

September 10, 2021



Ms. Carolyn Rogers
Secretary General
Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

Dear Ms. Rogers,

Ripple welcomes the opportunity to comment on the consultative document on the prudential treatment of cryptoasset¹ exposures (the "Consultation Paper") published by the Basel Committee on Banking Supervision ("BCBS") on June 10, 2021.²

Ripple would like to thank BCBS and its members for the in-depth and comprehensive analysis that has been taken on this subject prior to the publication of the Consultation Paper, including the statement on the risks associated with cryptoassets published in March 2019³ and the discussion paper on issues related to the prudential treatment of cryptoassets published in December 2019⁴ ("2019 Discussion Paper"). Ripple submitted a response to the 2019 Discussion Paper on March 13, 2020⁵ ("2020 Ripple Response"), and we thank the BCBS for considering feedback from the 2020 Ripple Response and other stakeholders in formulating the proposals outlined in the Consultation Paper.

Ripple seeks to drive the efficient globalization of value through multiple initiatives with financial services and open-source communities. RippleNet, our enterprise software solution which is powered by a standardized application programming interface and built on the market-leading and open standard Interledger Protocol, enables financial institutions to facilitate faster and less costly cross-border payments, demonstrating that deep interoperability between commercial financial institutions can make payments truly

¹ The terms digital asset, virtual currency, cryptocurrency, cryptoasset and others are used interchangeably in the marketplace. For the purposes of this letter, Ripple adopts the terminology and related definitions used by the BCBS in the Consultation Paper.

² See <https://www.bis.org/bcbs/publ/d519.pdf>, Consultative Document - Prudential treatment of cryptoasset exposures.

³ See https://www.bis.org/publ/bcbs_nl21.htm, Statement on crypto-assets.

⁴ See <https://www.bis.org/bcbs/publ/d490.htm>, Discussion Paper - Designing a prudential treatment for crypto-assets.

⁵ See <https://www.bis.org/bcbs/publ/comments/d490/ripplelabs.pdf>, Ripple response to 2019 Discussion Paper.

efficient, particularly in eliminating the uncertainty and risk historically involved in moving money across borders using interbank messaging alone.

In addition, Ripple offers these entities an On-Demand Liquidity capability which leverages XRP - the digital asset native to the XRP Ledger, a distributed ledger platform - as a bridge between fiat currencies, further reducing the friction and costs for commercial financial institutions to transact across multiple global markets. Although Ripple utilizes XRP and the XRP Ledger in its product offerings, XRP is independent of Ripple. The XRP Ledger is decentralized, open-source, and based on cryptography. Ripple leverages XRP for use in its product suite because of XRP's suitability for cross-border payments. Key characteristics of XRP include speed, scalability, energy efficiency, and cost - the benefits of which will be passed on to the consumer and will help reduce friction in the market for cross border payments.

With this overview, Ripple respectfully submits the following responses to the questions set forth in the Consultation Paper as well as some general comments and policy considerations in the attached Appendix.

Ripple appreciates the opportunity to comment on the proposals in the Consultation Paper as BCBS considers the prudential treatment of cryptoasset exposures. Should you wish to discuss any of the comments raised in this letter further, please do not hesitate to contact Rahul Advani (Policy Director, APAC) at radvani@ripple.com.

Sincerely,

Ripple Labs, Inc.

APPENDIX

A. General comments and policy considerations

Ripple commends the BCBS for taking a forward-looking view on the evolving cryptoasset landscape, and we believe that this Consultation Paper represents a basis to continue with further in-depth analysis and discourse on this important emerging subject.

We would like to highlight that any prudential framework for cryptoassets should encourage responsible innovation by financial institutions while also ensuring appropriate risk management. In doing so, the BCBS will not only promote the strengthened operational resilience of the financial system, but also transform the way financial services are provided. This will ultimately benefit both financial institutions and end-users, and encourage investment in new technologies and innovation.

Ripple respectfully encourages BCBS to develop and implement a prudential treatment for cryptoassets that is proportionate to the risk posed by this sector to the financial system as a whole. The Consultation Paper notes that *“the cryptoasset market remains small relative to the size of the global financial system, and banks’ exposures to cryptoassets are currently limited”*.⁶ As highlighted in Figure 1 below, data gathered from Bloomberg News reporting indicates that of the ten internationally active global systemically important banks (“G-SIBs”), less than half are currently offering or considering offering any form of cryptoasset services.⁷

