OFÍCIO FB-0385 /2024 São Paulo, March 28, 2024.

Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2, CH-4002 Basel, Switzerland

Ref: "Basel Committee on Banking Supervision ("BCBS") – Cryptoasset Standard Amendments - consultative document"

The Brazilian Banks Federation (FEBRABAN) is grateful for the opportunity to comment on the Basel Committee's public consultation on the "– Cryptoasset standard amendments".

We welcome the Basel Committee's continued focus on designing and improving the prudential framework for cryptoassets. Furthermore, we look forward to ongoing collaboration as these markets continue to evolve.

In that sense, FEBRABAN believes that considerations to the current proposal should be taken into account in order to preserve the intended purpose and suggests the Committee to take into account the following points in the review.

As a general comment, we do not currently find in any jurisdiction a local regulatory framework that fully meets the rating conditions that BCBS proposes (in terms of maturity, credit quality, bankruptcy mitigation, etc.).

Currently, some of the world's largest economies have finally begun to establish regulations to define, understand and regulate cryptoassets, providing clarity and security to keep up with the speed of this technology's transformation. The United Kingdom, the European Union ("EU"), the United States and Singapore have already laid the necessary legal foundations for the full operation of stablecoins.

Already established legal frameworks, such as the regulation of e-money tokens under the EU Regulation 2023/1114 on Markets in Cryptoassets ("MiCA"), as well as the proposed UK framework for stablecoins, are generally less stringent than the BCBS proposals, an indication that, at least in an initial scenario, the new regulation should also be less definitive or restrictive.

A critical point is that the rules set out in the SCO60 framework will only apply to financial institutions, so other market players will not be obliged to comply with these guidelines. This will create additional costs for financial institutions and may limit the operations of these players subject to the regulatory framework. Therefore, depending on how the CBSB determines the risk ratings of cryptoassets, there will be a great disincentive for financial institutions to operate in this new market.

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55 11 32449800
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Also in this context, it is worth mentioning that assets with the same risks should receive the same prudential treatment, which, as we have identified, is not addressed in the regulatory proposal made available by the BCBS.

Given the general comments above, some specific notes on the most relevant issues are as follows:

1) Permissionless Blockchains:

The BCBS document mentions that due to the constant changes in the cryptoasset markets, updates would be made to the original document, published in December 2022.

In carrying out this proposed review, the BCBS concluded that cryptoassets using permissionless blockchains present "unique" risks that cannot be sufficiently mitigated. Because of this view, the BCBS has established that cryptoassets using permissionless blockchains are not included in the Group 1 treatment.

However, the primary concern in this context is not in relation to the blockchain itself (whether it is publicly or privately issued, "permissioned" or "permissionless"), but rather in relation to the token, i.e. whether there are control and monitoring mechanisms, such as compliance with governance and compliance rules and what controls the issuer or other entity has over it.

In addition, we note that there are already strict rating criteria in the current framework proposal that act as mitigation and that the version of the SCO60, which is the subject of analysis in this consultation, would require financial institutions to fully document the information used to determine compliance with these rating conditions and to make this documentation available to supervisory authorities upon request, which we believe is an unnecessary additional step.

While we accept that it is not yet appropriate to fully recognize cryptoassets using permissionless blockchains within Group 1, we recommend that the BCBS continues to work with the industry and other stakeholders to explore the possibility.

2) Settlement:

According to SCO60.14, in order to be classified as a Group 1 cryptoasset, the legal system in which the cryptoasset falls must guarantee the purpose of settlement for the primary and secondary markets.

We can mention the case of the EU, which does not provide for such a system, nor is there any indication that it will do so in the near future. Even the FCA/Bank of England proposals (which provide for the use of stablecoins in payment systems) only apply to systemically important stablecoins.

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55 11 32449800
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3) Testing and monitoring:

We note that the BCBS proposes the introduction of certain risk management and due diligence requirements aimed at ensuring that financial institutions adequately assess and monitor the risks of reserve assets.

We emphasize that this analysis, if requested, will have a high compliance cost for the market and it is important to be concerned with the periodicity of the required assessment.

