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EBF response to BCBS consultation on Prudential treatment of cryptoasset exposures

General comments

The European Banking Federation (EBF) welcomes the opportunity to comment on the consultation paper on the prudential treatment of cryptoasset exposures published by the Basel Committee on Banking Supervision. Aside from responding to the different questions in the consultative document, the EBF would like to deliver a few general remarks that are not addressed by the questions in the consultation paper, but which we think should inform the debate about a prudential framework for cryptoassets.

The EBF supports a coordinated approach that creates a global framework for cryptoassets, which ensures a level playing field across different jurisdictions. In this respect, it is not only important to ensure a level playing field within the banking sector, but also with other market participants who are active in the issuance and trading of cryptoassets. In this respect it will be important to develop a framework that is sufficiently prudent and thereby captures the relevant risks, but also sets the right incentives for banks to engage with cryptoassets to contribute with their risk management expertise and enhance investor protection in this market. This would be conducive to the secure development of the market for cryptoassets and at the same time avoid that a large part of the activities are being shifted into the unregulated sectors. The EBF considers that there is currently room for improvement and that the capital treatment of cryptoassets should be closer to the regulatory treatment of more traditional assets, where this is justified by the relevant characteristics of the respective cryptoassets. 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 scrutiny and risk management best practices. 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 stability risks, rather than the opposite.

Generally, it can be said that the approach to develop the framework in an iterative process is important to account for the pace at which the cryptoasset markets and the technologies evolve and the different states of maturity of regulatory and supervisory frameworks connected to the prudential framework. Moreover, this would also allow a differentiating assessment of individual types of cryptoassets for which currently no common taxonomy is established. Lastly, the Basel Committee should also monitor and take into consideration

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developments in its member jurisdictions to ensure a level playing field across jurisdictions and to avoid regulatory and taxonomy mismatches with applicable law (notably with the cryptoassets taxonomy due to be adopted at the European Union level under the MiCA and pilot regime regulations).

Finally, it is important to remark that the discussion on the prudential treatment should be accompanied by a discussion on the accounting practices with respect to 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. Since the accounting treatment is not clarified, this creates a high level of uncertainty. In fact, 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 cryptocurrencies. Therefore, we advise that the decision to link the capital treatment to the accounting classification is deferred until the accounting treatment of cryptoassets has been clarified. In addition, the Basel Committee should also consider the ability of cryptoassets to cover risks or absorb losses as soon as they occur, which implies that the capital deduction would not be the most appropriate treatment. Therefore, a question that should be discussed is if the risks related to those intangible assets could be better captured in the market or credit risk RWA framework.

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

The EBF supports the principles as they are set out, in particular the principle on "same risk, same activity, same treatment". This principle should be the guiding principle for all further discussions on the subject. With regard to the proposal for the prudential treatment, the EBF believes that these principles could be better reflected in the proposed capital treatment. Currently, the consultation document does not sufficiently differentiate between different types of cryptoassets. The cryptoassets that would fall into group 2 are actually very different from one another and are also subject to different risks, but, nevertheless, they would have the same capital treatment. A more granular methodology would be the more appropriate way to deal with the complexity of the subject at hand. This would help to ensure that the regulation, and the prudential treatment therein, is proportional to the actual risks and complexity associated with the different types of cryptoassets, which is a key principle in prudential regulation.

The best approach in the view of the EBF would be to adopt a "substance over form" approach and to accomplish that objective would be to develop a taxonomy, based on clear definitions for the respective assets, which captures the different types of cryptoassets and determines their characteristics in relation to comparable assets under applicable law. This will also allow to examine to what extent the existing regulatory framework can be applied to those assets and consequently allow them to benefit from the same regulatory treatment. For example, the Committee currently does not foresee the possibility to treat cryptoassets of any group as a High Quality Liquid Assets (HQLA). However, if a cryptoasset does show characteristics similar to other HQLA-eligible assets, in line with the BCBS requirements, then this cryptoasset should be able to benefit from that same treatment. Therefore, we would consider an exclusion of cryptoassets from HQLA-eligibility at this point as too premature (see the response to question 14). This way the Committee would be truly able to guarantee a regulation based on "same risk, same activity, same treatment".

