September 10, 2021

Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel, Switzerland

Japanese Bankers Association

JBA comments on the BCBS Consultative Document: "*Prudential treatment of cryptoasset exposures*"

Dear Basel Committee members:

The Japanese Bankers Association[1] (JBA) appreciates the opportunity to provide our comments on the Basel Committee on Banking Supervision's (BCBS) Consultative Document: "*Prudential treatment of cryptoasset exposures*"[2] (the Proposal) released on June 10, 2021.

As per the JBA's previous comments[3] on the BCBS's discussion paper, the JBA is of the view that relatively conservative prudential treatments for high-risk cryptoassets may be warranted at this juncture, given the risks associated with cryptoassets are yet to be fully tested. However, we also stressed that those treatments should be provisional and be iteratively revised, given that the cryptoasset ecosystem has been evolving rapidly in recent years and various products related to cryptoassets have emerged with different risk characteristics. We believe that prudential treatments should be proportional to the respective risk profile of the cryptoassets.

Having written that, we understand that the Proposal is to provide a proportional approach based on the risk characteristics of the respective cryptoassets, which we are basically supportive of. We also appreciate that many aspects of our comments on the discussion paper were reflected in the Proposal, such as a provisional (iterative) approach, the concept of "technology neutrality", the treatment of those jurisdictions that prohibit their banks from having exposures to cryptoassets, and the treatment of those dematerialised securities that use electronic versions of traditional registers and databases.

On the other hand, it is unclear to us whether the Committee is going to consider a global regulatory framework for non-banks based on the principle of "same risk, same activity, same treatment". As we stressed in our response to the discussion paper, we believe that "*[e]ven if the banking system is shielded from risks of crypto-assets by the restrictive and conservative prudential treatments, it does not necessarily ensure global financial stability as a whole. If crypto-assets are held or transacted widely outside the banking system in the future, bank-only regulations can deteriorate global financial stability rather than ensure it*".

Unregulated or underregulated entities such as Fintechs or Bigtechs have already started providing financial service related to cryptoassets. Their core businesses are not banking services and are not within the scope of banking regulations. Establishing a regulatory framework only for banks would be insufficient for enhancing financial stability and would result in unequal regulatory treatments, which is undesirable in terms of a level playing field.

Therefore, we encourage again the BCBS to establish a global regulatory framework for non-banks that engage in cryptoasset-related business, collaborating with other international standard setting bodies such as the Financial Stability Board and IOSCO or G20, while continuing globally open discussions with all stakeholders across industries.

[1] The Japanese Bankers Association is the leading trade association for banks, bank holding companies and bankers associations in Japan. As of September 10, 2021, JBA has 114 Full Members (banks), 3 Bank Holding Company Members (bank holding companies), 74 Associate Members (banks & bank holding companies), 58 Special Members (regionally-based bankers associations) and one Sub-Associate Member for a total of 250 members.
[2] https://www.bis.org/bcbs/publ/d519.htm
[3] https://www.zenginkyo.or.jp/fileadmin/res/en/news/news200313.pdf

Our response to the questions

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?

We recommend further discussion and development of global common definitions regarding transferability, settlement finality and/or redeemability because those definitions are generally closely related to statutory, common or case laws in each jurisdiction and their international consistency is unnecessarily assured. In the absence of such definitions, every country needs to set its own definitions or standards, which may result in classifying a cryptoasset into different categories, for example Group 1b or Group 2. In that case, cryptoassets would have stronger interconnectedness with the banking system without being required sufficient capital charges in the jurisdiction where those definitions are loose enough to be regarded as Group1b. Such an unfavorable result will raise concerns over the concentration risk associated with cryptoassets, such as credit risk and market risk in that jurisdiction. To avoid such concentration of cryptoasset-related risks due to fragmentated regulations, we believe that it is necessary to take stock of these definitions in each jurisdiction and develop global common definitions or standards.

