Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2
CH-4002
Basel
Switzerland

21 September 2022

Re: Binance response to the second consultation on the prudential treatment of cryptoasset exposures

Dear Sir/Madam,

Binance welcomes the Basel Committee's work **to develop a robust prudential framework for bank exposures to cryptoassets.** Our detailed response are attached, we would however like to highlight the following key points:

The most effective tool for regulators to meet their statutory objectives is to provide a clear regulatory framework for cryptoassets built on global principles that foster a safe, secure and sustainable cryptoasset ecosystem.

Binance supports **a number of significant** clarifications and **amendments** introduced in the Second Consultation, in particular:

- **Modification of stablecoin** treatment to prevent a cliff effect by introducing the second threshold set at 20 basis points more than 10 times over a given year for the basis test; and

- **Recognition of hedging** for certain Group 2 cryptoassets with an introduction of a new category of assets that meet certain hedge recognition criteria (Group 2a) with modified versions of standardised capital models for calculating capital requirements (instead of 1250% RW).

- To protect users we **agree with the proposed redemption test alongside the amendments to classify conditionality** that ensures that reserve assets must be sufficient to enable the stablecoin to be redeemable at all times.

Overall, the BCBS proposals impose **very conservative prudential treatment** for banks holding of cryptoassets.

After undertaking detailed analysis on the proposals we conclude that:

- As the proposals are currently drafted, it is highly unlikely that any cryptoassets based on **permissionless blockchains** will be able to meet the classification conditions to be included in Group 1. This includes almost all global stablecoins such as USDT, USDC, BUSD (issued in permissionless blockchains such as Ethereum, BNB chain, and Tron). BCBS views on permissionless blockchain networks appear to stem from a

misconception about the operation and risks posed by such networks related to KYC and AML. However, **decentralisation of permissionless blockchains** makes it a more secure system that **is less prone to traditional hacking vulnerabilities** as compared to permissioned blockchain. The more nodes there are on a blockchain, the more difficult it is for bad actors to collude (please refer to **Appendix IV**);

- The most popular global stablecoins (USDT, USTC, BUSD) all narrowly pass the **conservative criteria for the basis risk test** (please refer to **Appendix II**);

- **All the top-20 cryptoassets** (by **market cap/volumes)** except for one stablecoin do **not pass classification criteria,** as specified in para 60.8-60.24. Therefore, they would be included in Group 2b and assigned a risk-weighted of 1250% (please refer to **Appendix III**);

- The very punitive **risk weight of 1250% for Group 2b** cryptoassets requiring lenders to hold $1 in capital for each $1 of cryptoassets. **A new Group 2 exposure limit** would cap a bank's total exposures to Group 2 cryptoassets at **1% of Tier 1 capital.** This would constitute **a significant constraint** on the extent to which banks can participate in markets for cryptoassets and leading many to conclude participation would not be financially feasible (please refer to **Annex I**); and

- In relation to the **Infrastructure risk add-on** (for cryptoassets from Group 1b and 2b). The proposed calibration of the add-on **is 2.5% of the exposure value appears excessive** and might overlap with the operational risk capital charge (please refer to **Annex I)**.

Please do not hesitate to contact us if you have any questions about our response or require any further information.

Yours faithfully,

Binance

Annex I: Binance Feedback on eligibility criteria of cryptoassets/stablecoin and capital treatment:

