September 10, 2021

Via Electronic Mail

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

Re: Consultative Document – Prudential Treatment of Cryptoasset Exposures (June 2021)

To Whom It May Concern:

The Bank Policy Institute[1] appreciates the opportunity to comment on the Basel Committee on Banking Supervision's Consultative Document addressing the prudential treatment of exposures relating to private digital assets that depend primarily on cryptography and distributed ledger or similar technology ("digital assets").[2] We support the Basel Committee's decision to pursue an iterative approach to policy development in this area, which is essential given the pace of evolution for digital assets and the interdisciplinary considerations relating to the asset class.

Like any sound bank regulatory framework, the prudential treatment of digital assets should be designed to promote bank activities and innovations that benefit their customers and the public more generally, establish requirements that are commensurate with risk, apply in a flexible manner in light of ongoing evolution in financial markets and services, promote a level playing field and avoid regulatory fragmentation. We are, however, concerned that many aspects of the Consultative Document would be inconsistent with these objectives.

Both interest in and use of digital assets by consumers and businesses has grown significantly in recent years, a trend that is expected to accelerate. Bank customers, the public more generally and regulators will benefit from increased involvement by banks in offering digital asset products and services. This is true for digital assets generally, including not only those that would be in Group 1 of the classification framework presented in the Consultative Document but also those that would be in Group

1 The Bank Policy Institute is a nonpartisan public policy, research and advocacy group, representing the nation's leading banks and their customers. Our members include universal banks, regional banks and the major foreign banks doing business in the United States. Collectively, they employ almost 2 million Americans, make nearly half of the nation's small business loans, and are an engine for financial innovation and economic growth.

2 For purposes of this comment letter "digital assets" is synonymous with the term "cryptoassets" in the Consultative Document.

2. Banks are subject to comprehensive and robust regulation, supervision and examination. Bank regulatory, supervisory and examination frameworks address customer protection, operational resilience, financial strength and resilience, anti-money laundering and anti-terrorist financing, and risk management. Banks have the resources, experience and expertise to develop and implement robust compliance programs, which is especially important given concerns about consumer protection and money laundering / terrorist financing risk in connection with digital assets. Accordingly, both customers and regulators will benefit from the involvement of banks in customer activities involving these assets. Digital assets, and related technologies, also present potential benefits to banks themselves, from reducing inefficiencies in traditional financial activities to allowing banks to offer innovative products and services to meet customer demand.

The prudential treatment of digital assets should not discourage bank involvement in digital assets, as aspects of the Consultative Document appear designed to do. Rather, the prudential treatment of digital assets should support a broader policy objective of encouraging digital asset activities that are conducted in a safe and sound manner through the robustly regulated banking sector. This could be accomplished by focusing on the importance of applying existing risk management frameworks and practices to digital asset activities, and establishing capital and liquidity requirements for such assets that are commensurate with risk.

It is critical to note that any final standard would be only one component of the bank regulatory framework for digital assets, which is, in turn, only one aspect of the broader regulatory framework applicable to digital assets. The Consultative Document need not, and should not attempt to, regulate both the prudential requirements applicable to, and the substantive permissibility of, digital asset activities. The prudential treatment should be designed to function within the context of evolving regulatory frameworks. Any final standard should reflect that it addresses only one piece – prudential treatment – of the regulatory framework applicable to digital assets.[3]

Part I of this letter addresses the three guiding principles presented in the Consultative Document and how the proposed prudential treatment is inconsistent with both those principles and the objectives described above. Part II explains flaws in the conceptual design of the proposed classification of digital assets as Group 1a, 1b or 2, which would result in an inflexible framework that lacks coherence and risk-sensitivity. Part III provides recommendations regarding the proposed capital requirements for digital assets in order to achieve the objectives described above. Part IV addresses aspects of the Consultative Document relating to liquidity standards, leverage requirements, disclosure and risk management.

I. The Proposed Prudential Treatment is Inconsistent with the Guiding Principles Set Forth in the Consultative Document.

The Basel Committee states that the proposed prudential treatment of digital assets has been guided by three principles: same risk, same activity, same treatment; simplicity; and minimum standards.

