



Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland
(By electronic submission)

9 September 2021

Standard Chartered's response to the Consultative Document (d519) on the Prudential Treatment of Cryptoasset Exposures

Dear Sir/Madam,

Standard Chartered ("**the Bank**") welcomes the opportunity to comment on the Basel Committee on Banking Supervision's ("**the Committee**") consultative document on the prudential treatment of cryptoassets exposures ("**the Consultation**"). In an effort to be as constructive as possible, please find enclosed in the Annex our response to the specific questions raised.

In summary, we support the Committee's three proposed guiding principles and its commitment to the iterative development of prudential standards. We agree that these standards should be proportionate and risk-based, while ensuring safety and soundness on three levels: the banks; the asset class; and the overall ecosystem. However, the proposed classification and subsequent treatment of cryptoassets is too simplistic and insufficiently granular, resulting in a generally punitive approach across cryptoassets that have different risk profiles. We caution that the proposed approach, if adopted as it currently stands, may inadvertently shift risky activity to less regulated areas and participants of the ecosystem. Therefore, we recommend the following modifications for consideration.

1. *Encourage bank participation in cryptoasset markets*

- Banks should be incentivised to participate at an early stage of development of the cryptoasset market for two reasons: (i) banks can help improve the transparency, liquidity and operational resilience of the market, with regular supervisory examination and reporting; and (ii) banks can develop risk management tools to support the overall policy goal of de-risking.

Recommendations:

- a. Provide interim guidance for the prudential treatment of cryptoassets (i.e., until the first iteration of the standard is complete) that enables bank participation, which will further enable the identification, collection and risk modelling of relevant data to drive greater understanding and future refinements;

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- b. Incentivise the development of risk management tools, for instance, it is important to enable netting and offsetting where appropriate, in view of similarities between cryptoassets and asset classes such as commodities, foreign exchange (FX) or credit derivatives that also feature complex price discovery and heterogeneous risk profiles, governance, volatility.

2. Sharpen differentiation in prudential treatment between cryptoassets

- More granularity is needed in classifying cryptoassets. The proposed Group 2 is too wide and buckets cryptoassets with very different risk profiles together. Group 1 cryptoassets may fall into Group 2 for process-related reasons unrelated to their intrinsic risk profiles and will be subject to the more conservative Group 2 treatment.
- Few (if any) cryptoassets would qualify for the proposed Group 1. Criteria such as an effective stabilisation mechanism and the regulation and supervision of certain cryptoasset entities will require further clarification.

Recommendations:

- a. Revisit and clarify the proposed classification conditions and add additional cryptoassets categories to achieve a more risk-sensitive framework;
- b. Build a dynamic, iterative and evolutionary framework, as it is important to enable an agile framework that allows reassessment and recalibration of conservative initial treatments periodically to reflect: (i) the changing risk profiles of cryptoasset markets, activities and ecosystems as they mature; and (ii) developments in the broader regulatory environment that provide risk mitigating benefits.

3. Develop integrated and holistic oversight across the ecosystem

- Banks are responsible for delivering good risk management outcomes across cryptoassets in relation to the products and services they provide. However, the proposed framework's reliance on banks to assess compliance with broad conditions for all cryptoassets and their ecosystems on an ongoing basis is disproportionate, and a material deterrent to participation.
- Banks can contribute to the de-risking of cryptoasset markets, but cryptoasset regulation must extend beyond the banking sector across the cryptoasset ecosystem. As regulatory changes and cryptoasset frameworks take shape, banks should be able to rely on such regulated status, rather than duplicating due diligence efforts across entities and jurisdictions.

Recommendations:

- a. Recalibrate the requirements around roles and responsibilities so that they are more proportionate to specific risks and activities undertaken, and more practical to implement on a consistent basis;



- b. Permit banks to read across to the authorisation/regulatory status of a cryptoasset and participants in its ecosystem when determining prudential treatments.

We look forward to continuing this discussion with you in the near future.