Group of cryproassets	Subgroup	Types of assets	Proposed Treatment	Binance concerns
Group 1 (Meets classification conditions)	Group 1a	Tokenized traditional assets	Capital treatment based on Basel framework as traditional assets + add-on for infrastructure risk	The proposed regulation requires the **add-on of 2.5%** of the exposure value to cover **infrastructure risk**. The consultation does not explain the rationale behind the calibration of this add-on. Furthermore, this add-on is added to the operational risk capital charge under the Basel III Standardized Approach making it duplicative meaning that **2.5% of the exposure value will likely result in an overall excessive capital requirement**. It would be more appropriately captured under operational risk which banks are well versed within their ordinary course of business when engaging with new technology and infrastructure.
	Group 1b	Stablecoins	Capital treatment based on Basel framework as traditional assets + add-on on infrastructure risks + add-on for stablecoins which only narrowly pass the basis risks test	For a stablecoin to be included in Group 1b, it has to pass two tests: the redemption risk and basis risk tests. As far as the **redemption risk test** is concerned, we calculate that BUSD is the only global stablecoin which fully passes the redemption requirement (please refer to **Appendix I**) **As for the basis risk test**, our analysis covering the most popular global stablecoins (USDT, USTC, BUSD) indicates that these stablecoins narrowly pass this test (please refer to **Appendix II**). Therefore, we would recommend the Basel Committee to disclose the details of the calibration and **to relax the pass/fail thresholds in the basis risk test**. Given the crucial importance of the basis risk test for classifying cryptoassets into Group 1a or 1b, respectively, performing this test at the level of an individual institutions might lead to calculation errors and manipulations. **A unified centralized calculation** of the test statistics carried out by a trusted third party or the supervisory body on a regular basis would ensure consistency. This approach would be fully in line with the modern **RegTech trends**. According to footnote 14 to para 60.14, **only the "downside" instances** when the market value of a cryptoasset falls below the peg value are counted as "breaches" for the test statistics. This deviates from a classical definition of the basis risk used in financial risk management and based on the absolute value of deviations of the prices both up and down. We would like clarity on whether the Basel Committee is only concerned about the cases when a cryptoasset is priced below its peg value? Our concern is that in case of **short position**, "upside" instances over the peg value might result in **negative P&L bottom** line result.

				The proposed capital treatment of Group 1b cryptoassets that fail to pass the basis risk test as compared to narrowly passing the basis risk test (as per para 60.15) **creates a cliff effect,** since they will automatically fall to Group 2b with RW of 1250%**.** The minimisation of these effects would provide for a smoother capital adequacy requirement trajectory, for example, by means of including **one more sub-group** for cryptoassets that failed to pass the basis risk test, but still merits a lighter capital treatment compared to 100% coverage with own funds.
Group 2 (does not meet classification conditions + unbacked cryptoassets)	Group 2a	Meets hedge recognition criteria[1]	Adapted market risk rules with netting and 100% capital charge + Group 2 exposure limits	1. **The calculation of the capital charge.** The proposed **netting rule** appears to be too conservative: *Net position(k)= max(Long position(k)|Short position(k)|) – 0.65 * min(Long position(k),|Short position(k)|)* The logic behind the proposal of trying to calculate the net position taking into account the basis risk by using an assumed correlation of 65%, does not seem justified or self-evident. Therefore, long and short positions **should be fully offset**, so that only **the unhedged position** (i. e. the difference between the long and short positions) is weighted by 1250%. **The covered position** (i. e. the minimum of the two positions measured by their absolute values) is to attract a capital charge lower than 1250% (for example, **625%**, which is currently used for certain types of assets, such as project finance in default in the IRB approach). This would not result in 100% capital charge. 2. **Hedging recognition criteria**: It may be hard to meet the requirement proposed in SCO60.60 2(b) for some liquid stablecoins in light of the EU plans to limit the daily trading volume at EUR 200m currently proposed under the MICA regulation.

