POLISH BANK ASSOCIATION

Warsaw, 9 September 2021

Basel Committee on Banking Supervision

Dear Sirs,

Polish Bank Association response to BCBS consultation on prudential treatment of cryptoasset exposures

General comments

The Polish Bank Association welcomes the opportunity to comment the consultation paper on the prudential treatment of cryptoasset exposures published by the Basel Committee on Banking Supervision. Aside from responding to the different questions in the consultative document, we would like to give a few general remarks that are not directly addressed in the questions presented in the consultation paper, but which are important in our position in this area.

We support a coordinated works in order to create a global prudential framework for cryptoassets. The result of these works should ensure the creation of a level playing field across different jurisdictions. It is not only important to ensure a level playing field within the banking sector, but also with other market participants who are active in the cryptoassets. In this respect it is important to develop a framework that is prudent and captures the relevant risks.

We consider that the capital treatment of cryptoassets should be regulated in order to avoid the potential risk generated for stability of banking industry. It is good to do it at the moment when the market is not yet developed strongly.

We consider also that the capital treatment of cryptoasset exposures should be established in the way which will be closer to the regulatory treatment of more traditional assets, where this is justified by the relevant characteristics of the respective categories of cryptoassets. Providing a carefully calibrated regulatory framework for banks' exposure to cryptoassets would encourage the introduction of related products and services by banks, subject to the highest levels of scrutiny and risk management best practices. On the other hand, non-bank providers are not necessarily subject to comprehensive and robust risk management requirements, supervision or consumer protection regimes. Therefore, a concentration of crypto-asset activity in this non-regulated environment might undermine efforts to prevent risk of instability in the financial sector as the whole.

Generally, it can be said that the approach to develop the framework in an iterative process is important to account for the pace at which the cryptoasset markets and the technologies evolve and the different states of maturity of regulatory and supervisory frameworks connected to the prudential framework. Moreover, this would also allow a differentiating

Kruczkowskiego 8, PL 00-380 Warsaw, phone: +48 22 48 68 180, +48 22 48 68 190, fax: +48 22 48 68 100,
Nip: 526 000 09 91, PKO Bank Polski SA XV Oddział Centrum 02 1020 1156 0000 7202 0008 6215

assessment of individual types of cryptoassets for which currently no common taxonomy is established. In our opinion the Basel Committee should monitor and take into consideration developments in different jurisdictions to ensure a level playing field across jurisdictions and to avoid regulatory and taxonomy mismatches with applicable law.

Q1. What are your views on the Committee's general principles?

The Polish Bank Association supports the general principles as they are set out, in particular the principle on "same risk, same activity, same treatment". Concerning the proposal of the prudential treatment, we believe that these principles could be better reflected in the detailed proposals of capital treatment. Nowadays, we are convinced that the consultation document does not sufficiently differentiate between different types of cryptoassets. The cryptoassets that would fall into group 2 are actually very different from one another and are also subject to different risks, but, nevertheless, they would have the same capital treatment. A more granular methodology would be the more appropriate way to deal with the complexity of the subject at hand. This would help to ensure that the regulation, and the prudential treatment therein, is proportional to the risks and complexity associated with the different types of cryptoassets, which is a key principle in prudential regulation.

The starting point for the differentiation should be to adopt a general rule expressed as "substance over form". The clear and detailed definitions for the respective categories of assets are needed and they should capture the different types of cryptoassets and their characteristics. This approach will allow to examine to what extent the existing regulatory framework can be sufficient to be applied to those assets and not add new elements in the same regulatory treatment.
We believe that an appropriate balance needs to be found that considers the existing spectrum of different crypto-asset categories and their associated risk profiles, which is much more diverse than currently represented in the proposed groups. Especially for those crypto-assets that neither fall into 1a nor in 1b. Bucketing them all into group 2 with the same strict prudential treatment does not consider their diverse nature.

Q2. What are your views on the Committee's approach to classify cryptoassets through a set of classification conditions? Do you think these conditions and the resulting categories of cryptoassets (Group 1a, 1b and 2) are appropriate? Which existing cryptoassets would likely meet the Group 1 classification conditions?

The classification conditions could be improved through further differentiation. The spectrum of cryptoassets between group 1a/1b and group 2 is very diverse and would not be adequately captured by the proposals. Classifying cryptoassets that do not meet the conditions for group 1a and 1b as group 2, would lead to a very restrictive treatment due to the 1250% risk weight.