Yours faithfully,

A handwritten signature in black ink, appearing to read 'Vinoy'.

Vinoy Kumar, Global Head
Digital Assets

A handwritten signature in black ink, appearing to read 'Farisa'.

Farisa Zarin, Global Head
Group Public and Regulatory Affairs



Annex

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

We are supportive of the Committee's three principles of "same risk, same activity, same treatment", simplicity, and minimum standards. It is also important that in a still-developing environment, a dynamic approach to regulation is adopted that leverages existing prudential frameworks where appropriate and accommodates changes in the risk profiles of cryptoassets as markets and use cases mature. In the near term, as a dedicated prudential regime for cryptoassets is under consideration and development, there is also a need for an interim risk-based supervisory approach that is proportionate to the risks posed by different classes of cryptoassets and consistent with existing regulatory requirements, to minimise uncertainty about the establishment of cryptoasset businesses. While a conservative treatment for many cryptoassets under an interim approach, it is important to begin the process of collecting, modelling, and analysing pertinent data at an early stage in order to enable dynamic and risk-sensitive approaches in the final prudential framework.

While we agree with the Committee's overarching goal of simplicity, the proposed classification and subsequent treatment of cryptoassets is too simplistic and insufficiently granular, resulting in a generally punitive approach across cryptoassets that have different risk profiles. This approach is likely to disincentivise the involvement of banks in cryptoasset markets, pushing cryptoasset activity out of regulated spaces, and thus potentially reducing overall regulatory oversight, transparency and bank-led risk management of cryptoassets. We strongly believe that the participation of regulated institutions in cryptoasset markets will further the policy goals of high standards of consumer protection and conduct with robust risk management and mitigation. More significantly, unregulated intermediaries may step in to provide cost-effective services around such products while posing greater risks to consumers.

Greater granularity in the prudential framework will also be critical to accurately capture not only different risk profiles of cryptoassets, but also changes in the risk profile of a cryptoasset over time. What is more, there are likely to be instances where a cryptoasset's Group classification changes, or where it temporarily fails to completely meet a classification condition (e.g. when awaiting supervisory approval). In order to ensure orderly transitions and avoid direct market impacts, further clarity on the availability of transitional relief, grace periods and timelines for compliance is required. Further, in the proposed framework a Group 1 cryptoasset that is temporarily dropped to Group 2 as a result of changes to the verifiability of its classification conditions will be subjected to the punitive treatment of 1250% risk weight. This would result in the traditional asset and the tokenised form of the asset being treated very differently for purely legal-regulatory reasons, which does not align with the Committee's first principle and is not technology neutral. This in turn could contaminate existing approaches for managing capital and liquidity for traditional instruments.

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?

It is important for market participants to have clarity on the relevant features and conditions for determining a cryptoasset's classification. The proposed classification criteria are not, in our view,



properly calibrated to enable an assessment of risk and result in a process heavy approach that impedes rather than enables safer innovation and activity.

For instance, few or no existing cryptoassets would qualify for Group 1 because all operators of the transfer and settlement systems of Group 1 cryptoassets need to be regulated and supervised, which is not the case in most major jurisdictions at present. In light of these current inconsistencies in regulatory coverage, further clarity is needed on the expected coverage and level of regulation or supervision that would meet the Committee's criteria for operators of the transfer and settlement systems: for instance, whether the application of anti-money laundering regulations alone would suffice, or whether operational resilience regulation would also be required. It is possible that the appropriate level of minimum regulation could vary across different entities, depending on their roles and responsibilities within a cryptoasset ecosystem.

The proposed Group 2 is currently designed as a "catch-all" classification, subject to a negative definition (everything that is not Group 1). Further granularity within this category would be appropriate to capture differences across the relative market depth, liquidity profile and operational resilience of different cryptoassets and associated markets. Moreover, the current proposed treatment does not account for cryptoassets that participants would expect to qualify for Group 1 but that temporarily fall outside Group 1, for reasons other than a change in their underlying risk profile, for instance because they are awaiting regulatory re-approval for a stabilisation mechanism. As noted above, in such a circumstance the more conservative treatment would apply regardless of the cryptoasset's underlying risk profile in a way that is likely to be disproportionate and disruptive to markets. We would therefore propose the creation of a fourth category encompassing Group 1 assets that have a risk profile between Groups 1 and 2. Such a middle ground could also include the more commonly traded cryptoassets such as Bitcoin and Ether, which are traded with sufficient volume levels to provide liquidity, price history and transparency.

