Bundesverband der Deutschen Volksbanken und Raiffeisenbanken e. V.
Bundesverband deutscher Banken e. V.
Bundesverband Öffentlicher Banken Deutschlands e. V.
Deutscher Sparkassen- und Giroverband e. V.
Verband deutscher Pfandbriefbanken e. V.

Die Deutsche Kreditwirtschaft

Comments

Second consultation on the prudential treatment of cryptoasset exposures

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The **German Banking Industry Committee** is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks finance group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks. Collectively, they represent approximately 1,700 banks.

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General remarks

GBIC welcomes the Basel Committee's continued consultation on developing a regulatory framework for cryptoassets. Though we generally support the proposed iterative approach, the proposal in its present form poses some pitfalls, which we would like to highlight and explain in greater detail below.

- We generally support the idea of differentiated risk weighting for cryptoassets. However, we believe that certain cryptoassets should benefit from lower risk weights.
- The specific requirements for Group 1a cryptoassets are overly restrictive. They should be revised to better accommodate innovation in token-based arrangements.
- We oppose the proposed Group 2 exposure limit (1% of Tier 1 capital), especially since it could lead to business shifting towards unregulated market participants.
- Overall, we need to ensure that regulation does not exclude well-regulated banks from specific segments of the cryptoasset markets.

In detail

Capital requirements for Group 1 cryptoassets
We support the Committee's proposal that it should be the banks' responsibility to assess whether the token assets confer the same level of legal rights as the underlying traditional assets. This includes an independent assessment by the bank of whether token assets meet the relevant requirements for recognition as collateral for credit risk mitigation purposes.

In addition, we believe there should be no increase in credit risk RWAs for Group 1b cryptoassets that "barely" pass the basis risk test if the bank can repurchase the Group 1b cryptoassets in question directly from the issuer.

Infrastructure risk add-on
The proposed infrastructure risk add-on departs from the general line of the second consultation document that Group 1a and 1b assets have similar risks to those of their underlying traditional assets. Thus it is no longer possible to speak of a technology-neutral approach to the capital treatment of cryptoassets. The Committee explicitly stresses that the DLT infrastructure on which (some but not all) cryptoassets are based is new and sees particular risks in it. All other things being equal, the regulatory cost of capital for token products or stablecoins and their underlying traditional assets will be higher for cryptoassets than for traditional assets. The infrastructure risk premium will discourage banks from offering cryptoasset products or services. As a result, banks will be less likely to provide innovative financial products and services in the form of digital assets based on new technological infrastructure. Ultimately, there is a risk that this activity could move from the regulated financial sector to less regulated or completely unregulated sectors. This cannot be intended by the Basel Committee. We therefore recommend that the technology-neutral approach also be applied to the add-on for infrastructure risk.

Furthermore, we believe that the envisaged singular risk add-on for Group 1a and 1b cryptoassets is inconsistent and unnecessary because existing and future operational risk capital frameworks, including internal and supervisory assessments, are already capable of taking such risks into account. We therefore strongly recommend that the existing and future operational risk capital framework should be applied to Group 1a and 1b cryptoasset exposures and activities.

In many use cases for Group 1a cryptoassets (e.g. tokenisation of bonds, equities, etc.), DLT aims at simplifying existing traditional solutions and making services and processes more cost-efficient. The proposed infrastructure risk add-on would result in significant additional capital costs which would outweigh the cost benefits of applying the new technology to many use cases and would therefore constitute a serious obstacle to the application of new technology like DLT in the banking sector.

The justification for the infrastructure risk add-on mentioned in the consultation document, namely that distributed ledger technology (DLT) infrastructure is still new and evolving and may pose various unforeseen risks, is quite extraordinary, in our view, as similar statements were made in the early days of other computer technologies (cloud technology, etc.) which did not, however, result in a similar infrastructure risk add-on. Furthermore, it should also be taken into account that DLT is actually reducing some sorts of risk.

We consider the chosen level of the risk add-on (2.5% x exposure value) to be disproportionately high compared, for instance, with the standardised approach for operational risk RWAs which will be applicable from 2025. Should a risk add-on be implemented, we kindly ask the Basel Committee to elaborate on its reasoning and to further explain the basis and evidence for the calculation of the suggested 2.5%.

