INDEPENDENT COMMUNITY
BANKERS of AMERICA®

September 10, 2021

Via Electronic Submission

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

RE: Public Consultation on Preliminary Proposals for the Prudential Treatment of Banks' Cryptoasset Exposures

Dear Sir or Madam:

The Independent Community Bankers of America® ("ICBA")[1] welcomes the opportunity to provide feedback on the Basel Committee for Banking Supervision's Consultation Document on the Prudential Treatment of Cryptoasset Exposures. Responsible innovation in financial services is critical for banks to offer solutions to meet new and existing customer needs. ICBA and its members appreciate the Basel Committee's efforts to raise awareness of the potential benefits and risks of cryptoassets and offer a forum for regulatory authorities to consider how to develop policy standards and solutions to support new technologies within the banking system.

Digital assets, ranging from cryptocurrencies like bitcoin to various tokenized financial or non-financial assets, represent new efforts to advance the digital economy and deliver new ways to increase speed, efficiency, and transparency in financial services for consumers and businesses. The promises of these technologies, however, are counter-balanced by serious concerns about the potential for disintermediation of traditional financial services by decentralized finance ("DeFi") and the use of cryptocurrencies to facilitate ransomware, money laundering, and other criminal activity. There are also significant concerns about market volatility, transparency, and risks to national and global financial stability.

[1] *The Independent Community Bankers of America® creates and promotes an environment where community banks flourish. ICBA is dedicated exclusively to representing the interests of the community banking industry and its membership through effective advocacy, best-in-class education, and high-quality products and services. With nearly 50,000 locations nationwide, community banks constitute 99 percent of all banks, employ more than 700,000 Americans and are the only physical banking presence in one in three U.S. counties. Holding more than $5.7 trillion in assets, over $4.7 trillion in deposits, and more than $3.6 trillion in loans to consumers, small businesses and the agricultural community, community banks channel local deposits into the Main Streets and neighborhoods they serve, spurring job creation, fostering innovation and fueling their customers' dreams in communities throughout America. For more information, visit ICBA's website at www.icba.org.*

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ICBA and its members look forward to continued engagement with national authorities and international organizations to ensure that all community banks continue to play a leading role in developing the products and services that enable their customers and communities to benefit from advances in financial technology.

Background

Since the birth of bitcoin in 2008, the global cryptocurrency market has quickly grown with the development of thousands of other cryptocurrencies and digital assets. The past few years have witnessed cryptocurrencies transition from a niche interest among cryptography experts into a wide range of assets and services that seek to provide new mediums of exchange, stores of value, or units of accounts. New technology companies, established financial services providers, and central banks are all experimenting with cryptoasset technologies to address payment system inefficiencies or improve the trading of traditional assets.

Although it is challenging to determine how many people invest in or utilize cryptoassets, a survey conducted by Cambridge University estimates a "total of up to 101 million users across 191 million accounts opened at service providers as of Q3 2020."[2] As of September 2021, the global cryptocurrency market capitalization stands at more than $2 trillion.[3] While this growth may bring new opportunities, the risks to consumers and the wider financial system cannot be ignored. Cybercriminals frequently target cryptocurrency companies and exchanges, inflicting damage on critical infrastructure and services with ransomware attacks.

As the digital asset market continues to rapidly expand, some U.S. banks are starting to consider offering crypto-related products and services, such as custodial services or holding stablecoin issuers' reserve accounts, to meet new and existing customer demands. Early adopters among community banks have created cryptocurrency rewards programs for debit card purchases, enabled bitcoin purchases at ATMs, and some also provide banking services for cryptocurrency companies. Most community banks in the United States, however, are still in the early stages of learning about the underlying technologies, potential use cases and assessing the associated risks.

Summary of Basel Cryptoassets Proposal

In the wake of this growing interest, policymakers and regulators around the globe are escalating their efforts to design an appropriate prudential treatment for cryptoassets. The Basel Committee is responding to the overwhelming rapid growth in the development of cryptocurrencies by attempting to create a framework for the treatment of cryptoassets as they present regulatory

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[2] Apolline Blandin, Dr. Gina Pieters, Yue Wu, Thomas Eisermann, Anton Dek, Sean Taylor, Damaris Njoki, *3rd Global Cryptoasset Benchmarking Study*, September 2020, https://www.jbs.cam.ac.uk/wp-content/uploads/2021/01/2021-ccaf-3rd-global-cryptoasset-benchmarking-study.pdf, pg. 44.
[3] See Coinmarketcap.com.

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exposure on bank balance sheets. The proposal establishes two specific groups of cryptoasset risk profiles with the first group further delineated based on tokenization. Group 1a represents the tokenization of traditional assets like real estate and commodities. Group 1b represents cryptoassets with stabilization mechanisms like stablecoins, and seeks to recognize the risks presented by the various stabilization mechanisms. Group 2 is designed to catch all other cryptoassets including bitcoin with a proposed risk weight of 1,250%. The proposal also addresses the responsibilities of banks and bank supervisors when assessing and managing cryptoasset risk within the Basel capital framework. Both banks and bank supervisors will need to address not only the safety and soundness aspect of cryptoasset exposures but also cybersecurity protocols, integrity of the digital ledger, private keys, and node operators. In addition, existing risks surrounding terrorism, money laundering, and general operations will need to be addressed for mitigation.

