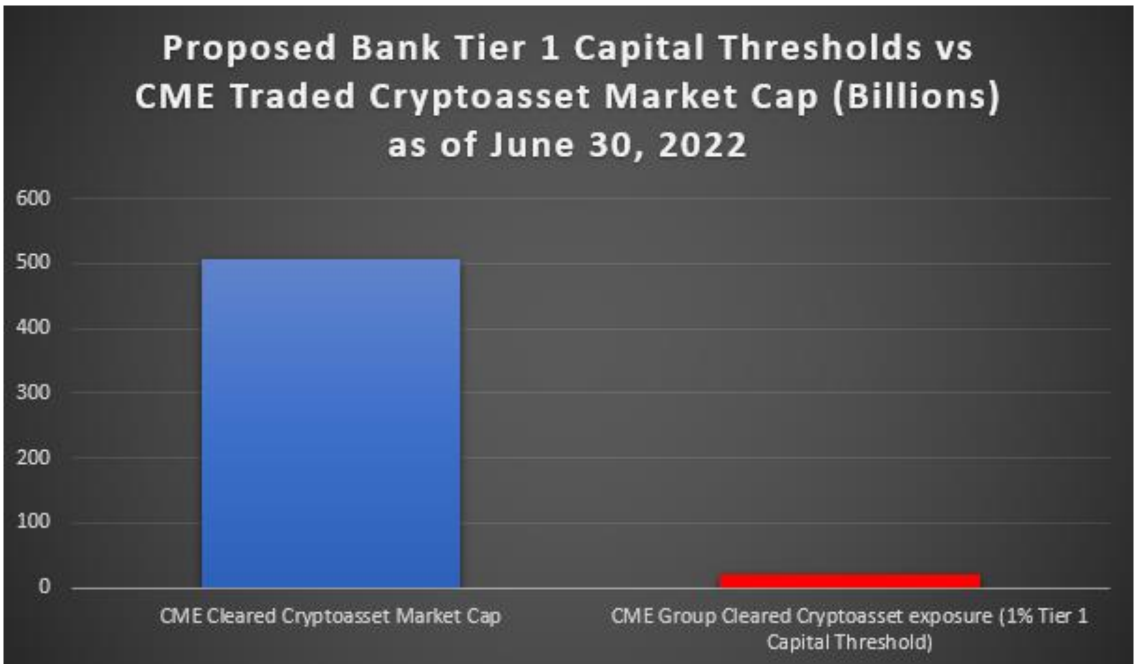
increase overall financial stability and reduce the likelihood that stress in the cryptoasset marketplace creates broader contagion risk.

The current limit of 1% of a bank's Tier 1 is substantially lower than the 25% of Tier 1 capital limit (for banks that are not globally systemically important banks ("G-SIBs")) and the 15% of Tier 1 capital limit (for banks that are G-SIBs) under the large exposure rules of the BCBS' framework. It would also be significantly lower than the 10% of Common Equity Tier 1 ("CET") capital limits under the threshold deduction approach for certain exposures under the BCBS' capital framework, such as significant investments in unconsolidated financial institutions. Further, the G-SIB and CET capital limits allow for full hedging benefits—benefits which are only partially granted to the cryptoasset universe under the Consultation. A modified limit can still be conservative, relative to other limits applied by the BCBS for bank exposure.



(2) Treatment of Client Cleared Derivatives

While the overall threshold of the Group 2 exposure limit is important, understanding the measurement of the limit is equally important. In the past, the treatment of client cleared derivatives in centrally cleared markets has been very important to ensure that the "*policy objective set by the G20 Leaders to promote central clearing of standardised derivative contracts*"[6] is not unintentionally harmed. **For these reasons, it is important for any bank which provides client clearing services for derivatives referencing Group 2 cryptoassets to have any related exposures be exempted from the exposure limit when such exposures are cleared at a QCCP**.

[6] *See* https://www.bis.org/press/p190626.htm

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In centrally cleared markets, especially when dealing with a highly regulated QCCP,[7] when a bank provides clearing services for any standardized derivatives contract, including derivatives referencing cryptoassets, those banks are required to collect collateral (i.e., margin) from those clients consistent with appropriately calibrated QCCP margin levels. The majority of this collateral is generally posted onward to QCCPs. This process is vital to the functioning of centrally cleared markets and ensures that banks providing client clearing services are well protected from the changes in the underlying value of any centrally cleared derivatives. The BCBS has long recognized this process and has provided appropriate exemptions for these exposures, importantly including the existing Large Exposures Framework where the BCBS provided a full exemption for exposures to QCCPs:[8]

> **"Large Exposures; Large Exposures Measurement**
>
> **Exposures to central counterparties**
> **30.55**
> Banks' exposures to qualifying central counterparties (QCCPs)[14] related to clearing activities are exempted from the large exposures framework. However, these exposures are subject to the regulatory reporting requirements as defined in LEX20.4."

For these reasons, it is necessary, and would be consistent with existing BCBS guidance, to exempt exposures resulting from providing client clearing services for cryptoasset derivatives from the Group 2 exposure limit quantification.

