EUROPEAN ASSOCIATION OF CO-OPERATIVE BANKS
The Co-operative Difference: Sustainability, Proximity, Governance

Brussels, 9th September 2021

EACB Comments on the Basel Committee on Banking Supervision's Consultative Document "Prudential treatment of cryptoasset exposures"

General comments

The members of the EACB welcome the opportunity to comment on the Basel Committee's Consultative Document on the prudential treatment of cryptoasset exposures. Despite the currently limited exposure to cryptoassets across financial institutions, the issue can become extremely relevant very fast. The trend toward cryptoasset markets becoming mainstream is rather obvious. The EACB therefore acknowledges that there is the growing need for a cryptoassets' market that is framed, with enforceable legal contracts, and clear and transparent regulatory requirements. In this regard, the EACB appreciates the initiative undertaken by the Basel Committee to address the issues related to the prudential treatment of banks' cryptoasset exposures.

As a general rule, the EACB particularly sees the need to connect the prudential regulation of banks' cryptoasset exposures with the accounting treatment of cryptoassets. A complicated reconciliation between prudential standards and the general accounting perspective must be avoided.

Further to that, the EACB supports the harmonization of regulatory treatment of cryptoassets at an international level. There is a need for regulatory clarity, consistent cryptoasset taxonomy and standardisation. Moreover, we advocate for prudential requirements that are easy to implement in a rapidly evolving crypto-asset market.

Please find below the EACB answers to the specific questions outlined in this consultative document.

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

We consider the proposed principles for the prudential treatment of crypto assets in general to be appropriate.

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?*

We generally agree with the proposed categorisation and the differentiated regulatory treatment. However, in addition to that, it has to be ensured that the definition of cryptoassets and the prudential requirements set out in the Basel consultation take into account and are in line with the regulatory initiatives already under way in major jurisdiction, for instance the ones outlined in the EU regulation on Markets in Crypto-assets (MiCA). In view of the dynamic development of the crypto market, we welcome the fact that the Basel Committee is striving to continuously develop the prudential treatment of cryptoassets.

With regard to the classification condition for a Group 1 cryptoasset, mentioned in section 2 on page 5 of the consultative document: *"All rights, obligations and interests arising from cryptoasset arrangements that meet the condition above are clearly defined and legally enforceable in jurisdictions where the asset is issued and redeemed. In addition, the applicable legal framework(s) ensure(s) settlement finality.",* it should be clarified that a clear contractual regulation is sufficient.

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?*

From our point of view, the condition *"Banks must also verify the ownership rights of any underlying traditional asset from which the stable value of the cryptoasset is dependent upon. In the case of underlying physical assets, they must verify that these assets are stored and managed appropriately. This monitoring framework must function regardless of the cryptoasset issuer."* can hardly or only with great difficulty be fulfilled as the banks would hardly have control on the "supply chain" behind the assets. Also, banks would be the only potential investor in the asset class that would have to face such "burden of proof", leading to questions of level playing field. We therefore ask for this requirement to be deleted.

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 believe that the responsibilities for banks and the supervisory authorities are overall understandable.

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?*

In general, we do not deem appropriate to assume an increased operational risk relating to cryptoassets relative to traditional assets and to substantiate this with capital surcharges. Instead, the existence of an additional operational risk of cryptoasset exposures should be checked on a case-by-case basis.

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, appropriately reflects the unique risks inherent in these assets?*

We would like to point out that we are not in favor of an application of a 1250% risk weight for high-risk cryptoassets in general. First of all, the application of the 1250% risk weight ensures that banks hold risk-based capital at least equal to their Group 2 crypto asset. It is by now practically the easiest way to cover potential risks of cryptoassets, but it does not take into account their different design options. Furthermore, especially for well-established cryptoassets like Bitcoin, we consider the proposed application of a 1250% risk weight too harsh. The key question is whether the cryptoasset will have any value in the event of its liquidation. It is true that the value of e.g. Bitcoin is highly volatile. But given that it has been in existence for over ten years, it must be considered to have more value than less established cryptoassets.

Given the above, we see merit in developing a more differentiated approach looking for equivalent use cases among current asset classes. One approach could be to compare high-risk cryptoassets to risky or volatile assets already available on the market. For example, as specified in the final Basel III framework in the area of credit risk, as of 2023, banks will assign a risk weight of 400% to speculative unlisted equity exposures[1]. Particularly the features of "*short-term resale purposes*" and being "*subject to price volatility and are acquired in anticipation of significant future capital gains*" we believe are apt to describe the situation of many cryptoasset holdings. We are therefore of the view that similar risk weights (between 300-400) could be assigned to some highly risky and volatile cryptoassets. Moreover, any prudential consideration and requirement on cryptoassets should, in any event, include a clear review clause so that requirements can be reassessed and adjusted in a timely manner. This is essential in such a new and rapidly evolving environment.

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?*

See answer to Q12.

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 believe that the responsibilities outlined in section 1.2 are comprehensive and reflect banks' risk management practices with respect to asset classes in general.

[1] Speculative unlisted equity exposures are defined as "equity investments in unlisted companies that are invested for **short-term resale purposes** or are considered venture capital or similar investments which are **subject to price volatility and are acquired in anticipation of significant future capital gains**".

Contacts:

For further information or questions on this paper, please contact:

- Mr. Volker Heegemann, Head of Department (volker.heegemann@eacb.coop)

- Ms. Maryia Sulik, Adviser (maryia.sulik@eacb.coop)