

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

Zug, 10 September 2021

Answers to the questions set out in the Consultation document “Prudential treatment of cryptoasset exposures”

Dear Ladies and Gentlemen,

We are writing in response to your request for comments on the Consultation document “Prudential treatment of cryptoasset exposures”. We thank you for the opportunity to comment and for the Committee’s ongoing work on crypto assets.

Founded in April 2018 and headquartered in Zug (Switzerland), SEBA is a pioneer in the financial industry, building a progressive technological bridge between the digital and traditional asset worlds. In August 2019, SEBA received a Swiss banking and securities dealer licence – the first time a reputed, regulatory authority such as FINMA has granted a licence to a financial services provider with a focus on digital assets and crypto. One of the primary crypto Bank of the world, SEBA enables clients to invest, safely keep, trade and borrow against traditional and digital assets, as well as issue tokens, in one place.

For SEBA it is of utmost importance to actively participate in the discussion on prudential treatment for crypto-assets. In our answers to your questions, you will also find our proposal to actively participate in a potential working group in order to discuss and work on prudential treatment for crypto assets.

SEBA has also supported the ACI Financial Markets Association (ACI FMA) working group, which submitted a separate document to the Committee. SEBA added additional answers based on our experiences in our daily business and submits a separate response to the Committee.

Yours sincerely

On behalf of SEBA Bank AG

Opening remarks

Following the review of the consultation paper, we generally support the Committee's effort to develop standards for the prudential treatment of crypto assets in the banking industry. However, the proposal is evidence of an overall hostility towards crypto assets that is unjustified and counterproductive. It is our clear conviction that DLT will form the basis for the digitization of financial services in the near future. If the Committee sets punitive capital requirements for banks holding crypto assets, the DLT-based digitalization will take place outside the banking sector. This would prevent the banking sector from fully participating in the process and in addition, it will be unregulated.

As a second preliminary remark, we would like to point out that the consultation paper completely fails to take into account the broad variety of crypto assets and differences in design and underlying technology. It also fails to fairly apply the principle "same business, same risks, same rules", by imposing extra charges on novel and innovative technologies and products.

We would therefore urge the Committee to reconsider its general approach to the prudential regulation of crypto assets. It should, in particular, take an approach which is truly technologically neutral and, at a minimum, does not prevent the digitization of financial services. Moreover it must take into account differences in crypto assets and the underlying technology. In view of the early state of the industry and the quickly evolving technology we finally urge the Committee to reconsider whether a prudential regulation of crypto assets is already ripe for a Pillar-1-Treatment.

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

The approach proposed to be taken is in our opinion, too broad, does not appropriately differentiate between or within the categories of Crypto, and ignores the differences in underlying technologies that in some cases affect directly on the asset. Specifically the group 2 includes a wide range of assets that are not comparable. In order to understand the risk of these asset classes, the framework should also consider the technical features of the underlying crypto assets, which are finally a key differentiator of the risks. The technical features are e.g. open vs. closed source software, consensus mechanism, transparency of the ledger or the generation of new coins.

In general, it is difficult to distinguish between the different classes and the extra burden on crypto assets compared to legacy assets.

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?

In general, we are of the opinion that the underlying risk should define the capital requirements. If the risk is related to a traditional asset class such as FI or FX, then the capital requirements should be the same with an add-on for operational risk covering the technical uncertainties. According to the proposal in the consultation paper, this is applicable for group 1. However, as explained in the answer to Q1, group 2 is a

collective pot of cryptocurrencies with a wide range of underlying risks, which are not comparable.

The operational workload of "screening the conditions on an ongoing basis" seems to be too extensive. A preliminary assessment of the conditions and the underlying risks needs to be performed in the beginning. Depending on the stability and the robustness of the crypto assets features, an ongoing assessment seems to be excessive. This should rather be defined as at "least annually or upon material changes in the framework".

Assessment of the conditions:

2/3: The second condition is too extensive and cannot be implemented in reality. In our view, this is even more stringent than for traditional assets.

Existing group 1a cryptoassets: SEBA Equity token

Existing group 1b cryptoassets: USDC stable coin (<https://www.circle.com/en/usdc>) some cases only develop the necessary functionality and become accepted as a means of payment over a period.

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?**

This is an innovative and emerging industry that we should be careful not to stifle but rather up skill with risk management techniques and expertise. Group 2 restrictions as proposed have the effect to prohibit Banks providing liquidity and housing risk which then has the knock on effect of reducing participants and perversely creating greater market risk.

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 would propose that regulators distinguish between the three major different types of stable coins that are in circulation today:

- Algorithmic (i.e. AMPL)
- Crypto asset backed (i.e. DAI)
- Cash backed (i.e. USDC)

They have completely different risk profiles, hence they belong in different classes/categories (RWA charges), however it is important to be aware that even within these categories that there are substantial differences between individual coins and as such only a complete risk based methodology should always be used.

