

BCBS Second consultation on prudential treatment of cryptoasset exposures

AMAFI's answer

Association française des marchés financiers (**AMAFI**) is the trade organisation working at national, European and international levels to represent financial market participants in France. It mainly acts on behalf of credit institutions, investment firms and trading and post-trade infrastructures, regardless of where they operate or where their clients or counterparties are located. AMAFI has 170 members operating in equities, fixed income and interest rate products, as well as commodities, derivatives and structured products for both professional and retail clients. Nearly one-third of its members are subsidiaries or branches of non-French institutions.

As such AMAFI represents firms including investment firms which in Europe are now regulated under the new prudential regime IFR/IFD and no longer subject to CRR and CRD. Given that Basel rules will have an impact on EU Regulation not only with respect to credit institutions but also investment firms, some of which are also much involved and interested in the current regulatory evolutions around the DLT and crypto assets, AMAFI wishes to contribute to the reflexion of the BCBS.

We support the work of the BCBS, as there is an urgent need to clarify at an international level the prudential treatment of crypto assets. In this respect, the BCBS second consultation is the adequate platform to foster a better understanding of such markets. We also welcome the new BCBS draft proposal which takes into consideration the industry comments on the previous consultation.

AMAFI would first like to raise some general comments.

1. GENERAL COMMENTS

First, we believe it is necessary to allow regulated firms and institutions to participate to crypto-assets markets while ensuring a sufficient level of transparency and appropriate supervision. Furthermore, to allow these markets to evolve, it seems essential to us that risks must be considered in a proportional way.

Having said that, conscious that this second BCBS consultation started addressing some of the requests made in that way in the responses to the first 2021 consultation, which we highly welcome, some issues remain problematic and may have a detrimental effect on banks and investment firms and seems to disadvantage them.

In fact, it appears that the proposed way of classification of crypto assets is restrictive for those actors as it seems that some products, for instance traditional financial instruments issued on a DLT, would be shifted to a lower category with heavy capital charges, restricting banks and investment firms to experiment. Yet, in the current environment and with the European Union having adopted a series of measures (Pilot Regime, MiCAR) favouring experimentation in these markets, that are inherently innovative and experimental, it would seem counterproductive to restrict the access of certain players.

Besides, these regulations provide a balanced legal framework, it proposes a clear taxonomy of crypto-assets distinguishing different types of instruments (former financial instruments and new crypto-assets), it enables supervisors to control those assets and activities surrounding cryptos, prevent money laundering and ensure a great transparency on both the service providers and the assets, which promotes confidence. For these regulations to have the desired effects, a certain amount of freedom of experimentation must be provided equally to all market participants. It seems important that the BCBS consider these regulations while developing its standards. In its current state, it feels that the BCBS text would make experiments on DLTs prohibitive for banks and investment firms.

Furthermore, imposing excessive and burdensome rules on banks and investment firms will only allow a greater flexibility for unregulated players to emerge in these markets, creating an unlevel playing field, and will deprive competent authorities of the ability to conduct rigorous supervision of crypto assets.

A specific add-on ("infrastructure" capital surcharge on Group 1 crypto-assets) is also proposed, introducing a new concept which is a potential deviation from the current Basel prudential framework.

Although the proposal shows some progress compared to the first consultation, we would appreciate the BCBS to take into account the above-mentioned arguments in order for banks and investment firms to take part in these markets and have sufficient latency to experiment, even more so considering new EU regulations.

2. RESPONSE TO THE CONSULTATION

CLASSIFICATION CONDITIONS

The characterisation of a crypto asset as Group 1 asset should only be based on the legal definition of this asset and its compliance with regulatory requirements under applicable law (of the issuer and/or the relevant service providers), and not on technological grounds. In many jurisdictions, including in OECD countries, securities laws already exist to ensure the same legal definition applies to issuances and trading of unlisted securities on either permissionless or permissioned blockchain technology (France, Germany, Luxembourg, etc.).

As such, **permissioned assets, applications and services built on permissionless DLT should be eligible to Group 1 assets**, provided that they are subject to appropriate governance : (i) the ownership of assets abides with applicable contract law and is covered by a continuity plan in case of a technological event (a major blockchain disruption for e.g.), (ii) transactions are strictly defined, tracked, controlled and are legally binding, (iii) whitelisted actors are authorized (by the issuer under the issuance documentation and/or by the regulation) to validate transactions *ex ante* before their registration on the blockchain, whatever the underlying technology (permissionless blockchain or permissioned). The 2021 experiment realised by Societe Generale-Forge with the issuance of digital bonds by the EU supranational EIB on the Ethereum permissionless DLT and its settlement by a digital representation of euro also carried out through the same permissionless DLT is a good example of what can be achieved in this field, under the constant and demanding oversight of relevant financial and prudential regulators.

In this respect, **stablecoins issued by an entity which is prudentially regulated and supervised should be exempted from the basis risk and redemption risk tests** proposed by the BCBS. In this respect, banks should not be held accountable for assessing and keeping records on an ongoing basis of the application by all involved entities (under conditions 3 and 4) of the risk management conditions set on them in part because the BCBS does not specify what due diligences are expected on such stakeholders.

PRUDENTIAL TREATMENT

The specific infrastructure add-on on Group 1, resulting in a capital surcharge of 2.5% of the exposure is excessively conservative and lacks evidence-based justification. The use of DLT could lower the level of operational risks in institutions and improve the quality of transactions (as shown by current experiments on CBDC for example). Consequently, **this add-on should correspond to a clearly stated and identified additional risk, which is clearly not the case on Group 1a assets, and not proven on Group 1b**, given the strict conditions imposed on them.

As a conclusion, while the exposure of the banking sector to crypto assets is relatively modest today, the Group 1 add-on as currently proposed is likely to severely curtail banks and investment firms' participation in the crypto-assets market, at the risk of (i) leaving crypto assets in the hands of lightly regulated to unregulated actors, and (ii) leaving behind banks and investment firms in this growing market, with considerable and potentially irrecoverable delays in investments for research, development and experiments in these fields.

In the EU, substantial regulations such as the "Pilot Regime", allowing the issuance and trading of blockchain-based listed financial instruments on trading venues, and the MiCA Regulation, for stablecoins, e-money tokens and utility tokens crypto assets issued, stored and transferred on a DLT that do not qualify as financial instruments, will open up opportunities for respected regulated institutions to improve efficiency of trading and post-trading processes, while ensuring consumer protection and financial stability. The capital framework should be designed so that EU banks and investment firms are allowed to take part in the market under these new regulations to help them scale up appropriately, in a well-regulated environment, to secure them and launch new experiments, with a similar framework as non-bank intermediaries.