Differentiation between Group 2a and 2b

In general, we welcome differentiating between Group 2a and 2b. We also welcome the adjusted risk weight (100%) for ETFs and ETNs. However, we believe that certain Group 2 assets should benefit from lower risk weights/capital charges. It is not helpful, in our view, to use the market risk approach for Group 2a cryptoassets and the credit risk approach for 2b. We believe that both groups should be treated using the same approach and would suggest using the market risk approach.

Collateral recognition of Group 1b and 2a crypto assets

For Group 1b (credit risk) cryptoassets, we recommend that the Committee recognise the eligibility of Group 1b cryptoassets as collateral. We also take the view that Group 2a cryptoassets should also be recognised as financial collateral if they satisfy the Basel framework’s general principles for the eligibility of collateral. These Group 1b and 2a cryptoassets should be included in the list of eligible financial collateral.

Capital requirements for Group 2a cryptoassets under the standardised approach (SA)

A risk weight of 100% has been selected for all Group 2a cryptoassets in the standardised approach (SCO 60.71-60.78), which means a simulation of a +100% increase and a decrease to 0 value needs to be carried out to calculate the curvature risk. Such extremely prudent market risk scenarios for all Group 2a cryptoassets, including the most liquid Bitcoin and Ether, is unjustified, in our view, and would result in banks being unable to offer their clients any products with none-linearity (e.g. call or put options) on Group 2a cryptoassets due to uneconomically high capital costs. We would recommend introducing different risk factor buckets with different risk weights for Group 2a cryptoassets along the lines of the different risk factor buckets for equities or FX in the FRTB standardised approach framework.

Justification for a lower risk weight is supported by the fact that Group 2a cryptoassets have similar liquidity to large cap equities. They should therefore receive a 10-day liquidity horizon.

Simplified standardised approach for Group 2a cryptoassets

The hedging recognition parameter of 0.65 in SCO 60.66 should be dropped (i.e. set at 1). In order to qualify for Group 2a and thus treatment in accordance with SCO 60.62 to SCO 60.70, a cryptoasset has to fulfil the criteria in SCO 60.60. These criteria are explicitly designed to ensure hedge effectiveness. It is therefore inconsistent and unjustified to limit hedging recognition by means of an additional factor even when these criteria are met. Dropping the hedge recognition factor of 0.65 would still result in conservative treatment as individual positions could be offset only by the exact same cryptoasset in the same market or exchange.

Minimum capital requirements for counterparty credit risk (CCR)

According to SCO 60.102, banks must apply a modified version of the SA-CCR to derivatives on Group 2a cryptoassets. This implies that banks which have not implemented the SA-CCR cannot engage in the respective markets at all. For various reasons, this rule should be amended for the sake of competitive fairness, the functioning of markets and consistency.

- Forcing banks which apply the ROEM or SSA-CCR to implement the SA-CCR if they want to participate in the corresponding market, irrespective of actual trading volumes, seems disproportionate and will likely result in those banks being excluded from the market.
- This would not only be to the disadvantage of the affected banks but would also hamper market liquidity and thus negatively affect market stability.
- It would also be inconsistent, as those banks would still be able to trade derivatives on Group 2b cryptoassets, which do not require implementation of the SA-CCR.

Hence it should be clarified that the ROEM or SSA-CCR can be used for derivatives not only on Group 1 cryptoassets but also Group 2a. Alternatively, banks should be allowed to voluntarily apply the conservative treatment for derivatives on Group 2b cryptoassets in SCO 60.103 to derivatives on Group 2a cryptoassets as well.

Capital requirements for group 2b cryptoassets

We would like to point out that we are not in favour of applying a 1250% risk weight to Group 2b cryptoassets in general. Although this is by now practically the easiest way to cover potential risks from cryptoassets, it does not take into account their different design options. What we would like to see is a more differentiated approach looking for equivalent use cases among current asset classes.

