FESE response to the Basel Committee consultation on the prudential treatment of banks' cryptoasset exposures

30th September 2022, Brussels

FESE welcomes the Basel Committee on Banking Supervision´s (BCBS) proposals, notably the proposals in the first consultation on the classification between Group 1 and Group 2 cryptoassets. We acknowledge BCBS's valuable work at monitoring developments in cryptoassets, and its efforts in coordinating its work with other global standard-setting bodies and the Financial Stability Board.

FESE wishes to highlight, as a general remark, that technology neutrality and “same business, same risks, same rules” principles should always apply to uphold the values of transparency, fairness, stability, investor protection, and market integrity. Cryptoassets that fall under Group 1 possess similar characteristics to traditional assets and/or have effective stabilisation mechanisms. As such, the rules applicable to Group 1 cryptoassets should not greatly differ in nature from the current rules of traditional assets.

Infrastructure risk add-on

FESE does not agree with Basel’s proposed “infrastructure risk add-on” to Group 1 crypto assets. The draft paper only vaguely refers to “infrastructure risks” and “unforeseen risks” (pages 2 and 4 respectively), while paragraph 60.57 only states that cryptoassets “may pose various additional risks”.

From our point of view, it is not justified why banks have to apply an add-on in addition to the obligations of determining and monitoring compliance of cryptoassets with the classification conditions (60.25). Conditions 3 and 4 seem to address the dimension of DLT infrastructure already. Rather than add additional capital requirements, we would advise applying the necessary IT security requirements subject to regulatory operational resilience provisions (e.g., in the EU the Digital Operational Resilience Regulation (DORA) will apply to most financial services undertakings, including banks).

While every technology bears a risk, existing operational risk (regulatory) frameworks handle it appropriately. Therefore, we do not see a justification or the need for a non-technological neutral infrastructure risk add-on to Group 1 cryptoassets. In addition, the proposed framework should recognise the enhanced structured environment that regulated entities licenced with local financial markets regulations (MiFID II/R for the EU) provide. The proposed risk add-on is unnecessary in the context of these regulated infrastructures as they are already subject to rules and regulations focusing, among others, on IT security and operational resilience.

Group 2 cryptoassets

Concerning Group 2 cryptoassets, we welcome the differentiation between Group 2a and 2b as well as the possibility to allow for netting. Further, we welcome that an adjusted risk weighting for Group 2a crypto-assets (100%) has been provided for ETFs, ETNs, and the largest crypto currencies. However, as most crypto-assets would fall under Group 2b, we wish to propose a different approach for the application of 1250% risk weight. The current approach would lead to low demand from institutional clients. We would suggest instead to compare high-risk crypto-assets with high-risk or volatile assets already accessible on the market. This would be in line with the principle of “same risks, same rules”.

We also believe that the recent exposure limit for Group 2 crypto-assets with 1% of Tier 1 capital should be increased. We understand that an excessive concentration of risk in cryptocurrencies should be prevented. However, we think that a limitation to 1% of Tier 1 capital without taking diversification and netting effects into account is too restrictive. Small and specialized institutions would not have enough flexibility to provide their services to the market. Rather than introducing 1% of tier 1 capital, we would suggest increasing the threshold in percentage (for example 5 %) or absolute terms similar to the Large Exposure Regime according to Article 395 CRR (for example EUR 15 million). We also suggest considering netting effects per cryptocurrency.

On the other hand, Group 2 crypto-assets traded and safeguarded via non-regulated services and platforms present an increased risk, for example in terms of system security and resiliency of the holdings. This is not the case for Group 2 crypto-assets that are traded and safeguarded by regulated financial market operators. Consequently, we consider that Group 2 crypto-assets traded and safeguarded via non-regulated services or solution providers should be covered by an additional risk weight. Inversely, the exposure limit for Group 2 assets should not apply to traditional exchange-traded, centrally cleared derivatives with crypto-asset underlying. This takes into consideration, as mentioned, the operators’ regulatory status, and as well whether it operates in a permissioned or open/distributed or centralised environment to balance the “same business, same risks, same rules” principle.

Other points

- We further propose under the principle “same business, same risks, same rules” to provide a suggestion on how investment firms should implement the prudential treatment of crypto-asset exposures. Investment firms in the European Union are under the investment firm regulation (IFR) partly subject to the same requirements as banks in terms of capital requirements but vary in other cases.
- Finally, we wish to confirm that reliance on the use of DLT for certain settlement or recordkeeping purposes does not necessarily subject the related asset to the cryptoasset exposure framework.