[3] In this regard, it is essential that jurisdictions continue their efforts to establish a broader, coherent regulatory framework for digital assets – encompassing all market participants, including banks and non-banks – that appropriately addresses the concerns cited by the Basel Committee, in particular financial stability, consumer protection and money laundering/terrorist financing, and that applies comparable requirements to both banks and non-banks.

Same Risk, Same Activity, Same Treatment. We support the principle of "same risk, same activity, same treatment" and the related concept of "technology neutrality." The Consultative Document does not, however, adequately reflect these ideas. Through the Group 1/Group 2 classification criteria and the proposed capital treatment, banks would become subject to significant operational burdens, limitations on the recognition of hedging, netting and collateral and, for Group 2 digital assets, an entirely new type of punitive, non-risk-sensitive capital charge due to the presence of technology.

An asset, exposure or activity should not be subject to different capital, liquidity or other regulatory requirements solely on account of the presence or absence of technology. Likewise, regulatory requirements should not be designed to encourage or discourage the use of specific technologies or technology generally. Beyond guiding the prudential treatment of digital assets, these principles and concepts should also apply to bank supervision and regulation generally, including for purposes of regulatory authorization and permissibility, as well as operational risk management and bank and supervisory assessments of step-in risk.

All regulatory and supervisory determinations – including those relating to capital and liquidity treatment, authorization and permissibility, operational risk, step-in risk, and classification of an asset as a security/commodity – should be based on the characteristics of the activity or asset in question, not the presence or absence of technology. For example, to the extent the presence of technology affects the operational risk profile of digital assets, any increase in operational risk should be addressed through application of a bank's existing risk management framework and practices and regular supervisory oversight processes. A heightened operational risk profile on account of the presence of technology does not warrant the creation and application of an entirely new and different framework. Operational risk relating to digital assets should not be treated as fundamentally different from operational risk relating to traditional assets. Rather, existing frameworks, practices and processes should be adapted and applied to digital assets. Likewise, digital asset products and services should not be viewed – by either banks or supervisors – as presenting different or greater step-in risk solely on account of the presence of technology. For example, there is no reason to view custody-related activities as subject to greater step-in risk depending on whether the activities relate to traditional or digital assets.

A prudential treatment for digital assets would fit more coherently within a robust, broader regulatory framework for digital assets if the treatment actually adheres to the principle of "same risk, same activity, same treatment" and the related concept of "technology neutrality." Adhering to those ideas would also result in the prudential treatment promoting, instead of inhibiting, bank activities and innovations that benefit their customers and the public more generally.

Simplicity. We support the objective of designing a simple framework for the prudential treatment of digital assets. Simplicity in the design of the prudential treatment for digital assets is valuable. First, a simple framework has the potential to be applied in a flexible manner as financial markets and services evolve. Given the pace of developments relating to digital assets as well as the difficulty in rapidly revising prudential standards at the international or jurisdictional level, it is essential that any final standard be flexible in application. Second, simplicity also supports the ability of standard setters at the international and jurisdictional levels to monitor whether the prudential treatment of digital assets remains appropriate in light of developments relating to digital assets and associated services and markets. Consistent with the Basel Committee's contemplated iterative approach to policy development, the Basel Committee should regularly monitor developments relating to digital assets and evaluate whether any final standard remains appropriate in light of those developments. Simplicity in design would make it easier to do so. Finally, simplicity also has the potential to promote a level playing field by facilitating consistent application within and across jurisdictions, and facilitate assessments of fragmentation risk, through greater transparency into the effects of a framework.

Simplicity must, however, be balanced with risk sensitivity and coherence, and the proposed prudential treatment does not reflect an appropriate balance. Risk sensitivity and coherence are essential to a sound prudential framework. Capital requirements that are too high and not commensurate with risk adversely affect the cost and availability of credit and services, and may limit the ability of banks to provide beneficial products and services to their customers at all. Ignoring the risk-mitigating benefits of hedging – as the proposed treatment of Group 2 digital assets would do – misstates a bank's exposures and results in capital requirements that lack coherence and do not reflect a bank's actual risks. Similar issues would arise under the proposed prudential treatment due to the limitations on the recognition of netting in connection with Group 2 digital asset exposures and collateral consisting of Group 1b or Group 2 digital assets. Moreover, a framework that is insufficiently tailored or that categorizes exposures based on inappropriate criteria – as the proposed Group 1/Group 2 framework would do – results in capital requirements that lack coherence and are not commensurate with risk.