Whilst the simplicity principle is important for a global framework of the prudential treatment of crypto-assets, an appropriate balance needs to be found that considers the existing spectrum of different crypto-asset categories and their associated risk profiles,

which is much more diverse than currently represented in the proposed Groups. Especially for those cryptoassets that neither fall into 1a nor in 1b. Bucketing them all into Group 2 with the same strict prudential treatment does not consider their diverse nature.

For Group 1b it would be helpful to define what constitutes a stabilisation mechanism.

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?

The EBF thinks that the classification conditions could be improved through further differentiation. The spectrum of cryptoassets between group 1a/1b and group 2 is very diverse and would not be adequately captured by the proposals. Classifying cryptoassets that do not meet the conditions for group 1a and 1b as group 2, would lead to a cliff-effect and would also lead to a very restrictive treatment due to the 1250% risk weight. In fact, based on our assessment, the requirements that cryptoassets need to meet to be classified as group 1a or group 1b are quite demanding.

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. Of course, this means that it is not possible for an existing cryptoasset to meet condition 1 before this one-year period. Furthermore, it is important to highlight that the DLT network is independent and the protocol is outside of the control of the bank, which raises the question which meaningful action a bank can take to ensure that the "cause of breach" of the threshold has been "addressed and will not reoccur". Finally, based on historical data analysis, it appears that the threshold of 10bp and the maximum yearly frequency of 3 excesses set very restrictive conditions and only very few cryptoassets could be eligible to group 1b, which may not be the objective of the Committee and does not seem proportionate with the actual risk of those assets. Thus, to better match with the reality of stabilisation mechanisms, we would recommend raising the 10bp-threshold and adopting a progressive approach beyond the 3 yearly occurrences of threshold excess with increasingly stringent prudential treatment before a mandatory classification in group 2 when the number of yearly occurrences reaches 10 for example.

Regarding conditions 3 and 4, those would not be met by any cryptoasset building on a permissionless network, while the regulations must be technologically neutral in order to facilitate an exhaustive assessment of the merits of DLTs by regulated institutions. The question that arises here is how banks are expected to deal with this situation and what regulators would like banks to do. After all, the concept of decentralisation and trust in the DLT network where no entity is in control is key to cryptoassets.

In addition, it was already mentioned in the response to question 1 that group 2 as a category is too broad and could benefit from more differentiation in order to maintain some risk-sensitivity. Otherwise, the methodology might not capture the risks of cryptoassets accurately.

Thus, as regards the granularity of group 2 cryptoassets, we believe in particular that tokenised traditional assets which do not meet all the conditions for a classification in group 1b and also stablecoins with reserves should benefit from a more favourable prudential treatment than bitcoin.

As for algorithmic stablecoins, as the Committee rightly states in its consultation paper, these assets would not meet the conditions for a classification as group 1 assets. However, the characteristics of those assets allow to introduce significant safeguards, for example, the need to provide certain documents before a participant is admitted to a blockchain. The bitcoin on the other hand is completely open, without such requirements. We believe that algorithmic stablecoins can be subdivided as follows:

a. Algorithmic stablecoin with centralised governance	Stabilization Mechanism: - Maintains peg to reference asset by dynamically controlling supply and demand via the protocol; Governance: - Individual company or consortium sets rules and guarantees 1-to-1 peg to reference asset
b. Algorithmic stablecoin with decentralised governance (e.g. Ampleforth, Euro/Usd/Gold) Celo	Stabilization Mechanism: - Maintains peg to reference asset by dynamically controlling supply and demand via the protocol; Governance: - Automated system of smart contracts guarantees 1-to-1 peg to reference asset

To enrich the classification criteria, the Basel Committee should consider for example to introduce the “existence of a liquid two-way market for the cryptoasset” as an additional classification criterion. This would be a relevant classification criteria which makes also reference to existing Basel Committee standards in the area of market risk. This is just one criterion and there could certainly be more. Generally, we would recommend having technology neutral criteria to ensure that the prudential framework remains flexible enough to keep up with the high pace of innovation taking place in the cryptoasset space. Otherwise, there is the risk that the cryptoasset market develops into a direction not foreseen by the regulation.

