BBVA response to BCBS Discussion Paper on designing a prudential treatment for crypto-assets

March 13, 2020

BBVA appreciates the opportunity to comment on the Basel Committee on Banking Supervision's (BCBS) discussion paper on designing a prudential treatment for crypto-assets, published on December 12th, 2019. As the crypto-assets market evolves and becomes more relevant, it is important that any regulatory response is built in close collaboration with all stakeholders. We believe that the BCBS' discussion paper represents a useful starting point on which to build a sound and forward-looking response. BBVA is keen to continue supporting the BCBS in this endeavour, and we are looking forward to discussing any of the issues covered in this paper with the authorities.

Question 1

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.

BBVA believes that the three features outlined in the Discussion Paper might be useful in identifying crypto-assets, considering that there is no universally agreed definition of the term. However, we are of the view that falling under the crypto-asset definition as triggered by those three features should not imply the application of a differentiated regulatory treatment versus other assets, nor that all crypto-assets should be regulated equivalently. Instead the prudential treatment of banks' exposures to crypto-assets needs to be based on a careful consideration of the risks associated to each crypto-asset class. In fact, as will be explained later in this document, some crypto-assets can perform the same economic functions and generate analogous risks to existing assets (i.e. securities), and therefore no further discussion of their prudential treatment is needed.

Having said that, BBVA wishes to highlight the importance of ensuring that any regulatory response in response to crypto-assets remains flexible and avoids being excessively prescriptive. This is due to the evolving nature of the crypto-assets markets and the speed by which developments in technology and the market might take place.

Question 2

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?

BBVA believes that any effort to define a prudential treatment for different types of crypto-assets should be underpinned by a careful classification of those assets, and in particular, on the appropriate identification of the risks associated to them. Therefore, any classification should be based primarily on identifying the key features of crypto-assets from this perspective. In that regard, we believe that the initial classification brought forward by the BCBS' Discussion Paper (distinguishing between payment, investment and utility tokens) is a useful starting point, as it is based on the economic function performed by each asset class.

Nevertheless, on top of this initial consideration there are many other features of crypto-assets that will significantly impact their risks, and that need to be captured by the prudential framework. These features could include, among others, the existence of an identifiable issuer, the rights attached to the crypto-assets, the enforceability of those rights or the underlying source of value.

The following example illustrates why the consideration of whether the token serves for payments, investment or utility purposes is not sufficient to build a classification of crypto-assets that serves regulatory purposes. Different types of crypto-assets could be used as a means of payment or exchange, including both the so-called crypto-currencies and stablecoins. Crypto-currencies such as bitcoin do not derive their value from any underlying asset and have no direct, identifiable issuer other than the network itself. Stablecoins, on the other hand, are generally issued by identified entities and their value is typically related to an asset or portfolio of underlying assets. This difference allows to preserve the nominal value of holdings of stablecoin, which is not the case with other cryptocurrencies.

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Question 3

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

While the benefits of crypto-assets are yet to be fully proven, BBVA believes that the underlying technology (DLT) can bring benefits to the financial industry and to consumers. For instance, it could serve to improve current payments infrastructures by potentially increasing resiliency, efficiency, transparency and traceability. Also, it could drive benefits in the form of increased efficiency at various parts of capital markets (from trading to settlement). Generally speaking, the tokenization of the economy might facilitate the access and transfer by investors of different types of assets.

Given these potential benefits, crypto-assets might become essential for the banking sector going forward. Therefore, it is important to avoid imposing a too burdensome framework on banks' exposures to these assets from the beginning, as only by experimenting and engaging with this technology will banks and supervisors be able to learn and eventually leverage DLT to the benefit of the financial system.

Question 4

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

As stated in question 2, BBVA believes that the risk factors listed in the discussion paper are appropriate and relevant in the context of determining the prudential perimeter. In particular, we support the importance of the issues considered around the creation of the crypto-assets. In particular, we believe that it is important to consider whether an asset has an identifiable issuer or not in defining the appropriate prudential treatment (i.e. it is key for assessing credit and counterparty credit risk).

Moreover, the existing legal regime applied to crypto-assets and the providers of associated services, which will probably vary by jurisdiction, is key in determining enforceability and guaranteeing that disputes can be resolved (i.e. it is key for credit, counterparty risk, legal risks, third-party risks, reputational risks…).

Question 5

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?