Minimum Standard. Promoting a level playing field and avoiding the risk of regulatory fragmentation across jurisdictions are important objectives for an international standard-setting body such as the Basel Committee. The Basel Committee establishes standards applicable to banks that operate across jurisdictions, often through subsidiaries subject directly to local requirements and indirectly to requirements of the parent's home-country supervisors. The Basel Committee notes that jurisdictions could apply additional or more conservative measures, and that jurisdictions that prohibit banks from having any digital asset exposures would be viewed as compliant with the Basel Committee standard. This is, of course, the nature of a minimum standard. However, the design and calibration of the proposed prudential treatment of digital assets, including commentary that could be read as encouraging "gold plating" or complete prohibitions in local jurisdictions, could create an uneven playing field, exacerbate the risk of regulatory fragmentation and push digital asset activities outside the robustly regulated banking sector. As discussed above, there are important and significant benefits of bank involvement in digital assets for bank customers, the public more generally and regulators.

As national authorities implement any final standard, the risk of regulatory fragmentation would be particularly acute for those jurisdictions, such as the United States, where both prudential and markets regulators have authority over digital assets and related activities, and where varying regulatory frameworks may apply depending on the regulatory classification of the digital asset and the regulatory status of the entity engaging in the activity (in the case of the United States, bank, special purpose charter entity, or non-bank entity). Accordingly, any final standard should be designed to achieve consistent and comparable application across jurisdictions and to minimize the risk of regulatory fragmentation within and across jurisdictions. The Basel Committee's commentary on the nature of a final standard as a minimum standard should also be consistent with these goals.

II. The Classification Framework Has a Flawed Conceptual Design.

First, narrowly defining Group 1, classifying any and all digital assets that are not Group 1-eligible as Group 2 and applying the same capital treatment to each and every Group 2 digital asset would result in a framework that is not risk sensitive and is insufficiently tailored to the varying characteristics of digital assets. In addition to revising the proposed qualification criteria for Group 1 digital assets, as discussed below, the Basel Committee should also distinguish among digital assets that would not qualify as Group 1 under the proposed classification criteria and not treat all such digital assets as falling into a catch-all category and subject to the exact same treatment. For example, the Basel Committee could broaden the scope of digital assets included in Group 1. The Basel Committee could also distinguish among digital assets included in Group 2. This could be done by distinguishing digital assets that are tokenized traditional assets or digital assets with stabilization mechanisms but that would not qualify for Group 1 classification (as proposed) due to the failure to satisfy one or more of the proposed eligibility requirements from other Group 2 digital assets, or by distinguishing among cryptocurrencies or other types of digital assets that would be classified in Group 2. Similarly, public block chains that would not qualify as Group 1 (as proposed) because of the impracticability of identifying all the node operators and block chain tokens held to facilitate holdings of and activities related to tokenized assets could be distinguished from Group 2 digital assets with different risk characteristics, such as cryptocurrencies.

The proposed capital treatment for Group 2 digital assets appears to be designed and calibrated in response to certain cryptocurrencies. Group 2 is, however, actually a catch-all category and, therefore, much broader. Under the framework presented in the Consultative Document, there would be many types of digital assets that would not qualify as Group 1 but that have fundamentally different characteristics and risk profiles from those cryptocurrencies. Indeed, because of the "seasoning" requirement for stabilization mechanisms, any new digital asset with a stabilization mechanism – irrespective of its other characteristics – would be classified as Group 2 for an indefinite period of time. The prior approval requirement for Group 1 classification determinations would likewise result in a similar outcome for virtually any new tokenized asset. Treating all digital assets that do not qualify for Group 1 in the exact same manner, as the Consultative Document contemplates, would create a framework that lacks coherence and risk sensitivity.

