Association of Proprietary Traders

Bank of International Settlements/ Basel Committee
Centralbahnplatz 2
4051 Basel, Switzerland
SUBMITTED via www.bis.org

Date: 30 September 2022
Subject: **Comments to 2nd consultation Prudential treatment of crypto asset exposures**

Dear Sir, Madam,

The Dutch Association of Proprietary Traders (APT) appreciates the opportunity to provide comments on the second Basel Committee Consultative Document on the Prudential treatment of crypto asset exposures, in follow up to our response to the first consultation.

APT represents 22 independent proprietary trading firms based in the Netherlands, trading professionally in financial instruments for own account and risk, contributing to price discovery and providing continuous liquidity on exchanges and trading platforms across the EU, US, and APAC, often in the capacity of designated *market makers*.

The proposals in the consultation are aimed at banks. However, in some jurisdictions, such as the EU, the scope of the proposed framework might also be (partly) extended to investment firms such as proprietary traders. Therefore, we would like to share our concerns around your proposals.

More generally, we believe that when the risk is different, the prudential treatment should also be different. Investment firms have a different risk profile from banks. Investment firms trading on own account do not hold client or third-party assets. Market makers appropriate the 'spread', i.e. the difference between buying and selling prices, in high volumes. Positions on either side of the balance sheet are sizeable, but the net risk is low as positions are fully hedged/netted and risk windows are short.

This second consultation document shows improvement compared to the first, but in our view, changes are needed on the following points:

- The **exposure limit**, limiting an institution's exposure to Group 2 crypto assets to 1% of the institution's Tier 1 capital, being the sum of all individual gross long and short positions, is not workable. E.g. an institution with EUR 1 billion in Tier 1 capital would already reach its exposure limit with EUR 5 million in long positions in crypto assets, hedged with EUR 5 million in short positions in related instruments, whilst the real market exposure is flat/fully hedged. Thus, the hedging recognition under Group 2a crypto assets will not have any value in practice. If carried through, such

a limit will be prohibitive for existing as well as new participants and prevent the market for cryptoassets from becoming more mature. In no other asset class such a methodology is used. Therefore, we would urge to re-assess/withdraw this proposal.

- For the **100% capital charge** for group 2 crypto assets, the risk weight of 1250% remains the basic assumption. As stressed in our earlier response, this assumption should be aligned with current Basel Framework risk weights for other, equivalent, assets, as it is not proportionate to the underlying risk and does not reflect the overall impact of crypto assets on the global financial markets and of crypto assets that are matured, established, traded on liquid markets and have internal governance controls.

  Instead, an operational an add-on not exceeding the risk weight of existing risk weight calculations for other asset classes could be considered. Furthermore, for the market and credit risk weights for crypto assets, the Basel Framework should set the criteria when and how to determine under which approach an individual crypto asset should be classified as either as 'equity' or as 'commodity'.

- As the use of DLT is limited and already well identified in the market and there is no need for additional covering on top of market-driven risk mitigating actions, we would recommend withdrawing the proposed **infrastructure risk add-on** to risk-weighted assets (RWA) for all group 1 crypto assets.

- As market makers keep net exposures flat **capitalizing net positions** is important for us. In this light the SCO 60.60.2 requirement, referencing the highly liquid underlying ETF/ETN, is too restrictive as many well-established crypto assets are excluded. Instead, we would recommend creating an appropriate scale of liquidity levels acceptable for this requirement specified per crypto asset, derivative or underlying ETF/ETN.

- On the topic of **classification conditions**, we would recommend an appropriate adjustment of the redemption risk and basis risk tests (SCO60.12 -60.14) to ensure a level playfield between regulated and unregulated firms and to ensure that these tests are not overly cumbersome, impractical, and not subject to manipulation by unregulated entities providing cryptoassets.

We are happy to provide you with further information with respect to these comments, our additional thoughts on the important issue of prudential treatment of cryptoassets, and answer any questions you might have in more detail.

Best regards,

Matthijs Pars,
Director APT