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BBVA Response to BCBS consultation on prudential treatment of cryptoasset exposures

General Comments

BBVA welcomes the opportunity to provide comments on the consultation paper on the prudential treatment of cryptoasset exposures published by the Basel Committee on Banking Supervision. Aside from responding to the specific questions set forth in the consultation document, BBVA would like to deliver the following general remarks:

- **BBVA supports the efforts by the BCBS to create a global framework for the prudential treatment of banks' exposures to cryptoassets.** Certainty on the prudential treatment of cryptoassets will help financial institutions to take part of this market. Also, it is important that any effort on this front is coordinated at international level to ensure a level playing field across geographies.
- **We support that the Basel Committee is following an iterative process to this endeavour.** We believe it is important to ensure that any regulatory response to cryptoassets at this stage remains flexible and avoids being excessively prescriptive. This is due to the evolving nature of the cryptoassets markets and the speed by which developments in technology and the market might take place, as well as the different states of maturity of regulatory and supervisory frameworks for cryptoassets. In this regard, the Basel Committee should monitor and take into consideration developments taking place in different jurisdictions to avoid mismatches in the classification and regulation of cryptoassets across jurisdictions (e.g. the cryptoassets classification and regulation to be adopted in the European Union under the Markets in Cryptoassets, or MiCA, Regulation).
- **BBVA believes that it is important to develop a framework that ensures a prudent treatment of risks, but also sets the right incentives for banks' involvement in this market. In this regard, the current proposal on the prudential treatment of banks' exposures to cryptoassets seems excessively punitive.**
  Given that the interest in and the use of cryptoassets by consumers and businesses is here to stay, absent action by regulators and policymakers to effectively allow banks to engage in such activities, consumers will increasingly look to non-bank financial service providers for crypto-assets products and services.
  Banks' involvement in the crypto-environment is essential to ensure a secure development of the market, and is beneficial both for the general public and regulators. This is because, while cryptoassets might be new, many of the potential harms to the financial sector that they might bring are not, and banks have a longstanding experience in dealing with the different types of risks. In fact, banks are already subject to comprehensive and robust risk management,

supervision and examination processes, and have long standing expertise in complying with consumer protection and anti-money laundering laws and regulations.
On the other hand, non-bank providers are not necessarily subject to comprehensive and robust risk management requirements, supervision or consumer protection regimes. Therefore, a concentration of crypto-asset activity in this non-regulated environment might undermine efforts to prevent financial instability risks, rather than the opposite.
Providing a carefully calibrated regulatory framework for banks' exposure to cryptoassets would encourage the introduction of related products and services by banks, subject to the highest levels of risk management best practices.
In this regard, we believe that the Basel Committee should ensure harmonization in the treatment of banks' exposures to cryptoassets and that having jurisdictions prohibiting their banks from having any exposures to cryptoassets should not be deemed compliant with the global standard.

- **Finally, we believe that any discussion on the prudential treatment of cryptoassets should follow or be accompanied by the discussion on the accounting treatment of cryptoassets.** The Basel Committee states in the consultation document that the proposed capital treatment would only apply to those cryptoassets that do not qualify for capital deduction (e.g. because they are considered as an intangible asset) following the existing accounting principles.
However, IASB has not yet issued any final ruling on this issue, but rather has so far only issued an Agenda Decision on June 2, 2019, trying to guide how to apply existing rules to the accounting treatment of some kind of cryptocurrencies (i.e. "bitcoin" type). Since the accounting treatment is not clarified, this creates a high level of uncertainty.
Thus, we believe that the accounting treatment of cryptoassets should be included in the work plan of the IASB for the following years. The banking industry is highlighting this in the response to the March 2021 Request for Information Third Agenda Consultation[1].

Q1. What are your views on the Committee's general principles?

