

March 13, 2020



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

Dear Ms. Rogers,

Ripple welcomes the opportunity to comment on the Basel Committee on Banking Supervision (BCBS) discussion paper "Designing a prudential treatment for crypto-assets."<sup>1</sup>

Ripple is a technology company that provides efficient solutions to send money globally – it is not a virtual currency or "crypto-asset," as that term is used by BCBS in its discussion paper. Using blockchain technology, Ripple allows financial institutions to process payments instantly, reliably, cost-effectively, and with end-to-end visibility anywhere in the world. In fact, Ripple was recently featured as the only blockchain company in a list of the top 100 cross-border payment providers.<sup>2</sup> With over approximately 300 customers as of the date of this letter, Ripple's software products allow financial institutions to send money globally, on a real-time basis, at a fraction of the cost of traditional services available to market participants.

Ripple's aim is not to replace fiat currencies, but rather to enable a faster, less expensive, and more transparent method of making cross-border payments that is in the public's best interest. Unlike the large majority of companies utilizing blockchain technology to leverage crypto-assets, Ripple's customers and partners are regulated financial institutions, both banks and payment service providers, who operate within the contours of the existing financial system.

XRP is the crypto-asset that is native to the XRP Ledger, a distributed ledger platform. Although Ripple utilizes XRP and the XRP Ledger in one of 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.

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<sup>1</sup> For purposes of this letter, Ripple adopts the terminology and related definitions used by the BCBS in its discussion paper.

<sup>2</sup> See <https://www.fxcintel.com/research/reports/the-top-100-cross-border-payment-companies>.

Ripple respectfully submits the following responses to questions 1-7 and 9 set forth in the discussion paper, and emphasizes again that XRP exists separately and independently from any enterprise, including Ripple.

**Q1. What features of crypto-assets should be considered in the context of developing any potential prudential regulatory definition? Please describe the features and their relevance for the prudential treatment of crypto-assets.**

BCBS acknowledges there “is no single or generally-recognised definition of crypto-assets at present,” though it cites several examples of “current technological and design features of crypto-assets relative to other traditional asset classes,” including their “[d]igital/virtual nature,” “[r]eliance on cryptography,” and “[u]se of distributed ledger technology.” Ripple respectfully submits such assets should not be solely defined relative to a specific technology (e.g., cryptography), but, for these purposes, should instead fall under broader headings such as “digital assets” or “convertible virtual currencies” and subsequently classified depending on the particular economic function and purpose they serve. Such an approach is consistent with that taken by other jurisdictions like the UK, which has issued a token classification that does not turn on whether a business model uses distributed ledger technology.<sup>3</sup>

More specifically, in the UK, exchange tokens, which “can be used to facilitate regulated payment services”<sup>4</sup> and utility tokens, which “provide[s] consumers with access to a current or prospective product or service and often grant[s] rights similar to pre-payment vouchers”<sup>5</sup> are both considered to be “unregulated tokens” (i.e., tokens that do not provide rights or obligations akin to specified investments) that fall outside the Financial Conduct Authority’s (FCA) regulatory perimeter.<sup>6</sup> This stands in contrast to security tokens, which are described as “tokens with specific characteristics that mean they provide rights and obligations akin to specified investments”<sup>7</sup> and do fall within the FCA’s regulatory perimeter, as well as that of the Prudential Regulatory Authority, as necessary.

The FCA has recognized that XRP is a hybrid exchange/utility token<sup>8</sup>, leaving it outside of its regulatory perimeter.<sup>9</sup> We believe these types of designations – which consider each token’s

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<sup>3</sup> See <https://www.fca.org.uk/publication/policy/ps19-22.pdf>, Appendix 1, § 18.

<sup>4</sup> *Id.* § 2.15. The FCA went on to note that unregulated tokens, which includes exchange tokens, “can be used to facilitate regulated payment services such as international money remittance” and it had seen several cases where such tokens were used “to make things cheaper and faster on a small scale.” *Id.* Appendix 1, § 57.

<sup>5</sup> *Id.* § 2.21.

<sup>6</sup> *Id.* Appendix 1, §§ 43, 50.

<sup>7</sup> *Id.* § 1.9.

<sup>8</sup> <https://www.fca.org.uk/publication/consultation/cp19-22.pdf>, § 2.7.

<sup>9</sup> The FCA acknowledged that while exchange tokens “can be acquired and held for the purpose of speculation rather than exchange,” it did “not view this as being sufficient for exchange tokens to constitute specified investments. The analogy would be an individual holding different fiat currency or a commodity, both of which are unregulated, in the hope of a gain.”

<https://www.fca.org.uk/publication/policy/ps19-22.pdf>, Appendix 1, § 42.

economic purpose and function – and the degree of regulation assigned to them, should be accounted for when designing prudential treatment for crypto-assets generally. To the extent crypto-assets move from one category to another, as the FCA recognized they might,<sup>10</sup> any treatment should necessarily be flexible enough to account for such a shift.

