Bank of International Settlements/Basel Committee
Centralbahnplatz 2
4051 Basel, Switzerland

SUBMITTED via www.bis.org

September 30, 2022

Response to the Consultative Document "Second consultation on the prudential treatment of crypto exposures"

Dear Sir, Madam,

D2X Group N.V. (D2X) welcomes the opportunity to comment on the Basel Committee Consultative Document "Second consultation on the prudential treatment of crypto exposures" dated June 2022.

D2X is a Dutch fintech start-up that intends to operate a regulated trading venue (multilateral trading facility) to facilitate the trading of cash settled digital assets derivatives by financial institutions in Europe.

We aim at proving a robust and reliable infrastructure and to bring financial innovation into an existing regulatory framework (in our case MiFID II). D2X strongly believes that crypto assets should be a fully regulated asset class.

We therefore highly appreciate the effort of the Basel Committee to design prudential standards for this asset class.

Nonetheless, it is of crucial importance to strike the correct balance between covering prudential risks and capturing institutions and/or the crypto market in the regulated sphere. If the prudential standards are too stringent this will have the adverse effect of (re)directing the crypto market to jurisdictions where Basel standards are not applied or embedded in national legislation.

Such would undermine regulatory efforts to bring crypto markets into the regulated space, such as MiCA in order to avoid risks (e.g. money laundering, market abuse) related to trading in unregulated jurisdictions and on unregulated platforms.

Instead, the prudential standards for crypto exposures should function as a strong regulatory step towards a fully regulated crypto asset class.

We believe the following issues should be addressed in any renewed or final proposal by the Basel Committee:

1. Group 2a Crypto exposures

- D2X welcomes the introduction of **Group 2a crypto assets** to which hedging recognition is given. Group 2a crypto assets should **include** crypto assets where a derivative exists that is traded on a **regulated trading venue** subject to a **liquidity threshold**. We believe that Group 2a provides an opportunity to distinguish between unregulated platforms and regulated trading venues that apply risk mitigation controls.
- In line with the current Basel Framework the possibility to net amongst Group 2a crypto assets should be based on **enforceable netting arrangements** of the **regulated trading venue.**
- We would like to point out that the proposed wording of SCO 60.65 and SCO 60.74 leaves **uncertainty** as to whether or not a bank acting as **a (prime) broker could net its** position with its client (**client leg**) **and** the corresponding position between the bank and the trading venue (**trading venue leg**). We believe that both these positions should be treated as a **position in the same market** (regulated trading venue) entailing that they can be considered as being part of the same netting set for calculation purposes of the net position. Without the above approach, a bank will have to apply a capital requirement charge to both legs whilst effectively such positions have no market risk.
- For **mature and well-established crypto assets** such as Bitcoin and Ether, that are traded on **liquid and regulated trading venues** which have governance controls in place, we consider the proposed application of a **1250% risk weight** (being equal to a 100% capital charge) to be disproportionate to the underlying risk. All crypto assets which **comply** with the requirements of **Group 2a are by definition highly liquid**, given the minimum requirements for this group: minimum market cap of USD 10 billion and minimum 10% trimmed trading volume over the previous year of USD 50 million. The requirement of availability of sufficient data over the previous year further adds to this fact. **The risk weight** for these crypto assets **should be aligned with current Basel Framework risk weights** for assets with an equivalent level of market risk. As an example: both in terms of price transparency and market liquidity, Group 2a crypto assets are far superior to speculative “equity investments in unlisted companies”. Nevertheless, **the final Basel III framework specifies a risk weight of 400% for these speculative, unlisted equities whereas** the proposed risk weight for Group 2a **crypto assets is 1250%.**

2. Group 2 exposure limit

- We urge the Basel Committee to **re-assess/withdraw** the proposed **Group 2 exposure limit of 1%** of the own funds.
- The calculation of the exposure limit **without taking account of offsetting and/or net positions is punitive and not proportionate** to, or reflective of, risk. In particular, it effectively precludes intermediaries acting as riskless principles between offsetting long and short positions.
- Unlike for the calculation of market risk and counter party credit risk **the exposure limit does not make any distinction between Group 2a and 2b crypto assets**. Consequently, no off setting of long and short positions in crypto exposures, that meet the Group 2a criteria, may be applied when calculating the net exposure. Such is not appropriate for assets that are considered liquid and that are traded on regulated trading venues (for which enforceable netting arrangements exist) and **renders the hedging recognition under Group 2a crypto assets obsolete**.
- **Nor** does the proposed limit **differentiate between market participants**. Should the standards be (partially) extended to investment firms, it would be **impossible for market makers to provide liquidity** in the assets class, resulting in higher liquidity risks. While adoption of the assets class into market making programs is crucial for the development of (liquidity in) the asset class.
- **Not** being able to **off set** the **two legs** of the position, will likewise have the adverse effect that banks will not be able to **act as prime brokers** for this assets class, as both legs of the position will **count towards the exposure limit**, although there is no net position.
- This **unworkable exposure** limit **prevents the crypto market to shift to a regulated environment**, which is certainly not the aim of these standards.

The Consultative Document does not give enough recognition to regulatory efforts of market participants to develop a fully regulated asset class and will harm the introduction of legislative proposals that aim to regulate the asset class such as MiCA.

D2X remains at the Basel Committee's disposal to discuss any elements of this response in more detail and is happy to provide any further information and answer any question the Basel Committee may have.

Yours sincerely,

D2X Group N.V.