

Prudential treatment of cryptoassets exposures

Grant Thornton Advisory

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Introduction

On December 2022, the Basel Committee on Banking Supervision (BCBS) published the standard on the prudential treatment of cryptoasset exposures* (hereinafter, the “Prudential Standard”), which will be incorporated into the consolidated Basel Framework in due course.

The BIS has published an **executive summary** on the applicability to cryptoassets of Pillars 1, 2 and 3 of the Basel Framework, emphasizing the necessary minimum capital requirements for regulatory supervision and disclosure of banks, with exposure to cryptoassets.

CRYPTOASSETS CLASSIFICATION

BCBS defines the cryptoassets as digital representation of value that can be used for payment or investment purposes or to access a good or service.

The **Prudential classification** of the cryptoassets done by BCBS is based on the characteristics of the cryptoassets, in two groups:

Group 1

- (Group 1a) Tokenized traditional assets
- (Group 1b) Cryptoassets with effective stabilization mechanism (i.e. stablecoins issued by supervised and regulated entities)

Cryptoassets must meet the full set of classification conditions specified in the Prudential Standard, including redemption risk test for cryptoassets in Group 1b, to ensure that the reserve assets are sufficient to enable the cryptoassets to be redeemable at all times for the peg value, even in stressed periods.

Group 2

Cryptoassets that fail to meet any of the Group 1 classification conditions, that is unbacked cryptoassets and tokenized traditional assets and other stablecoins not in Group 1.

- (Group 2a) Cryptoassets that meet hedging recognition criteria and receive limited hedge recognition
- (Group 2b) Cryptoassets where hedging is not recognized



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Applicability of Pillars 1, 2 and 3 of the Basel Framework to cryptoassets

The following diagram shows the applicability for each Pillar of the Basel Framework. Pillar 1 focus on Risk Based Capital (RBC) for credit, market and operational risks, and other

applicable elements (liquidity standards, leverage ratio and exposure limits); Pillar 2 on the banks and supervisors' responsibilities and Pillar 3 on bank disclosures.

CRYPTOASSETS AND APPLICATION OF BASEL FRAMEWORK



Pillar 1
Quantitative capital requirements, provisions and risk coverage

- **Group 1** subjects to capital requirements based on the **Risk Weights (RWs) of underlying exposure**, with possible, if applicable, add-on requirement for infrastructure risk coverage in the event of weakness by supervisory review.
- **Group 2 requires additional capital requirements than Group 1**
 - (I) Group 2a requires 100% capital charge (1,250% RW), except hedge recognition;
 - (II) Group 2b does not allow hedge recognition, which means RW of 1,250%.
- Standard approach applied in **Operational Risk**.
- **Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR)** – treatment consistent with current methods for traditional exposures. Only Group 1a can be considered HQLA (high-quality liquid assets). Groups 1b (stablecoins with redemption) and 2 cannot be considered HQLA.
- A **Leverage Ratio** is allowed according to exposure measure, based on accounting treatment for exposures with similar characteristics.
- On the **exposure limits**, Group 1 subjects to the same limits as large exposures standards; Group 2 subject to a limit of 2% (max. exposure) of Tier 1 capital although, it should not exceed 1% (any gap has to be communicated to the supervisor and fixed).



Pillar 2
Risk management and supervision

- **Responsibilities for banks**
Establishment of policies and procedures to identify, assess and mitigate risks. Technological, cybersecurity, legal, AML&FT and valuation risks must be considered.
- **Responsibilities for supervisors**
Review bank policies and procedures, assess risks and address any gap identified. It can include additional capital requirements, provisions for losses or impose mitigation measures (e.g. establishment internal limits).



Pillar 3
Transparency and market discipline

- **Banks must disclose information regularly** on any material cryptoassets Group, on all their exposures to cryptoassets, including:
 - exposure amounts
 - capital requirements
 - accounting classification

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Next steps on Basel Prudential Standard



Now, what are next steps for the Prudential Standard?

The BCBS expects that banks in BCBS member jurisdictions adopt the Prudential Standard by January 2025. The Basel Committee has said that it will be monitoring the implementation of this prudential treatment, as priority initiatives on the digitalization of finance for 2023-2024.

Banks expect that Basel Committee collect data from them as part of the regular Basel III monitoring exercise, adjust the Prudential Standard to consider the whole perspective of emerging risks, and provide results from the BCBS reviews. Some of the areas indicated to review are risks of cryptoassets that use permissionless blockchain can be sufficiently mitigated to allow for their inclusion in Group 1 (lower risk) and, if so, what adjustments to the classification conditions would be needed, e.g. assets as eligible collateral.



What about other prudential regulations with impact in cryptoassets exposures?

MiCA sets requirements for Crypto Asset Services Providers (CASP) –rather than exposures– which are required to have in place prudential safeguards.

The CRR 3 proposal does not give a specific guidelines of the prudential treatment of cryptoassets. However, a review will be done by the European Commission to determine if it would be needed, so an adoption of legislative proposal is expected, considering the work performed by BCBS.



What is expected from EU local regulators?

We expect that national EU regulators incorporate the Prudential Standard in their supervisory approaches, considering MiCA requirements and CRR as well.