BBVA supports the general principles outlined by the Basel Committee, and believes that these should guide the prudential treatment of crypto-assets. In particular, we believe that the principle of “same activity, same risk, same treatment” is of the utmost importance and that it should guide any regulatory response to crypto-assets. In this regard, it is important that the prudential framework remains technology-agnostic, so that is also accommodative of any future technology and market developments.

Moreover, we also welcome the principle of simplicity, and particularly the intention to, where possible and appropriate, build the prudential treatment of crypto-assets on the framework that already exists for other asset classes.

Regarding the timing of responses that is proposed, which implies starting with specifying the prudential treatment of those assets deemed “high-risk”, BBVA sees merit in authorities devoting special attention to it because of the potential associated risks of said assets. However, many of these “high-risk” assets remain at an early stage of development and banks’ exposures to them remain of limited size and relevance. Instead, other types of crypto-assets (such as stablecoins like those described in page 13 of the Discussion Paper) might be more capable of reaching a larger, global scale. Given that these crypto-assets show features and risks that differ from those of “high-risk” crypto-assets, they may warrant a different prudential treatment. Therefore, we believe that the prudential treatment of these “lower-risk” crypto-assets needs to be explored in parallel.

Question 6

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?

BBVA is of the view that the channels listed in the discussion paper are reasonable, and cover most of the exposures that could take place. Still, BBVA wishes to note that the risks associated with these exposures would vary depending on the type of crypto-asset involved. For instance, channels such as "underwriting initial coin offerings" could be regarded as underwriting a security when the crypto-asset shows the same economic function as a security. If the ICO involves other types of token, the channel of exposure might be assessed differently.

Moreover, each of these exposure channels should be assessed individually, as financial institutions would have different involvements and face different risks in each of them. Therefore, the classification should not only distinguish between direct and indirect exposures, as such approach could prove to be insufficient to define the appropriate prudential treatment.

Question 8

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?

The identification of risks outlined in the discussion paper is sound and largely complete. Regarding the relative importance of the different risks, we are of the view that nowadays the most material risks faced by the banking sector are the non financial risks (most notably, cyber and technological risks, legal risks, including those related to the compliance with the rules on personal data protection, risks arising from misconduct related to AML/CFT and third-party risks). Non-financial risks could also materialize in the form of regulatory risk, business risk, custodian risk, fiduciary risk or human resources risk. However, it could be expected that financial risks grow should banks' direct exposures to crypto-assets grow.

Regulated financial institutions already manage the types of risks outlined by the BCBS. Therefore, where the risks associated to crypto-asset exposures are similar to those of other activities and products, an equivalent regulatory treatment should be warranted.

Question 9

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?

BBVA believes that the proposed prudential treatment is appropriate for high-risk crypto-assets, and that this would be consistent with the prudential treatment applied to other assets that might generate a similar level of risks.

Nevertheless, the definition of high-risk crypto-assets should be clearly established so as to avoid that this punitive treatment is applied on a general basis to all crypto-assets, regardless the economic function performed and the actual risks involved. In this regard, BBVA believes that the first feature on page 11 of the discussion paper ("digital assets that are recorded on a distributed ledger technology platform and are secured cryptographically") should not on its own trigger the treatment as high-risk, as this would cover all crypto-assets. The other three features defined in page 11 of the discussion paper are appropriate and should be met to identify a particular crypto-asset as high-risk. This should cover, for instance, the crypto-assets such as bitcoin that have traditionally been referred to as cryptocurrencies.

Moreover, other features such as the differentiation of the risks associated with the various activities involving crypto-asset and the extent of direct and indirect exposure to crypto-assets are also important in specifying the scope for any potential treatment (see response to question 6).

Question 10

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

As aforementioned, any effort to clarify the prudential treatment of crypto-assets should avoid being excessively prescriptive, as it needs to be flexible to adapt to future developments in the market or technologies that can be reasonably expected in a field as incipient as is the one of crypto-assets. The supervisory response should therefore accompany the regulatory response, as the latter needs to remain sufficiently flexible and based on principles. In this regard, BBVA wishes to draw attention to the existing availability of supervisory powers to enforce governance and risk management requirements on banks, as well as to mitigate risks identified in the course of supervisory reviews and evaluations related to banks' exposures to crypto-assets. In the European case, the European Banking Authority already acknowledged this in 2019[1]. Therefore, we do not identify a need for supervisory powers to be modified in response to crypto-assets.