In particular the classification condition 1 for group 1b is expected to pose a considerable challenge, because it requires that the stabilisation mechanism guarantees that the difference in value of the cryptoasset vs that of its underlying traditional asset does not exceed 10bp more than 3 times over a one-year period, and requires banks to monitor this daily. The proposed threshold of 10bp and the maximum number of 3 excesses yearly seems to be very restrictive and exclude the big majority of existing cryptoassets from group 1b.

We have also already mentioned in the response to question 1 that group 2 as a category is too broad and is too less risk-sensitive.

Q3. What are your views on the classification conditions? Are there any elements of these conditions that should be added, clarified or removed in order to:

– ensure full transferability, settlement finality, and/or redeemability;

– limit regulatory arbitrage, cliff effects and market fragmentation; and

– take account of new and emerging cryptoassets?

There should be clear reference points as well as market data available on which cryptoassets are already considered to be compliant to know better which assets meet the conditions for group 1. It could be the start point for the discussion which category of cryptoassets fulfil these requirements.

Q4. For the first classification condition, is there an alternative methodology to assess the effectiveness of the stabilisation mechanism of Group 1b cryptoassets? Would this proposed methodology be consistent with ensuring the effectiveness of the stabilisation mechanism while also being practical?

We do not have knowledge to propose the alternative methodology to assess the effectiveness of the stabilisation mechanism. However, as we mentioned in answer to the question 2 the proposal of Basel Committee seems to be very restrictive and will eliminate a big majority of cryptoassets.

Q5. For the third classification condition, (i) would risk governance and risk control practices for Group 1 and Group 2 cryptoassets differ; and (ii) are there alternatives to the required risk governance and risk control practices that would ensure that material risks of the network are sufficiently mitigated and managed?

The spectrum of categories of cryptoassets in group 1 and group 2 is different and as the consequence the risk governance and risk control mechanism may differ.

Q6. For the fourth classification condition, (i) to what extent would the regulation and supervision of entities that execute redemptions, transfers, or settlement finality of the cryptoasset reduce risk in cryptoasset exposures held by banks; (ii) which entities should/ should not be in scope of regulation or supervision? For instance, are there entities involved in the transfer and settlement systems of cryptoassets (such as nodes, operators and/or validators) that should be excluded from the condition of required regulation and supervision?

It is obvious that the regulation and supervision of entities that execute redemptions, transfers or settlement finality of the cryptoassets reduce the risk in cryptoasset exposures held by banks. The question remains open to which extend the regulation and supervision should be implemented in order not to limit the potential market to strongly. The natural tendency going to the digitalisation of the market may provide to the implementation of regulation in the near future. However, today it seems to be unrealistic to regulate all the participants in decentralized protocols, as they can be very numerous, small and localized across the globe. However, given the risks at stake, the issue of regulation and supervision of professional cryptoasset service providers should be carefully assessed.

Q7. Do you consider the responsibilities of banks and supervisors to be clear and appropriate? Are there any other responsibilities for banks or supervisors that the Committee should consider?

As we indicated above it should be again analysed the responsibility of market participants (supervised bodies) and the supervisors for monitoring the effectiveness of the stabilisation mechanism.

We recommend also to establish the clear criteria which will allow to classify the cryptoassets exposures to the different groups by different banks. If the criteria is the efficiency of stabilisation mechanism the approach used by every bank may vary between them. The application of simple approach is very important particularly at the moment of first implementation of prudential regulations for banks in this area. This would avoid an excessive burden on banks and supervisors, and would guarantee consistency across jurisdictions.

Moreover, it would also be appropriate to provide a mechanism that grants that banks are not required to seek approval for Group 1 status on assets that have been already approved for other banks within a given jurisdiction. Bank supervisors or financial authorities should maintain a public record/list of approved Group 1 cryptoassets.

Q8. Are there ways in which the increased operational risk relating to cryptoassets (relative to traditional assets) can be measured? How should a pillar 1 add-on be designed to capture additional operational risks arising from exposures to cryptoassets?

We would like to remark that the current Basel framework on operational risk differentiates this risk by asset class, but rather takes into account certain metrics within the income statement and the balance sheet to compute the operational risk charge for each entity. Looking at this approach it is difficult to propose completely other solution in area of operational risk for cryptoasset exposures.

The future framework, as designed by the Basel Committee, will take into account the past operational losses of the relevant entity. Hence, banks will maintain their rigorous frameworks regardless of assets classes. The same operational risk standards will apply for all assets including cryptoassets. Therefore, we do not consider that an additional operational risk charge would be appropriate

Q9. Are there further aspects of the credit risk and market risk requirements that could benefit from additional guidance on how they should apply to Group 1a cryptoassets?