Domestically, however, the regulatory framework for digital assets remains fragmented as multiple U.S. federal and state banking and markets regulators strive to design a comprehensive framework for cryptoassets. The Federal Reserve, in collaboration with the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation, are currently evaluating digital asset taxonomies and terminology as part of a larger effort termed the Digital Assets Sprint Initiative. It is essential for U.S. banking regulators to coordinate on the regulation of cryptoassets to provide community banks with clear guidelines.

Without more information from prudential regulators in the United States, a chilling effect on innovation may arise, thereby leading to inaction or speculation among banks about prudent courses of action. Responsible innovation in financial services requires clear guard rails so that banks know which activities are permissible and how products and systems should operate. Many banks may choose not to engage in cryptocurrency or other digital asset activities if prudential regulators fail to provide critical guidance and information.

ICBA Comments

ICBA reviewed the Consultation Document with a group of members, and we have identified several critical observations for the Basel Committee to consider as it continues its efforts to provide guidance for cryptoassets:

- There is a growing digital divide between banks that have the resources and expertise to engage in digital assets and banks that lack those resources.
- Policymakers and regulators must work together to ensure a level-playing field for all financial institutions.
- New technology should not alter the regulatory treatment or capital requirements of an otherwise similar asset.

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- Community banks that choose to participate in a stablecoin system should not be held to a higher regulatory standard than cryptocurrency companies engaged in similar activities.
- The Basel Committee should consider additional groups or subgroups for Group 2 cryptoassets that reflect the varied uses, forms, and characteristics that may impact the underlying risks of the assets.
- If a risk weighting is set too high for banks, then banks may be disincentivized from offering cryptoasset products and services. The threat of shadow banking will continue to grow if cryptoasset users continue to utilize systems and platforms that exist outside the regulated financial system.

ICBA interviewed several bankers to hear their views on the current proposal and how it may impact banking in the United States and the potential role of cryptoassets in current and future customer needs. These bankers, who represented banks ranging in assets from less than $1 billion to more than $10 billion, expressed appreciation for the Basel Committee's leadership on cryptoassets and voiced support for the Committee's ongoing efforts to coordinate with other international organizations and invite public consultation on its proposals.

We also look forward to additional research from the Bank for International Settlements that will help financial institutions understand the digital assets market and the potential risks and benefits of cryptoassets. Community bankers have expressed concerns about a growing digital divide between banks that can have the resources and expertise to launch digital asset products and services and those that do not. The Bank for International Settlements provides a valuable service by supporting research into cryptoasset technology and its potential impact on the global economy.

ICBA and its members agree with the Basel Committee that the Consultation Document represents an important first step in an iterative process that will require more industry engagement and feedback. ICBA and its members welcome the Basel Committee's efforts to work with stakeholders as the future of finance continues to unfold. Bankers, however, conveyed concerns about several aspects of the proposed prudential treatment of cryptoassets.

A Level Playing Field for Cryptoassets

As the digital economy continues to grow, cryptoassets have the capacity to be important elements in a globalized financial system by supporting enhanced financial products and services for U.S. businesses and consumers. However, as regulators continue to chart a path forward, it is critical for regulatory authorities to ensure a level playing field for all financial institutions that choose to offer cryptoasset products and services. Regulation should not erect barriers to innovation or foster an environment in which only multinational banks and cryptocurrency companies have the ability and resources to participate in the growing digital economy. It is vital

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for international organizations, such as the Basel Committee, to encourage collaboration between national regulatory authorities to support regulatory harmonization and avoid fragmentation.

Technology Should Not Alter Regulatory Treatment of Assets

Community bankers support the Basel Committee's commitment to the principle of "same risk, same activity, same treatment." Bankers said that new technology should not alter the regulatory treatment or capital requirements of an otherwise similar asset. If the blockchain technology used to tokenize a traditional financial asset or commodity is sound in the eyes of prudential bank regulators, then regulators should treat the underlying asset the same as similar non-tokenized assets.

For example, a market has developed for tokenized gold on the Ethereum blockchain that allows holders of the token to realize changes in fair value of physical gold bars. The token is governed by a regulated custodian and is subject to periodic audits. If regulators conclude that the market risks that impact the token are substantially the same as the market risks that impact the physical commodity, both instruments should carry the same or substantially the same risk weights. It will become critical for prudential regulators to obtain a thorough understanding of the rights and obligations subject to all parties in the contract to properly assess the behaviors of the token and its associated blockchain(s) when compared to the known circumstances surrounding the asset in untokenized form.