[1] SCO 60.60 Group 2 cryptoassets that are assessed to meet all three of the following hedging recognition criteria, will be classified as Group 2a:
(1) The bank's cryptoasset exposure is one of the following: (a) A direct holding of a spot Group 2 cryptoasset where there exists a derivative or exchange-traded fund(ETF)/exchange-traded note (ETN) that is traded on a regulated exchange that solely references the cryptoasset. (b) A cash-settled derivative or ETF/ETN that references a Group 2 cryptoasset, where the derivative or ETF/ETN has been explicitly approved by a jurisdiction's markets regulators for trading or the derivative is cleared by a qualifying central counterparty (QCCP). (c) A cash-settled derivative or ETF/ETN that references a derivative or ETF/ETN that meets criterion (b) above. (d) A cash-settled derivative or ETF/ETN that references a cryptoasset-related reference rate published by a regulated exchange.
(2) The bank's cryptoasset exposure, or the cryptoasset referenced by the derivative or ETF/ETN, is highly liquid. Specifically, both of the following must apply: (a) The average market capitalisation is at least USD10 billion over the previous year. (b) The 10% trimmed mean of daily trading volume with major fiat currencies is at least USD50 million over the previous year. (3) Sufficient data is available over the previous year.
(a) There are at least 100 price observations over the previous year. The price observations must be "real" as defined in the four criteria of [MAR31.12]. (b) Sufficient data on trading volumes and market capitalisation.

	Group 2b	Does not meet hedge recognition criteria	1250% RWA to the greater of the absolute value of the aggregate long positions and the absolute value of the aggregate short positions in the cryptoasset + Group 2 exposure limit	As the proposals stand, lenders would be required to hold **$1 in capital for each $1 of cryptoassets classified as Group 2b** (**RW equal to 1250%**, i.e. full coverage with capital)**.** We do not support the use of a risk weight of 1250% for all cryptoassets in Group 2b, the highest risk weight possible under the Basel Accord which is applied only to the riskiest assets, for example, a bank's significant investments in non-financial business. At the same time, a new group-two exposure limit would cap a bank's total exposures at **1% of Tier1 capital,** applied at the aggregate level, without permitting the benefit of netting exposures. There should be more trust in BCBS own proposed tests and the availability of banks to use capital to cover their risks. This would constitute a significant constraint on the extent to which banks can participate in unbacked cryptoasset markets and may lead them to conclude the capital charge is too punitive to participate. It is not clear **why holding of assets should be restricted if they are de-facto fully capitalised** (set aside from the balance sheet)? Moreover, we have performed analysis of **top-20 market cap/volumes in cryptoassets** which shows that **ALL of top-20** (except for one stablecoin) do **not pass classification criteria** stated at para 60.8-60.24, and hence are to be included to Group 2b and risk-weighted by 1250% (refer to **Appendix III**). As shown in Appendix III, most actively traded cryptocurrencies will fail to pass the redemption test and/or the basis risk test and thus be relegated to Group 2b. This **would entail a high concentration of cryptoassets in a single Grade** of the proposed classification. To overcome this **we would suggest breaking up this group into two subgroups** to account for the wide variation in the financial quality of traded cryptoassets. The specific boundary criteria for the two groups need to be elaborated and tested. Such a tight limit may drive cryptoassets to **Non-Banking Financial Intermediaries (NBFIs)**. It is important to understand that there is a significant consumer demand for cryptoassets in a growing number of jurisdictions. Therefore, some banks want to potentially provide those services to their customers. Moreover, some banks have observed their deposits flowing to non-bank cryptoasset firms and, understandably, would like to stem that outflow by offering the services themselves, which will not be possible with a 1% cap. Moreover, for smaller banks wanting to specialize in cryptoassets, which might be able to develop bespoke solutions with a better customer value proposition with appropriate risk management procedures, it will likely be uneconomic to offer solutions covering cryptoassets.

				Therefore, we do believe that **the objective of the Basel Committee to legitimise bank's holdings** in cryptoassets and to regulate them **might not be achieved**, since *de facto* **banks will not be able to invest in cryptoassets in any meaningful way**. **We propose to significantly reconsider** the current capital requirement approach and: - **To raise 1% of Tier 1 limit.** However, if the Basel Committee still worries about this issue, it can be limited to the maximum of the two ceilings, for example, 100% from Tier 1 capital but not more than USD 100 bln; - Cryptoasset markets continue to mature and it would make sense to **formally consider that both the Tier 1 limits and the ceilings will be subject to review a couple of years after BCBS Members implement the proposals;** - **To reconsider** applying a **lower coefficient of 625%, instead of 1250%;** and - **To divide Group 2b into two subgroup**s to account for the wide variation in the financial quality of traded cryptoassets.

