ICBA
One Mission. Community Banks.

March 27, 2024

Basel Committee on Banking Supervision
Bank of International Settlements
Centralbahnplatz 2
4051 Basel
Switzerland

RE: Consultative Document: Cryptoasset Standard Amendments

Dear Sir or Madam:

The Independent Community Bankers of America ("ICBA")[1] appreciates the opportunity to comment on the consultative document titled *Cryptoasset Standard Amendments*. We support the work of the Basel Committee to develop a quality framework for the classification of cryptoasset exposures, as well as its focused effort to examine stablecoin exposures for banks. ICBA believes that the Basel Committee's proposal represents an accurate assessment of key risk factors associated with stablecoins. However, we think the consultative document also validates our misgivings about cryptocurrencies—the novel aspects of cryptoassets, including stablecoin instruments, do not provide any advantages over the existing banking system in the United States. By creating a new type of asset in Group 1b, we are concerned that the revised standard may even encourage the cryptocurrency advocates to re-double their efforts to build a shadow economy, thereby undermining Basel's wider objective of ensuring global financial stability.

<u>The Document</u>

This consultative document further refines the existing classification of cryptoasset exposures in Group 1 and Group 2 classifications used to determine bank capital allocation by elaborating on the stablecoin exposures that should be designated in the Group 1b category. Such need for more granular classification is driven by the popularity of stablecoin instruments issued by a wide array of organizations spanning the globe with characteristics that could call into question whether the instrument can be proven to be stable in different market environments under stressed conditions. If a stablecoin does not meet the committee's requirements for Group 1b

[1] The Independent Community Bankers of America® has one mission: to create and promote an environment where community banks flourish. We power the potential of the nation's community banks through effective advocacy, education, and innovation. As local and trusted sources of credit, America's community banks leverage their relationship-based business model and innovative offerings to channel deposits into the neighborhoods they serve, creating jobs, fostering economic prosperity, and fueling their customers' financial goals and dreams. For more information, visit ICBA's website at www.icba.org.

classification, that instrument would be categorized in Group 2, resulting in the need for the bank to allocate a higher risk weight to the asset in its risk-based capital calculations.

Because stablecoins are designed to be redeemed on demand at a valuation referenced to an underlying currency, the reserve assets backing the instrument should be sufficient to demonstrate that redemption expectations can always be met, even when redemptions far exceed customary transaction volumes. The Basel Committee has proposed the enhanced reserve asset criteria discussed below to demonstrate that value can be maintained at all times and redemption can be achieved efficiently in variable market conditions. Instruments that meet these enhanced reserve asset criteria, along with the statistical testing also included below, would meet the classification conditions for Group 1b.

Maturity. Reserve assets should always have short-term maturities to reduce market risk sensitivities that normally have the potential to impact pricing such as changes in interest rates. Longer term assets should only be permitted as reserve assets for stablecoins when overcollateralization is achieved to the point of covering any potential market risks that could impact valuation.

Credit Quality. Reserve assets should seek to achieve high credit quality by limiting inclusion to central bank reserves, investment securities guaranteed by sovereign entities with high credit quality, and deposits at high credit quality banks with due attention paid to concentration risks in issuers and guarantors.

Repurchase Agreements. Short-term and overnight lending arrangements through swap agreements provide for a quick transfer of cash in liquid markets but also pose risks for the stablecoin issuer that will need careful attention and focus. For example, securities lent in collateral swap agreements where the borrower fails to return funds to the lender could result in the stablecoin perfecting an interest in the arrangement with collateral that is of lesser quality than the instrument originally loaned.

Price Sensitivity. Reserve assets should be able to demonstrate a history of low pricing volatility in stressed market conditions to ensure that liquidations can occur orderly without the risk of price instability.

Active Markets. Reserve assets should trade in active markets with sufficient trading volume to demonstrate proper liquidity in adverse market conditions.

Straightforward Pricing. Reserve assets and their underlying cash flows should reflect stable structures that are easy to price with enough fungibility to promote liquidity without the need to rely on stretched assumptions about fair value.