We also have concerns about implementation and consistency. The classification conditions are subject to inconsistent application and supervision across jurisdictions, especially as the Committee has proposed that each bank is expected to monitor the classification conditions of each cryptoasset on an ongoing basis, for approval by each supervisor. This could result in increased risk of regulatory arbitrage and fragmentation across markets and participants.

We note that while the Committee's proposal focuses on banks, it does not differentiate between the roles and activities that a bank might undertake in the cryptoasset ecosystem, and the different risks that a bank might face and need to manage in each of those different roles and activities. For instance, the risks a bank as issuer might face would be different from those faced in market-making, providing custody services or operational and administrative services. Banks' process and due diligence requirements relating to the classification of cryptoassets should be proportionately calibrated to account for the risks that banks bring into the system and that they will be exposed to as a result of their specific activity, rather than risk assessments of entire ecosystems and unrelated actors.

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?

As outlined in Q2 above, the classification conditions will require further refinement and clarification, to avoid a disproportionate regulatory burden and treatment, an uneven application of the rules across entities and markets, and a build-up of risk in an unregulated market. As we discuss further in Q7 below, the classification conditions place a heavy onus of responsibility on banks for the policing of the cryptoasset, the cryptoasset's underlying technology and network, and the cryptoasset's chosen key operators, administrators and custodians.

The Committee's proposal to require that entities that execute redemptions, transfers or settlement finality of the cryptoasset are regulated and supervised is dependent on the presence of a regulatory and supervisory framework for cryptoassets and their related entities in a jurisdiction. Numerous jurisdictions globally are currently considering regulatory changes including the regulation of tokenised securities and stablecoins; however, the scope, substance, and timing of these rules vary markedly across jurisdictions and are unlikely to be aligned in the near term, even on core definitions. A regulatory framework that addresses core issues relevant to the ecosystem and its participants, such as data and technology risks, risk governance and control policies, conduct requirements and anti-money laundering ("AML")/combating the financing of terrorism ("CFT") risks should be sufficient for meeting classification condition 4. Where these types of requirements apply to regulated and supervised entities, banks should be able to rely on their regulated and supervised status when determining and appropriate prudential treatment, rather than undertaking duplicative due diligence reviews across entities and jurisdictions. Guidance on the minimum regulatory standards that should be in force for Group 1 classification to apply will ensure that fragmentation and opportunities for regulatory arbitrage are avoided.

To satisfy the Committee's classification conditions of full transferability, enforceability and settlement finality at all times, it will be necessary to have a clear understanding of what constitutes settlement finality and when it is ensured. The applicable legal framework to determine settlement finality and enforcement will depend on the legal classification of a particular cryptoasset, which could vary across jurisdictions. Work is underway in jurisdictions such as the UK to determine the law on cryptoasset possession qua property, which will be critical in determining legal treatment in title transfer and insolvency enforcement. As such, we would support efforts between the Committee, other market and banking regulators, market participants and legal experts to develop guidelines on what features of the underlying legal framework are necessary in order to make the requisite determinations, and how that might result in the issuance of standardised legal opinions that market participants can make use of.

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?

The Committee proposes a daily monitoring framework measuring the difference between the value of the cryptoasset and the underlying traditional asset, with a potential requirement for a bank to demonstrate to the satisfaction of supervisors that any breach of the difference threshold has been addressed and will not reoccur. However, the demand for stablecoins may be highly volatile and



distribution may be subject to frictions, resulting in significant price discrepancies, which have often been positive (i.e. the stablecoin traded at a premium compared to the nominal value it represented). A breach of this threshold will change a Group 1b cryptoasset to Group 2, with the attendant cautious Group 2 prudential treatment while potentially placing a significant administrative burden on supervisors seeking to reassess stabilisation mechanisms.

