POSITION PAPER

WSBI - ESBG: Response to Consultation Paper on the topic of designing a prudential treatment for crypto-assets

WSBI (World Savings and Retail Banking Group)
ESBG (European Savings and Retail Banking Group)
Rue Marie-Thérèse, 11 - B-1000 Brussels

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WSBI ESBG

WSBI-ESBG welcomes the opportunity to comment and provide feedback to the Basel Committee on Banking Supervision (BCBS) on the topic of designing a prudential treatment for crypto-assets.

WSBI-ESBG would like to highlight that we welcome the continuous efforts of the BCBS to monitor the different range of issues related to the prudential regulatory treatment of crypto-assets. Additionally we would like to remark that a general framework for crypto-assets is needed prior to starting a prudential treatment for these assets. A clear definition and classification of crypto-assets is essential in order to properly assign the risk they may imply to credit institutions.

WSBI-ESBG is concerned by the numerous reports of abuse of retail investors' trust on innovative services providers, as well as the emergence of highways circumventing policy frameworks carefully crafted over the last decades. The anonymity of the wallet holders and the existence of blockchains specifically designed to ensure secrecy over the sender, the receiver and the amount transferred, create virtually risk free ways of laundering money originating from criminal activities, or hiding the financing of terrorist organisations.

Please find bellow WSBI - ESBG preliminary replies, comments and feedback on the different elements covered in the discussion paper:

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.

ESBG – WSBI considers that as a first step, different types of crypto-assets have to be identified and classified accordingly to a common definition. Having said this, we believe that the BCBS should not only focus on the DLT consensus mechanism or any other technical development but on the risks that are inherent to crypto-assets.

While there are many different approaches to crypto-asset classification, the key take away from all of this is, market participants can benefit from grouping crypto-assets into classes based on similar functional goals and features. Use-cases should also be considered in classification, as well as how specific sectors of assets as a whole may react in regards to the market.

In addition, features that we believe should be taken into account are for example, the following:

- Who are the issuers (private individuals, companies, public authorities, etc.) and in which country is it established (seated);
- Do these "crypto-assets" represent a respective value per se ("digital or virtual asset") or reference to an "off-DLT" (physical assets e.g. real estates, non-physical legal rights such as securities or even data such as Identification Attributes or references to them);
- Targeted group of users (wholesale vs. retail);
- Impact on sovereignty of money creation.

While it is true that these features define the term crypto-asset, they say very little about what risk lies behind a given crypto-asset and are consequently of little relevance from a prudential point of view. The better approach would be to establish categories that give an indication of how much risk is associated with the crypto-asset in question and to link these categories to existing asset classes where possible.

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?

ESBG - WSBI considers that the indicated crypto-assets classification (Security Token, Payment Token and Utility Token) is a very first step and should be regulated based on existing regulation.

In addition, it is worth noting that a crypto-asset can have more than one economic function (security and/or payment and/or utility).

We agree with the Basel Committee that it makes good sense to classify crypto-assets on the basis of their different functions. The three major categories are, as mentioned in the discussion paper, payments, securities and utility access. Within these categories, a further distinction should be made as to whether or not the crypto-asset is backed by a conventional asset.

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

In terms of benefits of financial services, if the risks are mitigated in an appropriate manner there are a number of benefits, among them the provision of new services and therefore new customers.

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

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?

Yes, WSBI-ESBG believe that the prudential treatment of crypto-assets may be designed by adapting current prudential regulatory treatment to these assets, the design of a whole new framework not being necessary.

We generally agree with the principles set out in the consultation paper.

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?

One of the additional channels would be that banks would act as crypto-exchange (not only from/to fiat).

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

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?

Having a clear understanding of the risks involved and the capital requirements associated with them is of paramount importance provided there is need to facilitate their development and inclusion in the balance sheet of financial institutions.

