

Dear

Basel Committee on Banking Supervision – Bank for international settlements

Sella Group response to “Discussion Paper – Designing a prudential treatment for crypto-assets”

Sella Group welcomes and thanks for the opportunity to provide comments on the above mentioned Discussion paper.

Responses are reported below.

Feedback on the discussion paper

The Committee welcomes comments from interested stakeholders including academics, banks, central banks, finance ministries, market participants, payment system operators and providers, supervisory authorities, technological companies and the general public – on the different elements covered in this discussion paper by 13 March 2020. The purpose of this paper is to elicit comments and feedback from a broad range of interested stakeholders. The Committee particularly welcomes feedback on the following 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 (Chapter 2, Section Key features of crypto-assets)

Digital/Virtual nature is not a distinctive element of crypto-assets compared to digital assets in general and, therefore, should not be considered in a specific prudential framework. It is therefore appropriate the proposal of European Commission to limit the

scope of a regulatory framework to “crypto-assets” and not to “digital assets” in general.

In a regulatory perspective, the use of distributed ledger technology is the main distinguishing feature between “digital assets” and crypto-assets and should be considered.

The main issues in application of current regulatory framework (e.g. MiFID II, CSDR, AML) arise from the specific architecture of DLTs.

For instance, in permissionless DLT, it's difficult to mitigate AML/CFT risks, given the lack of intervention of any service provider. In this context, peer to peer transactions in permissionless and decentralised systems and without the provision of any service (e.g. payment gateway, wallet provider) could be compared to peer to peer cash payment. At the same time the operational, ICT and Cyber risks should be mitigated having the specific nature of DLT in mind.

DLT determines specific credit risk also, considering that the issuer or sponsor of crypto-assets marketed to EU investors/consumers could be established outside the EU, and, in case of permissionless blockchain systems, the geographical limitation of contracting of crypto assets towards EU countries is impossible.

With regard to market integrity and liquidity risk, the nature and architecture of the distributed ledger (i.e. permissionless) and the nature of the trading platform (i.e. decentralised) play a crucial role in the quantification of liquidity risk.

Furthermore, it's important the consideration of the specific nature and classification of different crypto-assets (e.g. investment tokens, payment tokens, utility tokens) and specific features (e.g. backed stablecoins present lower market risk than crypto-currencies). The provision of an effective prudential framework should be based on an EU regulatory classification of crypto-assets.

Pursuing this goal, the outcome of Consultation Document “On an EU framework for markets in crypto-assets” plays a crucial role and should be the base of the prudential treatment also.

In order to maintain a level playing field among European countries, classification should be provided on an European level and based on the main function of the crypto-assets (“payment”, “investment”, “utility”). For every classification a sub-classification in already regulated and not already regulated assets should be

provided. The sub-classification of regulated assets should include definitory links to regulatory classifications (e.g. "financial instrument", "electronic money").

Asset-classes e sub-asset classes should be mutually exclusive.

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? (Chapter 2, Section Economic functions and potential sources of value of crypto-assets)

As mentioned above, it's important the consideration of the specific nature and classification of different crypto-assets (e.g. investment tokens, payment tokens, utility tokens) and their link to regulatory definition (e.g. financial instrument, electronic money). The provision of an effective prudential framework should be based on an EU regulatory classification of crypto-assets (Consultation Document "On an EU framework for markets in crypto-assets"). It's also important to distinguish tokens in crypto-currencies and stablecoins, having the first an higher level of volatility.

Q3. What benefits do crypto-assets provide for the banking system, and the provision of financial services more generally? (Chapter 2, Section Economic functions and potential sources of value of crypto-assets)

The main potential benefit could be the reduction of costs in fundraising, in particular for SMEs and Start-ups. ICOs and STOs could be a useful and convenient fundraising source, but also a new investment opportunity for investors.

Sella Group agrees with ESMA's statement that "ICOs could provide a useful alternative funding source for blockchain start-ups and other innovative business that would find it difficult to raise capital through traditional funding channels" (Advice "initial coin offerings and crypto-assets").

Other potential benefits derive from the financial inclusion, the efficiency of cross-border payments and the increased speed of negotiations.