Another suggestion the EBF would like to put forward is to provide exceptions for Group 2 cryptoassets with no commercial objective, such as DLT-based voting rights or socially related cryptoassets, or crypto-assets used for transactions fees payments (or “gas” payments). For the latter, these fees are transaction costs that are paid automatically at the time of registration or transfer of data on a DLT. We consider that classifying such transaction fee-related cryptoassets as prepaid expenses would be an appropriate treatment from a prudential perspective.

With regard to the cryptoassets with stabilisation mechanisms, we support the distinction proposed by the Committee between cryptoassets that use protocols to maintain their value, i.e. algorithm-based stablecoins, and cryptoassets backed by assets or a pool of assets given their fundamental difference in terms of risks.

Lastly, cryptoassets 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, it is essential that the Basel Committee gives due consideration to the regulatory work ongoing in the different jurisdictions, in particular in the EU, such as the MiCA (Markets in Cryptoassets) and pilot regime regulations proposals and the classification therein to ensure consistency among the various pieces of regulation and jurisdictions.

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?

To facilitate the process of demonstrating which assets meet the conditions for group 1, there should be clear reference points as well as market data available on which cryptoassets are already considered to be compliant. This also helps ensuring a level playing field by increasing transparency on supervisory decisions. To give an example, it would be useful if the Basel Committee could explain how the 10bp threshold in the first classification condition was calibrated ("The difference in value must not exceed 10bp of the value of the underlying traditional asset more than three times over a one-year period").

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?

We would appreciate more clarification regarding the conditions based on which a stabilisation mechanism needs to be reassessed. This could be in the form of a non-exhaustive list of examples of stabilisation mechanisms that meet and others that don't meet the BCBS requirements.

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?

- (i) Yes, it even differs within a group as it may differ per individual DLT network and the governance on control model applied. The spectrum of categories of crypto-assets between Group 1 and Group 2 is diverse i.e. bucketing all crypto-assets not qualifying as Group 1a or 1b into Group 2 is inappropriate and needs to be reconsidered.

As an example, Group 1b / stablecoins can be sub-divided into:

a. Asset-backed stablecoin with centralised governance (e.g. Diem, Tether, USDC)	Stabilization Mechanism: - Maintains peg to reference asset by backing the coin with (safe) assets; Governance: - Individual company or consortium sets rules and guarantees 1-to-1 peg to reference asset
b. Asset-backed stablecoin with decentralised governance (e.g. DAI, Synthetix)	Stabilization Mechanism: - Maintains peg to reference asset by backing the coin with (safe) assets; Governance: - Automated system of smart contracts guarantees 1-to-1 peg to reference asset

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?

Regarding the fourth classification condition the EBF would like to make the following comments:

- We request further detail from the BCBS as to the level of supervision required to meet the fourth classification criteria across different jurisdictions in order to cater to different activities and different entities involved.
- Ideally, in line with the “**same risk, same activity, same treatment**” principle, all cryptoasset service providers - wallet providers, trading platforms, exchange services fiat-to-crypto and crypto-to-crypto, execution, placing, reception and transmission of orders... - should be regulated and supervised, as soon as they provide one or more cryptoasset services to third parties on a professional basis, especially if these services are critical in the chain. It may seem unrealistic to consider being able to regulate all the participants in decentralized protocols, as they can be very numerous, small and localized across the globe. However, given the risks at stake, the issue of regulation and supervision of professional cryptoasset service providers should be carefully assessed. In any case, a strong international coordination between supervisors/jurisdictions is necessary for cryptoassets based on decentralized protocols.

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?

Generally, it should be paid due consideration to the appropriate split between the banks and the supervisors, for example when it comes to monitoring the effectiveness of the stabilisation mechanism.

