DEUTSCHE BÖRSE GROUP

Gruppe Deutsche Börse

Comments on

„Basel Committee on Banking Supervision Discussion paper: Designing a prudential treatment for crypto-assets“

Frankfurt am Main, 13 March 2020

I. General remarks

Deutsche Börse Group (DBG) welcomes the efforts undertaken by the Basel Committee on Banking Supervision to develop a prudential treatment for crypto-assets.

We acknowledge the Committee´s valuable work at monitoring developments in crypto-assets, and its efforts in coordinating its work with other global standard setting bodies and the Financial Stability Board.

Given that the application of technology in financial markets is still at an early stage, we are in favour of a close alignment with global standard setting bodies and national regulators.

DBG, as a provider of financial market infrastructures (FMI), including "traditional" trading venues, clearing houses (CCPs) and central securities depositories (CSDs), has a long experience in building markets, and implementing rulebooks as well as several safeguard mechanisms on these markets.

We welcome the opportunity to comment on the Committee´s Discussion Paper: "Designing a prudential treatment for crypto-assets".

As an FMI, we do not offer "classic" banking services to the general public and we will therefore limit our focus to the questions that have a broader scope.

We believe it is time to **bring digital-assets**, including the **crypto-asset ecosystem, to the same level of regulation as the rest of the financial system**. **"Same business, same risks, same rules" should apply as a general principle,** while **"tech-neutrality" needs to be ensured.** This is also true with regard to the prudential treatment of digital-assets, as the lessons learned from the financial crisis 2008/9 are still important, even if the technology changes. With regard to the (capital) requirements, a distinction has to be made between closed/private environments and those digital-assets which are offered to the broader public.

DBG is of the opinion, that the digital transformation in general, and the distributed ledger technology (DLT) in particular, **should be closely analysed to mitigate potential risks and to derive benefits** both, within the banking system and within the financial system as a whole.

II. Comments in detail

Q1. 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.

Generally speaking, we agree with the definitions provided, but we want to highlight that as technology is evolving fast, the focus on crypto-assets could be too narrow for the future.

We would bring to the Committee´s attention that crypto-assets represent a subcategory of digital-assets. Hence, crypto-assets (like coin and token) are digital-assets based on cryptography, but other categories of digital-assets are imaginable.

It would furthermore make sense to follow a "substance over form" approach while categorizing such assets and adapting/designing prudential frameworks.

If digital-assets (like digital securities) qualify as a financial instruments due to their characteristics in a "substance over form" manner (see e.g. on EU-level the definition of financial instruments in the Annex I, Section C of the MiFID II), then they should be subject to already existing financial rules within the respective framework.

Digital-assets, which are currently not covered by current definitions of financial instruments (e.g. crypto-currencies) should be integrated into existing frameworks. We would propose a definition in line with the definition provided for in the German Banking Act (KWG), which could act as a blueprint for the international definition of such assets:

"Digital-assets are defined as digital representations of value that are not issued or guaranteed by a central bank or a public authority, are not necessarily attached to a legally established currency and do not possess a legal status of currency or money, but are accepted by natural or legal persons as a means of exchange that can be transferred, stored and traded electronically or serve investment purposes other than e-money or a monetary value used in limited networks for certain exempt electronic payments processed by telecommunication providers."

Moreover, in our view, digital payment-assets (payment tokens) or "digital money" should have different subcategories covering features such as the openness of the network and governance structure used (public or private ledger, permissioned or permissionless), the backing or the reserve (no backing or backing by assets) and the issuer. This would result in the following classification (illustrative):

a) Crypto-currencies: native tokens that have no issuer, usually on a public/permissionless ledger; example: Bitcoin

b) Stablecoins: issued by a private non-financial company, backed by asset(s), on a private or public ledger; example: Libra

c) Digital bank money: issued by financial institution with banking license, additional backing with assets is optional, usually on a private/permissioned ledger; example: JP Morgan Coin

d) Central Bank Digital Currency: issued by central bank

Q2. 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?

As stated above, the prudential treatments depend on the value represented/embodied by the specific digital-assets; for example, respective financial instrument differ from one another in terms of risks, collaterals, reporting etc. From our point of view, the principle "same business, same risks same rules" should apply, which is in line with the Committee´s general principles formulated in the discussion paper (see also Q1).