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 control practices that would ensure that material risks of the network are sufficiently mitigated and governance and risk managed?

1) Yes they would differ 2) As these markets evolve there are 'regulatory' RM structures within the TradFi space that could be adapted/adopted to underpin governance and risk management. However, the comparability of the risk of a crypto assets, specifically a crypto asset in the form of a payment token (refer to answer of question 2) with a "traditional asset" seems to be difficult considering the features of crypto-assets – as outlined in question 1.

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?

We are in favor of an enhanced regulatory environment for some market participants. The bad actors in this market tend to operate in the space that faces the most vulnerable group of consumers/customers. However, in the same way that TradFi exchanges and CCPs are regulated, similar 'infrastructure' in the Crypto space should be regulated. Blanket regulatory obligations are not appropriate, but for example, 'retail' facing entities should definitely be subject to regulatory requirements.

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?

Yes, it is clear. However, some Banks will need time and resources allocated to adapt their systems to monitor these risks/new assets.

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?

There are two different possibilities. The increased risk is captured either through an additional operational risk charge or through a framework for unsettled transactions / failed trades.

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?

Risk management, mitigation measures and charges should reflect the actual operational challenges and conventions of the underlying Crypto asset/market.

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

There needs to be more granularity to reflect the individual differences. A true risk based approach rather than broad categorization.

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?

The full risk spectrum implications need to be further analyzed and deconstructed in the examples given.

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?

This risk weighting is too high, costly and too broad (we refer to the answer of Q1). The effect of this will be to discourage Banks from participating and thereby removing their value as risk managers from the market which in turn increases the systemic risk of the market overall. The more participants with risk management expertise lowers the overall systemic risk of any market.

The proposed approach is too generic and does not include the following aspects:

- No differentiation between market and credit risks. In reality, these are very important aspects. The regulation should consider if the market risk is carried by the bank or by the customer. A bank can store crypto currencies in a collective account and keep them in the Balance Sheet but the market risk is with the customer. In this case, the bank should not have any market risk charges for customer's market risks. Credit risk strongly depends on the storage facility (Banks own storage solution, crypto currency exchange storage solution, included in or not included in bankruptcy assets etc. The distinction of the storage solution and the legal bankruptcy qualification is key to understand the underlying credit and/or default risk. We therefore cannot understand the conclusion of charging a fix risk weight of 1250% for cryptoassets for credit and market risk in general.
- Gross vs. net: The RWA is defined as $RW \times \max(\text{abs long}, \text{abs short})$. This is again very generic and is not reflecting the economic reality. As mentioned before, a Bank has no market risk on customers' crypto assets. If there is no market risk for the bank and in addition, the customer has agreed to take over the market risk, consequently, the Bank should not be charged with 1250% risk weight for the market risk on these assets.

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?

The new regulation of required capital for market and credit risks for crypto assets should be technology neutral with the approach as defined on page 2: same risk, same activity, same treatment. For exposures in the trading book we support the approach to allow the recognition of hedging transactions.

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?

LCR: HQLA eligibility needs to be assessed depending on the group 1a/1b and 2, as mentioned in the discussion paper. Regarding the consideration as inflow and outflow, here again and referring to question 12, the statement is too general. If a bank holds customers' coin on the B/S, it should also be possible to consider it as inflow and outflow at the same time. If the Bank keeps the coins in its own custody and shows it as a liability towards the client, there is no refinancing risk and the liquidity is even in the Bank (or with third party banks). The same for NSFR - these requirements need to be further elaborated.

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?

Hence, we are talking about a very new and young asset class and technology, it will be of utmost importance to share experiences and knowhow based on real use cases. It will be very important to have crypto asset working groups consisting of people from the regulation and supervisory side as well as from banks and crypto currencies exchanges.

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?

We don't see the need to implement adjustments to minimum Pillar 1 capital requirements. The prudential treatment of crypto assets has to follow the principle "same risk, same activity, same treatment". In order to punish crypto assets with high capital charges, we have to understand the underlying market, credit and operational risk. Based on the risk, it can be classified with comparable asset classes and/or treated with conservative haircuts.

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

The crypto assets (group 1 and 2) should be embedded into the existing disclosure requirements and be included of the bank's wide risk management framework.

Annex 2: Treatment of Derivatives.

The example given in the consultation paper is reasonable but also very simple and not realistic. SEBA Bank is offering Derivatives business but not without hedging the market risk. SEBA tried to calculate the scenario analysis including the calculation of the CCR and CVA with the most conservative asset classes. This approach also showed the highest possible loss with different spot movements and volatilities. The approach to define required capital for Derivatives needs to be further elaborated and should rely on generic market risk valuation models.