Second, dividing digital assets into Group 1 and Group 2, with the failure to meet any of the qualifying conditions for Group 1 at any time resulting in the digital asset being classified in Group 2 would create significant "cliff effects". These cliff effects would result from the punitive and novel capital treatment for Group 2 assets, as well as many of the eligibility criteria for Group 1. For example, the requirement that a stabilization mechanism "be effective at all times" would mean that temporary developments affecting a Group 1b asset – lasting potentially only four days over a one-year horizon – could result in that asset being reclassified as Group 2, with the reclassification applying for an indefinite period of time.

Third, banks' determinations to classify digital assets as Group 1 should not be subject to prior supervisory approval. A framework centered on a prior approval requirement is inconsistent with the ongoing rapid developments related to digital assets and related markets, services and products. New digital assets will be developed and emerge on an ongoing basis. Requiring prior regulatory approval for any new digital asset to be classified as Group 1 would result in a cumbersome and, ultimately, unduly burdensome process for both banks and supervisors. A prior approval requirement would also result in any new digital asset being treated as Group 2 for an indefinite period of time, pending regulatory approval of Group 1 classification determinations, irrespective of the characteristics of those digital assets. A prior approval requirement would also be inconsistent with the general design of the capital framework. Banks' determinations regarding whether an asset should be classified as one type of exposure or another are generally not subject to prior approval. For example, a bank's determinations as to whether an exposure is a claim on a bank, securities firm or corporate, a derivative, a securities financing transaction, a securitization, an equity exposure, an equity exposure in a fund, or an unsettled securities, commodities or foreign exchange transaction are not subject to prior approval.

As described above, consistency among frameworks and determinations regarding Group 1 eligibility is important across jurisdictions, particularly for banks that operate in multiple jurisdictions through subsidiaries subject to local prudential standards. A prior approval mechanism would not achieve global consistency and, instead, could result in an uneven playing field and regulatory fragmentation due to varying timelines and approaches for approvals across jurisdictions. A framework whereby banks make their own classification determinations; regulators supervise banks' frameworks and governance processes related to those classification decisions; and regulators provide guidance for classification determinations would be consistent with the general design of the capital framework and sufficient to achieve consistent treatment of digital assets within and across jurisdictions. This framework also would be strengthened if, as discussed below, the Basel Committee revises the eligibility criteria to make them clearer and more objective. Banks are responsible for understanding the risks relating to their digital asset activities and exposures. That includes being responsible for their classification determinations. Ordinary bank supervisory processes would provide a sufficient mechanism for supervisors to review and assess these determinations, in particular if the classification framework were revised to be clearer and more objective.

Below are specific recommendations relating to the proposed eligibility criteria for Group 1 assets:

- The criteria should be clear and objective. Subjective conditions – such as Condition 3 (requiring that the functions of a digital asset and its network be designed and operated "to sufficiently mitigate and manage any material risks") and the "seasoning" requirement for stabilization mechanisms (requiring sufficient data or experience to perform a detailed assessment of the stabilization mechanism) – would result in an uneven playing field across jurisdictions, inconsistent application within a jurisdiction and regulatory fragmentation.

- The "effective at all times" condition for digital assets with stabilization mechanisms should take into account the characteristics of the reserves for the digital assets. Specifically, the eligibility criteria should establish different thresholds for permitted variation, as measured by both degree and frequency, depending on the characteristics of the reserves for the digital assets.

- Condition 4 (requiring entities that execute redemptions, transfers or settlement finality be regulated and supervised) is overly broad. This condition would effectively require any public block chain to be classified as Group 2 because it is not feasible for a bank to identify all the node operators.

- New digital assets with stabilization mechanisms should be eligible for Group 1b classification from inception and should not be subject to a "seasoning" requirement relating to data and experience that would, as a practical matter, require any new digital assets to be classified as Group 2.