Q4. What additional factors affect the risk profile of different crypto-assets which are relevant in the context of determining a prudential treatment? (Chapter 2, Section Additional factors that could affect the risk profile of crypto-assets)

The validation mechanism and the distinction between permissionless and permissioned DLT play a crucial role in the quantification of different risks. For instance, in permissionless, decentralised DLT, without the intervention of any service providers it's more difficult to mitigate AML/CFT, operational, ICT and cyber-risks.

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? (Chapter 3, Section general principles)

Yes, we agree with all the general principles mentioned ("Same risk, same activity, same treatment", "Simplicity", "Minimum Standard"). However, Sella Group considers proportionality one of the key principles of prudential framework. The regulatory framework should therefore recognize the possibility for institutions to comply with the requirements in a manner that is appropriate to their size, internal organisation and the nature, scope and complexity of their activity.

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? (Chapter 3, Section Channels of bank exposures to crypto-assets)

The list includes a wide range of both direct and indirect exposures. However, another additional channel could be the provision of investment advice in crypto-assets (for investment and security token) and advice on issuance of crypto-assets in fundraising. Among those mentioned, the most probable and, therefore, material exposure channel for banks could be the provision of investment services related to crypto-assets (e.g.

transmission or execution of orders on behalf of clients) or custodian services as wallet providers. Indeed, the main potential benefits of crypto-assets derive from the financial inclusion, the reduction of costs in fundraising and the speed of negotiations. It's therefore feasible that banks will face the demand of clients for services in crypto-assets.

At the same time, crypto-assets could be an investment opportunity determining an increase of proprietary trading and owning of crypto-assets or products with underlying crypto-assets.

Q7. Are any exposure channels likely to change in response to ongoing or envisaged developments in crypto-asset markets? (Chapter 3, Section Channels of bank exposures to crypto-assets)

The certainty of the regulatory framework could facilitate the provision of services related to DLT by supervised entities (e.g. banks), exposed to compliance and reputational risks. Risks arising from indirect exposure (channels vii; viii; ix) could therefore increase.

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? (Chapter 8, Section Risk arising from crypto-asset exposures)

The most material risks would be AML/CTF (mostly in permissionless and decentralised platforms), operational risk (including ICT and cyber-security risk), liquidity risk, credit risk, market risk.

Other material risks are compliance and reputational risks, mostly in the provision of services to clients (channels viii; ix). The current uncertainty on the definitory framework – and, as a consequence, on the applicable law – increases risk of sanctions and is an obstacle for the access on the crypto-assets market for supervised entities (i.e. banks and investment firms).

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? (Chapter 3 section Illustrative example of capital and liquidity requirements for high-risk crypto-assets)

The prudential treatment proposed is referred to crypto-assets with no intrinsic value and not explicitly and directly linked to, or backed by, assets with intrinsic values. Stablecoins are aptly excluded.

Given the limitation of the purpose to high risk crypto-assets, the proposed prudential framework seems to be appropriate . Further quantitative impact analysis would be appropriate in order to assess capital impacts for banks and financial market and, therefore, to accurately calibrate risk weighting.

Q10. What further supervisory measures could be considered in specifying a potential prudential treatment for crypto-assets? (Chapter 3, Section Supervisory review process)

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? (Chapter 3, Section Pillar 3 disclosure requirements)

The proposal seems to be appropriate.

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? (Chapter 3, Section General considerations for the prudential treatment of other types of crypto-assets)

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? (Chapter 3, Section General considerations for the prudential treatment of other types of crypto-assets)

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? (Chapter 3, Section General considerations for the prudential treatment of other types of crypto-assets)

Crypto-assets with intrinsic value and explicitly and directly linked to, or backed by, assets with intrinsic values should be subject to a different treatment.

Further quantitative impact analysis would be appropriate in order to assess capital impacts for banks and financial market and, therefore, to accurately calibrate risk weighting

Q15. Do you have other suggestions regarding the design of a potential prudential treatment of crypto-assets? (Chapter 3, Section General considerations for the prudential treatment of other types of crypto-assets)

Kind Regards

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