



September 30, 2022

Neil Esho
Secretary General
Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland

RE: Second Consultation on the Prudential Treatment of Cryptoasset Exposures

Dear Secretary General:

Cboe Global Markets (“Cboe”) appreciates the opportunity to provide comments on the Basel Committee on Banking Supervision’s (the “Committee’s”) second consultation on the prudential treatment of cryptoasset exposures (the “Proposal”). Cboe supports the Committee’s efforts to incorporate cryptoassets into the prudential framework. As always, it is important that this prudential framework be well-calibrated.

Cboe is a global exchange operator, a leader in exchange-traded derivatives, and a leading voice for the healthy development of the digital asset ecosystem. Cboe has spent years growing markets safely around the world. In our experience, it is critically important for prudential frameworks to remain technology neutral and to fully support and incentivize risk management practices, such as hedging and clearing. We believe the below recommendations will help achieve these aims and allow customers to access crypto services through highly regulated and transparent infrastructures. This will aid the healthy maturation of the entire ecosystem.

- Group 2 Exposure Limit: In order to allow banks to support the cryptoasset ecosystem, especially as it relates to clearing, we encourage the Committee to: exclude exchange-traded, centrally cleared exposures from the exposure limit; allow banks to recognize economically offsetting exposures when calculating the limit (or at a minimum apply the limit to a bank’s max long or short positions); and raise the 1% exposure limit.
- Group 2a Hedging: In order to promote risk management practices, we encourage the Committee to expand the hedging criteria applicable to Group 2a assets to include, among other things, physically-settled derivatives.
- Permissioned vs. Permissionless Blockchains: In order to remain more technology neutral, we encourage the Committee to: eliminate the blanket declaration against permissionless blockchains being considered Group 1 assets; explicitly declare that permissioned applications utilizing permissionless blockchains may satisfy the classification criteria for Group 1; articulate the specific *prudential* risks that lead to Group 1 treatment; endorse the ability of local supervisors and regulators to determine whether a cryptoasset utilizing a permissionless blockchain may receive Group 1 treatment.

- DLT Add-On: In order to remain more technology neutral, we encourage the Committee to eliminate the distributed ledger technology (“DLT”) add-on or endorse the ability of local supervisors and regulators to determine whether a DLT add-on is appropriate.

Proposed Prudential Framework

The Proposal creates classification criteria that determine whether an asset will be generally incorporated into the current prudential framework applicable to non-cryptoassets (Group 1 assets) or be treated separately under more conservative prudential standards (Group 2 assets). Group 1 assets are intended to include tokenized traditional assets and stablecoins meeting certain conditions. Group 2 assets include all other cryptoassets but are divided into two groups: assets meeting certain conditions to allow limited hedging recognition (Group 2a) and assets for which banks must fully capitalize exposures (Group 2b).

Group 2 Exposure Limit

As noted, Group 2 is designed to include all cryptoassets except stablecoins and tokenized traditional assets. The Proposal includes an exposure limit for Group 2 assets that caps a bank’s exposure to Group 2 assets at 1% of Tier 1 capital. We share views of other commenters that the public would benefit from banking institutions playing a meaningful role in the cryptoasset ecosystem. Banking institutions have vast experience monitoring and managing risks. Allowing banks to leverage this experience and fully support customers will help risk management to permeate through the ecosystem. Moreover, if banks are not allowed to support the cryptoasset ecosystem customers may simply seek services provided by institutions that are less regulated or have less sophisticated risk management practices.

We are concerned that if the exposure limit applies to exposures that are from client clearing; exchange-traded, centrally cleared derivatives; or custody arrangements that banking institutions will find it difficult to provide important services. For this reason, we recommend wholly reconsidering whether a cryptoasset specific exposure limit is appropriate. At a minimum, it is especially important that the exposure limit exclude exchange-traded, centrally cleared exposures; recognize netting of economically offsetting exposures (or at a minimum is only applied to a bank’s max long or short positions); and that the limit be raised from 1%.