Regarding the responsibilities of banks and supervisors concerning the classification of cryptoassets, the EBF believes it might be reasonable to define a set of common criteria for the classification of widely used and accepted cryptoassets. This would avoid an excessive burden on banks and supervisors, and would guarantee consistency across jurisdictions. At the same time, sufficient flexibility to this classification should be left to allow for new use cases to be included into the framework. This approach would avoid a divergent treatment for the same asset for different banks, which will result from the following paragraph in the consultation paper (page 6): “In cases where the same cryptoasset is being sought for approval, bank supervisors may make a decision to approve or disapprove whether a cryptoasset would be a Group 1 cryptoasset, based on their assessments made for cases of the same cryptoasset put forth by other banks.” This proposed approach in the consultation would undermine the level playing field, but also be counterproductive to fostering a common understanding of the risks associated with cryptoassets, and therefore a common supervisory culture in the area of cryptoassets.

In this respect it is very important to consider that such an approval process would be counterintuitive to the principle “**same risk, same activity, same treatment**”. As is mentioned in other parts of the consultation response, the prudential treatment of cryptoassets should be determined based on the treatment of their traditional equivalent. In this sense, the EBF’s suggestion would be to advise against introducing stricter requirements for the digital equivalent of a traditional asset, also to ensure that banks have sufficient incentives to engage in cryptoassets/DLT or similar technologies. Ultimately, an approach that is at odds with current market practice, might have such a detrimental effect and stifle innovation.

Nevertheless, should the above approach be pursued, it would also be appropriate to provide a mechanism that ensures that banks are not required to seek approval for Group 1 status on assets that have been already approved for other banks within a given jurisdiction. Bank supervisors or financial authorities should maintain a public record/list of approved Group 1 cryptoassets.

Hence, we propose to not only use a set of common criteria that allows sufficient flexibility to embrace new types of cryptoassets, but also the creation of a list of already approved cryptoassets as Group 1 cryptoassets, to avoid a divergent treatment among supervisors, which we understand to be an unintended outcome of the abovementioned paragraph on page 6 of the consultation document. Both tools, a list of already approved cryptoassets and a set of common criteria would ensure a uniform treatment, increase transparency and enough flexibility. The list could be updated every time a supervisor approves a new type of crypto asset as Group 1.

Lastly, it needs to be borne in mind that any public list of “approved” and “low risk” group 1 cryptoassets may have unintended consequences in being understood as a “blank check” granted by supervisors, hence fuelling speculation and volatility.

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?

There are a number of considerations that should be considered when discussing operational risk in relation to cryptoassets:

- Regarding the approaches on operational risk, which are put forward in the consultation paper, we would like to remark that neither the current nor the forthcoming Basel framework on operational risk differentiates this risk by asset class, but rather takes into account certain metrics within the income statement and the balance sheet to compute the operational risk charge for each entity. Moreover, the new framework, as designed by the Basel Committee, may take into account the past operational losses of the relevant entity. That said, banks will maintain their rigorous frameworks regardless of assets held i.e. the same operational risk standards (e.g. KYC, AML, etc.) will apply for all assets including cryptoassets. Therefore, any significant event in relation to cryptoassets will be accounted for in the operational risk framework.
- In addition, the EBF would also like to highlight the following consideration, which the EBF considers to be key to understand the role of operational risk in cryptoassets: Cryptoassets can have characteristics that lower the operational risk related to those assets. Examples of those characteristics, include, but are not limited to, improved settlements or also automatic settlements. In addition, banks

have policies, procedures, and controls to manage and mitigate the risks that arise from this technology and other risks associated with it (KYC, AML...), as well as have developed bank continuity plans. Therefore, the EBF does not consider that an additional pillar 1 operational risk charge would be appropriate. Whenever the supervisor believes that the Pillar 1 is not sufficiently covering the risk, because entities do not have the appropriate governance, risk control and risk mitigation mechanisms, the supervisor has the Pillar 2 tool to tackle this and impose additional capital charges.

- Nevertheless, if, the Committee was to design a targeted methodology to cover the operational risk of these assets separate from the general operational risk requirements, this would add significant undesired complexity to the operational risk framework.