In terms of most material risks and additional risks, WSBI – ESBG would like to outline the following:

- Most material: cyber and operational risks (new technologies with limited experience/know-how) as well as reputational risks (mostly indirectly via respective underlying offenses);
- Liquidity and market and credit risks could become material based on the nature of the issuer (e.g. private companies) – for example based on the sole discretion of the issuer when determining the value of the crypto-asset (resulting in an immediate profit of the issuer e.g. from assets used to purchase the crypto-assets/currencies). In our opinion, if the asset is held in the trading book it will be subject to market risk, which may be significant in the case of non-backed assets with a higher volatility
- Counterparty (credit) risk: depending on whether the crypto asset is issued in a centralized way (i.e. crypto currency of a central bank) or not (i.e. bitcoin), calculating this risk may pose significant difficulties. Also, being or not backed by other assets (i.e. basket of commodities or securities) has to be taken into consideration
- Exchange rate risk: in the case of crypto-currencies, their exchange rate with the official currency in which the accounts are denominated will impose an added risk, higher for those not backed with real assets (algorithm-based), than for backed ones (stablecoins).
- Additional risks: all predicate offenses to ML/TF such as fraud, human trafficking, drug dealing, etc.;
- Risk difference extent: significantly enhanced due to high degree of automation and global reach (KYC?).

However, we consider that the risks, to which banks can be exposed, may differ depending on whether the crypto-asset is in custody on behalf of a customer (off-balance sheet) or owned by the bank (on-balance sheet).

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?

We believe that it is very important to differentiate very clearly what a high-risk crypto-asset is and what is not, before imposing a very restrictive prudential treatment.

It should be noted that the proposed treatment would not encourage banks to invest in crypto-assets or to trade them.

Q10. What further supervisory measures could be considered in specifying a potential prudential treatment for crypto-assets?

Q11. What are your views on the disclosure requirements related to banks' crypto-assets? Should additional information related to banks' crypto-asset exposures be disclosed?

In our opinion, imposing disclosure requirements related to banks' crypto-assets should be carefully analysed. In any case it should be in line with current disclosure requirements for other exposures and be proportionally taken into account.

Q12. What are your views on the appropriate prudential treatment of these types of crypto assets? Are there additional types of crypto-assets that would warrant a different treatment to the illustrative example outlined in this paper?

We consider that there are other types of crypto-assets representing lower-risk exposures, that also need to be explored and calibrated when designing a prudential treatment for crypto-assets.

Q13. What are your views on the potential prudential treatment of specific types of crypto assets that bear economically equivalent risks to traditional asset classes? To what extent could the prudential treatment of such crypto-assets build on the existing framework?

WSBI - ESBG believes that it is paramount to build on existing framework and adapt, if necessary, existing framework for treatment of traditional asset classes to crypto-assets. Furthermore, WSBI - ESBG is of the opinion that using or adapting existing highly regulated framework would help to avoid legal uncertainty.

Q14. What specific conditions and criteria are needed for different types of crypto-assets to be subject to a different treatment to the illustrative example discussed in this paper?

Q15. Do you have other suggestions regarding the design of a potential prudential treatment of crypto-assets?

About WSBI (World Savings and Retail Banking Institute)

WSBI represents the interests of 6,760 savings and retail banks around the world. WSBI focuses on international regulatory issues that affect the savings and retail banking industry. It supports the aims of the G20 in achieving sustainable, inclusive, and balanced growth, and job creation, whether in industrialised or less developed countries. Supporting a diversified range of financial services to meet customer need, WSBI favours an inclusive form of globalisation that is just and fair. It supports international efforts to advance financial access and financial usage for everyone. WSBI members have total assets of $16 trillion and serving some 1.7 billion customers in nearly 80 countries who seek retail banking services. WSBI members are committed to further unleash the promise of sustainable, responsible 21st century banking.

World Savings and Retail Banking Institute - aisbl
Rue Marie-Thérèse, 11 ▪ B-1000 Brussels ▪ Tel: +32 2 211 11 11 ▪ Fax : +32 2 211 11 99
Info@wsbi-esbg.org ▪ www.wsbi-esbg.org

About ESBG (European Savings and Retail Banking Group)

ESBG is an association that represents the locally focused European banking sector, helping savings and retail banks in 21 European countries strengthen their unique approach that focuses on providing service to local communities and boosting SMEs. An advocate for a proportionate approach to banking rules, ESBG unites at EU level some 885 banks, which together employ 656,000 people driven to innovate at 48,900 outlets. ESBG members have total assets of €5.3 trillion, provide €1 trillion billion in corporate loans, including SMEs, and serve 150 million Europeans seeking retail banking services. ESBG members are committed to further unleash the promise of sustainable, responsible 21st century banking.

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Rue Marie-Thérèse, 11 ▪ B-1000 Brussels ▪ Tel: +32 2 211 11 11 ▪ Fax : +32 2 211 11 99
Info@wsbi-esbg.org ▪ www. wsbi-esbg.org

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