The Committee noted that “the large exposure rules of the Basel Framework are not designed to capture large exposures to an asset type, but to individual counterparties or groups of connected counterparties. This would imply, for example, no large exposure limits on cryptoasset where there is no counterparty, such as Bitcoin.” This implies that the Committee is focused on exposures that do not have a counterparty. However, exchange-traded, centrally cleared derivatives do have traditional counterparties; thus, it begs the question as to why such assets would be included in this new exposure limit calculation. Moreover, exchange-traded, centrally cleared derivatives – regardless of the underlying asset – are fully incorporated into longstanding risk management processes (listing rules, margin requirements, clearing rules, etc.). This existing risk management framework reduces prudential risks associated with exchange-traded, centrally cleared derivatives; thus, excluding these exposures from the exposure limit appears appropriate.

At a minimum, we believe the exposure limit should exclude exposures arising from a bank clearing firm’s client clearing services. Central clearing reduces systemic risk, and bank-affiliated clearing firms play a vital role in the central clearing of derivatives. As Cboe has noted many times, the prudential

framework should encourage and enable bank clearing firms to support customer clearing.¹ Including exposures arising from client clearing will have the opposite effect.

Furthermore, we believe the exposure limit should allow netting of economically offsetting exposures. This of course encourages prudent risk management practices, such as hedging. Less obviously, it allows bank clearing firms to support market-maker customers, who provide much of the liquidity to exchange-traded, centrally cleared derivatives markets and are experts in managing risk. Derivative market-makers typically maintain large but balanced books of long vs. short exposures. If the exposure limit does not recognize netting, bank clearing firms will be less able to provide clearing services to market-makers, leading to less liquidity and market inefficiencies.

Lastly, 1% of Tier 1 Capital appears to be a conservative figure. The cryptoasset market is growing, and banking institutions can contribute to healthy expansion. We believe the 1% cap should be raised significantly to ensure banking institutions can meaningfully support customers.

Group 2a Hedging

Group 2 cryptoassets that satisfy certain hedging recognition criteria will permit a limited degree of hedging recognition in the calculation of the bank's net exposure (Group 2a). Group 2 assets that do not satisfy the hedging criteria would be subject to a new conservative treatment that would require banks to fully capitalize exposures (Group 2b). As proposed, in order to recognize hedging and thus be treated as a Group 2a asset, the asset must be highly liquid, have sufficient data available, and be one of the following:

- a) A direct holding of a spot Group 2 cryptoasset where there exists a derivative or exchange-traded fund(ETF)/exchange-traded note (ETN) that is traded on a regulated exchange that solely references the cryptoasset.
- b) A cash-settled derivative or ETF/ETN that references a Group 2 cryptoasset, where the derivative or ETF/ETN has been explicitly approved by a jurisdiction's markets regulators for trading or the derivative is cleared by a qualifying central counterparty (QCCP).
- c) A cash-settled derivative or ETF/ETN that references a derivative or ETF/ETN that meets criterion (b) above.
- d) A cash-settled derivative or ETF/ETN that references a cryptoasset-related reference rate published by a regulated exchange.

We are encouraged by the fact that the hedging criteria recognizes the relevance of regulated exchanges and clearinghouses. Supporting hedging reduces risk in-and-of-itself, but the additional elements

¹ See Cboe's letter to the BCBS in response to the consultation on the leverage ratio treatment of client cleared derivatives (January 16, 2019), *available at*, <http://www.cboe.com/aboutcboe/government-relations/pdf/basel-lrcomment-final.pdf>; letter 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>; joint letter to the BCBS in response to the consultation on revisions to the Basel III leverage ratio framework (July 6, 2016), *available at*, <http://www.cboe.com/aboutcboe/government-relations/pdf/20160706-bcbs-lr-final.pdf>; and joint letter to the FSB, BCBS, and European Commission on the unintended consequences of the leverage ratio (October 27, 2015), *available at*, <http://www.cboe.com/publish/ComLet/20151027.pdf>.

focusing on regulated exchanges and clearinghouses has the ancillary benefit of leveraging traditional infrastructures that have longstanding, tested risk management practices. We support this.

