

# **FIA response to the EBA consultation on draft technical standards on the prudential treatment of crypto assets exposures under the Capital Requirements Regulation**

Date: 8 April 2025

## **1. Introduction**

FIA<sup>1</sup> welcomes the opportunity to respond to the EBA consultation on draft technical standards on the prudential treatment of crypto assets exposures under the Capital Requirements Regulation (CRR) (Consultation). Our response focuses on client clearing of crypto derivatives and it has been split into two main parts. First, we provide high-level commentary and observations on why client clearing of crypto asset derivatives, from a clearing member perspective, should not count towards the total exposure limit that institutions will be subject to for certain crypto assets. Second, we set out our preliminary member views on Question 3 that requests feedback on whether Alternative A or B is a preferred method for calculating own funds requirements for centrally cleared transactions in crypto asset derivatives.

## **2. Client clearing of crypto derivatives should not be included in total exposure limit (i.e., 1% of an institution's Tier 1)**

FIA is of the view that only positions with direct price risk to crypto assets, i.e. where the bank is long or short, should be included in the total exposure limit. Conversely, where there is no direct price risk to the institution (e.g., where it serves as an intermediary), those exposures should not be included in the total exposure limit. As such, client clearing where the bank acts as clearing member to clear trades for clients 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, albeit interim, prudential framework for bank exposures to crypto assets.

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<sup>1</sup> FIA is the leading global trade organization for the futures, options and centrally cleared derivatives markets, with offices in Brussels, London, Singapore and Washington, D.C. FIA's membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from about 50 countries as well as technology vendors, law firms and other professional service providers. FIA's mission is to support open, transparent and competitive markets, protect and enhance the integrity of the financial system, and promote high standards of professional conduct. As the principal members of derivatives clearinghouses worldwide, FIA's clearing firm members play a critical role in the reduction of systemic risk in global financial markets. Further information is available at [www.fia.org](http://www.fia.org).

FIA urges the EBA 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 total crypto asset 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.

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.

**3. Question 3: Do you agree that a one-size fits all RW of 250% should apply also to CCR transactions requiring specifications on netting set treatment (Alternative A) or do you prefer using the counterparty's RW as is standard in CCR (Alternative B)? Please briefly justify your assessment.**

FIA believes that Alternative B would be a more appropriate method to calculate the own funds requirements for centrally cleared transactions in crypto asset derivatives. This means that the standard risk weighting rules for counterparty credit risk would apply such that institutions would apply the requirements specified in Part Three, Title II of CRR, using the risk weight applicable to that counterparty in accordance with those requirements. This approach would be consistent with the principle that the same risk/same activity receive the same treatment.

For consistency, Alternative B should also be applied to exposures referred to in Article 501d(2) point (c) that meet the hedging recognition criteria laid down in Article 3(1) of the draft EBA RTS. The risk weight of the counterparty should be used in the usual CCR approach for these exposures otherwise it would lead to divergence from the Basel treatment and result in unjustified conservative computation.

In addition, it is likely that many crypto asset derivatives that are centrally cleared will be classified as financial instruments/derivatives under MiFID II/R and fall under the same regulatory regime as cleared derivatives with a different underlying, rather than being subject to a separate regime in the EU (MiCAR) developed specifically for crypto assets that do not call under the MiFID II definition of financial instrument.