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Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland

Prudential treatment of cryptoasset exposures (consultative document)

Ladies and gentlemen,

The Committee has commenced in June 2021 the consultation on the document 'Prudential treatment of cryptoasset exposures' as an initial step towards the promulgation of the internationally binding capital and liquidity rules applicable to banks' exposure to cryptoassets.

METI Advisory AG (www.meti-advisory.com), a consulting boutique specialised in providing effective and sustainable solutions to crypto and blockchain businesses, welcomes the steady effort from the BCBS to regulate cryptocurrencies, because it believes that this is a key pre-condition for the new asset class to be broadly adopted and to deliver its benefits in a risk-controlled way.

Recap of Core Tenets of the Proposals

The consultation document builds on a discussion paper issued in December 2019, and introduces the distinction between i) tokenised traditional assets, ii) non-algorithmic stablecoins and iii) other cryptoassets, such as bitcoin, ether, utility tokens, DeFi tokens, and other network tokens, as well as algorithmic and crypto-backed stablecoins.

The Committee propose that the 'Pillar 1' formulaic minimum capital charge for banks' exposure to i) tokenised traditional assets should be at least equivalent to those of traditional assets. However, the exposure to ii) non-algorithmic stablecoins should be subject to new, dedicated Pillar 1 guidance.

The Committee also suggests that iii) other cryptoassets (e.g. bitcoin, ether, utility tokens, DeFi tokens, and other network coins), as well as algorithmic and crypto-backed stablecoins, should

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be subject to the one-size-fits-all, harshest possible Pillar 1 charge (1,250% risk-weight) corresponding to the full exposure deduction from the capital base.

The BCBS plans to supplement the Pillar 1 minimum charge with an operational risk add-on, as well as provide additional guidance under Pillar 2 (supervisory review process) and Pillar 3 (disclosure), and extend the current leverage ratio, large exposures, and liquidity ratio frameworks to cryptoassets.

Assessment & Way Forward

METI Advisory AG appreciates that by introducing the above-mentioned distinctions, the BCBS recognises the ineluctability of asset tokenisation and stablecoins. The BCBS sticks however to the idea of applying the one-size-fits-all, harshest possible capital charge to the exposure to all cryptoassets other than tokenised traditional financial assets and non-algorithmic stablecoins.

METI Advisory AG notes that that from a risk viewpoint, such an approach assimilates diverse cryptoassets such as bitcoin, ether, utility tokens, DeFi tokens, and other network coins, as well as algorithmic and crypto-backed stablecoins, to a single asset, akin to the worst externally rated traditional securitisation tranches.

METI Advisory AG firmly believes that the assimilation of diverse cryptoassets to a single asset evidences i) a poor understanding of the natures of these diverse cryptoassets and ii) a lack of progress, compared to the discussion paper issued in 2019, in the analysis and understanding of what constitutes the most genuine asset addition since the emergence of blockchain-based finance. This position cannot be the final one and needs to be further elaborated.

Bitcoin, ether, utility tokens, DeFi tokens, and other network coins, as well as algorithmic and crypto-based stablecoins differ widely in terms of their economic functions, risk profiles, and governance arrangements, and these differences need to be understood, acknowledged and taken into account when specifying capital adequacy and risk management prudential rules. The operational risk associated with these assets is bound to reduce over time as the framework ecosystem becomes more professional and possibly regulated (e.g., regarding cryptoexchanges).

MET Advisory AG thinks that, in an historical perspective with respect to the development of minimum capital requirements, the blunt assimilation of these diverse assets to the worst externally rated securitisation tranche is a simplified treatment when compared to the risk-weighting system introduced in 1988 for bank traditional assets - the so-called Basel 1 framework: Those initial rules considered at least five different risk weights applicable to five different categories of assets. These rules were subsequently significantly developed over time (Basel 2 in 2004, Basel 3 in 2010, and Basel 4 in 2017).

METI Advisory AG also refers to remarks articulated in its position paper provided to the Committee within the context of the consultation on the 2019 discussion paper when it comes to comment on the harshest possible Pillar 1 charge (1,250% risk-weight), corresponding to the full exposure deduction from banks' capital base, chosen against the one-size-fits-all cryptoasset class comprising Bitcoin, ether, utility tokens, DeFi tokens, and other network coins, as well as algorithmic and crypto-based stablecoins.

Such a high capital charge is likely to originate more from fear than from reason. The Committee should first achieve a full understanding of the additional risk factors and exposure channels currently associated with crypto-assets and clearly isolate the intrinsic risk carried by crypto-assets from the broad operational risk currently surrounding their development (which in part originates from a currently immature and incomplete market infrastructure).

The Pillar 1 standard as currently illustratively proposed would just prevent banks from participating in the crypto-asset market and from offering services vital for the development of such markets – effectively promoting parallel, unregulated, activities and delaying innovation.

The BCBS is not proposing new approaches for the large exposure rules and leverage and liquidity ratios. Rather, it suggests extending the current frameworks to cryptoassets. Therefore, the treatment of cryptoassets for large exposure purposes will follow the rules applicable to traditional assets, and cryptoassets will be included in the leverage ratio calculation according to their financial reporting values. METI Advisory AG agrees with this stance.

The BCBS also states that cryptoassets will not qualify as eligible high-quality liquid assets in the calculation of banks' liquidity coverages and net stable funding ratios. While METI Advisory AG believes that this position is correct at the current stage of cryptoassets development, it thinks that the nature and role of cryptoassets in the economy is poised to evolve materially going forward. METI Advisory AG suggests to keep the current stance open to accommodate further developments and situations.

Under Pillar 2, the BCBS specifies different sets of responsibilities for banks and supervisors. Banks are expected to ensure that risks not captured under Pillar 1 are assessed, managed, and mitigated appropriately, on an ongoing basis, and following internal policies. The scope includes operational and cyber risks, technology risks, and anti-money laundering risks. Supervisors should review the appropriateness of banks' policies and procedures and the adequacy of their results. Depending on the outcomes, supervisors may require stress testing and scenario analyses, additional provisioning (including in the form of capital charges), and mitigation measures. METI Advisory AG believes that the approach foreseen under Pillar 2 is adequate.

METI Advisory AG is strongly convinced that to achieve a more detailed and realistic understanding, it is important that the BCBS includes in the process the know-how of the cryptoindustry, which typically resides outside the scopes of BCBS-regulated entities.

A direct involvement of the unregulated industry will facilitate achieving a deeper understanding of cryptoassets and the recognition of the diversity of their economic functions, governance arrangements, and risk profiles.

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METI Advisory AG would like to thank the Committee for the opportunity to comment on the proposed rules and stands ready to contribute as requested.

Yours sincerely,

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