What about other jurisdictions apart from EU?

UK: it is expected that, based on the PRA Letter* and the BCBS Prudential Standard, PRA will conduct new guidelines on the prudential treatment of the cryptoassets, currently without a clear timeframe.

In other jurisdictions, so far, no activity has been identified. Hong Kong Monetary Authority (HKMA), announced that it intends to implement the Standard locally by 1 January 2025.

*The PRA Letter ([link](#)) complement some publications on the prudential framework such as: (i) the Financial Policy Committee publication on the assessment of the role that cryptoassets and associated markets currently play in the United Kingdom and globally; (ii) the Bank of England summary of responses to its Discussion Paper on New Forms of Digital Money; (iii) the Financial Conduct Authority statement to highlight certain risks such as financial crime and custody risks related to crypto activities.



Grant Thornton view

Our vision on capital requirements for banks



Is the banking sector ready for the Prudential Standard implementation?

It is pretty clear that banking sector has identified appetite of investors, individuals and large corporations for products and services related to digital assets, particularly in cryptoassets.

Financial entities are already re-assessing their processes and risk management models to develop and implement procedures that allow to the Board to be able to understand, manage and control risks, in a way which supports the entity safety and stability.

We are aware that the banking industry is being prepared to actively participate in a field that is becoming more and more known.

The new business models based on cryptoassets must be integrated in a cross-way into the entity, from business, processes, technology, risk management and Governance, where they actively should evaluate the prudential needs necessary to control and mitigate risk they are exposed to.

This Prudential Standard benefits the transparency and stability the banking sector, and easily help banks for entering into the cryptoassets environment. Although some adjustments have to be developed, the European Central Bank has already indicated that in the EU, banks with exposure to cryptoassets should start applying it.



For the banking industry, stop attending its stakeholder needs on cryptoassets is not an option



All areas in the Entity are part of the change management and are elements that must actively collaborate to respond to the needs of their stakeholders

Risk, Compliance and Internal Audit are functions that play a key role in elements that have a direct impact on capital requirements, such as appetite for crypto exposure, incorporation of new players into the entity's ecosystem or governance decisions.



From standard models to internal models for cryptoassets... a challenge from risk factors knowledge to their modelling.

What if the sector plans to develop advanced models for these new products / asset classes that allow adjust their capital requirements?

Do entities have sufficient data to be able to develop robust models?

Are the control functions prepared to validate advanced models (methodology, tests, skills,...)?

How would these advanced models coexist with the models currently implemented in entities?

Then... will we see in the medium-term regulatory guidelines to develop and review advanced models for crypto assets?

How Grant Thornton can help



Grant Thornton, your Risk and regulatory advisors

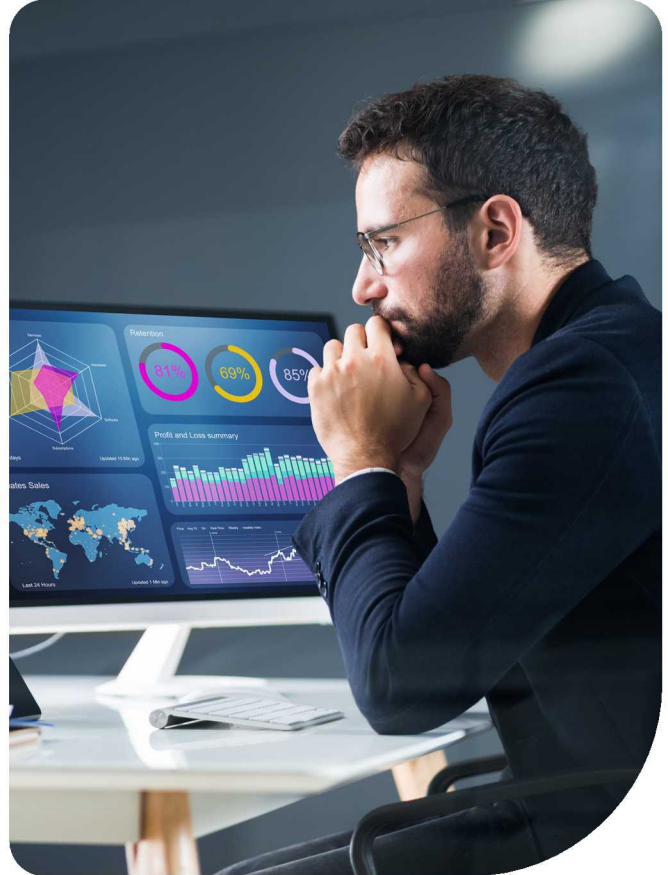
We support the risk management and control in a cross way throughout the risk cycle, from the identification, assessment, control and risks mitigation on digital assets.

We are dedicated to giving our clients a comprehensive service, made up of a group of professionals with extensive experience in different areas, including technology, risk, compliance, legal and tax, and incorporating specific industry experience.

We provide global advisor, supported by a group of international experts in charge of bringing the best practices to our clients, with real experiences and specific use cases implemented.

We accompany our clients in making the launch of products and services based on digital assets a reality, taking advantage of our assets, such as in-house tools and own methodologies.

We align the company business strategy with the regulatory expectation, providing a complete integration in the organization.



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