- The Basel Committee should clarify that the "full redeemability" requirement for a digital asset with a stabilization mechanism is not a requirement that the reserves for the digital asset consist solely of the asset to which the stabilization mechanism is linked. That is, the digital asset could satisfy the requirement so long as it could be redeemed, in full, for the asset to which the stabilization mechanism is linked at the designated ratio, even if a portion of the reserves are held as other assets. For example, a digital asset with a stabilization mechanism referencing the U.S. dollar could satisfy the requirement if a portion of the reserves are held as U.S. Treasury securities, so long as it can be redeemed for U.S. dollars.

- The Basel Committee and national regulators should provide guidance on expectations for the frequency of determinations and reevaluations in connection with the requirement that banks make "ongoing assessments" of Group 1 eligibility. Aside from the "effective at all times" condition tied to daily monitoring of the effectiveness of a stabilization mechanism, the criteria are generally not suited for daily or other frequent reassessments.

- The Group 1 eligibility criteria should not automatically exclude stabilization mechanisms that reference other digital assets. Such an exclusion is inconsistent with the concept of technology neutrality. If a digital asset could otherwise satisfy the eligibility criteria for Group 1, the mere fact that a digital asset has a stabilization mechanism referencing another a digital asset should not automatically result in Group 2 classification. For example, if a digital asset has a stabilization mechanism referencing a tokenized version of a traditional asset, there is no reason to automatically exclude the digital asset from Group 1b merely on account of the fact that it is linked to another digital asset.

III. The Proposed Capital Requirements for Digital Assets are Inappropriate.

We are concerned that the proposed capital treatment reflects a flawed conceptual design. In particular, the proposed treatment of Group 2 assets would be an entirely new type of capital requirement that would eliminate the long-standing and fundamental distinction between the trading book and banking book, would prevent the recognition of hedging and would broadly misapply a 1,250 percent risk-weight as a proxy for a capital deduction.

As a threshold matter, the Basel Committee should not impose an entirely new type of capital requirement – different in kind and degree – to Group 2 digital assets. For Group 2 assets, the Basel Committee should maintain the long-standing separate treatment for banking book and trading book exposures. Failing to do so would inappropriately disregard the real and significant risk-mitigating benefits of hedging trading book exposures. Eliminating the separate banking book and trading book treatment for Group 2 digital assets would also be fundamentally inconsistent with the fact that any final standard should and would address only one piece of the regulatory framework applicable to digital assets: prudential treatment (here, capital treatment). Eliminating the separate treatment would likewise be inappropriate as regulatory frameworks develop and banks increasingly engage in financial intermediation activities related to digital assets, in accordance with and as permitted by those frameworks. Moreover, the existing Basel Committee market risk standards are fit for purpose, including with respect to bank exposures to digital assets. To the extent banks have digital asset exposures in the trading book, those exposures would be risk-weighted as part of market RWAs. If those digital assets are volatile, the banks' trading book exposures receive a corresponding capital charge just like any other highly volatile asset. If the banks are hedging their exposures, those hedges factor into measures of market risk, as they would for any other exposure. There is no reason for a standard setter, such as the Basel Committee, to act rashly in establishing a standardized charge for digital assets that would not reflect the actual risks relating to the digital asset, particularly a standardized charge that completely disregards the risk-mitigating benefits of hedging. Doing so would make the overall capital framework more complex and less risk sensitive and coherent.

The calibration of the 1,250 percent weight also incorrectly disregards the impact of buffers. The Consultative Document states that the risk weight "is similar in effect to the deduction of the asset from capital."[4] It is not. A 1,250 percent risk weight corresponds to an 8 percent requirement. Due to buffers, a bank's effective total capital requirement is at least 10.5 percent and can be much higher than that due to the G-SIB buffer or jurisdiction-specific buffers, such as the stress capital buffer in the United States. Take, for example, a bank with a 1 percent G-SIB surcharge. Its effective total capital requirement would be 11.5 percent, inclusive of a 2.5 percent capital conservation buffer and the G-SIB surcharge. A $100 exposure would give rise to risk weighted assets of $1,250, which, when multiplied by the effective total capital requirement of 11.5 percent results in an effective capital requirement of $143.75. The effective capital requirement would, of course, be higher if the buffer requirement were higher, whether on account of activation of the countercyclical capital buffer, a higher G-SIBs surcharge or jurisdiction-specific buffers such as the stress capital buffer in the United States. Even if a risk weight approximating a capital deduction were appropriate – and it is not – the proposed 1,250 percent risk weight would not achieve that objective. The Basel Committee should not apply a uniform and excessively high risk weight across the board to all Group 2 assets and, instead, should develop a more risk sensitive treatment for Group 2 assets.