The paper does not discuss whether the use of risk mitigants, such as the contracting of insurance policies in relation to activities with cryptoassets, could be considered when measuring operational risk. Therefore, if, in the BCBS view, an amendment to the Pillar 1 approaches is warranted, it is important that the BCBS re-introduces some of the broader risk mitigation benefits that have been omitted under the revised approach, namely with regards to recognising ex-ante insurance benefits (20% under current AMA rules). This would be aligned with the long-standing BCBS principle of incentivising good risk management and recent regulatory practice in credit 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?

From chapter 2.1 we understand that any cryptoasset which involves additional counterparty credit risk is not considered to fall under the definition of tokenised traditional assets. In the view of the EBF this should either be removed or at least differentiated.

In terms of credit risk, the following considerations should in our view have an influence on the provisions regulating credit risk:

- Investing directly in crypto tokens via a wallet directly on a blockchain (unhosted wallet) should not have credit risk as one of the foundational purposes of this is to be able to transact in a trust-less manner.
- Investing via an exchange or other venue that is managing a wallet (hosted wallet) for you will bring about credit risk with respect to the entity claiming to hold the assets.
- The counterparty and the way the transaction is instrumented should matter with respect to for credit risk assessment purposes.

In terms of market risk, the EBF believes banks should retain the possibility of using IMA for cryptoassets where the relevant risk factors can be modelled using appropriate data which meet the regulatory requirements. To that effect, we would appreciate supervisory guidance on the use of proxies for current approaches (SVaR) and potentially extended liquidity horizons under the FRTB SA.

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

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, the EBF holds the view that such risk could be considered as a secured exposure to the redeemer in case there is a dual recourse to the underlying asset.

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?

As mentioned above, we consider that the Group 2 encompasses too many different assets, which have quite different risks. 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. But in the current proposal all those exposures would be subject to the same capital treatment. Further differentiation between the different exposures and a higher granularity of the categorisation (including appropriately calibrated risk weights) would be important in this respect. For example, the lack of differentiation of treatment between “trading book” and “banking book” is inconsistent with the rest of the framework and a longstanding history of prudential standards. From a long term perspective and corporate purposes, a bank may have to hold amounts of Group 2 cryptoassets as part of participating to the governance of a DLT (the so-called “governance tokens”), being in the capacity at any time to pay DLT-based transaction fees (the “gas” payments) in order to register data on a DLT, or of establishing and maintaining a tokenized version of a traditional asset. The risks related to these “banking book exposure” holdings would not be related to trading activity and day-to-day volatility but rather related to long term strategy and potential value changes, and are not the same than typical market making/trading of cryptoassets.

Note that a blanket 1250% RW not only creates a disincentive for banks to participate in the cryptomarket, it also creates adverse selection issues where high quality issuers have a low incentive to enter the market given they are treated in the same way as low quality ones. There should be a more risk sensitive framework for the sake of right incentives.

On that basis, banking book exposures that fall under the credit risk treatment should continue being treated based on the existing approaches, as the underlying technology used in a transaction does not impact the creditworthiness of the obligor. Other risks (e.g. bitcoin volatility) captured under the market risk approach should be based on risk-weights or risk factors calibrated to reflect a level of risk commensurate with the underlying exposure.

However, should the BCBS insist on the punitive approach regardless of the considerations above, regarding the calibration of the 1250% risk weight, it would be useful to understand which are the risks that were identified by the Basel Committee that in the end led to this requirement. Ultimately, the 1250% risk weight would only be appropriate if a 100% loss scenario of the asset is expected.

Moreover, in this respect, it is important to keep in mind that 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. equity exposures under an internal models approach or positions in a basket for which an institution cannot determine the risk weight under the IRB approach). 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 based on liquid two-way markets, and the holding of these cryptoassets would presumably have value and allow for liquid trading transactions in case of stress of the institution.

If in the end it is considered appropriate for some exposures to hold capital equal to the value of the exposure, the capital deduction would be the preferred option. In fact, the 1250% could lead to a capital charge that is higher than the exposure value, due to additional Pillar 2 charges, buffer requirements etc.). Therefore, the sensible approach would be to allow banks to choose to apply the capital deduction or to apply a 1250% RW.