Moreover, additional clarity is needed on the risk-based reasons for applying a 10bp limit. The peg range could potentially be revised after comparing market data on commonly available stablecoins such as Tether and USD Coin against similar traditional products to determine whether 10bp and the three-breach a year range is an appropriately calibrated threshold. An alternative to this might include an acceptable periodic attestation of the adequacy of reserves by accredited audit firms, or the acceptance of appropriate guarantees that a stablecoin can be redeemed at its notional value. This may allow for (secondary market) price discrepancies due to market frictions and the imperfect transmission of changes in yield of the underlying assets.

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 third classification condition states that any issuers, operators of transfer and settlement systems, administrators of the stabilisation mechanism and custodians of the cryptoasset's underlying assets must follow robust risk governance and risk control practices to address a range of risks across credit, market and liquidity risks, outsourcing risk, operational risk, third party risk management and AML/CFT. We note that risks such as outsourcing risk, operational risk and third-party risk, as well as their governance and control practices may be less identifiable in Group 2 cryptoassets that may not have central issuers or administrators.

The Committee also proposes that an assessment of the distributed ledger technology on which the cryptoasset is based is needed, including the operational structure, degree of access, technical role of the nodes, and validation and consensus mechanism of the network. While banks should maintain robust technology risk management procedures to manage and monitor material risks associated with their cryptoasset activities, we encourage regulators to examine and address any unique technology risks that may arise rather than seeking technology risk assessments of entire cryptoasset ecosystems from financial institutions that do not own, operate or administer those networks. Such assessments might be more efficiently and centrally undertaken by an external certified auditor with the necessary technical expertise to ensure an accurate assessment, and managed by the issuer of such Group 1 cryptoasset.

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?



As noted in our response to Q3, the Committee has proposed that in order for a cryptoasset to qualify as Group 1, entities that execute redemptions, transfers, or settlement finality of the cryptoasset must be regulated and supervised. However, the requirement for regulation and supervision of such entities relies on jurisdictions to have comprehensive regulatory frameworks around the activities of these entities. At this stage, cryptoasset regulation is progressing unevenly across markets, and such a requirement for regulation and supervision prior to Group 1 qualification will be difficult to meet. Guidance on what constitutes sufficient regulation as well as clarity on interim approaches for cryptoassets activity in markets where regulatory changes are pending would be helpful in this respect.

Cryptoasset intermediaries/service providers should be regulated and supervised proportionately to their roles and responsibilities, similarly to those of financial asset intermediaries, in order to ensure a level playing field. A settlement network operator (e.g. multi-party computation-based networks) that enables settlement of assets by taking temporary custody of the asset should be treated the same as a custodian or settlement agent for the traditional asset that the cryptoasset represents or is linked to. Conversely, technology service providers, such as node operators that provide node infrastructure without controlling keys, should not be regulated as a financial intermediary and their regulated/supervised status should not be required under the fourth classification condition.

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?

We do not consider them to be proportionate as currently drafted, and recalibration and clarity is required. The Committee's proposal relies solely on banks to be responsible, on an ongoing basis, for assessing compliance with classification conditions for all cryptoassets. This will place a high regulatory and operational burden on banks looking to provide regulated, secure and risk-managed services related to such cryptoassets. For instance, banks are expected to assess the risk governance and risk control policies and practices of entities performing activities associated with issuance, validation, redemption and transfer of the cryptoassets. This has the potential to be a wide pool of entities, especially where banks are dealing with multiple cryptoassets. Such assessments by different banks will in turn need to be demonstrated to and approved by supervisors, who will require adequate resources to manage such a key role in facilitating banks' potential business. We expect the process and resource burden associated with these requirements to be material and a likely disincentive to participation in these markets.