The treatment of Group 2 assets would inappropriately prevent the recognition of netting agreements. If a netting agreement relating to a Group 2 asset exposure would be enforceable and otherwise satisfy the criteria in the capital framework, a bank should be permitted to recognize the risk-mitigating benefits of the netting agreement as it could in connection with any other exposure. There is no reason to limit the recognition of netting among derivatives relating to digital assets and/or traditional assets if the relevant criteria – including enforceability – are satisfied. Any other approach would be inconsistent with the guiding principle of same risk, same activity, same treatment, and the related concept of technology neutrality.

Similarly, the treatment of Group 1b and Group 2 assets would also inappropriately prevent the recognition of collateral by excluding all those digital assets irrespective of the characteristics of any particular digital asset. The same principles that guide the recognition of collateral for traditional assets should apply in connection with digital assets. If the collateral arrangement is legally enforceable, the bank has a perfected first-priority security interest and if the collateral is sufficiently liquid, the bank should be able to recognize the risk-mitigating benefits of collateral. To the extent a collateral arrangement involving a Group 1b or Group 2 digital asset can satisfy these requirements, a bank should be able to recognize the risk-mitigating benefits of the collateral.

We do, however, strongly support the Basel Committee's express statement that the proposed capital framework for digital assets does not seek to provide a capital charge for digital assets if there is not an existing charge in the context of traditional assets (for example, providing custody and other services to customers that invest in traditional assets).[5] If a traditional asset – such as an off-balance-sheet asset held in custody for a client – would not attract capital charges under the existing Basel Committee framework, the same treatment should extend to a digital asset. This approach is consistent with the guiding principle of same risk, same activity, same treatment, as well as the related concept of technology neutrality.

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4 Consultative Document at 14.

5 Consultative Document at 7, note 10.

With regard to operational risk, there should not be Pillar 1 add-on charges for exposures relating to digital assets. As the Basel Committee acknowledges, calibration of these charges would be a "significant challenge,"[6] in particular given that both digital assets and banks' activities relating to digital assets vary. Appropriately designing and calibrating add-on charges would be impracticable given the pace of developments relating to digital assets. Further, an asset-specific add-on charge would be fundamentally inconsistent with the design of and rationale for the new standardized approach for operational risk released in December 2017. That standard reflects the Basel Committee's view that "the combination of a simple standardised measure of operational risk and bank-specific loss data provides a sufficiently risk sensitive measure of operational risk."[7] The emergence of digital assets as a new asset class does not warrant a fundamental revision to a recently finalized new operational risk standard.

More generally, the Consultative Document appears to reflect a mistaken view that digital assets present only heightened operational risk and do not have the potential to reduce, rather than exacerbate, operational risk. Digital assets and the use of related technologies offer a number of potential benefits that could mitigate operational risk, including: reducing needs for data reconciliation and confirmation of trade details between front and bank offices post-trade; reduced operational inefficiencies and risk incidents, including with respect to cross-border payments; shortened settlement cycles; improved end-to-end processing speeds, data transfer and availability of funds; and enhanced compliance, auditability, traceability and transparency abilities according to the nature of certain distributed ledger technology networks.

Finally, the Basel Committee should clarify in any further consultation and final standard that the concerns expressed in the Consultative Document regarding the application of models-based approaches to Group 1 digital assets do not apply to the models-based market risk standards.[8] Digital asset exposures in the trading book (including, as discussed above, those relating to Group 2 digital assets) should be treated like any other exposures in the trading book. The Basel Committee should also clarify that the standardized approach for counterparty credit risk (SA-CCR) would be regarded as a standardized, non-modeled approach for credit risk, and that concerns about the application of models-based approaches to digital assets would not apply to SA-CCR.

