

Response of the Global Legal Entity Identifier Foundation (GLEIF) to the Bank for International Settlements Basel Committee on Banking Supervision Discussion Paper Designing a Prudential Treatment for Crypto-Assets

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The Global Legal Entity Identifier Foundation (GLEIF) is pleased to provide comments to the Bank for International Settlements Basel Committee on Banking Supervision (the Committee) Discussion Paper Designing a Prudential Treatment for Crypto-Assets. GLEIF will focus its comments on the use of the Legal Entity Identifier (LEI) in the Discussion Paper.

In the Discussion Paper, it is stated that while banks have limited direct exposures to crypto assets, there may be a number of channels, by which they could be exposed to the risks from crypto assets. The Committee is considering whether to specify a global prudential standard. Supporting the Committee's consideration to develop a global prudential standard, GLEIF suggests that this new global prudential standard for crypto-assets should be based on existing global standards that were developed for making financial markets robust and transparent, such as the Legal Entity Identifier (LEI).

Given this background, GLEIF would like to respond to Q1, Q4 and Q11 in the Discussion Paper.

Q1: What features of crypto-assets should be considered in the context of developing any potential regulatory definition? Please describe the features and their relevance for the prudential treatment of crypto-assets.

GLEIF is of the opinion that the issuer of the crypto-assets, the platform where they are distributed and/or transacted, and the provider of custody/safekeeping services should all be easily identified facts in any crypto-asset transaction. GLEIF suggests to the Committee that this information should never be considered anonymous in a crypto-asset transaction and furthermore should be identified via a global standard so as to ensure that a framework for prudential treatment of crypto-assets may develop. [The European Securities and Markets Authority \(ESMA\) Advice on Initial Coin Offerings and Crypto-Assets](#) highlights that there are concerns around fraudulent Initial Coin Offerings (ICOs), whereby crypto-assets either do not exist or issuer/developers disappear after the ICO. These could represent up to 80% of ICOs according to some sources¹.

The Committee could consider recommending all banks to require exchange of the LEI for crypto-assets transactions which are created with the involvement of a legal entity or entities such as the issuer of the crypto-assets, the platform where they are distributed and/or transacted, and the provider of custody/safekeeping services. Given crypto-assets operate cross-border, developing a prudential treatment would require global standards. The Legal Entity Identifier (LEI), a global standard (ISO

¹ <https://cryptoslate.com/satis-group-report-78-of-icos-are-scams/>

17442), could be leveraged by all regulators, as well as participants in a crypto-asset transaction, across jurisdictions for uniquely identifying entities involved in creation of crypto-assets. In particular, parties involved in crypto-asset transactions could easily exchange the information in a protected and private manner, but leverage the LEI to access the publicly available LEI data pool in order to identify precisely who is involved in a particular transaction. Additionally, regular, consistent and standardized use of the LEI would prevent regulatory arbitrage across different jurisdictions.

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

The Committee has rightly identified that the creation, users, and validators of crypto-assets, applied legal framework and transparency related to key crypto-asset market data affect the risk profile of different crypto-assets.

GLEIF is of the opinion that, as also highlighted in Q1, for crypto-asset types that are created by or involve guarantees from legal entity or entities; application of the LEI enables understanding of who is involved in a particular transaction regardless of the jurisdiction or type of legal entity involved. This would substantially enhance the ability to conduct risk analysis (e.g. aggregation of exposures to particular counterparties), thereby reducing risk perception relative to these crypto-assets vis-à-vis banks, investors and regulators. The same logic can be also applied to users and validators of crypto assets. As mentioned by the Committee, some crypto-assets could be restricted solely for intra-group payments or could be limited to a specific industry. However, for certain crypto-asset markets, given a handful users own a significant amount of crypto-assets, consistent identification of these users by their LEIs would enable authorities' ability to identify such situations. When the credit and counterparty risk is not well understood, banks which are lending to entities that invest in crypto-assets or that form a crypto-asset ecosystem may find it difficult to adequately price the risk of the borrower defaulting on the loan due to the lack of historical data on crypto-assets. This leads to inefficiencies in the financial system and room for arbitrage.

That being said, when the LEI is used for identification of such entities, banks can easily and correctly match the LEI of entity involved in the crypto-assets transaction with this entity's profile in the bank. Once the LEI is used as a data connector across different datasets, the Banks can assess their and their customers' risk exposure correctly.

In summary, the LEI is a critical building block for establishing a risk profile of the entities involved in a crypto-asset transaction.

Q11: What are your views on the disclosure requirements related to banks' crypto-assets? Should additional information related to banks' crypto-assets exposures be disclosed?

GLEIF agrees with the Committee's approach that a crypto-asset and a traditional asset that are otherwise equivalent in their economic fundamentals and the risks they pose should not be treated differently for prudential purposes. The prudential framework should account for any additional risks resulting from the unique features of crypto assets relative to traditional assets.

As highlighted in the Discussion Paper, as part of the Pillar III requirements, banks would be required to disclose granular information on any material crypto-asset holdings on a quarterly basis, which would

include information on the exposure amounts of different direct and indirect exposures based on several exposure channels, the capital requirement for such exposures and the accounting treatment of such exposures.

GLEIF would like to underline that banks may only include accurate information on the exposure amounts of different direct and indirect exposures given they have a clear risk profile of their customers, third party providers (e.g., wallet providers) and issuers. As the recent global financial crisis has demonstrated, creating accurate risk profiles can only be achieved through correct and unambiguous identification of entities involved in transactions and the connections between these entities. With the introduction of crypto-assets and their associated ecosystems, the global financial system has new and rather opaque players, for which unique identification of legal entities is more important than ever.

In summary, additionally, for example in the European Union, the 5th Anti Money Laundering (AML) Directive, 5MLD requires firms offering crypto-asset exchange services and custodian wallet services to fulfill customer due diligence obligations and verify the identity of their customers. Going forward, the LEI could be considered as a requirement for identifying and verifying crypto-asset exchange and custodian wallet service providers and their customers.

GLEIF suggests the Committee consider requiring the use of global standards and identifiers as part of the disclosure requirements related to banks' crypto-assets. In particular, embedding the LEI into the prudential framework for crypto-assets ensures transparency and predictability in financial markets in alignment with the G20 and Financial Stability Board original objectives for the Global LEI System.

Submitted by:

Stephan Wolf, CEO GLEIF

Stephan.Wolf@gleif.org