CONSULTATION PAPER

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on technical advice on standard formula capital requirements for investments in crypto-assets

EIOPA-BoS-24-413
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European Insurance and Occupational Pensions Authority

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RESPONDING TO THIS PAPER

EIOPA welcomes comments on the Consultation paper on technical advice on standard formula capital requirements for crypto assets.

Comments are most helpful if they:

- respond to the question stated, where applicable;
- contain a clear rationale; and
- describe any alternatives EIOPA should consider.

Please send your comments to EIOPA by Wednesday 16 January 2025, 23:59 CET responding to the questions in the survey provided at the following link: LINK

Contributions not provided using the survey or submitted after the deadline will not be processed and therefore considered as they were not submitted.

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Your responses will be published on the EIOPA website unless: you request to treat them confidential, or they are unlawful, or they would infringe the rights of any third party. Please, indicate clearly and prominently in your submission any part you do not wish to be publicly disclosed. EIOPA may also publish a summary of the survey input received on its website.

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[1] Public Access to Documents.

1. INTRODUCTION

1.1. CALL FOR ADVICE

On 30 April 2024, the European Commission requested technical advice[2] from EIOPA on the Solvency II standard formula capital requirements for investments in crypto-assets. The deadline for the advice is 30 June 2025.

EIOPA provides this draft advice for consultation in accordance with Article 16a of Regulation (EU) No 1094/2010.

1.2. CONTEXT

According to Art. 3(1)(5) of Regulation (EU) 2023/1114[3] on Markets in Crypto-Assets Regulation (MiCAR), a crypto-asset is defined as a digital representation of a value or of a right that is able to be transferred and stored electronically using distributed ledger technology or similar technology. In accordance with MiCAR recital 3, crypto-assets that are considered financial instruments under Directive 2014/65/EU also fall within the scope of existing Union legislation on financial services.

The genesis of crypto-assets began in 2008 with the advent of Bitcoin. Since then, crypto-assets have grown in popularity, often attracting media interest.

MiCAR, in its recital 5, acknowledges that markets in crypto-assets are still modest in size. However, it is possible that types of crypto-assets, including those that aim to stabilise their price in relation to a specific asset or a basket of assets, could in the future be widely adopted.

The adoption of MICAR sets out a framework designed to cover crypto-assets, markets, and service providers that were previously unregulated at the EU level. It will apply to issuers of crypto-assets and those providing crypto-asset services including issuers of asset-referenced tokens (ARTs) and electronic money tokens (EMTs) to hold the relevant authorization to operate within the EU.

[2] Call for advice on the review of specific items in the Solvency II Delegated Regulation - European Union (europa.eu)

[3] Regulation - 2023/1114 - EN - EUR-Lex (europa.eu)

1.3. STRUCTURE OF THE DRAFT ADVICE

The draft advice details the current prudential treatment of investments in crypto-assets, assesses the appropriateness of that treatment, and recommends changes that could be made to the standard formula treatment, as needed.

It is articulated in several sections as follows:

- Extract from the call for advice
- Relevant legal provisions, previous EIOPA advice and other regulatory background
- Identification of the issue
- Analysis of the policy options and impact assessment
- EIOPA's draft advice

2. DRAFT ADVICE

2.1. EXTRACT FROM THE CALL FOR ADVICE

C. Standard formula capital requirements for investments in crypto-assets

The provisional agreement on the amendments to the Solvency II Directive provides that the Commission may adopt Delegated Acts to better reflect the risks posed by crypto-assets.

*We request EIOPA to assess the appropriateness of the prudential treatment of investments in such assets under current rules and to provide, where appropriate, advice on possible revised calibrations considering also the differences in risk features of different categories of crypto-assets. **

**Regulation (EU) 2023/1114 on markets in crypto assets distinguishes between asset-referenced tokens, e-money tokens and ordinary crypto-assets.*

2.2. RELEVANT LEGAL PROVISIONS

There is currently no specific provision in Directive 2009/138/EC and Commission Delegated Regulation (EU) 2015/35 ('Delegated Regulation') that addresses crypto-assets. However, the following provisions of Solvency II are relevant for the treatment of crypto-assets: on intangible assets particularly Article 203 of the Delegated Regulation; on equity specifically Articles 168 to 173 of the Delegated Regulation; and on look-through notably Article 84 of the Delegated Regulation.

The Implementing Technical Standards on supervisory reporting templates (Commission Implementing Regulation (EU) 2023/894[4]) request the identification of assets linked to crypto-assets and provides the following definition for their identification.