Bankruptcy Remote. Reserve assets should be legally isolated from all parties that are affiliated with stablecoin operations so that the assets cannot be correlated to the creditworthiness of the stablecoin issuer.

Independent Audit Requirements. An appropriate risk management framework should be instituted by the stablecoin issuer to identify and verify the key terms of the reserve assets including an annual independent external audit requirement.

Correlation. When reserve assets and stablecoin issues are not designed to peg currency values, the correlation of reserve assets to the reference rate of the stablecoin should share the same risk profile.

In addition to reserve asset requirements, banks should maintain statistical tools to periodically analyze the stabilization mechanisms present to maintain stablecoin values as expected in the arrangement. The test results should be used to support the idea that a stablecoin sufficiently meets the requirements to be placed in Group 1b. Due diligence activities should also be performed on a regular basis to demonstrate that the stablecoin issuer fully understands the effectiveness of the stabilization mechanism and its ability to operate as intended.

ICBA Comments

Since the first stablecoins launched about a decade ago, the asset category has witnessed explosive growth and rapid diversification. There are now approximately $147 billion worth of stablecoins in circulation, ranging from large stablecoins backed by US Treasuries and bank deposits to newcomers that strive to maintain a stable value by hedging derivatives.[2] Stablecoins are widely used throughout the burgeoning crypto universe, primarily to support the trading of cryptoassets. The cryptocurrency industry frequently claims that stablecoins can offer a better payment experience than traditional payment systems like the ACH and card networks, but the evidence to the contrary is quite striking: **No stablecoin has managed to maintain parity with its peg to the reference asset at all times**.[3]

Additionally, researchers at the Bank for International Settlements assessed last year that “stablecoins are seldom used for payments outside the crypto economy.”[4] More significantly, they concluded that “stablecoins in circulation today do not meet the key criteria for being a safe store of value and a trustworthy means of payment in the real economy.”[5] Therefore, it should come as no surprise that cryptoassets have seen extremely limited demand in many real world economies, leading to minimal adoption by financial institutions, particularly within the United States. Nevertheless, the recent resurgence in cryptocurrency trading and investing has led to a rebound for stablecoins. Cryptocurrency entities, such as publicly traded exchanges, and their supporters continue to seek new ways to expand stablecoins beyond this trading activity to capture more traditional payments.

However, community bankers have repeatedly expressed that their customers are simply not asking for more cryptocurrency-related products and services; instead, customers are turning towards innovations developed within the regulated financial system, such as instant payments powered by FedNow and The Clearing House’s RTP Network. Community bankers have also raised concerns about the broader consequences that may arise from bridging the volatile crypto ecosystem to the traditional financial sector. Indeed, the Bank for International

[2] Ethena Labs, Ethena Labs Overview, https://ethena-labs.gitbook.io/ethena-labs (accessed March 22, 2024).
[3] Bank for International Settlements, Monetary and Economics Department, “Will the Real Stablecoin Please Stand Up?”, by Anneke Kosse, Marc Glowka, Illaria Mattei, and Tara Rice, BIS Papers No. 141, November 8, 2023, https://www.bis.org/publ/bppdf/bispap141.pdf.
[4] Ibid, 16.
[5] Ibid, 1.

Settlements has already cautioned that the continued growth of stablecoins may undermine the "singleness" of money across the globe.[6] The International Monetary Fund has conveyed similar warnings about the potential for cryptoization, or the displacement of national monetary systems by cryptoassets, to inhibit a country's ability to execute monetary policy and collect taxes.[7]

We also recognize that every stablecoin in existence today has lost its peg, including the two largest, Tether and USDC. This observation is also important because Tether and USDC operate on permissionless blockchains, notably Ethereum and Tron.[8] Stablecoin issuers support the deployment of new tokens on permissionless networks because these networks enable the development of the wider decentralized finance ("DeFi") ecosystem. Without the use of permissionless networks and the DeFi activities they sustain, what benefits could these stablecoins offer to banks and their customers? By the same token, what value would a stable asset excised from the decentralized ecosystem have for DeFi users?