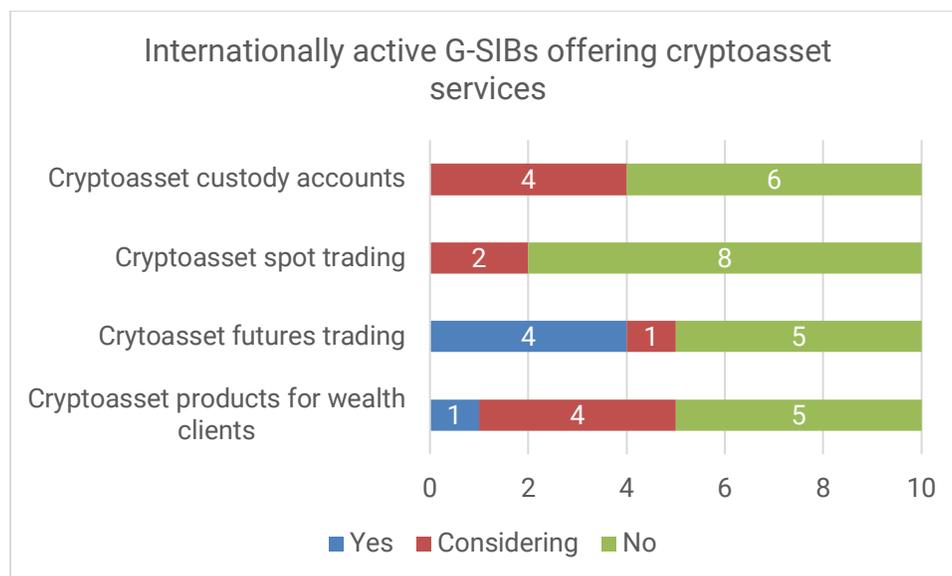


Figure 1 : Internationally active G-SIBs offering cryptoasset services

⁶ See Consultation Paper, Page 1.

⁷ See <https://www.bnnbloomberg.ca/banks-chart-cautious-crypto-policy-with-regulators-taking-aim-1.1619514>, Banks chart cautious crypto policy with regulators taking aim.

Bank of England Deputy Governor Jon Cunliffe reiterated this point in a July 14, 2021 interview,⁸ indicating that *“the speculative boom in crypto is very noticeable but I don’t think it’s crossed the boundary into financial stability risk”* and also that *“were we to start to see those links develop, were we to start to see it move out of retail more into wholesale and see the financial sector more exposed, then I think you might start to think about risk in that sense”*.

We therefore believe it is important that the BCBS not assign a punitive prudential treatment to cryptoassets for this will make it uneconomical and unviable for financial institutions to provide any cryptoasset-related services for end-users. This could have the additional unintended consequence of making cryptoasset markets opaque and inefficient, to the detriment of end-users.

Ripple respectfully suggests that the BCBS consider a phased approach for the implementation of a prudential framework for cryptoassets. Phase 1 should focus on developing a taxonomy for cryptoassets and the design of disclosure requirements outlined in the Consultation Paper,⁹ while phase 2 could make the prudential requirements capital-binding at an appropriate time. Such an approach will ensure that there is disclosure and transparency into holdings of cryptoassets by financial institutions, while ensuring that any capital requirements are appropriate for the size of the market and appropriately address systemic risk concerns.

B. Specific questions

Ripple respectfully submits the following responses to questions 1, 2, 3, 12 & 13 set forth in the Consultation Paper.

Question 1: What are your views on the Committee’s general principles?

Ripple is supportive of the overall design of the general principles proposed by BCBS,¹⁰ namely:

- Same risk, same activity, same treatment (“Principle 1”);
- Simplicity (“Principle 2”); and
- Minimum standards (“Principle 3”).

However, it is important to note that Principle 1 does not appear to have been adequately applied when considering the classification conditions¹¹ for Group 2 cryptoassets (which,

⁸ See <https://www.cnbc.com/2021/07/14/crypto-not-yet-a-financial-stability-risk-says-bank-of-england.html>, Cryptocurrencies don’t yet pose a threat to financial stability, Bank of England’s Cunliffe says.

⁹ See Consultation Paper, Page 19.

¹⁰ See Consultation Paper, Page 2.

¹¹ See Consultation Paper, Page 4.

in practical terms, will consist of all other cryptoassets not covered under Group 1a or Group 1b).¹²

In actual practice, Group 2 cryptoassets cover a broad range of use cases and therefore have differing risk profiles, and we respectfully recommend that the BCBS consider implementing a taxonomy to better identify the risk profiles for Group 2 cryptoassets. Ripple has suggested an appropriate taxonomy in our response to Question 2 below.

Question 2: What are your views on the Committee’s approach to classify cryptoassets through a set of classification conditions? Do you think these conditions and the resulting categories of cryptoassets (Group 1a, 1b and 2) are appropriate? Which existing cryptoassets would likely meet the Group 1 classification conditions?

As highlighted in the 2020 Ripple Response,¹³ it is important to note that there is no single or generally recognised definition of digital or cryptoassets at present. Ripple respectfully submits such assets should not be solely defined relative to a specific technology (e.g., cryptography), but, for the purposes of regulation and prudential requirements, should instead be classified depending on the particular economic function and purpose they serve. Such an approach is consistent with that taken by jurisdictions like the United Kingdom (“UK”) and Singapore, which have issued classifications that do not depend on whether a business model uses distributed ledger technology or not.