4) Reserve requirements for Group 1b cryptoassets:

The BCBS has proposed additional requirements that must be met for stablecoin reserves to be classified in Group 1b, many of which will ensure that the reserves are highly liquid, have high credit quality and low volatility. However, the current prudential framework maintains that Group 1b cryptoassets are not eligible as High-Quality Liquid Assets (HQLA) (SCO60.108) and are also not eligible as collateral for credit risk mitigation purposes (SCO60.39). In other words, the consultation would not change these restrictions, even if Group 1b cryptoassets were to meet the additional requirements it introduces.

We, therefore, propose that stablecoins that meet the new additional requirements, as well as the existing classification conditions for Group 1b, should be eligible as HQLA, provided they follow the rules for the liquidity framework and also should be eligible for collateral recognition.

It is also important to mention that this treatment will create additional costs for financial institutions and may limit the operations of these players subject to the regulatory framework. Therefore, depending on how the BCBS determines the risk ratings of cryptoassets, there will be a great disincentive for financial institutions to operate in this new market.

5) Removal of insolvency of custodians/deposit takers of reserve assets:

The BCBS's proposed amendments to SCO 60.12(2)(b)(iv) and SCO 60.12(2)(c)(iii) do not appear to allow a bank acting as a custodian of reserve assets to hold any stablecoin cash in deposit, whether actual cash reserves or those resulting from the provision of day-to-day asset custody and management services. This is a major problem that would essentially prohibit banks from acting as custodians of stablecoin assets.

We agree with the BCBS regarding the adoption of requirements that allow reserve assets to be placed/deposited in i) any prudentially regulated bank or ii) banks that demonstrate adequate segregation of assets in the event of credit problems for participants in the stablecoin ecosystem.

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6) **Group 2 exposure limit:**

Consistent with the consultation on financial institutions' exposure to cryptoassets, counterparty credit risk and Credit Valuation Adjustment (CVA) risk are excluded.

It would therefore be important for the BCBS to clarify our understanding that the scope of Group 2's exposure limit will be credit risk and market risk.

7) **Group 2 exposure limit formula:**

Evaluating the formula of this Public Consultation (PC) for defining the limits and RWA of group 2 cryptoassets, we see that the exposure limits are in practice more restrictive and discourage banks from acting as relevant players in this market.

Even though the net positions for cryptos eligible for group 2 are partially taken into account within the established conditions, the RWA obtained by the formula shows a significant increase compared to what we expected. In practice, this means that the 1% limit, when taking into account the institution's actual risk in net positions, is much lower than this percentage and restricts banks' activities in this market.

We believe that banks can play a relevant role in the cryptoasset market by operating as financial intermediaries, providing liquidity to the market and arbitrating long and short positions. However, in these modalities, banks can generally remain neutral in their exposure to the cryptoassets and the gross volumes traded tend to be higher, without representing a significant increase in risk.

In this sense, the excessive conservatism arising from both the maximum netting of 65% and the 1% limit proposed quickly equalizes the treatments of groups 2a and 2b, without any relevant benefits for maintaining neutrality to the volatility risk of cryptoassets. Instead of reducing the risks for the financial system, this encourages the maximization of potential results by maintaining directional positions by banks, especially in 2b cryptos, as well as stimulating the development of the market predominantly in unregulated environments, increasing the risks of shadow banking.

BCBS already takes into account the concern with unmitigated risks in the net position formula for group 2a exposures, since the minimum net exposure possible is 35% of the gross position, which we consider to be extremely conservative. Even if banks always zero out the risk in the asset, they will have sufficient capital allocation to cover any remaining risks, and there will be no need to include additional capital charges, as suggested by the public consultation document.