Stablecoins

As noted within the Consultation Document, stablecoins are cryptoassets that seek to "maintain a stable value relative to a specified asset." Currently, the most significant asset-backed stablecoins on the market, such as Tether and USDC, are pegged to the U.S. dollar. In the past year, stablecoins pegged to the U.S. dollar have surged in adoption. Tether remains the most widely used stablecoin with an estimated $64 billion in circulation, and USDC follows with approximately $27 billion in circulation.[4] Collectively, the top five asset-backed stablecoins now add up to more than $100 billion in total value.[5]

However, despite the recent growth of stablecoins, the technology is still in its infancy. Some speculate that stablecoins may be able to provide for faster cross-border payments or address other inefficiencies in domestic payment systems, but bankers agreed that the future remains uncertain. Nevertheless, community banks that participate in stablecoin systems should not be held to a higher regulatory standard than cryptocurrency companies that may offer similar

[4] See CoinMarketCap.com for a full list of asset-backed stablecoins.
[5] Ibid.

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products and services. Regulatory parity and harmonization are key to maintaining a level playing field for all parties that want to pursue cryptoasset activities.

Group 2 Cryptoassets

The Basel Committee proposes that any cryptoassets that fail to meet a detailed list of conditions to quality for classification as a Group 1 asset will automatically be deemed a Group 2 asset and be subject to conservative capital treatment. Compared to the tokenized traditional assets and cryptoassets with stabilization mechanisms in Group 1, the Consultation Paper contends that Group 2 assets "pose unique risks" and should be subject to a risk weight of 1250%.

Bankers expressed concerns that Group 2, as currently proposed, encompasses too many different types of cryptoassets and fails to distinguish between the risk profiles presented by such a wide variety of cryptoassets. Bankers noted that cryptoassets utilized to access a smart contract platform, such as Ethereum, may not have the same risks as a governance token for a particular application.

Additionally, the bankers said that not all Group 2 assets aim to provide the same function. Some, such as Bitcoin, strive to become a store of value and possibly a mechanism of exchange. Others, however, are designed to signify which users may vote on the development of a project. These examples are only a handful of the varied uses of assets that may be categorized as Group 2, and there will almost certainly be new types of cryptoassets with novel characteristics created in the future. The Basel Committee should consider additional subcategories within Group 2 that acknowledge how the varied uses, forms, and characteristics of cryptoassets may impact underlying risks and provide additional guidance to help financial institutions.

Bankers also cautioned that a risk weighting set too high may disincentivize banks from offering services or prompt individuals to refrain from bringing cryptoassets to regulated financial institutions. The risks of shadow banking may grow more significant if cryptoasset users continue to utilize systems and platforms that exist outside the regulated financial system.

In order to more precisely reflect the risk characteristics present in Group 2 assets, ICBA believes that the Group 2 cryptoassets designation should be broadened in additional groups or sub-groups to better reflect the diverse nature of cryptocurrencies as they have evolved thus far and will continue to evolve at a rapid rate for the foreseeable future. The broadening of categories should reflect the classes of cryptoassets in Group 2 that function solely as stores of value, the classes that function as financial contracts where expected cash flows could potentially be forecasted, and the classes that function as gateways to access blockchain technology in an attempt to bring stability to the cryptoasset. As this diverse group of Group 2 cryptoassets is assessed by regulators, it will become quickly apparent that not all Group 2 cryptoassets exist to meet the same objective or serve the same function; therefore, diversity in approach to regulation

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will be needed. In some cases, regulators may choose to prohibit a cryptoasset with the characteristics of a stablecoin from qualifying for inclusion in Group 1b, but the cryptoasset could exhibit enough functionality to prevent it from the most punitive risk weighting under Group 2.

For example, an industry-accepted stablecoin may fail to meet regulatory requirements for inclusion in Group 1b because its stability is driven by a formulaic mechanism within the contract that is used to provide stability with little to no liquid cash reserves. However, such an asset may be proven over time to exhibit stability in times of market stress that would limit market volatility. It would be inappropriate to categorize the cryptoasset in the most punitive manner if it does not demonstrate the same risks of other assets in Group 2. ICBA believes that it is too early to determine the number of categories under Group 2, the types of assets that should be placed in each category, and the associated risk weights for each category until a more robust framework for cryptocurrency regulation is adopted among prudential regulators. However, the Basel Committee has outlined a general structure that can serve as a valid starting point for identifying the risks and rewards associated with these assets.

Conclusion

ICBA and its members appreciate the opportunity to comment on the Basel Committee for Banking Supervision's Consultation Document on the Prudential Treatment of Cryptoasset Exposures and look forward to continued dialogue to ensure that all community banks continue to play a leading role in developing the products and services that enable their customers and communities to benefit from advances in financial technology. If you have questions or require additional information about ICBA's statements, please contact me at (202) 821-4427 or by email at Brian.Laverdure@icba.org.

Sincerely,

/s/

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Vice President, Payments and Technology Policy

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