Note: for the groups above other regulatory rules and restrictions also apply: operational risk capital charge, liquidity ratio, leverage ratio, large exposure, supervisory review and disclosure requirements.

B: Binance Feedback on permissionless blockchain:

Binance feedback on permissionless blockchain, including proposals on modifications to the classification conditions that would be required to permit the inclusion of cryptoassets that use permissionless blockchains in Group 1; the risk such modifications would raise; and ways to mitigate such risks are presented in Appendix IV.

C: Binance Feedback on requirements on banks' holding of cryptoasset:

The Bank will need to **determine, monitor, and assess compliance** with the eligibility criteria and classification conditions, verify that stablecoins effectively track the underlying asset, and demonstrate to supervisors how a cryptoasset fulfills these conditions.

Tthe industry will benefit from, at least, a **partial centralisation** of assessment and monitoring compliance with classification requirements, such as the redemption and basis risk tests. This could be done by the **national supervisory authorities** or **trusted third party with** the support of the industry, which would be a good case of implementation of RegTech.

Appendix IV:
Binance feedback on permissionless blockchains treatment as requested by BCBS

The Committee comments that cryptoassets underpinned by permissionless blockchains would, under current specification, be highly unlikely to fit the criteria set out in Group 1. It is seeking feedback in relation to possible amendments to the classification conditions that would be required to permit the inclusion in Group 1 of cryptoassets that use permissionless blockchains. The Committee would welcome feedback on:
(1) what modifications to the classification conditions would be required to permit the inclusion in Group 1 of cryptoassets that use permissionless blockchains;
(2) the risk such modifications would raise; and
(3) ways to mitigate such risks.

Overall, we want to state that **permissionless blockchains tend to be more secure than permissioned blockchains**, because there are many nodes to validate transactions, and it would be difficult for bad actors to collude on the network. However, permissionless blockchains also tend to have long transaction processing times due to the large number of nodes and the large size of the transactions. T**he decentralization of permissionless blockchains** makes it a more secure system that **is less prone to traditional hacking vulnerabilities** as compared to permissioned blockchain. The more nodes there are on a blockchain, the more difficult it is for bad actors to collude.

We have also addressed the key BCBS concerns on permissionless blockchains treatment, which are summarized at the tables below:

Classification condition as stated at BCBS	**Binance concerns**	**Modifications required**	**Any risks related to such modification**	**Risk mitigation**
60.21 Classification 3: The functions of the cryptoasset and the network on which it operates, including the distributed ledger or similar technology on which it is based, are designed and operated to sufficiently mitigate and manage any material risks				
60.22 To meet classification condition 3 the following requirements must be met:				
(1) The “sufficient” condition would be satisfied if the functions of the cryptoasset, such as **issuance**, **validation**, **redemption** and **transfer** of the cryptoassets, and the network on which it runs do not	BUSD approved by the New York State Department of Financial Services (NYDFS), issued on Ethereum in	No modification required	n/a	n/a

