Brussels, 30th September 2022

EACB comments on the Basel Committee on Banking Supervision's Consultative Document "Second consultation on the prudential treatment of cryptoasset exposures"

General comments

The members of the EACB welcome the opportunity to comment on the Basel Committee's second consultation on the prudential treatment of cryptoasset exposures. In view of the dynamic development of the crypto market, EACB appreciates the fact that the Basel Committee is striving to continuously address in an iterative process the issues related to the regulatory framework for cryptoassets.

We support the harmonization of prudential treatment of cryptoassets at an international level. There is a need for regulatory clarity, a consistent cryptoasset taxonomy and standardisation so that cryptoassets and cryptoasset markets are as regulated as "normal" banking assets and the banking sector. Moreover, we advocate for regulatory requirements that are easy to implement in a rapidly evolving cryptoasset market.

We generally agree with the proposed categorisation and the differentiated regulatory treatment in the second consultative document. However, in addition to that, it has to be ensured that the definition of cryptoassets and the prudential requirements set out in the Basel consultation take into account and are in line with the regulatory initiatives already under way in major jurisdictions, for instance the ones outlined in the EU regulation on Markets in Crypto-assets (MiCA).

Further to that, the EACB particularly sees the need to connect the prudential regulation of banks' cryptoasset exposures with the accounting treatment of cryptoassets. While in general we find the proposed differentiated regulatory treatment in the second consultative document comprehensible, it nevertheless neglects the fact that normally the regulatory reporting has to be based on the accounting treatment. A complicated reconciliation between prudential standards and the general accounting perspective would lead to unforeseen problems and therefore must be avoided.

Finally, EACB would like to express our concerns that climate related risks are not at all considered in the Committee's proposal, albeit ESG-risks posed by certain highly energy intensive cryptoassets are one of the key concerns. We therefore would propose an aligned approach regarding ESG-risks with all other reporting requirements which are currently under discussion.

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Please find below the EACB answers to the specific questions outlined in this consultative document.

Minimum capital requirements for credit risk for Group 1 cryptoassets

We consider the proposed refinement of the classification conditions for the prudential treatment of Group 1 cryptoassets in general to be appropriate.

EACB is in favour of the Committee's proposal for banks to separately analyse whether Group 1a cryptoassets (tokenised traditional assets) and underlying non-tokenised traditional assets confer the same level of legal rights and the same likelihood of paying the owner all amounts due on time. In particular, we appreciate the explicit reference in SCO60.34 that banks should assess whether tokenised traditional assets meet the relevant eligibility requirements to be recognised as collateral for the purposes of credit risk mitigation within the credit risk standards. Nevertheless, in relation to SCO60.44, we encourage the Committee to consider Group 1b cryptoassets as eligible forms of collateral for the purposes of recognition as credit risk mitigation.

EACB is also concerned about the proposed requirement for cryptoassets that meet all the classification conditions for inclusion in Group 1b but only "narrowly pass" the basis risk test to be subject to a risk weighted assets' adjustment as outlined in SCO60.15. We firmly believe that there should be no capital add-on in cases when a bank is able to repurchase these Group 1b cryptoassets directly from the issuer.

Infrastructure risk add-on for Group 1 cryptoassets

EACB is concerned about the Committee's proposal to introduce an add-on to risk weighted assets that would apply to all Group 1a and Group 1b cryptoassets to cover various unforeseen risks that may be posed by the distributed ledger technology (DLT) infrastructure on which cryptoassets are based. If introduced, the proposed add-on to capital requirements as set out in SCO60.57 and SCO60.58 would lead to an unequal cost of capital for token products or stablecoins and their underlying traditional assets for cryptoassets and traditional assets. This would be inconsistent with the direction taken by the Committee in the second consultative document to assign similar risks to Group 1 cryptoassets and the traditional asset that the cryptoasset references. We are therefore concerned of a negative effect of a DLT infrastructure add-on for Group 1 cryptoassets on banks' ability to provide competitive cryptoasset products and services. We suggest that the technology neutrality line is also considered in the mark-up for the infrastructure risk.

Furthermore, we believe that infrastructure risks could adequately be considered in the operational risk framework which includes internal risk management process of the banks as well as supervisory review. We would encourage the Committee to consider that Group 1 cryptoassets are covered by the operational risk framework.

