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BCBS Consultation Paper on the topic of designing a prudential treatment for crypto-assets

The Division Bank and Insurance of the Austrian Federal Economic Chamber, as legal representative of the entire Austrian banking industry, appreciates the possibility to comment on the above cited Consultative Document regarding and we would like to note the following comments and remarks.

General remarks
We generally welcome the Basel Committee's approach to this topic and believe that this could serve as an appropriate and useful basis for an initial prudential framework. The following main asepcts should be kept in mind from our point of view:

1. **technology-neutrality – prevent regulatory arbitrage**

Regulatory classification as digital/crypto-assets and their business models should be global, not local. Regulatory arbitrage should be prevented.
A classification of crypto-assets should ensure that, where necessary, existing regulation can be easily applied instead of unnecessary introduction of new concepts. The classification also has to ensure proper differentiation between (digital/crypto) assets that are de-facto already regulated (as e.g. they can be seen as financial instruments) and those which are not regulated yet.

One problem is, that it seems that many initiatives could fall within the category of utility tokens. In our current understanding the hybrid categories are very broad and do not seem to fit optimally. If regulatory rules depend on the classification this easily can become a problem. Therefore, it seems too early to put a constraint or prejudice on the (sub-)classification. It is rather important to define the overall approach that should be followed: Any classification scheme should be embedded in current existing schemes to keep current differences in regulations between e.g. fungible and non-fungible financial instruments.

One Example: It is possible to issue and post-process, on DLT, a Schuldscheindarlehen as non-transferable asset. Then the same regulatory terms should be applied to this case just as with any other "conventional" Schuldschein (which is e.g. not a financial instrument) or any other form of digitization of a Schuldschein (e.g. based upon non-DLT technology).

2. Need for risk-based treatment, weighting should reflect characteristics

Different characteristics of different crypto-assets (that affects the scalability, volatility, etc.) should be reflected in the applicable prudential treatment. We are supportive on the illustrative example of a prudential treatment for high-risk crypto-assets. For low-risk crypto-assets an appropriate design of prudential treatment should be designed.

Specific answers to the questions

Q1. What features of crypto-assets should be considered in the context of developing any potential prudential regulatory definition? Please describe the features and their relevance for the prudential treatment of crypto-assets.

Not only focus on the DLT consensus mechanism, but also:

- Who are the issuers (private individuals, companies, public authorities, etc.) and in which country is it established (seated);
- Do these "crypto-assets" represent a respective value per se ("digital or virtual asset") or reference to an "off-DLT" (physical assets e.g. real estates, non-physical legal rights such as securities or even data such as Identification Attributes or references to them);
- Do they also use a business logic such as e.g. Smart Contracts.
- Scalability of the crypto-assets (e.g. Bitcoin vs. Libra)
- Targeted group of users (wholesale vs. retail)
- Impact on sovereignty of money creation (e.g. Libra, eEUR, eKrona, etc.)

Q2. What are the main economic and related functions and potential sources of value of crypto-assets that are relevant in the context of developing a prudential treatment? To what extent do these functions and potential sources of value affect the relative prudential risks of different crypto-assets for banks? Are there other potential sources of value that are relevant in designing a prudential treatment for crypto-assets?

- Indicated Token (technical representation of "crypto-assets") classification is a very first step and should be regulated on existing – maybe slightly enhanced definitions - legal grounds and shall affect prudential risks for banks accordingly:
  - Security Token: securities relevant regulations (MiFID, MIR, MAD, etc.)
  - Payment Token: payment relevant regulations (AML/CTF, PSD2, etc.)
  - Utility Token: product- and service relevant regulations (in AT: ABGB, UGB, etc.)
- Please note:
  - a token can have more than one economic function (security and/or payment and/or utility)
  - a smart contract is validated by its written code:
    - More logical and less ambiguous than classic paper contracts;
    - When programmed in a functional programming language (f.ex. Haskell), they can even be mathematically proven (what they do and what they don't do)

Q3. What benefits do crypto-assets provide for the banking system, and the provision of financial services more generally?

- Provision of new services and therefore new customers;
- Simplification of transactions;
- Higher anonymity (depending on the regulation);
- Full Digitization of business subjects and objects (Stakeholders, Assets, Rights, Contracts, etc.);

- Full Automation of business processes (workflows, interaction, event triggers, etc.)
- Avoiding centralization and intermediaries (payment service providers, exchanges, settlement/netting service providers);
- High level of legal assurance when using Smart Contracts or even Ricardian Contracts

Q4. What additional factors affect the risk profile of different crypto-assets which are relevant in the context of determining a prudential treatment?

- Limitations: Token availability, trade on crypto-/traditional exchanges, IT systems/solutions & their availability; public (dis-)trust in issuers of crypto-assets, etc.

Q5. Do you agree with these general principles in guiding the design of a potential prudential treatment of crypto-assets? Are there additional principles that should be considered?

- Yes, see answer to Q2
- Customer protection should be mentioned as a leading principle as well. Given the uncertainty of design of future crypto-assets, customer protection needs to be pointed out as a one of the leading principles of regulation (together with AML and CFT).