With regard to the potential sources of value/risks, aside from the inherent features of the concerned digital-asset, its "environment" (liquidity, trading place, governance of the chain, network integrity, IT security, supervision etc.) should also be considered.

In our opinion, it would be helpful to develop guidelines defining minimum criteria and standards to facilitate the assessment of relevant "environments" at an international level.

Q3. What benefits do crypto-assets provide for the banking system, and the provision of financial services more generally?

In our view, digital-assets, including crypto-assets, could provide efficiency, transparency, and cost reduction benefits. This new asset class could be made attractive for institutional investors with proper rules and standards.

Q4. What additional factors affect the risk profile of different crypto-assets which are relevant in the context of determining a prudential treatment?

Depending on the represented value, the following factors could be taken into consideration when evaluating the risk profile of digital/crypt-assets:

- Build-up of leverage, pro-cyclicality and interconnectedness (as addressed e.g. in the EU SFTR)
- Delivery vs. Payment
- Price discovery
- User concentration and "whales" etc.
- A change in protocol ("Forks")
- The use of smart contracts
- Other technology inherent risks

Those could be addressed by monitoring and reporting, as within any other asset class.

Even today, it is possible to address some of the technology-related issues connected to transparency, since the users of the networks are only pseudo-anonymized. Additionally, there exist special services in the market to analyse such networks, notably some that are already used by supervisors (e.g. Chainalysis).

Q5. 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?

In general, we agree with the general principles.

However, with respect to the "minimum standards", as different jurisdictions have different approaches (e.g. with regard to risk management, internal models or stress tests), regulatory arbitrage should be prevented.

Therefore, we would prefer for jurisdictions to refrain from prohibiting their banks from having any exposures to digital-assets; instead, an adequate regulatory framework should be created to ensure investor protection and market integrity.

We would also like to highlight the need for a technology-neutral approach to grant the same level of security as with other asset-classes.

Additionally, we would propose that requirements should be considered, if the digital/crypto-assets are sold to whole-sale only or also to retail-clients. Further, there has to be a distinction between digital-assets used in closed/private and only "technical" environments and those offered as an investment asset (See Q12).

Q12. 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 an FMI, DBG is heavily involved especially in post-trade and settlement transactions belonging to traded contracts on regulated markets. Therefore, we highly welcome the idea of a reasonable treatment, especially for the first example of crypto-assets used for intra- and inter-bank settlements.

One example is the idea of allowing instant settlements via crypto-assets (or other digital-assets) backed by pre-financed fiat currencies outside of business hours from e.g. central bank settlement systems like TARGET2. Internationally active banks around the world diversify their business not only across asset classes, but also across regions and especially in the foreign exchange market, where continuous trading around the clock is possible and required. In such an example, late trades outside the business hours of the TARGET2 system that involve the settlement of Euros may create a margin requirement and related settlement instructions that cannot be fulfilled until the business hours of TARGET2.

Such a situation would lead to unnecessary risks for the concerned FMI, because unsettled instructions and margin requirements would only be fulfilled on a Monday morning even though the requirement and instructions would already have been given on a Friday evening.

As, in this case, the use of a digital-asset would be limited to a closed environment and would need to be viewed as a "technical solution" rather than an investment vehicle, an appropriate and different prudential treatment of these types is almost mandatory due to the decoupling of the intra-/interbank system and the global financial system.

Q13. 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?

We agree with the view on the general principles posed in the context of Q5, notably the "same risk, same activity, same treatment".

However, there needs to be a careful and clear definition with unambiguous criteria for specific types of digital-/crypto-assets:

a) which, on the one hand, indeed bear, economically equivalent risks as traditional asset classes available for investment and exposure build-up by a broader public

b) on the other hand, a specific type of digital-/crypto-assets should be seen and treated as a (internal) "technical solution" to reduce certain risks and increase efficiency of technical processes (see Q12).

Q14. 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?

This question should be seen in direct conjunction with the first questions on how to adequately define a digital-/crypto-asset. It is our opinion that the conditions for separate prudential treatments should directly relate to the core of the meaning of "(macro-)prudential":

If digital-assets are offered to a wide audience/public without access restrictions and qualify as a financial instrument (as an investment asset-class), then they should be treated in accordance with the "same risk, same activity, same treatment" principle.

Otherwise, if digital-/crypto-assets are more comparable to a "technical solution" to be used in a closed environment (with restricted access only), then they should be treated differently (see Q12).