"Crypto-asset means a digital representation of value or rights which may be transferred and stored electronically, using distributed ledger technology or similar technology. One of the options in the following closed list shall be used:

- *Electronic money token means a type of crypto-asset the main purpose of which is to be used as a means of exchange and that purports to maintain a stable value by referring to the value of a fiat currency that is legal tender.*

[4] Implementing regulation - 2023/894 - EN - EUR-Lex (europa.eu)

- *Asset-referenced token means a type of crypto-asset that purports to maintain a stable value by referring to the value of several fiat currencies that are legal tender, one or several commodities or one or several crypto-assets, or a combination of such assets.*
- *Utility token means a type of crypto-asset which is intended to provide digital access to a good or service, available on DLT, and is only accepted by the issuer of that token.*
- *Other crypto-assets includes any crypto-asset that does not fall into the categories of electronic money token, asset-referenced token or utility token."*

2.3. PREVIOUS EIOPA ADVICE

There is no previous EIOPA advice on the standard formula capital requirements for crypto-assets. However, several publications and a warning that are relevant for crypto-assets have been issued. In 2024, EIOPA published a report[5] on the digitalization of the European insurance sector. In 2022, EIOPA publicly consulted on a discussion paper[6] on blockchain and smart contracts in insurance and published a feedback statement on that consultation[7]. Additionally, the European Supervisory Authorities (ESAs) issued a warning[8] to consumers about the risks associated with crypto-assets.

2.4. OTHER REGULATORY BACKGROUND

Regulation (EU) 2023/1114 on Markets in Crypto-Assets Regulation (MiCAR) introduces a bespoke regulatory framework for crypto-assets. MiCAR entered into force on 29 June 2023, with Titles III and IV (requirements for issuers of ARTs and EMTs), applying from 30 June 2024, and the rest of the regulation from 30 December 2024. MiCAR does not apply to assets already covered by other EU legislation, such as financial instruments under MiFID II, deposits, funds (except EMTs), securitizations, and certain types of Non-Fungible Tokens (NFTs).

For banks, the Basel Committee on Banking Supervision outlined the prudential treatment of crypto-assets[9] in December 2022, to be implemented by January 2026.

Recent amendments to the Capital Requirements Regulation (EU) No 575/2013 (CRR) include transitional prudential measures for crypto-assets, considering the requirements under

[5] EIOPA's Report on the digitalisation of the European insurance sector - European Union (europa.eu)

[6] Discussion paper on blockchain and smart contracts in insurance - European Union (europa.eu)

[7] EIOPA reacts to stakeholders' views on blockchain in insurance - European Union (europa.eu)

[8] Warning to consumers on the risks of crypto-assets - European Union (europa.eu)

[9] https://www.bis.org/bcbs/publ/d545.htm

MiCAR. These amendments specify, amongst others, the capital requirements for EMTs and ARTs.

Further amendments to CRR are expected[10] to take place at a later stage to further align the CRR with the Basel standards.

Article 501d(2) of CRR sets out the current transitional prudential measures applicable to EU Banks'[11].

The CRR transitional treatment covers most crypto-assets excluding central bank digital currencies (CBDC). The table below illustrates how specific crypto-assets are categorised under CRR, and how those categories align with MiCAR's definitions of crypto-assets.

The CRR defines Tokenised Traditional Assets (TTA) in Article 5a(5) as being a type of crypto-asset that represents a traditional asset. TTA includes EMTs.

Table 1. CRR transitional measures for crypto-assets exposures

Asset Type	**Credit Risk Weight (CRW)**	**CRR reference**	**MiCAR Definitions**
Central bank digital currencies	Out of scope		
Tokenised Traditional Assets			
- values referenced to traditional assets	Look through	Art. 501d(2)(a)/ Art. 5a(4)	Not defined
- Electronic Money Tokens	Look through	Art. 501d(2)(a)/ recital 59 and Art. 5a(5)	Article 3(7)
values dependent on any other crypto-assets	1250%	Art. 501d(2)	Recital 19
Asset Reference Tokens			
- Referencing traditional assets only	250%	Art. 501d(2)(b)	ARTs Article 3(6)
- Not referencing traditional assets only	1250%	Art. 501d(2)(c)	ARTs Article 3(6)

[10] Article 501d(1) of CRR

[11] https://data.consilium.europa.eu/doc/document/ST-15883-2023-INIT/en/pdf

Other crypto assets	1250% (to be developed in RTS)	Art. 501d(2)(c)	Recital 19 /Some are described

2.5. IDENTIFICATION OF THE ISSUE

The lack of clarity in the treatment of crypto-assets under Solvency II results in these exposures being categorized in practice either as intangibles or as equity risk type 2. This ambiguity raises concerns regarding the risk-sensitivity of such classification and the level of prudence.

2.6. ANALYSIS

Crypto-assets landscape for (re)insurance

EIOPA's discussion paper on blockchain and smart contracts in insurance categorized crypto-assets into three functional types: payment-type, investment-type, and utility-type. Payment-type crypto assets function as virtual currencies for transactions, while investment-type crypto-assets confer ownership rights or entitlements similar to traditional financial instruments like shares or bonds. Utility-type crypto-asset provides access to goods or services on a distributed ledger technology platform, typically issued for particular uses such as cloud services.