**Q2. What are the main economic and related functions and potential sources of value of crypto-assets that are relevant in the context of developing a prudential treatment? To what extent do these functions and potential sources of value affect the relative prudential risks of different crypto-assets for banks? Are there other potential sources of value that are relevant in designing a prudential treatment for crypto-assets?**

In its discussion paper, BCBS distinguishes between crypto-assets that may be used for “one or several of the following economic functions,” including payments and exchanges, investments/securities, and utility access. We believe that XRP falls within the “payment” category as it shares many of the same use case characteristics: its usage facilitates cross-border payments; no rights to Ripple are conferred by XRP; and the XRP Ledger, through which XRP transactions are validated, is a decentralized, distributed ledger platform.

While we do not purport to advise on all crypto-assets, we believe that crypto-assets used by regulated financial institutions and payment providers as a bridge for exchange or payment purposes, like XRP, are inherently less risky than other crypto-assets 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 approximately 150 exchanges globally. Accordingly, we believe any prudential treatment applied should be reduced proportionally as assets like XRP pose less systemic risk to the financial system.

**Q3. What benefits do crypto-assets provide for the banking system, and the provision of financial services more generally?**

As BCBS recognizes, different types of crypto-assets can serve different functions in the banking system. Ripple’s use of XRP in conjunction with its software products allows financial institutions to settle cross-border transactions globally, on a real-time basis, at a fraction of the cost of traditional services available to market participants.

Historically, remittance providers enable payments by pre-funding correspondent accounts. This not only traps enormous amounts of capital, but also creates foreign exchange and foreign counterparty risks that often must be hedged. The trapped capital also creates compliance costs and large lost opportunity costs. This process limits the reach of efficient payment solutions to high-volume currency pairs and is a major driver of the high fees being charged to

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<sup>10</sup> <https://www.fca.org.uk/publication/consultation/cp19-22.pdf>, § 2.7.

customers sending smaller amounts to friends and families overseas. Payments between less frequently-traded currencies can be even more expensive and cumbersome.

Crypto-assets specifically designed for payments – like XRP – have the potential to reduce these limitations by enabling payments without the need to pre-fund overseas. Ripple’s software leverages XRP as a bridge between currencies. This allows financial institutions to access liquidity on demand through digital asset exchanges without having to pre-fund accounts in the destination country. The payer and payee continue to use fiat currency for their payment, with XRP used as a bridge between the regulated financial institutions that are facilitating the remittance transaction. This is particularly useful for smaller institutions with limited capital; using Ripple products, they can achieve broad global payment reach without additional capital needs.<sup>11</sup>

Ripple’s aim is not to replace fiat currencies, but rather enable a faster, less expensive, and more transparent method of making payments that is in the public’s best interest. Ripple’s solution can also serve as bridge between crypto and crypto and crypto and fiat. For example, a Central Bank Digital Coin can be bridged to another store of value using Ripple’s products.

#### **Q4. What additional factors affect the risk profile of different crypto-assets which are relevant in the context of determining a prudential treatment?**

In its discussion paper, BCBS recognizes that “validators” are a relevant factor in distinguishing between the relative risks of crypto-assets. Specifically, BCBS notes that “[f]or certain crypto-assets, the validation could be carried out predominantly by a small group of validators; the behaviour of these validators could potentially significantly impact the value of [a] relevant crypto-asset.”

Ripple agrees that validation in particular deserves close scrutiny in determining a prudential treatment. Proof-of-Work networks like Bitcoin and Ethereum concentrate mining power among those users who have the most advanced hardware and cheapest energy sources to deploy.<sup>12</sup> Over time, these networks – because of miner incentives – become more centralized, not less. By contrast, the XRP Ledger uses “consensus” to validate transactions. Consensus is a fast, low-cost process that requires negligible energy consumption, making it more efficient and sustainable than the Proof-of-Work approach. More importantly, nodes running the XRP Ledger software identify consensus validators to review and confirm transactions without incentivizing any one party.<sup>13</sup> Nodes can modify their consensus validators at any time – to the extent the node disagrees with the actions of its consensus validator, it can immediately replace it with

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<sup>11</sup> We believe that use of Ripple software, in conjunction with XRP, has the potential to reduce costs by 40-60%. <https://ripple.com/rippletnet/on-demand-liquidity>.

<sup>12</sup> Bitcoin and Ethereum mining power is concentrated in China.

<sup>13</sup> XRP Validators act as standard servers that run software and perform the purely mechanical work of making sure proposed transactions meet the XRP Ledger Protocol’s requirements. See <https://xrpl.org/consensus.html>.

one it prefers. Validators also review and vote on changes to the network; 80% of validators are required to approve a change. Validators are different from miners because they are not paid when they order and validate transactions. Of the approximately 150 validators today, Ripple runs only six.

This stands in direct contrast to Bitcoin, for which four miners control over 51 percent of the hashrate, meaning they have total control over the validation of transactions on the blockchain.

<sup>14</sup> In addition, three miners control over 51 percent of Ether's average weekly capacity, with a large number of pools also located in China.<sup>15</sup> This effectively allows a minority of miners to wield veto power and control which transactions are approved and which are not.