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In view of the above, we make the following suggestions:

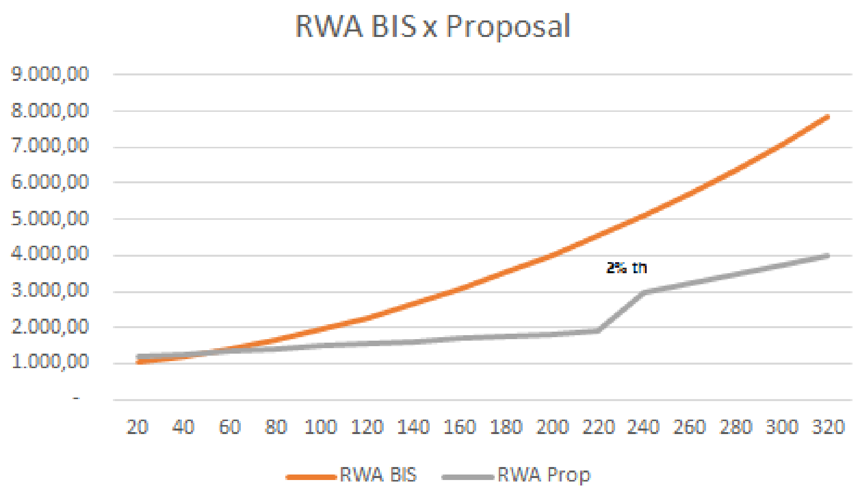
i) Exposure overflows in crypto 2a should be calculated directly by the difference between 1% of tier 1 and the net position, as established in SCO60.61. In this sense, if the exposure in crypto 2b added to crypto 2a exceeds the level of 2% of tier 1, the total exposure should be classified as 2b, considering the maximum between long and short positions in the same cryptoasset.

Example:

In the graph below, we start from the same position as exemplified in the consultative document, keeping the position in crypto 2b at 80, varying the position in crypto 2a and keeping the ratio of long - short = +20, in order to check the effects on RWA (considering RW = 1000% for 2a and 1250% for 2b, as in the document).

Alternatively, we prepared a less conservative approach, considering the limit of group 2a always based on net position, so that the increase in RWA becomes more gradual, with a significant increase only when group 2 exceeds 2%.

In this case, as we can see in the graph, the net position of group 2a will exceed the 1% threshold of tier 1 around point 205 and group 2 will exceed 2% from 220, when we see an increase in RWA in the proposed alternative approach. However, even in this case, the RWA suggested by BIS is much higher than that obtained in the current formula, demonstrating its excessive conservatism.



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Schematically, we would have the following:

$exposi$ção = $\sum net\ Positionk$ + $\sum gross\ Positionimi$ = 1nk =1

Where n is the number of different cryptocurrencies eligible for group 2a, and m is the number of different cryptocurrencies classified within group 2b.

$gross\ Positioni = max(longi, shorti)$

This would be the highest value between the long and short positions in a given cryptocurrency classified in group 2b.

If exposure >2%; RWA = (2a + 2b) * RW2b

If exposure <2%; Group 2 RWA = min(1%tier1; net position 2a)*RW2a*12.5 + (max(0;(net position - 1%tier1)) + 2b) * RW2b

2a = exposures eligible for group 2a

2b = exposures not eligible for group 2

ii) Raise the netting percentage for risk-neutral positions and strategies to 95%, instead of 65%, which is similar to the maximum mitigation provided for derivatives netting in the SA-CCR.

The current formula considers a 65% netting percentage for 100% risk-neutral positions and strategies, i.e. buying and selling the same amount of the same cryptocurrency.

However, we believe that this is a very low and conservative percentage, which leads to a very punitive allocation of capital. This will happen even if our previous proposal is complied with, and will greatly discourage financial institutions from acting as arbitrators and market makers, which would improve price conditions and liquidity in this market.

Given the requirements associated with the hedging recognition criteria, we believe that credit risk is the main risk that could dismantle one of the positions considered within netting, but that this risk is already being treated as an additional allocation. We also emphasize that this criterion already takes into account liquidity issues and, also considering that the cryptocurrency market operates 24/7, we believe that calculating the net position in the manner proposed in the consultation text is extremely conservative and punitive. This certainly restricts the actions of financial institutions in this market, generating liquidity and improving the price by acting with protected positions.

