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Bank for International Settlements

Centralbahnplatz 2,

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Paris, 10th September 2021

Consultative Document on the Prudential Treatment of Cryptoasset Exposure by the Basel Committee on Banking Supervision

Introduction and Summary of Response from ACI Financial Markets Association

ACI Financial Markets Association (ACI FMA) is a leading global trade association representing the interests of the professional wholesale financial markets community. Established in 1955, ACI FMA is focused on enhancing best market practices and supporting market participants to adhere to principles of ethical conduct and good market practices. ACI FMA is an international association with 60 National Associations worldwide representing over 8.000 members.

ACI FMA is well placed to offer real "boots on the ground" advice on this topic. It has had an active Working Group in place now for over three years drawing in expertise from regulated Crypto Banks, Brokers to Investment Funds and the wholesale OTC banking industry in general. We believe that the existing banking industry has a wealth of risk management expertise and experience that would bring a lot of value to this new and emerging asset class. To us, Crypto has a similiar risk profile to many currently traded OTC Commodities and Emerging Market currencies including NDF (Non Deliverable Forwards).

Therefore, in our view, the potential impact of this proposal will be to keep banks and their expertise out and thereby deny citizens the opportunity to experience this asset class, guided by professionals and thus leaving them more exposed than they should be as this market continues to grow.

We can and should do better. Crypto is not going away and it needs a properly functioning wholesale market with more participants, not fewer. Banks should be encouraged to actively engage with this sector and develop products/capabilities at a pace that matches their development of in house expertise in Crypto and managing similar volatile OTC assets such as Fixed Income, Currencies and Commodities.

Q1. What are your views on the Committee's general principles?

The approach proposed to be taken is, in our opinion, too broad and does not appropriately differentiate between or within the categories of Crypto and ignores the differences in underlying technologies which in some cases impact directly on the asset. We believe that a more granular and even individually specific risk-based approach is more appropriate.

Q2. What are your views on the Committee's approach to classify cryptoassets through a set of classification conditions? Do you think these conditions and the resulting categories of cryptoassets (Group 1a, 1b and 2) are appropriate? Which existing cryptoassets would likely meet the Group 1 classification conditions?

In general, we are of the opinion that the underlying risk should define the capital requirements. If the risk is related to a traditional asset class such as Fixed Income or Foreign Exchange, then the capital requirements should be the same with an add-on for operational risk covering the technical uncertainties.

Q3. What are your views on the classification conditions? Are there any elements of these conditions that should be added, clarified or removed in order to: − ensure full transferability, settlement finality, and/or redeemability; − limit regulatory arbitrage, cliff effects and market fragmentation; and − take account of new and emerging cryptoassets?

This is an innovative and emerging industry that we should be careful not to stifle but rather up skill with risk management techniques and expertise. Group 2 restrictions as proposed have the effect (intended or not) to prohibit banks providing liquidity and housing risk which then has the knock-on effect of reducing participants and perversely creating greater market risk. Those banks that have the expertise in risk management of illiquid and volatile OTC assets should be encouraged to engage with this new and emerging marketplace in an appropriate manner.

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Q4. For the first classification condition, is there an alternative methodology to assess the effectiveness of the stabilisation mechanism of Group 1b cryptoassets? Would this proposed methodology be consistent with ensuring the effectiveness of the stabilisation mechanism while also being practical?

As a starting point, we would propose that regulators distinguish between the three major different types of stablecoins that are in circulation today:

- Algorythmic (i.e. AMPL)
- Cryptoasset backed (i.e. DAI)
- Cash-backed (i.e. USDC)

They have completely different risk profiles, hence they belong in different classes/categories (RWA charges), however, it is important to be aware that even within these categories that there are substantial differences between individual coins and, as such, only a complete risk-based methodology should always be used.

Q5. For the third classification condition, (i) would risk governance and risk control practices for Group 1 and Group 2 cryptoassets differ; and (ii) are there alternatives to the required risk control practices that would ensure that material risks of the network are sufficiently mitigated and governance and risk managed?

(i) Yes they would differ;

(ii) As these markets evolve, there are 'regulatory' RM structures within the TradFi space that could be adapted/adopted to underpin governance and risk management.

Q6. For the fourth classification condition, (i) to what extent would the regulation and supervision of entities that execute redemptions, transfers, or settlement finality of the cryptoasset reduce risk in cryptoasset exposures held by banks; (ii) which entities should/ should not be in scope of regulation or supervision? For instance, are there entities involved in the transfer and settlement systems of cryptoassets (such as nodes, operators and/or validators) that should be excluded from the condition of required regulation and supervision?

We are in favour of an enhanced regulatory environment for some market participants. The bad actors in this market tend to operate in the space that faces the most vulnerable group of consumers/customers. However, in the same way that TradFi exchanges and CCPs are regulated, similar 'infrastructure' in the Crypto space should be regulated on a like for like basis. Blanket regulatory obligations are not appropriate, but for example, 'retail' facing entities should definitely be subject to regulatory requirements that are similar to those in place for retail Foreign Exchange.

Q7. Do you consider the responsibilities of banks and supervisors to be clear and appropriate? Are there any other responsibilities for banks or supervisors that the Committee should consider?

Yes it is clear. However, some banks will need time and resources allocated to adapt their systems to monitor these risks/new assets.

