ASSOCIAZIONE INTERMEDIARI
MERCATI FINANZIARI - ASSOSIM

Milan, 30 September 2022

Basel Committee on
Banking Supervision

Prot. n. 48/22

Re: ASSOSIM contribution to the second consultation on the prudential treatment of banks' cryptoasset exposures

ASSOSIM[1] welcomes the opportunity to provide comments on the BCBS's Consultation in subject as better detailed here below.

In terms of introductory remarks, we would like to underline that the proposals described in the consultation paper would penalize banks, which could be discouraged - and in some cases prevented - from providing those services from which they derive exposure in crypto-assets. In this context, it is clear that, on the one hand, banks would be heavily jeopardized because they will not be able to compete with other entities (i.e. *FinTech*, *BigTech*, *Virtual Asset Service Providers*, etc.), while, on the other hand, investors will be less protected because their providers would be not supervised (e.g. non-EU *Crypto Asset Services Providers-CASPs*) or, in any case, subject to less stringent regulatory and supervisory requirements than those applicable to banks (e.g. the requirements for CASPs under MiCAR).
Moreover, small and medium-sized banks would be adversely affected by this excessively strict approach, as they will not be able to afford the proposed capital requirements.

Some critical aspects of the proposal are highlighted here below:

- The proposed classification in Group 1 and Group 2 is not aligned with the taxonomic classes provided by the regulatory framework (i.e. MiCAR). By comparing the section on classification conditions (SCO60.6-SCO60.27) with the regulatory classification (outlined in MiFID II, EMD2 and MiCAR), it is clear that doubts and grey areas have not been solved, especially considering the complexity of the requirements outlined in the BCBS proposal.

[1] *Associazione Intermediari Mercati Finanziari* - ASSOSIM is the Italian Association of Financial Markets Intermediaries, which represents the majority of financial intermediaries acting in the Italian markets.

- Verifications and analyses that banks would have to perform in order to classify crypto-assets into Group 1 (SCO60.8-SCO60.18) are overly burdensome, too complex, and unsustainable for those banks that cannot afford to set up in-house facilities dedicated to the verification of every feature of each crypto-asset. For example, the two tests required to classify a crypto-asset in Group1 are the redemption risk test and the basis risk test. The first test requires the bank to ensure that the crypto-asset arrangement meets the value and composition of the reserve assets and their management. The second test is even more burdensome, because the bank must monitor the percentage difference between the crypto-asset's peg value and its market value on a daily basis; the results are used to determine whether the test is fully passed, narrowly passed or failed. Furthermore, "banks should have in place the appropriate risk management policies, procedures, governance, human and IT capacities to evaluate the risks of engaging in crypto-assets and implement these accordingly on an ongoing basis and in accordance with internationally accepted standards" (SCO60.25). As mentioned above, this proposal penalizes small and medium-sized banks because, on the one hand, they cannot afford the analytical efforts required to classify crypto-assets in Group 1 and, on the other hand, they cannot bear the capital requirements resulting from the consequent inclusion of these crypto-assets in Group 2. As a result, some crypto-assets would be included in Group 1 by larger banks and in Group 2 by smaller entities, leading to a paradoxical and unacceptable result and to a concentration of crypto-asset services in larger entities. Moreover, this unequal treatment is even more serious considering that the crypto-asset market and the Decentralized Finance will probably redefine financial services business models. Therefore, the exclusion of smaller players from this market may cause their complete exclusion from the future financial system.

- Capital requirements proposed for Group 2 (SCO60.59-SCO60.91; SCO60.102-SCO60.104) are excessive, not comparable to the ones stemming from the exposure to any other asset and unsustainable for small and medium-sized banks. Consequently, banks could not provide services from which an exposure in crypto-assets is derived, like the reception of crypto-assets as a collateral of financing operations, or services that require to hold crypto-currencies for the payment of the fees applied by the specific DLT platform.

- The proposed approach is even more penalizing considering that Group 2 includes all of the most widespread crypto-assets, including crypto-currencies (e.g. Bitcoin and Ethereum).

Hence, we suggest the following solutions and amendments:

- ✓ The possibility of using certain assumptions for the classification of all stablecoins issued under Group 1 regulations[2]. For example, the MiCA Regulation provides some specific requirements for the majority of stablecoins - both e-money tokens and asset-backed tokens - regarding collateralisation, reserve management and stabilisation. Moreover, these types of tokens will only be offered once the relevant whitepaper has been approved by the competent Authority. Therefore, according to the classifications under the MiCA

[2] Please, see also our *Feedback regarding stablecoins (SCO60.14)* below.

Regulation, all crypto-assets classified as e-money tokens or asset-referenced tokens could be allocated to Group 1 without any bank's obligation to verify further than the control of the relevant whitepaper approval by the competent Authority.

- ✓ The drafting of a bridging table comparing the different classifications provided for in the current legislation (e.g. MiCAR, MiFID II, EMD2) and the Groups described in the proposal, in order to ensure legal certainty and to avoid misapplication. For instance, e-money tokens and asset-referenced tokens could be included in Group 1 by a regulatory act, as also tokenization of traditional assets. Following this approach, crypto-assets 'other than' could be included residually in Group 2. However, a regulatory classification of the most widespread crypto-assets would be welcomed.
- ✓ A significant reduction of the capital requirements proposed for Group 2 in line with those provided for other (even speculative) products. This action seems necessary in view of the fact that the most widespread crypto-assets (e.g. crypto-currencies) would be included in Group 2.