Q6. Are there additional channels other than those listed above by which banks could be directly or indirectly exposed to crypto-assets? Which channels could potentially be the most material for banks? How do these exposure channels vary by different types of crypto-assets? What are the benefits and risks associated with banks' crypto-asset exposures through these different channels?

- Additional channels: Banks acting as crypto-exchange (not only from/to fiat)
- Most material channels/differing via types/benefits and risks through these different channels:
    - too complex to comprehensively answer on such a detailed level
    - when Q2 proposed approach is applied, the answers are already given as applied to existing regulations and risk management accordingly

Q7. Are any exposure channels likely to change in response to ongoing or envisaged developments in cryptoasset markets?

- In general, the more regulated, the riskier the proposed exposures will become for the ordinary customer (high risk lending, derivatives on "crypto-assets", etc.)

Q8. Which risks would be the most material with respect to banks' exposures to crypto assets? Are there additional risks other than those listed above which banks could be exposed to as a result of holding direct or indirect exposures to crypto-assets, or providing related services? To what extent do these risks differ based on the type and design of crypto-assets, and how do they differ to traditional asset classes?

- Most material: cyber and operational risks (new technologies with limited experience/know-how) as well as reputational risks (mostly indirectly via respective underlying offenses)
- Liquidity & market & credit risks could become material based on the nature of the issuer (e.g. private companies) – for example based on the sole discretion of the issuer when determining the value of the crypto-asset (resulting in an immediate profit of the issuer e.g. from assets used to purchase the crypto-assets/currencies)
- Additional risks: all predicate offenses to ML/TF such as fraud, human trafficking, drug dealing, etc.

- Risk difference extent: significantly enhanced due to high degree of automation and global reach (KYC?)

Q9. What are your views on the illustrative example of a prudential treatment for high-risk crypto-assets? Which crypto-assets would classify as high-risk based on the criteria set out above? What other features could be considered in specifying the scope for such a potential treatment?

- In general: **fully supportive** as crypto-assets are high-risk per se due to their still not very well known, unprecedented cyber and operational risk nature in combination with its per definition global reach (KYC, etc.)
- Nevertheless, it should be noted that the proposed treatment would not encourage banks to invest in crypto-assets or to trade them.

Q10. What further supervisory measures could be considered in specifying a potential prudential treatment for crypto-assets?

- Non-licensed crypto-assets should be forbidden.
- Mixing-services/-asset types should be forbidden (Money Laundering/Terror Financing as well as all predicate offenses)
- AML/CTF should be also considered

Q11. What are your views on the disclosure requirements related to banks' crypto-assets? Should additional information related to banks' crypto-asset exposures be disclosed?

- Full and detailed disclosure. Timeline development of crypto-asset exposures shall be also provided to prevent reporting-date "optimization"

Q12. What are your views on the appropriate prudential treatment of these types of crypto assets? Are there additional types of crypto-assets that would warrant a different treatment to the illustrative example outlined in this paper?

- Different characteristics of different crypto-assets (that affects the scalability, volatility, etc.) should be reflected in the applicable prudential treatment. Nevertheless, legal certainty must be achieved at the highest possible level.
- Stable-coins may not pose the same threats as the "high-risk crypto-assets" and therefore should not be treated in the same way, but should be treated according to classifications as outlined in Q2., i.e. stable coins can be classified as money-money funds (depending on underlying collateral).
- CBDC and possible supranational CBDC (e.g. e-euro) should be also considered when designing prudential treatment for other types of crypto-assets. Clear and comprehensive approach should prevent discrepancies in regulation and guarantee the level playing field.

Q13. What are your views on the potential prudential treatment of specific types of crypto assets that bear economically equivalent risks to traditional asset classes? To what extent could the prudential treatment of such crypto-assets build on the existing framework?

- See answer to Q2.
- The use of existing framework for treatment of traditional asset classes on crypto-assets could be beneficial for banks, given the current speed and volume of regulation. Furthermore, it avoids legal uncertainty.

Q14. What specific conditions and criteria are needed for different types of crypto-assets to be subject to a different treatment to the illustrative example discussed in this paper?

- The use of stabilization tools (e.g. claims or backing by tangible assets) should lead to a different treatment. These assets should be less volatile and therefore be more secure than the illustrated high-risk crypto-assets.
- The legal nature of the issuer and the risks of him to break his obligations should be reflected in the design of the prudential treatment.

Q15. Do you have other suggestions regarding the design of a potential prudential treatment of crypto-assets?

- Licensing, notification - always similar to traditional assets.
- investment risk similar to high-risk junk bonds unless mitigated with respective underlying (nonvolatile fiat, gilt-edged securities or similar)
- APIs / traceability for "crypto-asset" flows should be made mandatory (similar to payment networks, f.ex. chainalysis.com, blockseer.com, elliptic.co, …)
- the following crypto-asset types/functions should be forbidden due to either inherent, not manageable high-risk nature and/or money laundering and terror financing enablement:
    - derivatives on crypto-assets
    - mixing services
    - anonymous cryptocurrencies (Zcash, Monero, Dash, …)
    - anonymous wallets (electrum, darkwallet, …)
    - anonymous payment services (z-pay, …)

Yours sincerely,

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