Furthermore, while banks must retain responsibility in undertaking the appropriate due diligence and monitoring cryptoasset classification, supervisory coordination will also be key in a cohesive global approach to cryptoasset regulatory treatment, especially given the borderless nature of cryptoassets. The approach currently proposed by the Committee suggests that each bank is to assess the classification of each cryptoasset on an ongoing basis. While the Committee encourages supervisors to compare and share their supervisory approval criteria, the individual ongoing assessments of each cryptoasset by each bank may introduce a wide variation in assessment across the industry globally which could potentially lead to uneven prudential treatment and the risk of regulatory arbitrage across banks, cryptoassets and jurisdictions, or cause delays in a fast-



moving market. Supervisors will also need to be adequately resourced to similarly assess and provide approvals for cryptoasset treatment across its supervised banks.

On this basis, and as we suggested in response to Question 3, we believe that where appropriate regulatory frameworks are in place for issuers, intermediaries, and other key participants, banks should be able to rely on those frameworks and their risk-reducing impacts when determining the appropriate prudential treatment of a cryptoasset. A balanced and proportionate approach would enable banks to rely on the presence of authorisation, supervisory, and regulatory frameworks as a replacement for the requirement that banks determine and monitor compliance with the classification conditions. In this respect, greater reliance could be placed on initiating or certifying classification of a cryptoasset from a single origination point, such as a regulated and supervised issuer, who may be better placed to access and thoroughly investigate the governance and policies of central entities that are key to the operation of its cryptoasset, such as the operators of the transfer and settlement systems for its cryptoasset, administrators of its stabilisation mechanism, and custodians of its underlying assets supporting its stabilisation mechanism. We further support the creation of a common and publicly available list of Group 1 cryptoassets as well as clear and transparent communication on approval decisions to facilitate market understanding and minimise differences across jurisdictions. To reduce the process burden on both market participants and their supervisors, Group 1 status for a cryptoasset should remain consistent within a jurisdiction without requiring repeated approval across different banks with the same supervisor.

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 are of the opinion that the current and upcoming operational risk frameworks should form the basis to calculating operational risk capital requirements for cryptoassets:

- Existing operational risk Pillar 1 methodologies like the standardised approach (TSA) and the new standardised measurement approach (SMA) currently provide avenues to measure capital charges related to cryptoasset businesses. Similar to other business activities, the income generated through cryptoasset businesses will feed into the income factor for the TSA and the business line multiplier and internal loss multiplier for SMA.
- Over and above this, any Pillar 2A assessments can be conducted through the Scenario Analysis framework. Use of expert views informed by internal and market data from various functions and businesses to assess and quantify the operational risk will reflect a risk-based assessment of cryptoasset risks that complement existing Pillar 1 methods such as TSA or SMA.
- Any add-on over and above Pillar 1 may be applied as an amount that reduces over time as the underlying technology becomes more established, conditional upon it demonstrating robustness through stressed events.

We also note that the use of tokenized formats can minimize or ease operational risks in comparison to traditional assets, and bring efficiency to collateral management, trading and settlement processes. Faster settlement times, reduced trade breaks and reconciliations can mitigate



counterparty and settlement risk. Any calculation for determining additional operational risk charges should therefore take into account the positive benefits of using these new technologies.

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 relation to Group 1a, we agree with the general approach to credit risk and market risk proposed by the Committee, where Group 1a assets will be subject to minimum credit and market risk capital requirements that are equivalent to those for the related traditional asset.

The Committee's proposal notes that a tokenised asset may have different liquidity characteristics than the traditional non-tokenised asset, and that such different liquidity characteristics could give rise to different market values of tokenised versus non-tokenised assets that are otherwise identical. It is important to note that the difference in liquidity between tokenised versus non-tokenised assets could be the direct result of intentional design choices, for instance a tokenisation of a security that is undertaken in order to democratise (and perhaps fractionalise) its ownership and direct its distribution towards a different market segment relative to the non-tokenised traditional assets. It is therefore important to understand the broader context and arrangements that might result in a variation in the liquidity profiles of tokenised and non-tokenised formats of a single security; such a variation does not automatically correlate with greater risk and may reflect economic and commercial factors beyond the use of cryptographic and tokenisation technology. In our view, this merits a more nuanced regulatory treatment rather than the automatic imposition of a more conservative prudential treatment.

