ASSOCIATION FRANÇAISE DES MARCHÉS FINANCIERS

FINANCIAL MARKET PROFESSIONALS

AMAFI / 23-26EN
31 March 2023

PRUDENTIAL TREATMENT OF CRYPTOASSET EXPOSURES

Basel Committee on Banking Supervision Standard

In December 2022, the Basel Committee on Banking Supervision agreed on a standard on the prudential treatment of cryptoasset exposures[1]. This standard will be incorporated into a future consolidated version of the Basel Framework. It is to be implemented from 1 January 2025.

Two groups of cryptoassets are identified[2].

- Assets that have the characteristics of traditional assets (including stocks, bonds etc.) are subject to the existing prudential framework, even if they take the form of tokens (tokenisation). These are defined as Group 1 cryptoassets.

  However, an add-on can be applied when Group 1 cryptoassets are held in an infrastructure. The initiative for this add-on lies with the national regulators, based on observed weaknesses in these infrastructures. The standards state the objective (to encourage banks to take infrastructure risk into account), without specifying any rules. The approach is said to be "flexible".

- As for Group 2 cryptoassets, the standards define them as those that do not have the characteristics of traditional assets. These assets include algorithmic stablecoins, stablecoins that need protocols to maintain their value and all unsecured cryptoassets.

  Sub-distinctions apply depending on whether the cryptoasset meets certain criteria (the hedging recognition criteria). If these criteria are met (group 2a), adjusted rules from the simplified standard approach or the standard approach for market risk apply (the internal model cannot be used), with the possibility of netting and a capital charge of 100%. In the opposite case (Group 2b), a treatment is applied which does not allow for position hedging by providing for a 1250% weighting of the assets concerned.

  The 1250% weighting also applies to Group 2a assets when the institution's exposure to cryptoassets of the whole of Group 2 exceeds the limit of 1% of its Tier 1 capital: the part that exceeds the 1% is applied this weighting. However, when the institution's exposure to cryptoassets exceeds 2%, the distinction between Group 2a and 2b assets disappears and the whole is subject to the 1250% weighting.

[1] https://www.bis.org/bcbs/publ/d545.pdf
[2] Note that central bank e-money is not in the scope of the standards - Art. 60.3 of the consolidated standards.

AMAFI welcomes the framework defined by the Basel Committee, noting that the 1250% risk weighting on Group 2b assets is incorporated into the capital ratio on RWA (risk-weighted assets), which is equal to at least 8%. This means that an institution that acquires in its own name (i.e. not holding assets for clients) a given amount of class 2b cryptoassets retains an amount of capital strictly equal to its exposure to these cryptoassets[3].

The distinction between class 1 and class 2 according to the intrinsic characteristics of the assets is in line with EU legislation which applies separate legal regimes to cryptoassets that have the characteristics of financial securities and those that do not.

However, AMAFI draws the attention of European co-legislators and national authorities to two issues.

First, it should be explicitly clarified that the weightings apply only to assets that an institution holds for its own account, to the exclusion of custody for clients.

Secondly, there is a possible interaction between the standard and the pilot regime regulation[4] which allows national supervisors to grant exemptions from the legislation governing settlement systems (CSRD) and trading platforms (MiFID) when these infrastructures operate on the basis of blockchain technology. The Basel Committee's standard allows for the application of an additional weighting on Group 1 cryptoassets held by institutions within these DLT infrastructures where weaknesses in these infrastructures have been observed. It would be contrary to the objective of the pilot regime to provide for such an add-on for cryptoassets held by these institutions in the infrastructures set up within this framework. AMAFI therefore calls on European co-legislators and national authorities to define the conditions for the application of the add-on by national supervisors by transposing the Basel Committee standard, so as not to affect the success of the pilot regime.

[3] For example, an institution acquires €1,000,000 of class 2b crypto-assets. It first applies a weighting of 1250% by multiplying the amount of exposure by 1250, before dividing by 0.08 (8%). The result of this calculation is 100. In other words, the standard requires that for an acquisition of crypto-assets of this class, this institution retains 100% of the value of these crypto-assets in equity, i.e. in this example: €1,000,000.

[4] Regulation (EU) 2022/858 of the European Parliament and of the Council of 30 May 2022 on a pilot regime for market infrastructures based on distributed ledger technology.