

# Basel Committee announces revised proposals on crypto regulation

## AT A GLANCE

July 2022

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### What's new?

- The Basel Committee [published](#) a second consultation on the prudential treatment of crypto asset exposures on 30 June 2022. This consultation builds on the Committee's [2021 consultation](#) and seeks to address issues raised in feedback as well as providing more detail on the proposed standard.
- The Committee emphasises that the continued growth of the cryptoasset market could raise financial stability risks and states that it may further tighten the proposed policy standard ahead of finalisation, in the event that it identifies deficiencies to its proposals or if new risk elements emerge.

### What does this mean?

- The proposed policy standard classifies cryptoassets into two groups - Group 1 assets would fully meet a set of classification conditions, while those assets classified under Group 2 would not meet any of the conditions. Group 2 assets would be subject to a more conservative capital treatment compared to those in Group 1, given that they are judged to present greater prudential risks.
- The Committee stipulates four classification conditions to determine whether a bank's cryptoasset exposures would be allocated towards Group 1 or Group 2:
  - the cryptoasset is either a tokenised traditional asset or has an effective stabilisation mechanism that links its value to a traditional asset
  - all rights and obligations linked to the cryptoasset are clearly defined and legally enforceable, including settlement finality
  - the cryptoasset functions (including those of its operating network) operate to sufficiently mitigate material risks
  - entities that are involved in the organisation and processing of cryptoassets should be regulated and supervised, or subject to appropriate risk management standards.
- The proposed capital treatment of Group 1 assets would be based on the existing Basel credit and market risk framework, with the addition of capital add-ons for infrastructure risks and stablecoins that only narrowly passed the stabilisation risk test. The Committee is seeking specific feedback on the treatment of cryptoassets based on permissionless blockchains, and how these types of assets could meet the classification conditions for Group 1 assets.
- Group 2 assets which met specified hedge recognition criteria (assessing exposure type, liquidity and data availability) would be assessed through an adapted market risk framework, which incorporates netting and a 100% capital charge. Group 2 assets which did not meet the hedge recognition criteria would be treated with a 1250% risk weight (which would imply full capitalisation of the exposure, based on an 8% minimum capital requirement).

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In addition, a large exposure limit would be established for all Group 2 assets, provisionally set at 1% of Tier 1 capital.

- For both Group 1 and Group 2 cryptoassets, additional capital requirements would be set in relation to operational and liquidity risks. The Committee has stated a clearer delineation between the application of the operational risk framework compared to credit and market risk and provided more detail on the application of the Liquidity Coverage Ratio and the Net Stable Funding Ratio to cryptoasset exposures. The Committee also confirms that cryptoassets in both Groups 1 and 2 would also be included in the leverage ratio and large exposure limits that apply to banks.
- The Committee proposes that the supervisory review process should be applied to banks' exposures to cryptoassets, covering the adequacy of bank risk management practices and the responsibility of the supervisory review function. In the event that supervisors identify inadequate capital allocation or risk management practices, the Committee proposes that additional actions are considered (including additional capital charges, provisioning or supervisory limits).
- Compared to its 2021 consultation, the main changes that the Committee has implemented in the second consultation consist of:
  - refinement of the classification capital conditions (including a revised stabilisation test for Group 1b cryptoassets, namely stablecoins)
  - introduction of an infrastructure risk add-on for Group 1 assets and a large exposure limit for Group 2 assets
  - recognition of hedging for certain Group 2 assets
  - clarifications on the application of rules governing operational and liquidity risk
  - delinking of the accounting classification of cryptoassets (as tangible or intangible assets).

## What do firms need to do?

- While the Bank of England [noted](#) earlier this year that UK banks' direct involvement in cryptoasset markets is currently limited, this may change in the future. Firms will therefore need to consider the economics underlying their potential involvement in this market, given the potentially significant capital and compliance implications of the Committee's proposals.
- On the current UK prudential treatment, the PRA published a [letter](#) to firms earlier this year setting out its expectations regarding firms' exposures to cryptoassets. The PRA is requiring firms to include relevant risks in their Internal Capital Adequacy Assessment Process and has also stated that it will consider additional measures under Pillar 2.
- Given that the PRA has explicitly situated its short-term approach with reference to the Basel Committee's longer-term work in this area, firms should therefore consider the Committee's proposed policy standard in the context of its likely implementation into UK regulation.

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## Next steps

The consultation will close on 30 September 2022 and the Committee will aim to finalise the policy standard by end-2022.

[www.pwc.co.uk/regdevelopments](http://www.pwc.co.uk/regdevelopments)

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