Second Basel Committee on Banking Supervision consultation on prudential treatment of crypto-asset exposures

ABI response

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General remarks

ABI welcomes the opportunity to contribute to the second Basel Committee on Banking Supervision consultation on the prudential treatment of banks' crypto-assets exposures.

ABI considers the definition of a prudential treatment a fundamental component for a crypto-assets regulatory framework that could contribute to mitigating the related risks and put those new instruments under a regulated environment, so enabling intermediaries to set up a specific offer in this new market segment.

Compared to the previous consultation, the Association considers very relevant:

- the definition of "crypto-assets" which is aligned with EU Markets in crypto-asset regulation proposal;
- the recognition of hedging for some Group 2 crypto-assets;
- the introduction of an alternative to the basis risk and redemption risk tests for regulated and supervised issuers.

However, according to the general principles "Same risk, same activity, same treatment," and "Simplicity", identified in the previous consultation, and with the aim to create a level playing field for all operators who are about to have exposures in crypto assets and/or to offer services in this area, some further improving changes can be made to the current scheme.

In our opinion, the proposal in the Consultation document still penalises banks, as they could be discouraged from the provision of those services that will lead to an exposure in crypto-assets. In this context, it is clear that banks are strongly penalised since they would not compete on an equal footing with other entities, i.e., FinTechs, BigTechs and new players like Crypto-Asset Service Providers (CASPs) which are not subject to the same capital requirements. Looking at the regulatory proposal at the European level and in particular the MiCAR proposal as a reference, CASPs would be held to less strict regulatory and supervisory requirements. In this case, the competitive advantage of extra-EU players could attract European consumers who would therefore be more exposed to risk.

This rigid approach would disproportionately affect banks with a smaller volume of business in this market, which would likely always apply the 1250% risk weight due to the huge compliance costs for access to specific (and less expensive) approaches. This could give rise to different assessments among banks leading to different crypto-asset categorisations and thus different prudential treatments. Unequal treatment for the same exposure is undesirable and in conflict with the principles guiding the consultation.

As a last general consideration, we stress the point that the categories identified for prudential purposes need to be, to any extent, consistent with the categories of crypto-assets that are being defined in the relevant legislation, since work in this regard is underway in some jurisdictions. Even if we understand the global reach of the BCBS, taking into consideration the Markets in crypto-asset regulation for the EU as an example, Group 1 and Group 2 classification is not aligned with the MiCAR taxonomic categorisation and comparing it with the classification conditions (section SCO60.5-SCO60.27), some doubts and grey areas will persist.

Having said that, and due to the global competition imposed by the nature of these instruments, we call for the need to prioritise the taxonomic harmonisation of the various crypto-assets at the international level, in order to create a level playing field on a global scale.

Specific aspects and proposed amendments

Based on the feedback gathered from our members, we want to emphasize some aspects that, in our opinion, would merit reconsideration or further analysis. At the same time we propose amendments aimed at allowing banks to significantly reduce the unlevelled playing field and the required efforts, balancing the prudential needs with more proportionated and balanced ones.

Specific aspects

- We see a disproportionate approach coming from the "*ongoing basis*" required for*: (i) assessing whether a cryptoasset is compliant with the classification conditions; and (ii) demonstrating to supervisors how a cryptoasset fulfils these conditions"* (SCO60.25), especially with regard to the tokenised financial instruments. Consider, for example, the disparity that would arise with a bond issued by a company on DLT with another bond issued by the same company "traditionally". The ongoing assessment of the classification conditions and the obligation to demonstrate to the competent authorities how these are fulfilled, would more likely penalise the instrument issued on DLT, even if these two instruments were exposed to the same risks for the purposes of calculating the prudential treatment. Moreover, another risk of this approach is a potential fragmented assessment derived by interpretation and application of the rules across the banking sector.

- We disagree with the default approach which categorise all crypto-assets in group 2 as a starting point, thus leaving the burden of evaluation on banks to exclude a crypto-asset from this category. The verification and analysis of the redemption, the basis risk test (SCO60.12-SCO60.16) and of all the classification conditions that banks should perform in order to classify crypto-assets in Group 1 (SCO60.8-SCO60.18) are burdensome, complex and hardly to be sustainable. Since some banks may not have the resources to perform these tests, they would have to apply the more conservative Group 2 treatment for all exposures, leading to an unacceptable application of stricter prudential requirements for some of them.

- Keeping the 10bp criteria would mean automatically put almost all existing stablecoin in group 2 or in the category of stablecoin that "narrowly passed" the basis risk test. To this respect, we welcome and suggest to apply from the outset the provision contained in SCO60.17: "*The Committee is considering this* *requirement as an alternative to the basis risk and redemption risk tests described in SCO60.12 to SCO60.16 above."*

- We believe that the prudential treatment proposed for Group 2 crypto-assets (SCO60.59-SCO60.91; SCO60.102-SCO60.104) and the 1% limit for overall exposures prevent the provisioning of those services that are strictly dependent on these exposures, thus limiting the competition in the whole crypto-asset market.