Especially for established cryptoassets, we also consider the proposed application of a 1250% risk weight to be too harsh. The key question is whether the cryptoasset will have any value in the event of its liquidation. Given that established cryptoassets have been in existence for many years, however, they must be considered to have more value than less established cryptoassets. We would suggest evaluating recoverability with the help of historical data. Instead of a risk weight of 1250%, one approach could be to compare certain high-risk cryptoassets with risky or volatile assets already available on the market. The risk weights for these are much lower (between 300 and 400%). This would be in line with the Basel framework, where a 400% risk weight is assigned to speculative unlisted equity exposures. In other respects, this risk weight would also be assigned if a joint venture were to issue or be invested in cryptoassets. Any regulation of cryptoassets should, in any event, include a review clause so that the regulation can be reassessed and adjusted in a timely manner. This is absolutely essential in such a new and rapidly developing area.

Group 2 exposure limit

We suggest dropping the Group 2 exposure limit, since it could lead to a shift in business towards unregulated market participants. This cannot be welcomed from a supervisory and market stability point of view.

If an exposure limit is imposed, we suggest increasing the threshold from 1% of Tier 1 capital to at least 5% and introducing an absolute threshold of EUR 15 million, whichever is higher (based on the large exposure regime). The loss of 5% of Tier 1 capital would not endanger the stability of an institution.

We welcome the idea of recognising netting in principle. We therefore cannot understand why the Group 2 exposure limit should be applied with no netting. We recommend that netting rules be taken into account when calculating total exposure to Group 2 cryptoassets, along the lines of how netting rules are applied to the calculation of market risks by considering netting effects per cryptocurrency. Without such netting rules and with a limit of just 1% of the bank's Tier 1 capital, banks will find it virtually impossible to offer services or products on Group 2 cryptoassets. Take, for example, a bank with Tier 1 capital of EUR 10bn, which will yield a Group 2 cryptoasset exposure limit of EUR 100m. If the bank sells its clients derivatives on Bitcoin or on the CME Bitcoin future with a delta equivalent of EUR 50m and hedges the market risk with a corresponding matching CME Bitcoin future also with a delta equivalent of EUR 50m, the bank will have already reached the Group 2 exposure limit despite the fact that the market risk of the position might be close to zero. It is clear that no profitable business case covering all infrastructure and administration costs can be developed based on such a tight exposure

limit together with no netting rules. In consequence, such services and products would only be offered outside the banking sector.

It is worth mentioning that the similar financial sector entity exposure limit under Basel III is much higher (10%) and allows netting in the exposure calculation.

Responsibility for classification determinations

The consultation document requires supervisors to review and approve how banks demonstrate whether a cryptoasset should be classified as a Group 1 cryptoasset. Additionally, it is stated that "[a] cryptoasset must be classified as a Group 2 cryptoasset unless a bank demonstrates to the supervisor that the cryptoasset meets all the classification conditions" (SCO 60.26). This could mean that prior supervisory approval is required for any classification of a Group 1 cryptoasset. We believe banks, not regulators, should be responsible for determining whether a cryptoasset can be classified as Group 1 assuming, of course, that the classification criteria are met.

We also believe banks should be responsible for determining whether a Group 2 cryptoasset meets the hedge recognition criteria for inclusion in Group 2a. The current consultation document does not specify whether banks or regulators should be responsible for making such determinations. For the same reasons that banks should be responsible for Group 1 determinations, they should also be responsible for Group 2a determinations. We would appreciate clarification of this point.

Crypto custody business

When a bank holds cryptoassets in custody for third parties, these cryptoassets will not appear in its balance sheet. We therefore assume that the consultation document does not cover cases where a bank holds cryptoassets for third parties, since otherwise crypto custody by banks would be economically unviable due to the high capital requirements that would be generated. This would lead to the crypto custody business migrating to unregulated sectors. With this in mind, we would appreciate clarification that holding cryptoassets in custody for third parties does not fall within the scope of the Basel standards.

Investment firms

We recommend explaining how investment firms should implement the prudential treatment of cryptoassets. In the EU, investment firms (under the Investment Firm Regulation) are subject to some of the same requirements as banks in terms of capital requirements, though regulation differs elsewhere. We would appreciate consideration of these requirements and correspondingly uniform global standards.