Moreover, it should be noted that, as regulation, supervision should also remain consistent with the principle of "same activity, same risk, same treatment". Thus, should banks deal with crypto-assets that are deemed analogous to traditional assets, the prudential treatment should also be analogous, including as regards supervision. Only when it can be proven that in engaging with those crypto-assets there are incremental risks versus the traditional asset should the treatment be subject to differences.

Question 11

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

Disclosure requirements should not follow a one-size-fits-all approach. Therefore, the granularity and timing of the requirements should take into account the risks of the different exposures.

Question 12

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?

As has been already stated alongside this response, BBVA believes that it is crucial that the BCBS ensures a technology-neutral approach in the prudential framework. Therefore, DLT-based solutions should, when possible, be assessed on the basis of the existing prudential framework, even if firms would still evidently need to consider any differential risks. In other

[1] See European Banking Authority Report with advice for the European Commission on crypto-assets. January 2019.

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words, the principle of “same activity, same risk, same treatment” should prevail. With that in mind, BBVA believes that he examples cited in the Discussion Paper (i.e. crypto assets for intra/inter bank settlements and those that use stabilisations tools linked to other assets) warrant a differential prudential treatment than the one outlined for high-risk crypto assets.

The examples described by the BCBS are commonly referred to as asset-backed stablecoins. Still, there is a wide variety of implementations of stablecoins that could become used by banks and end-users, which means that stablecoins could have several possible categorisations and treatments. This could depend on specific features such as their linking to fiat currency, types of underlying assets, stabilisation mechanisms, types and level of collateralization, management of the assets, etc. BBVA encourages authorities to provide a classification and then treatment for stablecoins that is analogous to the classification and treatment of traditional asset types. For instance, stablecoins that are backed by fiat currencies and other very safe and liquid assets (i.e. government securities), could be considered to be some form of regulated payments instrument[2]. Also, as existing rules should be leveraged whenever possible, banks’ exposures to stablecoins, to the extent that they are backed by assets that are eligible as collateral under existing prudential regulatory frameworks, should lead to a capital consumption that reflects the existence of that colateral. When the assets used to back the stablecoin are not eligible as collateral or when the stablecoin is not fully collateralized by such eligible collateral, the treatment could be one of full deduction from CET1 capital (in the latter case, this refers only to the part not collateralized).

Finally, BBVA calls for international cooperation in the development of the regulatory treatment of stablecoins, given their borderless nature and the possibility that they become more widely used in the near future than other types of crypto-assets.

[2] The European Banking Authorities identified cases where payment crypto-assets could qualify as electronic money as defined in the EU Electronic Money Directive (EMD2). This would the case of tokens pegged to a given currency and redeemable at par value at any time. See EBA (2019) Report with advice for the European Commission on crypto-assets.

Question 13

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?

The prudential treatment of crypto-assets that perform the same economic function, and bear economically equivalent risks to traditional asset classes (i.e. as a security or other financial instrument.) should be subject to the same prudential treatment as those assets. This is consistent with the principles of "same activity, same risk, same treatment" and technology-neutrality that are defended by the Basel Committee throughout the discussion paper. The latter should also apply to exposures to those crypto-assets that, not being of a purely financial nature, are a virtual representation of a physical asset (i.e. real estate).

Question 14

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 BCBS should clearly differentiate between exposures to high-risk crypto-assets, which meet the criteria set forth in page 11 of the discussion paper, and other exposures to crypto-assets that either resemble more traditional financial assets/products, for which the prudential treatment is already defined, and/or do not meet the features proposed by the Basel Committee to characterize high-risk crypto-assets. In both of the latter cases the crypto-assets should be subject to a different treatment to the illustrative example.

Question 15

Do you have other suggestions regarding the design of a potential prudential treatment of cryptoassets?

An agile and fit for purpose regulatory framework for crypto-assets should make the financial system safer, but it should also allow institutions to transform the way financial services are provided, bringing benefits to both financial institutions and end users. Therefore, we believe it is important that the BCBS does not assign an overly rigid and punitive prudential treatment to all crypto-assets, as this would render it unnecessarily onerous for banks to provide any crypto-asset related services for end-users.

Therefore, we believe that the prudential treatment should build on the existing framework. Thus, crypto-assets and traditional assets otherwise equivalent in economic function and risks should not be treated differently for prudential regulatory purposes. However, there might still be gaps in regulation that will need to be filled. In doing so, it is essential that the regulatory response ensures an adequate capture of risks while ensuring a level playing field between banks and non-banks.