Whether a crypto-asset is truly decentralized is a factor we believe deserves weight in distinguishing "high-risk crypto-assets" from others like XRP, which is an inherently decentralized, democratic, consensus mechanism that no one party can control.

**Q5. Do you agree with these general principles in guiding the design of a potential prudential treatment of crypto-assets? Are there additional principles that should be considered?**

BCBS has outlined the following general principles in considering how to specify a prudential treatment for crypto-assets:

- Same risk, same activity, same treatment: Crypto-assets that exhibit the same economic functions and risks as "traditional assets" should be treated similarly for prudential purposes.
- Simplicity: Because certain types of crypto-assets may become systemically important, even if they currently comprise a relatively small asset class globally and are not widely used, the design of any applicable prudential treatment should be both simple and flexible. Where possible, prudential treatment should build on the existing framework, particularly for crypto-assets with equivalent economic functions and risks as other asset classes.
- Minimum standards: Any specified prudential treatment of crypto-assets by the Committee would constitute a minimum standard, though individual jurisdictions could apply more conservative standards, should they choose to do so.

We agree these principles serve as an appropriate baseline to guide the design and treatment of a prudential treatment for crypto-assets. In particular, we support the proposition that any prudential treatment should be both simple and flexible, accounting for the fact that different crypto-assets present different risks to the financial system and should be treated accordingly.

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<sup>14</sup> <https://www.blockchain.com/pools>.

<sup>15</sup> <https://www.etherchain.org/charts/topMiners>.

**Q6. Are there additional channels other than those listed above by which banks could be directly or indirectly exposed to crypto-assets? Which channels could potentially be the most material for banks? How do these exposure channels vary by different types of crypto-assets? What are the benefits and risks associated with banks' crypto-asset exposures through these different channels?**

BCBS identifies a number of channels through which banks could be directly or indirectly exposed to crypto-assets, including “exchanging crypto-assets for fiat currency, and vice-versa” and “using crypto-assets for internal or inter-bank operational processes.” As discussed in response to Question 3, the key benefit of XRP is that it allows financial institutions to settle cross-border transactions globally, on a real-time basis, at a fraction of the cost of traditional services available to market participants. Financial institutions can access liquidity on demand through digital asset exchanges, avoiding the need to pre-fund correspondent accounts and allowing for more efficient use of working capital. We believe the usage and utility of crypto-assets like XRP, which has the ability to create a reliable, instant, and lower-cost cross-border payments experience, will only continue to grow as blockchain adoption becomes more widespread.

**Q7. Are any exposure channels likely to change in response to ongoing or envisaged developments in crypto-asset markets?**

We believe that banks can and should be using crypto-assets like XRP as a bridge for exchange and payment purposes as they allow the transmission of money globally, on a real-time basis, at a fraction of the cost of traditional services currently available to market participants. While banks generally do not need to hold XRP on their balance sheets to facilitate transactions, because crypto-assets like XRP are inherently less risky than other crypto-assets that could be deemed investments or securities, we believe that banks should be able to do so under less stringent capital and liquidity requirements than those proposed for “high-risk crypto-assets.”

**Q9. What are your views on the illustrative example of a prudential treatment for high-risk crypto-assets? Which crypto-assets would classify as high-risk based on the criteria set out above? What other features could be considered in specifying the scope for such a potential treatment?**

BCBS describes “high-risk” crypto-assets as having the following features: (1) “they are digital assets that are recorded on a distributed ledger technology platform and are secured cryptographically”; (2) “they are not issued by a jurisdictional authority or another identified issuer”; (3) “they have no intrinsic value and are not explicitly and directly linked to, or backed by, assets with intrinsic values”; and (4) “holdings of the assets do not give rise to a contract between the holder and another identified issuer.” It proposes that outright or direct holdings of such crypto-assets be allocated to the banking book and subject to a full deduction from Common Equity Tier 1 capital, while indirect exposures be allocated to the trading book and

subject to the equivalent of a full deduction treatment for market risk and credit valuation adjustment.

While we do not disagree with the proposition that “high-risk” crypto-assets warrant more conservative treatment by prudential authorities, we have concerns with the definition as proposed. XRP is a digital asset that is recorded on a distributed ledger technology platform and secured cryptographically; it is not issued by a jurisdictional authority; and XRP holdings do not give rise to a contract between the holder and Ripple. However, because XRP’s primary use case is to enable a faster, less expensive, and more transparent method of making payments, rather than speculation, we do not believe it is accurately characterized as “high-risk.” We would further note that while trading in digital assets has historically been considered a speculator’s market, traditional institutional players have begun entering this space, principally on the infrastructure and equity investing side. Ultimately, the more participants there are in liquidity provisioning, the more competitive and stable the market will be.

We believe whatever prudential standards BCBS ultimately adopts should take into account the specific economic purpose and functions served by various crypto-assets in assigning risk, rather than grouping all crypto-assets into a single category.

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Ripple appreciates the opportunity to comment on the discussion paper as BCBS considers what prudential treatment to recommend be applied to crypto-assets. We are happy to discuss any of the issues raised in this letter further with BCBS.

Sincerely,

Ripple Labs, Inc.