In any case, given the novelty and the quick pace of the development of this asset class, the BCBS should set a review date to re-assess the calibration of the framework based on discussions with regulators and firms specialised in crypto-assets and relying on historical data which would improve the understanding of the risks inherent to crypto-assets. This would align with the BCBS's own principle (P2) but also adhere to the approach suggested by the BCBS (p. 6): "A bank supervisor may rely on: other **regulators or supervisors** overseeing the entities management of risks attributable to the functions mentioned above; as well as **independent third-party assessors** determined to have the requisite expertise and skills, to evaluate the specific risk characteristics of cryptoasset arrangements".

Furthermore, in the context of Group 2 cryptoassets, the consultation states that "cryptoasset exposures would not be part of any hedging set". This seems too restrictive. For example, if a bank owns bitcoin but hedges with bitcoin futures via the CME exchange the net risk would be minimal. Also, it is not totally clear whether this applies only to Group 2 or to all cryptoassets and should be clarified. The lack of recognition of netting among long and short positions on the same cryptoassets or among different cryptoassets is inconsistent with the highly liquid and hedgeable nature of various kinds of cryptoassets (notably various tokenised traditional assets as well as many cryptocurrencies), even in the relatively early stage of their evolution. The netting restrictions of the BCBS consultative document would essentially prohibit banks to provide market making in cryptoassets and cryptoasset linked products and force such activities outside the regulated banking sector.

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?

For positions on the same cryptoasset, the hedging should be recognised under the same prudential standards for credit risk mitigation that are applied to other assets; 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.

Consequently, we support a modified version of the Standardized Approach for Counterparty Credit Risk (SA-CCR).

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?

The consultation paper excludes all cryptoassets from HQLA-eligibility. The EBF considers this too restrictive. At least group 1a assets, which are considered equivalent to traditional assets, should be able to be recognised as HQLA. Ultimately, based on a "substance over form" approach the EBF thinks the best approach in this respect would be to determine the liquidity treatment of cryptoassets based on the characteristics they exhibit. If they share the key characteristics with other HQLA-eligible assets, in line with the eligibility criteria defined by the BCBS, then they should receive the same treatment. There should be no separate treatment for cryptoassets. The lack of recognition of all types of cryptoassets as high-quality liquid assets (HQLA) is inconsistent with the capital treatment of tokenised assets. Most notably, for Group 1a, tokenised traditional assets should be treated as equivalent to traditional assets from a taxonomy and prudential treatment perspective. As such, based on the key principle of substance over form, where the traditional assets, e.g. government bonds, qualify as HQLA, the tokenised traditional assets should also be recognised as such, provided they comply with the conditions required.

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?

Banks should ensure that the same rigorous standards are maintained for all risk types regardless of cryptoassets. Hence, adding it should not change banks broader views on risk management.

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?

Any capital adjustments should in principle take place at the Pillar 2 level in line with the current BCBS prudential framework. However, if the BCBS deems a pillar 1 add-on is essential it is critical not to remove the option of using models as long as firms can justify they meet all the relevant existing criteria.

The paper does not discuss whether the use of risk mitigants, such as the contracting of insurance policies in relation to activities with cryptoassets, could be considered in the

prudential treatment of exposures to cryptoassets (see response to Q8 on the need for insurance and amendments to the framework required particularly for operational risk).

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

We support the Basel Committee's purpose of including cryptoassets into the scope of existing disclosures. However, these assets should be subject to firms' own assessments of materiality before being included into the scope of the disclosures. This will prevent the latter from becoming an overly onerous exercise and remove any additional burden for firms with non-material exposure to these type of assets, especially at a time where the crypto-market is still in its development stage. As such, the design of the disclosures should be left to each firm to decide on based on what befits their existing material portfolios.

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The European Banking Federation is the voice of the European banking sector, uniting 32 national banking associations in Europe that together represent some 4,500 banks - large and small, wholesale and retail, local and international - employing about 2.1 million people. EBF members represent banks that make available loans to the European economy in excess of €20 trillion and that securely handle more than 300 million payment transactions per day. Launched in 1960, the EBF is committed to creating a single market for financial services in the European Union and to supporting policies that foster economic growth.

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