Infrastructure Risk Add-on
The Consultation has proposed to apply an add-on to risk-weighted assets in the Group 1a and 1b categories to cover unforeseen risks, calibrated at 2.5%. CME Group is concerned this risk add-on sets a precedent for applying capital penalties for the introduction of new technologies. Cryptoasset markets and distributed ledger technologies are developing and the application of this charge risks stifling innovation, which is particularly concerning considering the lack of justification for the charge by policy-makers.

Federal Reserve Chairman Jerome Powell has previously remarked that the Federal Reserve has worked "*with a wide range of stakeholders to improve the speed, efficiency, and safety of the U.S. payments system*,"[9] specifically related to distributed ledger technology. Other policy-makers around the globe have also heralded the possibilities and efficiencies which these technologies could possess and it is troubling to see the BCBS introduce a specific charge and tax on these technology developments.

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[7] *See* https://www.bis.org/basel_framework/chapter/CRE/50.htm?inforce=20191215&published=20191215 (noting, "50.3 A qualifying central counterparty (QCCP) is an entity that is licensed to operate as a CCP (including a license granted by way of confirming an exemption), and is permitted by the appropriate regulator/overseer to operate as such with respect to the products offered. This is subject to the provision that the CCP is based and prudentially supervised in a jurisdiction where the relevant regulator/overseer has established, and publicly indicated that it applies to the CCP on an ongoing basis, domestic rules and regulations that are consistent with the Principles for Financial Market Infrastructures issued by the Committee on Payments and Market Infrastructures and the International Organization of Securities Commissions").
[8] *See* https://www.bis.org/basel_framework/chapter/LEX/30.htm?inforce=20191215&published=20191215
[9] *See* https://fraser.stlouisfed.org/title/statements-speeches-jerome-h-powell-1164/innovation-technology-payments-system-576483

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Finally, when reviewing the infrastructure risk add-on under the Financial Stability Board's ("FSB") principle of "same risk, same regulatory outcome,"[10] it is confusing to see a different regulatory outcome being applied here to this category of risk weighted assets. The stated aim of the FSB, International Organization of Securities Commissions ("IOSCO") and the BCBS is to achieve a technology-neutral approach to cryptoasset regulation. U.S. Secretary of the Treasury Janet Yellen has also echoed this sentiment.[11] When new technologies enable new activities, products, and services, and subsequently financial regulations need to adjust, this process should be guided by the risks associated with the services provided to households and businesses, not the underlying technology.

The infrastructure risk add-on proposal in its present form is not consistent with the principle of the U.S. Secretary of the Treasury, FSB, IOSCO or BCBS of "same risk, same regulatory outcome." As such, we believe that the infrastructure risk add-on should be removed to ensure that this principle is followed and to foster the development of new technologies.

Group 2a Hedging Considerations

While Group 2a cryptoasset exposures covered by the Consultation appear to allow for some recognition of hedging, some exposures still contain specific treatments designed for cryptoassets which may lead to unintended consequences. Under section 60.66 of the Consultation there is a 65% cap on hedging recognition for Group 2a cryptoassets, which continues to significantly overstate bank and bank-affiliated clearing members' exposures and would fail to reflect the correct risk-sensitivity of their positions traded on liquid and transparent centrally cleared markets. For example, in CME Group's highly regulated markets, a market participant can enter (i.e., buy) into 100 cash-settled BTC futures and then hedge (i.e., sell) 100 of those futures to manage their position; in this example, the participant could have to record the extra 35 futures exposures, despite the futures perfectly netting at the CME Clearing, which a QCCP.

We urge the BCBS to modify the Group 2a hedging criteria to promote the use of central clearing and provide robust risk management opportunities for market participants using regulated markets. The hedging criteria proposed in the Consultation continues to apply an overly punitive limit on the ability to recognize a long and short position on the same cryptoasset even when accounted for on the same ledger.

Group 2a Financial Collateral

In the current iteration of the Consultation, Group 2a cryptoassets do not qualify as eligible financial collateral (*see* 60.35). CME lists cash-settled exchange-traded derivatives referencing BTC and ETH, and while we do not presently accept BTC or ETH as eligible financial collateral, it would seem short sighted to rule out the possibility of allowing for their inclusion, particularly where the assets are posted to cover short exposures in cryptoassets. We recommend that as the BCBS takes account of the evolving nature of cryptoasset markets, and where there are pledges made in the Consultation to review and adjust the prudential treatment for cryptoasset exposures in the future, they provide a specific timeline or establish a dedicated committee for ensuring these reviews are done in a way that allows for these markets to develop and realize their full transparency potential to all market participants.

[10] *See* https://www.fsb.org/2022/07/fsb-issues-statement-on-the-international-regulation-and-supervision-of-crypto-asset-activities/

[11] *See* https://home.treasury.gov/news/press-releases/jy0706

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Conclusion

CME Group welcomes the Consultation and is appreciative of the BCBS incorporating market stakeholders' views as they finalize the framework. With our comments provided today, we hope to strengthen the regulation, supervision and practices of banks worldwide while enhancing financial stability.

We would be happy to further discuss or provide additional detail regarding our comments with the BCBS. If you have any comments or questions regarding this submission, please feel free to contact me at +1 312 930-8167 or Sean.Downey@cmegroup.com.

Sincerely yours,

Sean Downey
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CME Clearing