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Overall, we do not deem appropriate to assume an increased operational risk relating to cryptoassets relative to traditional assets and to substantiate this with capital surcharges. Instead, the existence of an additional operational risk of cryptoasset exposures should be checked on a case-by-case basis.

Minimum capital requirements for credit and market risk Group 2 cryptoassets

EACB appreciates that the Basel Committee adopted a more granular methodology for Group 2 cryptoassets and proposed a further differentiation into Group 2a and Group 2b cryptoassets based on the screening of cryptoassets against a set of hedging recognition criteria. Still, we remain of the view that the approach proposed in the second consultative document – consisting in the use of modified market risk requirements for Group 2a cryptoassets and the conservative prudential treatment for Group 2b cryptoassets – is not appropriate. We would suggest that the market risk requirements are applied to both Group 2 cryptoasset exposures.

As regards the proposed simplified standardised approach (SSA) for Group 2a cryptoassets, EACB members suggest dropping the hedging recognition parameter equal to 0.65 in the formula to calculate the net position for each Group 2a cryptoasset as set out in SCO60.66. We are of the view that once a cryptoasset has been assessed to meet all the hedging recognition criteria as listed in SCO60.60 to be classified as Group 2a cryptoasset, further limiting hedging recognition by introducing the 0.65 parameter is not at all justified. Dropping the hedge recognition factor of 0.65 would still result in a conservative treatment as individual positions may be offset only for the very same crypto asset in the same market/ exchange.

Further to that, we believe that capital treatment for Group 2a cryptoassets under the standardised approach (SA) as set out in SCO60.71-60.87 is too conservative. Such an extremely prudent market risk scenarios for all Group 2a crypto assets - including the most liquid Bitcoin and Ether - is unfounded. This would lead to a situation when banks would not be in the position to offer any products with call options or put options on Group 2a crypto assets to their clients due to inefficiently high capital costs. EACB would encourage the Basel Committee to introduce different risk buckets with different risk weights within the Group 2a crypto assets similar to the different risk buckets for equities or FX within the FRTB standard approach framework.

Minimum capital requirements for counterparty credit risk (CCR)

As for SCO60.102 that sets out modified SA-CCR rules for derivatives on Group 2a cryptoassets, this would lead to tremendous consequences to the banks that have not implemented the SA-CCR and are therefore excluded from participating in the respective markets. We strongly advocate that ROEM or SSA-CCR can be used for derivatives on Group 2a cryptoassets. As an alternative, banks should be allowed to voluntarily apply the conservative treatment for derivatives on Group 2b cryptoasset in SCO 60.103 to derivatives on Group 2a cryptoassets as well.

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Minimum capital requirements for Group 2b cryptoassets

EACB members would like to point out that we are not in favor of an application of a 1250% risk weight for high-risk cryptoassets in general. It should be well noted that the application of the 1250% risk weight as set out in SCO60.89 ensures that banks hold risk-based capital at least equal to their Group 2b cryptoasset. Even though in practice it remains the easiest way to cover potential risks of cryptoassets, it fails to consider their different design options. Furthermore, especially for well-established cryptoassets like Bitcoin, we consider the proposed application of a 1250% risk weight too harsh. The key question is whether a cryptoasset will have any value in the event of its liquidation. It is true that the value of e.g., Bitcoin is highly volatile. But given that it has been in existence for over ten years, it must be considered to have more value than less established cryptoassets.

Given the above, we see merit in developing a more differentiated approach looking for equivalent use cases among current asset classes. One approach could be to compare high-risk cryptoassets to risky or volatile assets already available on the market. For example, as specified in the final Basel III framework in the area of credit risk, as of 2023, banks will assign a risk weight of 400% to speculative unlisted equity exposures[1]. Particularly the features of "*short-term resale purposes*" and being "*subject to price volatility and are acquired in anticipation of significant future capital gains*" we believe are apt to describe the situation of many cryptoasset holdings. We are therefore of the view that similar risk weights (between 300-400) could be assigned to some highly risky and volatile cryptoassets. Moreover, any prudential consideration and requirement on cryptoassets should, in any event, include a clear review clause so that requirements can be reassessed and adjusted in a timely manner. This is essential in such a new and rapidly evolving environment.

Contact:

The EACB trusts that its comments will be taken into account.

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[1] Speculative unlisted equity exposures are defined as "equity investments in unlisted companies that are invested for short-term resale purposes or are considered venture capital or similar investments which are subject to price volatility and are acquired in anticipation of significant future capital gains".