From an implementation point of view, we would recommend that the Committee formalise the Fundamental Review of the Trading Book Standardised Approach ("FRTB-SA") risk weights and correlations applicable for cryptoassets as soon as possible to provide banks with enough time. This is because the added complexity with the FRTB-SA (and other more sophisticated standardised calculations such as Standardised Approach for Counterparty Credit Risk or "SA-CCR") is that even the standardised capital charge is sufficiently complex that calculating it in a spreadsheet or similar end-user developed tool generates unacceptable operational risk. Instead, large international banks have implemented the FRTB-SA in their strategic market risk infrastructure. Extensive testing requirements mean that even minor changes to these calculations will have an implementation lead time of roughly 6 months. These concerns relating to the implementation of FRTB for Group 1a cryptoassets are also relevant for other groupings including Group 1b and the cryptoassets that we have identified as being appropriate for a new sub-category within Group 2 (per our remarks in Q2).

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

The responsible development of cryptoasset markets and the ability of banks to provide cryptoasset related services requires that an appropriate risk-based prudential treatment is applied to all cryptoassets. The proposed approach disables the development of these markets and ancillary risk management tools and drives the development of these away from regulated institutions.



For instance, while we agree with the Committee's first principle of "same risk, same activity, same treatment", the Committee has proposed that Group 1b cryptoassets that can be redeemed for traditional instruments included in the list of eligible collateral under Chapter 22 of the Calculation of Risk Weighted Assets for Credit Risk (CRE22) Basel Framework are not eligible themselves for credit risk mitigation purposes, because the process of redemption adds counterparty risk that is not present in direct exposures to traditional assets. Our view is that Group 1b cryptoassets that satisfy existing eligible collateral criteria should themselves qualify as eligible collateral. If a Group 1b cryptoasset's price is publicly available on a daily basis, and the underlying assets of such Group 1b cryptoasset are eligible collateral themselves (provided also that other qualifications such as verified legal enforceability is met), then such Group 1b cryptoasset should qualify as eligible forms of collateral. This is consistent with the treatment of funds based on the qualification of their underlying securities.

Separately, on market risk, our understanding of the proposed treatment of Group 1b cryptoassets held on the trading book (see for example, footnote 13) is that the exposure to the underlying asset (e.g. the FX risk of a USD-based stablecoin held by a bank reporting in JPY) is treated in exactly the same way as other market risk exposures and can be fully hedged using conventional non-cryptoasset hedge instruments (FX forwards in this case). This should be made explicit in the final regulatory text.

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?

Offsetting long and short trading book positions in different product types referencing the same cryptoasset (for example, long "physical" Bitcoin offset by a short forward, or long forward/short future) results in minimal market risk. Any cryptoasset-specific risks of this type of trade would be counterparty credit risk (e.g. the risk of transacting on cryptoasset exchanges) or operational risk (e.g. the cybersecurity risks of holding cryptoassets directly). Different exposures to the same cryptoasset are more fungible, than different exposures to the same physical commodity given the relative ease of transporting and storing cryptoassets. We recommend applying existing market risk treatment such as those that are in place for commodities with an initial 100% risk weight as a suitably conservative way of capitalising the residual market risk. Alternatively, the Committee could seek to publish specific rules for calculating cryptoasset basis risks once more market data becomes available. These concerns are relevant for Group 1 and the cryptoassets that we have identified as being appropriate for a new sub-category within Group 2 (per our remarks in Q2).

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?