IV. The Basel Committee Should Revise the Proposed Liquidity and Disclosure Requirements, Implement the Proposed Approach to Leverage Requirements, and Clarify Expectations Regarding Risk Management.

Liquidity. Consistent with the principle of same risk, same activity, same treatment and the related concept of technology neutrality, the Basel Committee should not automatically exclude all digital assets from potentially qualifying as HQLA. A digital asset that has the characteristics of HQLA should be recognized as HQLA. In particular, a Group 1a digital asset representing a tokenized version of a traditional asset that would qualify as HQLA should itself be recognized as HQLA if the market for the digital asset is sufficiently deep and liquid and the digital asset has a proven record as a reliable source

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6 Consultative Document, at 7.

7 Basel Committee, Consultative Document – Standardized Measurement Approach for Operational Risk (March 2016), at 1.

8 Consultative Document, at 7.

of liquidity. Tokenization of an asset that is otherwise eligible HQLA should not preclude recognition as HQLA so long as the relevant criteria relating liquidity and market depth are satisfied.

Likewise, a Group 1b digital asset should, itself, be eligible as HQLA if (i) the Group 1b digital asset has a stabilization mechanism referencing a traditional asset or Group 1a digital asset that, in either case, itself qualifies as HLQA, (ii) the Group 1b digital asset is redeemable without restriction and within a standard settlement cycle for such HQLA, (iii) the market for the Group 1b digital asset is sufficiently deep and liquid, (iv) the Group 1b digital asset has a proven record as a reliable source of liquidity and (v) the entities operating transfer and settlement systems, administering stabilization mechanisms and acting as custodian for the assets collateralizing the Group 1b digital asset are regulated financial institutions. Conditioning HQLA eligibility for Group 1b digital assets on regulated financial institutions fulfilling those roles provides additional assurance that the digital asset would remain a source of liquidity even during stressed market conditions.

Automatically excluding all digital assets from being recognized as HQLA would detract from the coherence of any final standard and contribute to regulatory fragmentation. The overall regulatory frameworks for digital assets are continuing to develop and the markets for digital assets are growing. Permitting digital assets to qualify as HQLA – if the criteria relating to the markets for and liquidity of the digital asset are satisfied – would reflect that the prudential treatment of digital assets is only one component of a broader, evolving regulatory framework.

Disclosure. The Consultative Document would require, as part of Pillar 3 disclosures, qualitative information presenting an overview of a bank's activities related to digital assets and related risk exposures. The Consultative Document appears to contemplate that banks would provide qualitative disclosure about digital asset activities and exposures irrespective of materiality, which could result in the disclosure of immaterial information, undue prominence of digital asset-related information and the imposition of undue disclosure burdens on banks. A materiality standard would be consistent with the general guiding principle for Pillar 3 disclosures that disclosure should be meaningful and useful. Any final standard should clarify that banks would not be required to provide separate disclosure on digital asset activities and exposures unless those activities and exposures are material.

Leverage Requirements. We support treating digital-asset exposures like any other on- or off-balance-sheet exposure for purposes of leverage-based capital requirements. This approach would be consistent with the general design of leverage ratio requirements and the principle of technology neutrality. Although we have long-standing concerns with leverage requirements given their inherent lack of risk sensitivity, we believe the Basel Committee correctly decided not to propose a unique or exceptional leverage ratio treatment for digital asset exposures.

Risk Management. Any further consultation and final standard should clarify that banks are expected to address digital assets within their existing risk management practices and frameworks. The Consultative Document describes the responsibilities of banks in connection with their digital asset activities. The Basel Committee should make clear that banks should not, and would not be expected to, establish entirely new risk management processes and frameworks devoted solely to digital assets.

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BPI appreciates the opportunity to comment on the Basel Committee's Consultative Document. If you have any questions, please contact the undersigned by phone at (202) 589-2424 or by email at dafina.stewart@bpi.com.

Respectfully submitted,

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