Q8. Are there ways in which the increased operational risk relating to cryptoassets (relative to traditional assets) can be measured? How should a pillar 1 add-on be designed to capture additional operational risks arising from exposures to cryptoassets?

Time to access the token is critical. If and only if token can be accessed with the same speed as traditional assets, should their credit and operational risks be considered the same? 2-5 days to access tokens should carry a hefty charge against traditional continuously accessed products.

Q9. Are there further aspects of the credit risk and market risk requirements that could benefit from additional guidance on how they should apply to Group 1a cryptoassets?

Risk management, mitigation measures and charges should reflect the actual operational challenges and conventions of the underlying Cryptoasset market.

Q10. Do you have any views on the Committee’s current thinking on the capital requirements for Group 1b cryptoassets?

There needs to be more granularity to reflect the individual differences. A true risk-based approach rather than broad categorisation.

Q11. What further aspects of the credit risk and market risk requirements could benefit from additional guidance on how they should apply to Group 1b cryptoassets?

The full risk spectrum implications need to be further analysed and deconstructed in the examples given.

Q12. Do you think the proposed capital treatment of Group 2 cryptoassets, including the application of a 1250% risk weight instead of deducting the asset from capital (for the reasons explained above), appropriately reflects the unique risks inherent in these assets?

This risk weighting is too high and costly. The effect of this will be to discourage banks from participating and thereby removing their value as risk managers from the market which in turn increases the systemic risk of the market overall. Having more participants with risk management expertise lowers the overall systemic risk of any market.

Q13. Are there alternative approaches that the Committee should consider that are simple, conservative and easy to implement? For exposures in the trading book, would it be appropriate to permit recognition of hedging via the application of a modified version of the standardised approach to market risk?

The industry is hedging risk today using existing OTC and exchange-traded hedging instruments. This fledgling wholesale market should be encouraged as it makes the industry as a whole safer and less fragile.

Q14. Do you have any views on the Committee's current thinking regarding the leverage ratio, large exposures framework and liquidity ratio requirements? Are there further aspects of these requirements that could benefit from additional guidance?

LCR: HQLA eligibility needs to be assessed depending on the group 1a/1b and 2, as mentioned in the discussion paper. Regarding the consideration as inflow and outflow, here again, and referring to Q12, the statement is too general. If a bank holds customers coins on the B/S, why is it not possible to consider it as inflow and outflow at the same time? If Banks keep the coins in their own custody and show it as a liability towards the consumer/costumer, there is no refinancing risk and the liquidity is even in the bank (not with third party banks).

The same for NSFR: these requirements need to be further elaborated.

Q15. Do you have any views on the responsibilities of banks? Are there any other responsibilities or aspects that should be covered by banks for the purposes of the supervisory review?

Banks should be encouraged to start engaging in this sector at a pace that is appropriate to their in-house capabilities.

Q16. Do you have any views on the responsibilities of supervisors? Are there any other responses that could be considered by supervisors when conducting supervisory review?

Supervisors should tread carefully, this sector must be free to continue to innovate in different directions.

Q17. Do you have any views on the adjustments to minimum Pillar 1 capital requirements to capture additional credit and/or market risk? Are there any other potential modifications that supervisors may need to consider?

We have no comments.

Q18. Do you have any views on the potential design of disclosure requirements?

There are plenty of good templates used today with other illiquid and volatile OTC asset classes.

Annex 2: Treatment of Derivatives.

Derivatives are often designed for the explicit purpose of enabling hedging and de-risking an asset. For example, today the wholesale FX market provides NDFs (Non Deliverable Forwards) for currencies that are excluded from offshore markets, and that is a case in point. An NDF for Crypto would enable exposure to the underlying asset (for either hedging or speculative purposes) without the risk of dealing with the physical. Such an innovation in the Cryptoasset market could be a very good initiative for both institutions and consumers/customers.

Please do not hesitate to contact Kim Winding Larsen at kwl@acifma.com if you require further feedback and/or clarifications.

Kind regards,

ACI Financial Markets Association

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History of ACI FMA:

ACI Financial Markets Association ("ACI FMA") is a global non-political, non-profit association of wholesale financial market participants. ACI FMA was established under the French Law of 1901 and based on mutual recognition of markets professionals, with the objective of developing the profession, without discrimination of any sort.

Since 1955, ACI FMA has represented the interests of individuals in professional trading, broking, operations, regulatory and compliance activities in global financial markets.

Its main mission is to be a leading, global association of wholesale financial markets professionals, contributing to market development through education, best market practices, technical advice and networking events.

Focused on three core values of Membership, Education and Ethical Conduct, ACI FMA is committed to supporting market participants to operate at the highest standards of ethical conduct and best market practice. Specifically, these values represent:

- Membership: ACI FMA counts over 8,000 individual members representing 60 National Associations globally

- Education: Accredited, portable qualification and certification of professional and ethical standards to market participants worldwide

- Ethical Conduct: ACI FMA members are expected to maintain the highest ethical conduct in adherence to global Codes relevant to them.

ACI FMA members are proud to represent individual responsibility, and benefit from a network of global peers who place great emphasis on the best possible practices in our profession, in the same way as modern regulatory regimes and industry codes.

Through cooperation with ACI FMA, an entity is able to demonstrate that concrete steps are being taken to ensure all the staff have been trained to the highest ethical standards of conduct, and that they understand their individual obligation.

ACI FMA members are longstanding proponents and influencers of ethical conduct and good market practices to financial markets professionals.