These are crucial questions for any assessment of the proposed revisions. **The Basel Committee affirmed in this document that it will not allow any stablecoins issued on permissionless blockchains to qualify for Group 1 treatment because the "use of permissionless blockchains gives rise to a number of unique risks, some of which cannot be sufficiently mitigated at present." ICBA and community bankers strongly agree with this conclusion.** Community bankers consider DeFi to be a shadow banking system filled with myriad risks to the global financial system, especially illicit activities associated with rogue nations and transnational organized crime. We have urged domestic policymakers and international standards-setting bodies to strengthen and harmonize their efforts to address these risks. Given the fact that all major stablecoins exist on permissionless chains, what then would qualify under the new criteria for Group 1b and what purpose would it serve that cannot be fulfilled by other payments systems and/or tokenized deposits that fall under Group 1? Once a cryptoasset enters the banking system, most, if not all, of its benefits are severely curtailed or entirely compromised. Unless use cases dramatically improve, a cryptoasset held in a regulated depository institution introduces new regulatory burdens for facilitators, while providing no benefits to users when compared to regulated traditional bank deposits.

Another concern is that by creating a category that is neither fish nor fowl, the Basel Committee may even unintentionally fuel the growth of the risky assets that it seeks to address. The new asset for Group 1b is not a "stablecoin" as the banking and cryptocurrency industries widely understand the term today. Instead, this is a neutered version, stripped of its "decentralized" identity with the exclusion of permissionless networks. We cannot lose sight of the fact that cryptocurrencies have always been designed to circumvent the banking system, not operate within it. This ethos, which was first articulated in the bitcoin white paper, remains a guiding light for

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[6] Agustín Carstens, "Innovation and the Future of the Monetary System" (keynote speech at the Monetary Authority of Singapore, February 21, 2023, https://www.bis.org/speeches/sp230222.htm).
[7] Kristalina Georgieva, "Leaving the Wild West: Taming Crypto and Unleashing Blockchain" (remarks by the IMF Director at the MOEF-BOK-FSC-IMF International Conference on Digital Money, December 14, 2023, https://www.imf.org/en/News/Articles/2023/12/13/sp121423-leaving-the-wild-west-kordigitalmoney).
[8] DefiLlama, Stablecoins by Chain, https://defillama.com/stablecoins/chains (accessed March 24, 2024).

cryptocurrency proponents, including stablecoin issuers.[9] The current market leaders are unlikely to completely overhaul their business models and abandon permissionless networks simply to gain acceptance among banks.

Therefore, while the new revisions may serve to limit banks' exposure to stablecoins, they may not succeed in shielding the financial system from disintermediation if the crypto ecosystem continues to advance. ICBA and community bankers urge the Basel Committee to take more actions to confront the hazards of stablecoins—and the wider decentralized ecosystem—head on. The repeated breakdowns detailed in recent research should motivate policymakers to take more decisive actions to curtail these dangers. As we approach nearly two decades since cryptocurrencies were first created, we are troubled by the fact that policymakers are still struggling over how to proceed. After countless scams, multiple stablecoin failures, and several exchange collapses, we are compelled to ask: Have we not already witnessed enough to act?

Conclusion

ICBA appreciates the opportunity to provide comments on this consultative document. While we acknowledge that it is important for policymakers to consider banks' exposure to stablecoins, we believe that the international community must engage in more proactive measures to contend with the risks posed by stablecoins and the wider DeFi ecosystem. Without the development of stronger legal and regulatory safeguards, we are concerned that the proposed revisions could backfire, leaving banks and their customers more exposed to the myriad risks associated with cryptoassets.

If you have any questions or would like additional information, please do not hesitate to contact us at james.kendrick@icba.org and brian.laverdure@icba.org.

Sincerely,

/s/

James Kendrick
First Vice President, Accounting & Capital Policy

/s/

Brian Laverdure
Senior Vice President, Digital Assets and Innovation Policy

[9] Satoshi Nakamoto, "Bitcoin: A Peer-to-Peer Electronic Cash System", October 31, 2008, https://bitcoin.org/bitcoin.pdf.