- The introduction of an add-on related to market infrastructures seems conservative and not future proof. First, it would be useful to differentiate the infrastructure risk between DLT permissionless and permissioned. For instance, in permissionless blockchains it is more difficult to mitigate AML/CFT, operational, ICT and cyber-risks. It is also pointed out that in permissionless blockchains it would be more difficult, or in some cases impossible, to clearly identify responsibility and accountability. Second, we see other Regulators working for the inclusion of DLT solution providers into some category of regulated and supervised entity (see EU DLT Pilot Regime regulation): this should be taken into consideration as it could reduce the infrastructure risk, especially when compared to other market infrastructure. In this regard, we strongly believe that the prudential framework should at least differentiate between DLT infrastructure configurations, applying the appropriate calibration and eliminating, in some cases, the add-on buffer. Ultimately, an infrastructure add-on would inhibit the development of the digital markets, as investors will always prefer the cheaper traditional instruments, due to lower capital requirements: in the case of bonds, investors will prefer to buy the traditional bond vs. the digital bond. Even though the DLT technology can provide significant efficiency benefits and simplify current solutions, those would be outweighed by the additional costs that the regulation would entail. Therefore, this would be a significant obstacle to the adoption and application of DLT technology in the banking sector.
- We rise a point of attention with reference to SCO60.4 and the definition of "exposure". In the document, the term "exposure" includes on- or off-balance sheet amounts that give rise to credit, market, operational and liquidity risks. It includes activities, such as non-fiduciary custodial services, that may only give rise to operational risk. We consider the safekeeping of digital keys is/could be qualified as non-fiduciary custodial service. To this respect, in July the Office of the Comptroller of the Currency[1] explains that a bank that provides custody for cryptocurrency in a non-fiduciary capacity, typically would not involve physical possession of the cryptocurrency, but rather "essentially provide safekeeping for the cryptographic key that allows for control and transfer of the customer's cryptocurrency". Should this understanding be correct, we foresee a possible market distortion when comparing keys safekeeping service provided by a bank, versus the same service provided by a third entity (e.g., "FinTech") which doesn't have to comply to the Basel Committee framework.

Proposed amendments and suggestions

- We suggest identifying a subset of instruments for which presumptions or a more simplified evaluation processes can be envisaged. Also, we suggest introducing a mechanism that grants banks not to seek approval for Group 1 status for crypto-

[1] https://www.occ.gov/topics/charters-and-licensing/interpretations-and-actions/2020/int1170.pdf

assets that have been approved within the same jurisdiction. In this respect, the BCBS or any other international authorities should maintain a public record/list of approved Group 1 cryptoassets qualified as eligible to ensure transparency and level playing field across jurisdictions. A further alternative that could be considered, in order to ensure that no fragmentation is created, could be the categorisation within Group 1 (at least as a starting point) for crypto-assets that have been evaluated as such by other supervised entities.

- Taking the MiCAR Regulation as an example for the European jurisdiction, it could be useful to note that it will provide some specific requirements for most of the stablecoins on the reserve management, on the stabilisation mechanism and from an organisational standpoint. Starting from this assumption, we strongly support the idea (raised by the BCBS in article 60.17 of the proposal) that issuance by a prudentially regulated and supervised entity (subject to capital and liquidity requirements) is considered as an alternative requirement to the basis risk and redemption risk tests. On this basis, we deem that all the crypto-assets classified as e-money tokens or asset-referenced tokens according to MiCAR should be attributed to Group 1 without any other verification obligation for the bank.

- When responsibility to assess a crypto-asset to be considered within Group 1 falls on banks, the conditions of classification must be clear, adequate and unambiguous. We recommend identifying objective criteria rather than classification conditions that cannot be measured. To this end, we underline the difficulty of measuring whether a network on which a crypto-asset is based is “sufficient” enough not to compromise transferability, redeemability and settlement finality. We promote a clear and objective classification requirement classification otherwise "fragmentation" could occur, thus allowing banks to be able to comply with the envisaged treatment and to have more certainty about valuations. Having said that, we believe it is essential to provide guidelines that can make the assessment of all classification conditions less burdensome and more objective.

- We advocate for a revision of the prudential treatment scheme for Group 2. It is considered that the proposed prudential treatment for crypto-assets belonging to Group 2 should be aimed at ensuring the proper capital robustness without, however, unduly burdening the competitiveness of operators. Indeed, taking into account the prudential framework for Group 2 crypto-asset (more conservative RWA and the 1% limit exposure) compared to the capital requirements to which crypto-asset service providers will be subject under MiCAR, the application of the more conservative treatment for these assets makes the provision of the same services more costly for banks. This intervention seems necessary as most of the services available and of interest to banks clients are based on these instruments (e.g. Bitcoin and Ether) which would inevitably fall into the Group 2 category. This intervention is also crucial to enable banks to operate in the crypto-asset market in a more integrated and competitive manner.

- Finally, we find of utmost importance that the Committee clarifies that certain off-balance sheet exposures (e.g. those from custody services) only generate operational risk (if any). Clarification is deemed necessary as the current wording “may” raises some ambiguity in this regard.