

Bank for International Settlements

Re : **Designing a prudential treatment for crypto-assets**

March 13, 2020

Dear BIS,

I have the following comments on the following issues:

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

First, how should the value of crypto-assets be measured prudently? When the crypto-asset is initial issued or exchanged in VASPs (Virtual Asset Service Provider), what kind of financial models are used to determine the value? Moreover, when the legal person holding crypto-assets it can be present the value in a financial report. It is recognized by the intangible asset or inventory, and it can fully disclosed information.

Second, we need to examine how crypto-assets are transferred or exchanged. It is important to understand what technology and infrastructure is used to enable crypto-assets to perform value transfers or exchanges. Moreover, its value transfer or exchange can be verified, and its results are trustworthy, and no errors occur.

Third, we must also consider how crypto-assets create liquidity value? If crypto-assets can't create liquidity, what method is allowed to make liquidity in market? It can help the market of crypto-assets to grow steadily and healthily.

Finally, for smart contract of crypto-assets that have auto-run function in any application, it is necessary to review whether their programs can be trusted without code bugs? Assume that the program error has occurred, and the value of crypto-assets has been lost due to transfer or exchange. Is there a protection mechanism to remedy or restore the original loss?

Q2. What are the main economic and related functions and potential sources of value of crypto-assets that are relevant in the context of developing a prudential treatment? To what extent do these functions and potential sources of value affect the relative prudential risks of different crypto-assets for banks? Are there other potential sources of value that are relevant

in designing a prudential treatment for crypto-assets?

In view of the value of payment or exchange, crypto-assets can easily complete the function of cross-border payment or exchange, and it can be completed in a short time, which is more efficient than traditional financial systems such as SWIFT. However, this is also an easy tool for illegal persons to commit illegal acts. Therefore, developers and issuers of crypto-assets must consider related risk management mechanisms to control abnormal behavior.

Second, the investment behavior for crypto-assets is to invest in intangible value. There is no physical existence, and no physical assets can be used as support or mortgage. Therefore, intangible value is easy to be manipulated by human nature, and may be valued high or zero.

Furthermore, even though crypto-assets can provide utility services, these services cant meet the needs of everyones life. For example: it is not possible to use every crypto-asset to buy goods in a supermarket. The utility services of many crypto-assets are limited to specific fields.

Regarding the stable-coin of crypto-assets, it is not used to stabilize the price fluctuations of the crypto-asset market, it is only a tool for exchanging physical fiat currencies. Moreover, compared to the total market value of stable-coins and the total market value of crypto-assets (1:30), the price of crypto-assets is easily manipulated by humans and exposes the existence of liquidity risks.

Q3. What benefits do crypto-assets provide for the banking system, and the provision of financial services more generally?

Accelerate trust between each other and generate more value. With open decentralized ledger technology, establishing mutual credit is more efficient than traditional financial systems. For example, based on crypto-assets, it is easy to establish a credit line between each other and apply it to traditional financial services through the credit line.

When the holders of crypto-assets are connected to the banking system, each holder is a branch of the banking system, which means that the bank has many micro branches to perform related traditional financial services.

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

In the field of DeFi (Decentralized Finance), an application may be a service generated by one or more smart contracts, or it may be a service generated by linking one or more smart contracts through other applications. Therefore, an application is a service, and many applications can combine one or more services. DeFi here is called a stacked architecture. In practice, an application can ensure that no errors occur in its services. However, if an application is integrated by other applications, it is difficult to ensure that the operation of its system is reliable and no errors will

occur.

Q5. Do you agree with these general principles in guiding the design of a potential prudential treatment of crypto-assets? Are there additional principles that should be considered?

Crypto-assets can be treated with the same types of activities and risks. Crypto-assets are often updated through underlying protocols to form cross-type activities and unpredictable risks.

According to the Simplicity principle, there must be a minimum valuation method for crypto-assets to measure the minimum value of crypto-assets. The issuers must be asked how to build value management actions for crypto-assets.

Q6. Are there additional channels other than those listed above by which banks could be directly or indirectly exposed to crypto-assets? Which channels could potentially be the most material for banks? How do these exposure channels vary by different types of crypto-assets? What are the benefits and risks associated with banks' crypto-asset exposures through these different channels?

The investors use crypto-assets to invest in securities around the world. Settle directly with crypto-assets and obtain securities of specific countries and companies. Or, policyholders use crypto-assets to purchase insurance services around the world. Settle directly with crypto-assets and obtain insurance services in specific countries and companies.

For "exchanging crypto-assets for fiat currency, and vice-versa" is more immediate, especially in anti-money laundering. It is difficult for the banking system to detect suspicious transactions in crypto-assets and establish blacklist management.

Q7. Are any exposure channels likely to change in response to ongoing or envisaged developments in crypto-asset markets?

We need more observations and reviews!

Q8. Which risks would be the most material with respect to banks' exposures to crypto-assets? Are there additional risks other than those listed above which banks could be exposed to as a result of holding direct or indirect exposures to crypto-assets, or providing related services? To what extent do these risks differ based on the type and design of crypto-assets, and how do they differ to traditional asset classes?

The liquidity risk is the first priority for crypto-assets. The crypto-assets are traded 24 hours a day, with more than 10,000 VASPs serving in the worldwide. There is no limit to the rise and fall of prices, and there is no mechanism to stop trading. Once the information is under asymmetry, the market is easy to be controlled by human, and the true value of crypto-assets can't be found.

The taxation is a risk faced by the banks holding crypto-assets. The holders of crypto-assets are intangible assets (IAS 38) or inventories (IAS 2) and non-financial assets (IAS 32) in the interpretation of the IASB. If each country has different taxation principles for crypto-assets, the country A will charge transaction tax and the country B will charge income tax, which will cause the banks to bear a lot of costs in handling tax operations.

Q9. What are your views on the illustrative example of a prudential treatment for high-risk crypto-assets? Which crypto-assets would classify as high-risk based on the criteria set out above? What other features could be considered in specifying the scope for such a potential treatment?

The stable-coins of crypto-assets do not necessarily belong to high-risk assets. If the stable-coin can be subject to the supervision of the local country, its risk management can be recognized, and it can be used as a financial collateral to establish a credit line.

Assuming that the stable-coin base is based on gold reserves, does it belong to Common Equity Tier 1 capital? We need to discuss and observe.

Q10- Q15.

No comment.

Yours sincerely,

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