BBVA supports the general principles outlined by the Basel Committee, and believes that these should guide the prudential treatment of cryptoassets. 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 cryptoassets.
However, we are concerned that the proposed capital treatment, specially for Group 2 cryptoassets, might be too simplistic and fail to follow the principle of "same activity, same risk,

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[1] In March 2021, the International Accounting Standards Board (Board) published the Request for Information Third Agenda Consultation. The Board is asking for stakeholder comments by 27 September 2021. Responses to this Request for Information will help shape the Board's thinking when determining how to prioritise its activities and what new projects to add to its work plan for 2022 to 2026. In this regard, **several discussions are currently taking place in the Accounting Working Groups of the different banking industry associations BBVA belongs to (ie. IIF, AFME) in order to promote the inclusion of the accounting of cryptocurrencies in the workplan of the IASB for the following years.**

same treatment". This is because, following the proposed classification conditions, Group 2 would encompass a wide range of cryptoassets with potentially very different risk profiles, which would all be subject to the same capital treatment. Thus, while the principle of simplicity is important for a global framework, a more granular methodology that further differentiates the different types of cryptoassets would provide a better balance.

Q2. What are your views on the Committee's approach to classify cryptoassets through a set of classification conditions? Do you think these conditions and the resulting categories of cryptoassets (Group 1a, 1b and 2) are appropriate? Which existing cryptoassets would likely meet the Group 1 classification conditions?

While we are supportive of the Committee's overall approach to classify cryptoassets on the basis of several conditions, we believe that the latter could be improved through further differentiation.

In fact, we are concerned that conditions for recognition as Group 1 are too restrictive, and that in practice it would be difficult that existing cryptoassets would satisfy the conditions to qualify as group 1, and specially as group 1b.

- In particular the classification condition 1 for group 1b is expected to pose a considerable challenge, because it requires that the stabilisation mechanism guarantees that the difference in value of the cryptoasset vs that of its underlying traditional asset does not exceed 10bp more than 3 times over a one-year period, and requires banks to monitor this daily.
- Regarding condition 3 and 4, those would not be met by any cryptoasset building on a permissionless network.

As a result of this, we fear that the proposed classification conditions, and in particular condition 1, would result in a cliff-effect, so that cryptoassets that do not meet one of the conditions for group 1a and 1b would fall under group 2, which is likely to be a very diverse group of cryptoassets, would then be subject to a very restrictive treatment due to the 1250% risk weight. This might lead to situations in which two crypto-assets that are very similar, but that differ in one particular feature relevant for the classification conditions, would be subject to very different prudential treatment.

Finally, cryptoassets present a wide range of financial, functional, technical and other characteristics. As a result, they can be subject to overlapping and at times conflicting regulatory categorizations, which might result in differing compliance obligations before different authorities in different jurisdictions. Therefore, we believe that efforts to classify cryptoassets by the BCBS should take into account existing approaches in different jurisdictions (e.g. in the EU's Regulation on Markets in crypto-assets), and strive to ensure consistency among borders and regulatory frameworks.

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Q3. What are your views on the classification conditions? Are there any elements of these conditions that should be added, clarified or removed in order to:

− ensure full transferability, settlement finality, and/or redeemability;

− limit regulatory arbitrage, cliff effects and market fragmentation; and

− take account of new and emerging cryptoassets?

Q4. For the first classification condition, is there an alternative methodology to assess the effectiveness of the stabilisation mechanism of Group 1b cryptoassets? Would this proposed methodology be consistent with ensuring the effectiveness of the stabilisation mechanism while also being practical?

Q5. For the third classification condition, (i) would risk governance and risk control practices for Group 1 and Group 2 cryptoassets differ; and (ii) are there alternatives to the required risk governance and risk control practices that would ensure that material risks of the network are sufficiently mitigated and managed?

Q6. For the fourth classification condition, (i) to what extent would the regulation and supervision of entities that execute redemptions, transfers, or settlement finality of the cryptoasset reduce risk in cryptoasset exposures held by banks; (ii) which entities should/ should not be in scope of regulation or supervision? For instance, are there entities involved in the transfer and settlement systems of cryptoassets (such as nodes, operators and/or validators) that should be excluded from the condition of required regulation and supervision?

Q7. Do you consider the responsibilities of banks and supervisors to be clear and appropriate? Are there any other responsibilities for banks or supervisors that the Committee should consider?