pose any material risks that could impair the **transferability**, **settlement finality** or **redeemability** of the cryptoasset.	partnership with Paxos and are always purchased and redeemed at 1 BUSD for 1 US dollar. There is a possibility to purchase and redeem the stablecoin assets (among all available stablecoins at the moment) at all the times, because: (1) Trading is available 24/7 (and even in conditions of high market volatility) - so that our users can exchange their assets for stablecoins and vice versa. (2) Here is the guide on how users can purchase and redeem BUSD			
To this end, entities performing activities associated with these functions* must follow robust risk governance and risk control policies and practices to address risks including, but not limited to: credit, market and liquidity risks; operational risk (including outsourcing, fraud and cyber risk) and risk of loss of data; and various non-financial risks, such as data integrity; operational resilience (ie operational reliability and capacity); third party risk management; and AntiMoney Laundering/Countering the Financing of Terrorism (AML/CFT).	BUSD is regulated by NYDFS and has the mentioned risk policies and operating procedures in place. However, it may be worth noting that Paxos does not offer credit facilities via its trust company and the reserves are mandated to be placed in cash or cash equivalents. The credit risk involved is of counterparty and sovereign credit risk, which is deemed miniscule. Custody banks are insured by FDIC and private insurance is also secured for amounts exceeding the insured quantum.	No modification required	n/a	n/a
(2) Networks that fulfill this condition would be those where the key aspects are well-defined such that all transactions and participants are traceable. Key aspects include: (i) the operational structure (ie whether there is one or multiple entities that perform core function(s) of the network);	BNB Smart Chain has 21 validators. BNB Beacon Chain has 11 validators. The validator election is decided by chain governance exercised by the existing validators. The validator election is decided by BNB staking logic and refreshed every 24 hours. Anyone can apply to become a validator of BNB Beacon Chain and BNB Smart Chain, and	No modification required	n/a	n/a

(ii) degree of access (ie whether the network is restricted or unrestricted); (iii) technical roles of the nodes (ie whether there is a differential role and responsibility among nodes); and (iv) the validation and consensus mechanism of the network (ie whether validation of a transaction is conducted with single or multiple entities).	get elected after getting enough community support.			
Classification condition 4 **60.23 Classification condition 4:** Entities that execute redemptions, transfers, storage or settlement finality of the cryptoasset, or manage or invest reserve assets, are regulated and supervised, or subject to appropriate risk management standards.	Cryptoassets may be traded on decentralized, unregulated exchanges (i.e., DEX), in addition to centralized exchanges for which regulations are being developed and which may have in place appropriate risk management. The fact that entities other than centralized, regulated exchanges may execute certain of these functions does not affect the risk associated with a particular cryptoasset.(Centralized SE and DEX)	To be removed	**n/a**	We do believe that iis not risk if remove this classification because the fact that entities other than centralized, regulated exchanges may execute certain of these functions does not affect the risk associated with a particular cryptoasset.
60.24 Entities subject to condition 4 include operators of the transfer and settlement systems for the cryptoasset, wallet providers, administrators of the cryptoasset stabilisation mechanism and custodians of any underlying assets supporting the stabilisation mechanism. Node validators may be subject to appropriate risk management standards as an alternative to being regulated and supervised.	General statement, no modification is required	No modification required	n/a	n/a
60.130 Risks that banks should consider in their risk management of cryptoassets activities include, but are not limited to, the following: Validating design of the DLT, permissionless or permissioned: Cryptoassets may rely on a public ('permissionless') ledger, whereby the validation of transactions can be done by any participating agent, or distributed among several agents or intermediaries, which could be unknown to the users. In contrast, a private ('permissioned') ledger restricts	The key issue is not whether the identity of the validating entities is known to the users but rather the security of the blockchain on which the validation takes place. P**ermissionless blockchains tend to be more secure than permissioned blockchains, because there are many nodes to validate transactions, and it would be difficult for bad actors to collude on the network. Thus, the distinction drawn between**	We propose not to concentrate so much risk management efforts on contrasting permissioned vs permissionless blockchains	n/a	n/a

and pre-defines the scope of validators, with the validating entities known to the users. On a permissionless ledger, there may be less control of technology and on a permissioned ledger there may be a small group of validators with greater control. Risks related to the validating design of the DLT include the accuracy of the transaction records, settlement failure, security vulnerabilities, privacy/confidentiality, and the speed and cost of transaction processing.	**permissioned and permissionless ledgers does not address the security of the blockchain itself. The individual risks/factors (**accuracy of the transaction records, settlement failure, security vulnerabilities, privacy/confidentiality, and the speed and cost of transaction processing) are more important than whether the ledger is permissioned or permissionless.			

**Examples of these entities include but are not limited to: issuers, operators of the transfer and settlement systems for the cryptoasset; administrators of the cryptoasset stabilisation mechanism and custodians of any underlying assets supporting the stabilisation mechan*ism.