The proposed capital treatment of Group 2 cryptoassets, as well as related funds, equity investments, derivatives or short positions in such funds or entities, is overly punitive. The Committee has suggested a risk weight of 1250%, an inability to net across different cryptoassets or among long and short positions on the same cryptoasset, and a lack of recognition of collateral eligibility for the purpose of calculating counterparty credit risk exposures. An initial risk weight of 1250% may be prudent but should be subject to recalibration as the outright risk of the cryptoasset



changes over time. The risk profiles of Group 2 cryptoassets are more likely to reduce over time where intermediaries including banks are incentivised to participate in these markets and introduce effective risk management practices and tools. The proposed lack of offsets, assumption of zero value, and collateral ineligibility disincentivises this participation.

Cryptoassets vary in risk, and it is not accurate to treat all Group 2 cryptoassets as inherently trending to zero value in the short term. This does not allow for the ongoing realization of value that can be obtained from these assets as markets and use cases develop. In determining the capital treatment, consideration should be given to the ability of an institution to measure and respond to the risk of a particular asset. For example, where there is liquidity, transparency and price discovery, and a suitably measurable history for a specific asset then the ability to model the risk increases significantly. Some Group 2 cryptoassets, including Bitcoin and Ether, have active and transparent markets with price discovery further supported by derivative instruments. For such cryptoassets, market participants' existing systems and controls can be used to measure risk and determine capital requirements. These tools can ensure banks understand market and pricing trends and respond adequately including taking steps to reduce exposures and/or revise strategies.

Similarly, the inability to net in the Committee's proposal will stifle the development of risk mitigation techniques and is inconsistent with the potential for observable price correlation in Group 2 cryptoasset markets.

As an alternative we propose a treatment that is consistent with that for other asset classes, such as commodities or FX or credit derivatives, that also demonstrate significant volatility and heterogeneity in market structure and price discovery mechanisms across spot and futures markets and physical and cash formats, and yet are eligible for netting under existing regulation. We would urge the Committee to consider the similarities in features across analogous asset classes and their markets, which could be reflected in a similar netting treatment for Group 2 cryptoassets. We recognize that such an approach would still need to be calibrated for differences between asset classes, such as the possible allocation of a proportionately higher initial risk weight.

While the 1250% risk weight that the Committee has proposed may be appropriate as an initial weighting for some cryptoassets, it also overlooks the potential value in cryptoassets that a bank may realise in an active market with sufficient liquidity. This weighting also assumes that banks are subject to a minimum capital requirement of 8%; however, this is a minimum requirement as surcharges will increase the minimum capital requirement beyond 8%, necessitating a more granular and dynamic approach to risk weighting. As such, we would propose that the total capital requirement should be capped at the maximum loss on Group 2 cryptoassets, considering the actual minimum required capital ratios of each institution.

These changes to the proposed framework are likely to incentivise participation and risk management in these markets by banks, increasing the availability of market data and potentially lowering risks. It will be important for flexibility to be built into the prudential framework, with appropriate review mechanisms as the underlying technology and markets become more established, deep, and liquid.

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?

As discussed in Q12 above, as markets in cryptoassets to develop, there will be a growing need for the provision of cryptoasset-related services and products such as derivatives to manage risk and hedge exposures. It will also be critical for such activities to be available to and through regulated intermediaries in regulated markets. Hedging is critical to reducing volatility, and banks can aid with ensuring transparency, resilience, and liquidity in markets for secondary products as well as price discovery. The development of the cryptoasset market, along with the recognition of such potentially risk-reducing related services and products and the participation of regulated entities should accordingly be encouraged with proportionate risk-based prudential treatment.

Similar to comments made in relation to Group 1b cryptoassets, the outright exclusion of Group 2 cryptoassets as eligible collateral is inconsistent with the Committee's stated principles. We believe that Group 2 cryptoassets should be permitted to qualify as eligible collateral where they satisfy the Committee's stated conditions of "whether the collateral can be liquidated promptly and there is legal certainty of access to the collateral". Meeting criteria such as legal enforceability, perfected security interests and sufficient levels of price transparency and liquidity will also be key to ensuring that a Group 2 cryptoasset is suitable as eligible collateral. Per our response to Question 3, we recognise that not all Group 2 cryptoassets will immediately meet such requirements and further assessment is needed relating to legal frameworks and their impacts. As such, the prudential framework should allow for future developments and changes as the legal framework applicable to cryptoassets continues to develop and markets continue to mature.