In terms of credit risk, the proposed regulation are sufficiently restrictive and the capital buffer will cover all component of credit risk connected with the cryptoasset exposures in banks.

In terms of market risk, the general rules should be used to cover that risk for prudential purpose.

Q10. Do you have any views on the Committee's current thinking on the capital requirements for Group 1b cryptoassets?

Our opinion in this area has been expressed above.

Q11. What further aspects of the credit risk and market risk requirements could benefit from additional guidance on how they should apply to Group 1b cryptoassets?

We do not express futher aspects in this regards.

Q12. Do you think the proposed capital treatment of Group 2 cryptoassets, including the application of a 1250% risk weight instead of deducting the asset from capital (for the reasons explained above), appropriately reflects the unique risks inherent in these assets?

As mentioned above, we consider that the group 2 encompasses too many different assets, which have quite different risks. While we can understand that in certain cases the regulatory framework foresees the possibility to introduce a 1250% risk weight for certain exposures, we believe that in the proposed approach the group 2 category would also encompass exposures which would deserve a lower risk weight. But in the current proposal all those exposures would be subject to the same capital treatment. Further differentiation between the different exposures and a higher granularity of the categorisation (including appropriately calibrated risk weights) would be important in this respect. For example, the lack of differentiation of treatment between "trading book" and "banking book" is inconsistent with the rest of the framework and a longstanding history of prudential standards.

A 1250% risk weight is as the burden in order not to have such cryptoasset exposures, not to participate in the crypto-market. It would be good for industry to understand which are the risks that were identified by the Basel Committee that in the end led to this requirement and application of sanction risk weights for every assets belonging to group 2.

From our perspective the application of a 1250% risk weight or deducting the asset from capital for prudential purpose have similar financial consequences for supervised entities. However, the application of a 1250% risk weight can lead also to a capital charge that is higher than the exposure value, due to additional Pillar 2 charges, buffer requirements etc.). Therefore, the sensible approach would be to allow banks to choose to apply the capital deduction or to apply a 1250% risk weight.

Q13. Are there alternative approaches that the Committee should consider that are simple, conservative and easy to implement? For exposures in the trading book, would it be appropriate to permit recognition of hedging via the application of a modified version of the standardised approach to market risk?

For positions on the same cryptoasset, the hedging should be recognised; the risk weight should apply to the net position, not to the maximum between the net absolute long and short position. This will be more aligned to the risk of the exposure to the cryptoasset.

Q14. Do you have any views on the Committee's current thinking regarding the leverage ratio, large exposures framework and liquidity ratio requirements? Are there further aspects of these requirements that could benefit from additional guidance?

The consultation paper excludes all cryptoassets from HQLA-eligibility. In our opinion this approach is too restrictive. At least group 1a assets, which are considered equivalent to traditional assets, should be able to be recognised as HQLA. If they share the key characteristics with other HQLA-eligible assets, in line with the eligibility criteria defined by the BCBS, then they should receive the same treatment. There should be no separate treatment for cryptoassets.

We don't believe that cryptoasset exposures cana have important impact on the leverage ratio or large exposures framework. In these areas the general rules of prudential treatment as sufficient and they do not have to be extended.

Q15. Do you have any views on the responsibilities of banks? Are there any other responsibilities or aspects that should be covered by banks for the purposes of the supervisory review?

Banks should ensure that it maintains the same rigorous standards around all risk types regardless of crypto-assets. Hence, adding it should not change banks broader views on risk management.

Q16. Do you have any views on the responsibilities of supervisors? Are there any other responses that could be considered by supervisors when conducting supervisory review?

This is not the area where we should express our position.

Q17. Do you have any views on the adjustments to minimum Pillar 1 capital requirements to capture additional credit and/or market risk? Are there any other potential modifications that supervisors may need to consider?

No.

Q18. Do you have any views on the potential design of disclosure requirements?

We support the Basel Committee's purpose of including cryptoassets into the scope of existing disclosures. However, these assets should be subject to firms' own assessments of materiality before being included into the scope of the disclosures. This will prevent the latter from becoming an overly onerous exercise and remove any additional burden for firms with non-material exposure to these type of assets, especially at a time where the crypto-market is still in its development stage. As such, the design of the disclosures should be left to each firm to decide on based on what befits their existing material portfolios.

Yours sincerely,

Krzysztof Pietraszkiewicz

President