As for the responsibilities of banks and supervisors regarding the classification of cryptoassets, **we believe it might be reasonable to ask for authorities to define a unified criteria for the classification of widely used and accepted cryptoassets.** This would avoid an excessive burden on banks and supervisors, as would guarantee consistency across jurisdictions.

Also, regulators need to remain aware that any classification effort will likely not be useful or accurate in all circumstances, given the wide variety of cryptoassets that exist today and the rapidly evolving nature of the market. Therefore, it should be accepted that, where banks find that the classification conditions are not fit for the categorization of a given cryptoasset, they might seek approval from supervisors for the classification of such cryptoasset as Group 1, on the basis of reasoned arguments.

An alternative would be to provide a mechanism that grants that banks are not required to seek approval for Group 1 status on assets that have been otherwise approved for other banks within a given jurisdiction. Bank supervisors or financial authorities should maintain a public record/list of approved Group 1 cryptoassets.

Q8. Are there ways in which the increased operational risk relating to cryptoassets (relative to traditional assets) can be measured? How should a pillar 1 add-on be designed to capture additional operational risks arising from exposures to cryptoassets?

Measuring the operational risk in cryptoassets activities is likely to be a challenging task. On the one hand, the future general framework for operational risk relies both on a measure of the bank's income and also on the past operational risk losses. Given that cryptoasset activities are fairly new, it is possible that neither of those measures will capture the risk in these activities (because they do not generate an income at the beginning and/or because we do not have big operational events related to cryptoassets activities yet). Therefore, we understand the rationale behind the Committee's proposal of introducing a pillar 1 add-on to capture operational risks.

Nevertheless, designing a very detailed and complex target methodology to cover for the operational risk of these assets separately from the general operational risk requirements at this stage could be difficult, given the novelty of these markets, and would add an undesired complexity to the framework which is not justified by the size of the activity in bank's balance sheets. Therefore, should the Committee opt for the introduction of such an add-on, we would favor a simple approach that ensures certainty for banks. This might rest on a metric based on the volume of crypto-assets exposures, rather than income generated or past operational losses, as justified from our comments in the previous paragraph. Moreover, whenever the supervisor believes that pillar 1 is not sufficiently covering the risk, they would still have the pillar 2 tool to tackle this and impose additional capital charges.

In addition, we believe that any operational treatment adopted should also cover indirect exposures to group 2 cryptoassets, as these could also give raise to operational risks.

Moreover, we should take into account that it is more than possible that banks will cover potential operational risks arising from cryptoasset activities through insurance policies, which should be taken into account when measuring this risk.

Q9. Are there further aspects of the credit risk and market risk requirements that could benefit from additional guidance on how they should apply to Group 1a cryptoassets?

The treatment of Group 1a assets would largely follow the principle "same activity, same risk, same treatment", and thus, **we largely support the capital treatment proposed for cryptoassets under Group 1a**, although it is not yet clear which assets would satisfy the classification conditions to fit in this group (as explained before) and which are the risks that could be differential relative to the traditional assets, and what treatment would that differences trigger.

Q10. Do you have any views on the Committee's current thinking on the capital requirements for Group 1b cryptoassets?

The treatment of Group 1b assets would largely follow the principle "same activity, same risk, same treatment", and thus, **we largely support the capital treatment proposed for cryptoassets under Group 1b**, although it is not yet clear which assets would satisfy the classification conditions to fit in this group (as explained before).

Having said that, illustrative example 1 suggests that, to account for the **counterparty credit risk associated with the redeemer**, the RWAs for credit and market risk would include the value of the stablecoin exposure multiplied by the risk weight applicable to an unsecured loan to the redeemer. However, we are of the view that such risk **could be considered as a secured exposure to the redeemer as, in fact, the underlying asset can be seen as a guarantee.**

Q11. What further aspects of the credit risk and market risk requirements could benefit from additional guidance on how they should apply to Group 1b cryptoassets?