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 Proposal requires "*a monitoring framework in place verifying that the stabilisation mechanism is functioning as intended*" as one of the conditions for Group 1 cryptoassets. However, in cases where a bank invests in an external investment fund/trust that holds cryptoassets with the stabilization mechanism (ie stablecoins) as part of the fund/trust's portfolio or as a result of dividends from investee companies, it is almost impossible for the bank to conduct such monitoring by themselves, because the bank has no direct relationship with the redeemer of the crypoassets. In that case, it is highly likely that the 1,250% risk weight will be applied as Group 2 cryptoassets, since the monitoring requirements for classifying in Group 1 are not met. It also may result in contradictory outcomes that the capital charges for direct holdings becomes lower than those for indirect holdings. We therefore propose adding complementary conditions that allow banks to monitor the stabilization mechanism through the asset manager of the external fund/trust, subject to the conditions where the bank is regularly reported the result of the monitoring by the asset manager and verifies whether the monitoring is effectively functioning.

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?

It is appreciated if the BCBS could provide support to address practical challenges, such as providing a consistent reporting template. We note that the Proposal requires banks to demonstrate to supervisors how a cryptoasset fulfils the classification conditions, as set out in section 1.2. However, internationally active banks would be required to demonstrate to both home and host supervisory authorities the rationale of the categorisation at every single level of each entity or subsidiary. If the respective reporting templates, glossaries or reporting requirements are diverse among jurisdictions, it would pose unreasonable resource constraints and operational burdens on banks and also makes it difficult for them to ensure international consistency of the reporting. Therefore, they should be coordinated globally.

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

The possibility of assessing and quantifying risks associated with Group1b assets should be explored, before concluding to exclude them from eligible collateral. The Proposal notes that "*Group 1b cryptoassets (ie stablecoins), including those that can be redeemed for traditional instruments that are included on the list of eligible collateral, are not eligible forms of collateral in themselves for the purposes of recognition as credit risk mitigation. This is because, as discussed further below, the process of redemption adds counterparty risk that is not present in a direct exposure to a traditional asset.*" However, the counterparty risk is not necessarily the decisive reason for such exclusion. At least, counterparty risk can be deemed to be effectively zero under certain conditions, as discussed in our response to Q14.

In addition, the RWA calculation method for cryptoassets in illustrative example 1 seems to have a "fallacy of composition". The proposal notes that "*[t]o calculate RWA for cryptoassets in illustrative example 1, the bank must include in risk-weighted assets the sum of the following two amounts: (i) the risk weighted assets applicable to a direct holding of the underlying traditional asset, (ii) the value of the cryptoasset holding multiplied by the risk weight applicable to an unsecured loan to the redeemer*". The respective RWA calculation methods for exposure to the underlying asset and to the redeemer are generally understandable. However, in some cases, simply adding up the two elements, the total risk weight for exposure to Group1b cryptoassets could go beyond 1,250%[4], which is unintendedly even higher than the risk weight for Group 2 cryptoassets. This is because the proposed method is using the same exposure twice for calculating the synthetic RWA. To avoid such fallacy of composition, we propose putting a cap at 1,250% for this calculation method.

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 Proposal notes that "*cryptoassets would not qualify as eligible high-quality liquid assets (HQLA). However, the Committee will continue to investigate the prospect*". We are of the view that certain types of cryptoassets with a stabilization mechanism should qualify as eligible HQLA for liquidity requirements, when the counterparty risk can be deemed to be effectively zero, in case where, for example, the underlying asset is classified as HQLA and the purchase clause for that cryptoasset is secured. Otherwise, a clear rationale for the proposed treatments should be provided.

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

The Proposal notes that "*[i]n accordance with the general guiding principles, banks must disclose information regarding any* ***material*** *Group 1a, 1b and Group 2 cryptoasset exposures on a regular basis*". However, the term "*material*" is not defined either in the proposal or in the general guiding principles[5] and may be interpreted in a variety of ways, including strategic importance, the importance in profit, or systemic importance to the global financial system. We urge to clarify or give further consideration regarding the term "*material*".

(End)

[4] For example, under the IRB approach, the combined risk weight for exposure to the underlying asset and to the redeemer could go beyond 1,250%.

[5] Guiding principles of banks' Pillar 3 disclosures