We therefore request that the BCBS consider adopting a taxonomy consistent with such global practices, thereby providing clarity to the legal character of digital assets for the purposes of prudential requirements.

In line with global practices, we recommend that there be a clear distinction between payment tokens, utility tokens, and security tokens, as outlined below:

- *Payments or Exchange tokens*: to describe non-fiat native digital assets that are used as means of exchange and have no rights that may be enforced against any issuer;
- *Utility tokens*: to describe those digital assets that create access rights for availing service or a network, usually offered through a blockchain platform; and
- *Security tokens*: to describe tokens that create rights mirroring those associated with traditional securities like shares, debentures, security-based derivatives, and collective investment schemes.

¹² See Consultation Paper, Page 3, Table 1.

¹³ See 2020 Ripple Response, Page 2.

It is also important to account for hybrid tokens (such as tokens that are used as a means of exchange and also create access rights), which is the approach that the Financial Conduct Authority (“FCA”) has considered in the UK.¹⁴

The taxonomy for digital assets proposed by Ripple is summarised in Figure 2 below:



Figure 2: Proposed taxonomy for digital assets

While we do not purport to advise on all cryptoassets, we believe that cryptoassets used by regulated financial institutions and payment providers as a bridge for exchange or payment purposes, such as XRP, are inherently less risky than other cryptoassets that could be deemed investments or securities, since XRP does not present any counterparty risk and does not grant the holder any claim against or control over an “issuer”. The value of XRP is set by market forces as it is traded on over 100 exchanges globally.¹⁵

Accordingly, we believe any prudential treatment applied should be reduced proportionally based on the degree of systemic risk they pose to the financial system.

Question 3: What are your views on the classification conditions? Are there any elements of these conditions that should be added, clarified or removed in order to:

- **ensure full transferability, settlement finality, and/or redeemability;**
- **limit regulatory arbitrage, cliff effects and market fragmentation; and**
- **take account of new and emerging cryptoassets?**

As highlighted in our response to Question 1 & Question 2 above, Ripple is supportive of the classification conditions identified. However, we respectfully request that the BCBS consider a taxonomy that better represents the risks presented by specific cryptoassets, as proposed by Ripple in Question 2 above.

Such a taxonomy will also accommodate new and emerging cryptoassets and be better aligned with Principle 1 proposed by BCBS in the Consultation Paper.

¹⁴ The FCA has recognized that XRP is a hybrid exchange/utility token. See <https://www.fca.org.uk/publication/consultation/cp19-22.pdf>, FCA Consultation Paper CP19/22, paragraph 2.7, page 8.

¹⁵ See <https://ripple.com/faq>, Frequently Asked Questions.

Question 12: Do you think the proposed capital treatment of Group 2 cryptoassets, including the application of a 1250% risk weight instead of deducting the asset from capital (for the reasons explained above), appropriately reflects the unique risks inherent in these assets?

Ripple respectfully submits that the 1250% risk weight proposed by BCBS in the Consultation Paper is not sufficiently risk-sensitive to account for the various economic functions and purposes served by cryptoassets currently covered by the classification criteria for Group 2 cryptoassets.

As highlighted in our response to Question 2 above, we request that the BCBS consider adopting a taxonomy consistent with global practices, thereby providing clarity to the legal character of digital assets for the purposes of prudential requirements. This will allow the development of a risk-based framework that factors in the particular economic function and purpose served by the cryptoasset.

Taken in totality, such a framework will help to better assign the appropriate risk weightage for cryptoassets, and we welcome the opportunity to engage further with BCBS to help develop such a framework.

Question 13: Are there alternative approaches that the Committee should consider that are simple, conservative and easy to implement? For exposures in the trading book, would it be appropriate to permit recognition of hedging via the application of a modified version of the standardised approach to market risk?

As highlighted in the *General comments and policy considerations* section of this response, Ripple respectfully suggests that the BCBS consider a phased approach for the implementation of a prudential framework for cryptoassets.

Phase 1 should focus on developing a taxonomy for cryptoassets (as highlighted in our response to Question 2 and Question 12 above) and the design of disclosure requirements outlined in the Consultation Paper,¹⁶ while phase 2 can make the prudential requirements capital-binding at an appropriate time.

Such a phased approach will ensure that there is sufficient data to provide transparency into the holdings of cryptoassets by financial institutions, while making sure that any prudential requirements are appropriate for the size of the market and are calibrated to address systemic risk concerns. Such an approach will also ensure that end-users can continue to benefit from continued innovation in the sector.

¹⁶ See Consultation Paper, Page 19.