This conservatism would also be reflected in the final price for operations with clients, since institutions will not have much space to operate, which will reduce supply. For this reason, we believe it would be desirable to adjust this percentage to 95%, instead of 65%, which is similar to the maximum mitigation provided for derivatives netting in the SA-CCR.

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55 11 32449800
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8) **Criteria for the framework**

With regard to the framework criteria, we suggest that:

i) The text of the public consultation should focus on the issue of the public price, rather than on the entity in which the cryptoassets or products related to it can be traded.

The criterion set out in SCO60.55(1)A seems to have as its main objective to guarantee that the cryptocurrency has a reliable public price disclosed by a qualified entity, with transparent market data, which can even be by means of indices.

However, the way it is written in SCO60.55(1)A could lead to misinterpretations by the market in the future. It seems to us that cryptocurrencies acquired outside a QCCP environment could not fall into this group, which does not seem a reasonable criterion, since we can trade cryptocurrencies on the OTC market or in non-QCCP trading environments that are liquid and reliable.

In addition, the expression "direct holding" could be interpreted as referring to where the cryptocurrencies are held, which does not seem to be the intention.

ii) Extend the list of products considered in SCO60.55(1)B, C and D

The provisions of **SCO60.55(1)B** seem to establish criteria for where products referencing cryptocurrencies can be traded in order to be eligible for Group 2a.

However, the list provided in this paragraph seems to cover only a few products and we think it would be more appropriate to provide a more generic and less restrictive text.

To this end, we propose:

a) **Change the consultation text from "a derivative or ETF/ETN" to "products with cryptocurrencies as underlying."**

b) **Include in this list products traded on the OTC market, such as derivatives, or products issued for funding purposes, with the condition that the underlying cryptocurrency has a reliable public price, as provided for in the proposal of SCO60.55(1)A.**

c) **Add the following text to the end of SCO60.55(1)B:**

"or sufficient financial resources, risk management frameworks and robust operational capacity to meet obligations, as per the principles generally applicable to CCP participants in the relevant jurisdiction".

as an argument for this addition, we propose the comment below:

"Similarly to a CCP participant, the VASP should be required to identify, measure, monitor, and manage their credit, liquidity, operational, and other relevant risks - with a regulatory stringency consistent to that usually described by CCP protocols in the relevant jurisdiction.

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55 11 32449800
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These protocols generally include the necessity for participants to post initial and variation margin to mitigate credit exposures and to contribute to the default fund designed to cover losses that exceed a defaulting member's collateral on deposit. Although a default fund does not seem appropriate, margin requirements could be imposed on VASPs according to BIS standards - though not by the requirement of a CCP, the margin could be kept in "quasi money" (for instance, in money market funds), deposited with a regulated financial institution at the discretion of the VASP, given its accounts should be subject to periodic external audit"

Finally, with regard to the criteria set out in SCO60.55(1)C and D, it would be important to amend the text and expand the products, just as we proposed above for SCO60.55(1)B.

9) Custody of cryptoassets for third parties

We propose that, for providers of cryptoassets custody services, the cryptoasset of these providers' clients should not be considered as exposures and therefore does not form part of the cryptoassets limits, regardless of the accounting rules (off-balance or included in assets/liabilities) observed by these providers.

The context of this request is to prevent that future changes in accounting rules, which do not have intentions related to prudential treatment, impact custody services by providers who may have to include their clients' cryptoassets positions in their assets and liabilities for accounting reasons, even when the custody providers are not exposed to the risks of their clients' cryptoassets**.**

Once again, we appreciate the opportunity to comment on revisions to the "Cryptoasset Standard Amendments". Should you have any questions on the issues raised in this letter, please contact the undersigned com.gestao.riscos@febraban.org.br.

Very truly yours,

Rubens Sardenberg
Director of Prudential Regulation,
Risk and Economic Affairs

Tatiana Grecco
Director of Risk Management Committee

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Assinaturas

Rubens Sardenberg
rubens.sardenberg@febraban.org.br
Assinou

Tatiana Grecco
tatiana.grecco@itau-unibanco.com.br
Assinou

Tatiana Grecco

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