Q12. Do you think the proposed capital treatment of Group 2 cryptoassets, including the application of a 1250% risk weight instead of deducting the asset from capital (for the reasons explained above), appropriately reflects the unique risks inherent in these assets?

First, **we are concerned that this punitive treatment would be applied equally to all group 2 cryptoassets, regardless of their actual risks.** As mentioned above, we consider that Group 2 would encompass too many different assets, which have quite different risks. A 1250% risk weight or a deduction from capital would suggest that these assets do not have a verifiable market price or that the value of the asset cannot be realised in the event of stress of the institution holding it. This is at least the logic that applies to other assets that receive this treatment today (e.g. positions in funds where the entity can not determine the composition of the fund and thus can't RW according to that composition). However, we believe that this is not the case for all cryptoassets falling under Group 2. Among the latter, there would be cryptoassets for which there is public data to verify their market value, and the holding of these cryptoassets would presumably have value in case of stress of the institution.

Therefore, while we understand that in certain cases the regulatory framework foresees the possibility to introduce a 1250% RW for certain exposures, we believe that in the proposed approach the group 2 category would also encompass exposures which would deserve a lower risk weight, for example utility tokens. Further differentiation between the different exposures and a higher granularity of the categorisation (including appropriately calibrated risk weights) would be important in this respect.

Second, the Basel Committee proposes a 1250% risk weight for all Group 2 cryptoassets, rather than a capital deduction, and states that this would in practice ensure that banks are required to hold risk-based capital equal in value to their Group 2 cryptoasset exposures. **We are afraid that, in practice, this capital treatment could be even more conservative/penalizing than the deduction.** This is because many banking organisations are effectively subject to capital requirements in excess of the 8% minimum risk-based capital requirement (as a result of buffer requirements, Pillar 2 requirements and additional buffers held as a prudential management buffer). Therefore, the 1250% risk weight would in practice mean that banks need to hold risk-based capital in excess of the exposure to the cryptoasset. For example, for a bank managing a 12% total risk based capital ratio, a 1250% risk weight would translate to a $150 total capital requirement for a $100 gross exposure to Group 2 cryptoassets. Therefore, **we suggest that banks are given the option to decide whether they prefer to apply the 1250% risk weight or deduct from capital**, as it is currently the case with other assets that receive the same treatment**.**

Q13. Are there alternative approaches that the Committee should consider that are simple, conservative and easy to implement? For exposures in the trading book, would it be appropriate to permit recognition of hedging via the application of a modified version of the standardised approach to market risk?

In the context of Group 2 cryptoassets, the consultation states that “cryptoasset exposures would not be part of any hedging set” for the purpose of calculating the Potential Future Exposure (PFE), while for calculating the Replacement Cost (RC), netting will not be allowed between different cryptoassets. We believe this is too restrictive.

For positions on the same cryptoasset, the hedging should be recognised; the risk weight should apply to the net position, not to the maximum between the net absolute long and short position. This will be more aligned to the risk of the exposure to the cryptoasset.

The risk of non-delivery of one leg of the transactions should be covered by the counterparty credit risk. For the calculation of the PFE, hedging of positions on the same cryptoasset in the netting set should also be recognised.

For non-linear positions in the trading book, the exposure amount should be based on the delta, vega and curvature metrics, not on the gross notional amount.

Also, it is not totally clear whether this applies only to Group 2 or to all cryptoassets, and should be clarified

Q14. Do you have any views on the Committee's current thinking regarding the leverage ratio, large exposures framework and liquidity ratio requirements? Are there further aspects of these requirements that could benefit from additional guidance?

Q15. Do you have any views on the responsibilities of banks? Are there any other responsibilities or aspects that should be covered by banks for the purposes of the supervisory review?

Q16. Do you have any views on the responsibilities of supervisors? Are there any other responses that could be considered by supervisors when conducting supervisory review?

Q17. Do you have any views on the adjustments to minimum Pillar 1 capital requirements to capture additional credit and/or market risk? Are there any other potential modifications that supervisors may need to consider?

Q18. Do you have any views on the potential design of disclosure requirements?