However, we believe the hedging criteria could be improved by including additional products that are traded on regulated exchanges and cleared through regulated clearinghouses. Specifically, we believe criteria (b)-(d) should be amended to also include physically-settled derivatives as physically-settled derivatives are a mainstay of traditional markets. As with cash-settled derivatives, this treatment will encourage traditional, regulated infrastructures to offer these products, instead of unregulated entities that do not have the long history of incorporating risk management practices into their operations.

Furthermore, it is important that the framework recognize that contract terms need not be perfectly offsetting in all respects to serve as beneficial hedges and to reduce overall risk. For example, banks may have exposure to an underlying cryptoasset through derivatives contracts with varying maturities, different counterparties, and indeed transacted on different exchanges or cleared through different clearinghouses. This does not mean that recognition of these offsetting positions will subject banks to material prudential risk. We encourage the Committee to ensure that the framework allows economically offsetting exposures to be recognized to the greatest extent possible – in the treatment of Group 2a assets, netting set creation, or in other contexts.

Additionally, given that certain stablecoins may not satisfy Group 1 classification requirements, it may be helpful to consider whether Group 2 stablecoins should also receive Group 2a status. It is conceivable that a bank may have offsetting stablecoin exposures that should rightfully be considered hedged positions.

Permissioned vs. Permissionless Blockchains

The Proposal provides that “[a]s currently specified, it is highly unlikely that any cryptoassets based on permissionless blockchains will be able to meet the classification conditions to be included in Group 1.” We encourage the Committee to reconsider such a blanket declaration and exclude it from any final guidance. As a general matter, we do not believe the prudential framework should wholly discount the possibility that cryptoassets utilizing permissionless blockchains may in fact present no greater prudential risk than cryptoassets utilizing permissioned blockchains. Moreover, given that existing cryptoassets, future cryptoassets and our collective understanding of the relevant risks will undoubtedly evolve, it would be helpful for the Committee to specifically detail the prudential risks the Committee believes could lead to Group 2 treatment. In that way, over time market participants may find solutions to help mitigate such risks.

We note that unrelated to the classification criteria, the Proposal already contemplates a robust and detailed risk management and local supervisory review process with which banks are expected to comply.² For example, banks are expected to, among other things, evaluate the reliability of the source code, governance around protocols; and integrity of the technology to understand the stability of the network. Banks are also expected to closely monitor the risks inherent in the validating design of the DLT (i.e., permissioned vs. permissionless).³ With this risk management and supervisory review process the Committee recognizes that local supervisors and regulators are best placed to analyze the risk

² See 60.126- 60.130.

³ See 60.130

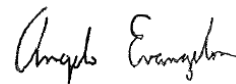
management process applied to cryptoassets. We encourage the Committee to similarly endorse the ability of local supervisors and regulators to determine whether cryptoassets utilizing permissionless blockchains may receive Group 1 treatment.

DLT Add-On

To allay the Committee's concerns about potential risks associated with DLT infrastructure, the Committee proposes to apply a 2.5% add-on to risk weighted assets for all Group 1 assets ("DLT add-on"). We believe the DLT add-on is contrary to a technology neutral approach, which is a sound principle that allows new technologies to develop within a regulatory framework. It is also not apparent from the proposal how infrastructure providers may improve infrastructure to prevent the application of the DLT add-on. We recommend an alternative approach of explicitly empowering local jurisdictions to implement a DLT add-on if they determine the local characteristics and maturity of the digital ecosystem are such that a DLT add-on is necessary. At the very least, we encourage the Committee to articulate an off-ramp for the DLT add-on that allows jurisdictions to remove the add-on as the technology matures.

Our objective is a prudential framework that not only supports prudent financial risk management but also supports the healthy maturation of the digital system. We believe the recommendations herein will help achieve these goals. Cboe appreciates the opportunity to share its views and welcomes the opportunity to discuss these comments further.

Sincerely,



Angelo Evangelou
Chief Policy Officer
Cboe Global Markets