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?

With regard to the liquidity ratios, the Committee have proposed that the treatment of Group 1a mirrors that of their traditional asset counterparts, and this should extend to qualification as high-quality liquid assets (HQLA), i.e. where the traditional asset qualifies as HQLA, the tokenized asset should parallel that. We would suggest that where a cryptoasset meets the requirements to be eligible as HQLA, such cryptoasset should be permitted to qualify. As we have outlined elsewhere, we do not agree that Group 2 cryptoassets will result in zero value or 0% Liquidity Coverage Ratio inflow. An alternative to this could instead look to realized value in the case of devaluation, based on a model that measures probability of zero value with adjustments to capital holdings.

With regard to the Leverage Ratio, we are supportive of the proposed treatment based on the value for financial reporting purposes and using the same credit conversion factor for off-balance sheet items. The exposures arising from cryptoassets derivatives transactions should be calculated using the SA-CCR framework as in the case of other derivatives transactions under the leverage and large exposures frameworks.

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?



We agree with the Committee that banks must establish processes to identify and assess cryptoasset risks and the management of such risks, and that requirements and expectations should be as harmonised as possible across jurisdictions. We support the risk-based approach to virtual assets and virtual asset service providers as set out by the Financial Action Task Force (“FATF”) for the purposes of AML/CFT that the Committee has highlighted, as it aims to provide a level playing field, applying obligations to entities across the cryptoasset ecosystem that introduce risk to the financial system, and minimising the potential for regulatory arbitrage between jurisdictions. As elaborated in detail in our response to Question 7, it is important that banks’ obligations relating to risk assessment and due diligence are consistent with their roles and responsibilities within - and the risk that they bring into - a cryptoasset ecosystem. Banks will also undertake client and counterparty risk management but may not be positioned to perform a full tech audit of a cryptoasset ecosystem’s underlying technology, for instance any capacity constraints in the ecosystem and the sufficiency of computing and digital storage resources.

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?

Per our previous comments, we request supervisory clarity around interim approaches for cryptoassets activity in markets where regulatory changes are pending, and risk-based guidance for the prudential treatment of cryptoassets while the prudential framework is being finalised. This will aid in providing certainty to the firms they oversee on expectations, treatments, and processes, to enable innovative and risk-managed cryptoasset activity.

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?

As markets develop, best practices will emerge and data will be increasingly available. To promote the development of both best practices and related datasets we strongly disagree with a complete prohibition of model-based approaches for all banks across all cryptoassets. Instead, it would be helpful to understand what level of coverage, depth of look-back, or stability of data or market points would be sufficient to enable the use of model-based approaches. Alternatively, the use of the internal model for market risk capital, could be considered for cryptoassets where the underlying distributed ledger or technology is appropriately audited for vulnerabilities.

We would also request clarity as to the need for measurement of the basis risk to account for potential differences between cryptoassets and the equivalent traditional assets. While such measurement is a requisite for determining market risk and designing appropriate risk management techniques, the development of a basis is not in itself cause to apply capital add-ons. As noted in our response to Question 9, a basis may in fact be a design feature of some applications of tokenisation and should be weighed in that context.

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



We agree that the disclosure requirements for banks' exposures to cryptoassets or related activities should follow the current general guiding principles for banks' Pillar 3 disclosures, both qualitative and quantitative, thus allowing disclosures to follow existing reporting processes and templates.

We do not support the use of bespoke disclosures templates for exposures to cryptoassets outside of regular supervisory disclosures. While at an initial stage of market development, supervisors may need specific information to monitor the market, risks and risk mitigations. This would be better achieved by active engagement with banks and other cryptoassets participants, especially as information requirements are likely to evolve along with market maturity.