Feedback regarding the definition of Crypto-assets (SCO60.1)

We welcome and endorse the definition given in SCO60.1 "Crypto-assets are defined as private digital assets that depend on cryptography and distributed ledger or similar technology", notably in the part where it specifies "or similar technology". This shouldn't be revised.

Feedback regarding the definition of "exposure" (SCO60.4)

According to the consultation document, "the term "exposure" includes on- or off-balance sheet amounts that give rise to credit, market, operational and liquidity risks. It includes activities, such as non-fiduciary custodial services, that may only give rise to operational risk."
Our understanding is that the safekeeping of digital keys is/could be qualified as non-fiduciary custodial service. To this respect, we recall the interpretative letter #1170, July 2020, of the U.S. Office of the Comptroller of the Currency (OCC), where the OCC explains that a banking service that provides custody for cryptocurrency in a non-fiduciary capacity typically would not involve physical possession of the cryptocurrency, but rather "essentially provide safekeeping for the cryptographic key that allows for control and transfer of the customer's cryptocurrency". Should this understanding be correct, we foresee a possible market distortion when comparing keys safekeeping service provided by a bank versus the same service provided by a third entity (e.g. so called "fintech") which doesn't have to comply with the Basel Committee framework.

Feedback regarding stablecoins (SCO60.14)

About stablecoins and classification conditions the threshold of 10bp seems to be appropriate with reference to the use case of a stablecoin for DvP, as it could strongly contribute to the reliability and robustness of such mean of payment. It might look conservative, though, with respect to other cases, such as trading or investment, which, on the other hand, are currently the most common ones and where we observe more consistent (>10 bp) variations towards peg-values. Keeping the 10bp criteria would mean automatically put almost all existing stablecoin in group 2. To this

respect, we welcome and recommend SCO60.17 "For a stablecoin to be classified as Group 1b the issuer must be supervised and regulated by a supervisor that applies prudential capital and liquidity requirements" and in particular the point: "The Committee is considering this requirement as an alternative to the basis risk and redemption risk tests described in SCO60.12 to SCO60.16 above."

Feedback regarding infrastructure risk add-on (SCO60.57)

We believe that the operational risk add-on charged to Group 1a crypto-assets, as proposed by the consultation, is inconsistent and unnecessary because current and upcoming operational risk capital frameworks, including internal and supervisory assessments, already take into account such risk.

It is worthy considering that in many use cases referred to Group 1a crypto-assets (e.g. tokenization of bonds, equities, etc) the DLT technology aims at simplifying existing traditional solutions and making services and processes more cost-efficient. The proposed infrastructure risk add-on would result in a significant additional capital cost which will outweigh the cost benefits of the application of the new technology and would therefore constitute a serious obstacle for the application of DLT in the banking sector.

The reason for adopting an infrastructure risk add-on mentioned in the consultation document (i.e. distributed ledger technology (DLT) infrastructure is still new and evolving and may pose various unforeseen risks) seems to be quite unique as similar statements were made in the early days of other computer technologies (cloud technology, etc) which, however, did not result in an infrastructure risk add-on.

Furthermore, the proposed size of the risk add-on (2.5% x exposure value) appears to be disproportionally high in comparison, for instance, with the standard approach for operational risk RWA which will be applicable from 2025 onwards.

We therefore strongly suggest that the general operational risk capital framework is applied also to Group 1a crypto-asset exposures and activities.

Feedback regarding risk weight for Group 2a crypto-assets according to the standardized approach (SA) for market risk (60.71-60.78)

In the standardized method a risk weighting of 100% was proposed for all Group 2a crypto-assets, which means that a simulation of a +100% increase and a decrease to 0 value has to be performed for the calculation of the curvature risk. Such extremely conservative market risk scenarios for all Group 2a crypto-assets seem to be unjustified and would have the consequence that banks will not be in the position to offer any non-linear product (e.g. call options or put options) on Group 2a crypto-assets to their clients due to high capital costs. Therefore, we would propose to introduce different risk buckets with different risk weights within the Group 2a crypto-assets like those provided for equities or FX within the FRTB standard approach framework.

Feedback regarding Group 2 exposure limit (60.121-60.124)

We do not understand why the calculation of the total exposure to Group 2 crypto-assets does not take into account netting rules similar to the ones applied to the calculation of market risks. Without such nettings rules and with a limit of just 1% of the bank`s Tier 1 capital, banks will

hardly be able to offer services or products on Group 2 crypto-assets. Please consider, for example, a bank with a Tier 1 capital of EUR 10 billion which has a Group 2 crypto-asset exposure limit of EUR 100 million. If the bank sells derivatives on Bitcoin or on the CME Bitcoin future with a delta-equivalent of EUR 50 million to its clients and hedges the market risk with a corresponding CME Bitcoin future (also with a delta-equivalent of EUR 50 million), then the bank would have already reached the Group 2 exposure limit despite the fact that the market risk of the position might be close to zero. It is clear that it is not possible to develop a profitable business case covering all infrastructure and administrative costs on the basis of such a tight exposure limit and without netting rules, with the consequence that such services and products would only be offered outside the banking sector.

It is worth mentioning that the similar exposure limit for financial sector entities under Basel III regulation has a much higher limit value (10%) and allows for netting in the exposure calculation.

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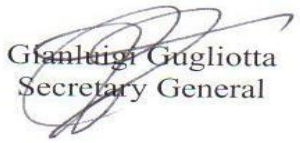
We remain at your disposal for any further information or clarification.

Yours faithfully,



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