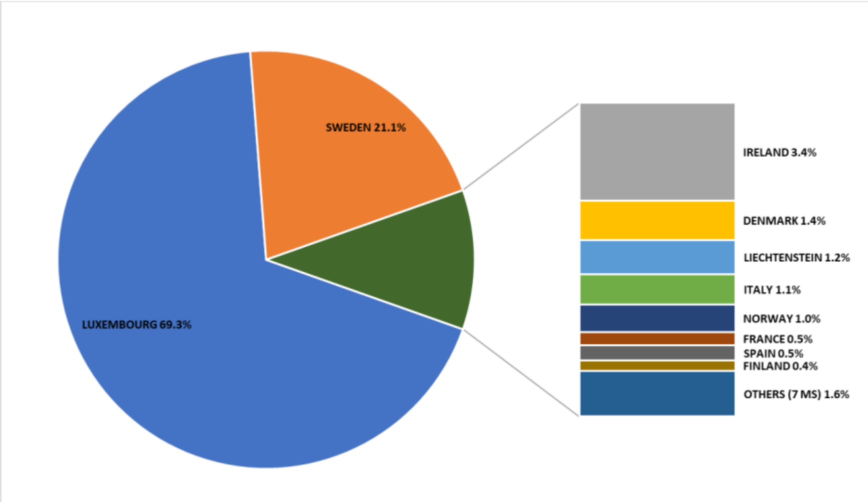
The feedback statement noted minimal current use of crypto-assets in the EU insurance sector, despite recognized potential. A few examples were identified for accepting premium payments in crypto-assets, mostly outside the EU. Also, respondents considered that investments on crypto-assets by (re)insurance undertakings will increase over the next three years.

When determining the standard formula capital requirement, only the investment type of crypto-assets is considered. Payment-type crypto-assets are expected to be instantly converted, thereby mitigating currency risk through conversion services.

Under Solvency II, the Implementing Technical Standards on supervisory reporting templates identify two ways in which crypto-assets may be reported - either as intangible assets in QRT S.02 or as financial assets in QRT S.06. On the one hand, QRT S.02 on the balance sheet does not provide a breakdown to retrieve the share of crypto-assets within intangibles. On the other hand, the Implementing Technical Standards introduced the identification of crypto-assets in QRT S.06. However, the quality of the initial reports is currently insufficient to draw conclusions.

For this paper, exposures to crypto-assets were identified through line-by-line reporting in QRT S.06 using specific keywords and ISIN codes. At 2023 Q4, solo (re)insurance undertakings reported EUR 9 631 554 million assets, of whom EIOPA identified EUR 655 million are invested in crypto-assets. The share of crypto-assets of the total assets of insurance and reinsurance undertakings is 0.0068%. Overall, the investments of undertakings in crypto-assets are immaterial.

Graph 1. Crypto-assets exposure proxy per country as of 2023Q4



Source: QRT S.06.02

Above 90% of the identified exposures to crypto-assets are located in Luxembourg and Sweden. In these countries, observed practices indicate that investments are typically structured within funds, such as exchange-traded funds, and held on behalf of unit-linked policyholders.

Throughout this paper, exposures to crypto-assets achieved through funds or similar vehicles (e.g. exchange traded funds, exchange traded notes and exchange traded commodities[12]) are referred to as 'indirect exposures’. Conversely, investment held not through funds or similar vehicles are referred to as 'direct exposures'.

<u>Observed practices for the prudential treatment of crypto-assets in Insurance</u>

EIOPA’s observed practices is that indirect holdings in crypto-assets are typically reported at the perceived market price of those funds in the QRT S.06. The valuation of assets is covered by Article 10 of the Delegated Regulations, which sets a valuation hierarchy to be followed:

[12] These financial instruments that are sometimes used to enable investment in crypto-assets.

from Article 10(2), where undertakings use quoted market prices in active markets for the same assets, to Article 10(7) where undertakings use alternative valuation methods.

It is possible that both direct and indirect holdings in crypto-assets are reported as intangibles with either a zero or positive value in the QRT S.02. Whether or not an asset is accounted as intangible would depend on the principles of IAS38, which sets out the criteria for recognising intangible assets. The valuation of intangible assets is covered by Article 12(2) of the Delegated Regulations and requires that intangible assets are valued at zero unless Article 10(2) can be applied. Article 9(1) of the Delegated Regulations says that recognition of assets should be performed in conformity with international accounting standards.

When crypto-assets are classified as intangible assets with a positive value, the standard formula applies an 80%, undiversified, stress to their value. Alternatively, if the crypto-assets classified as intangible assets with a zero value, this valuation is equivalent to a 100% stress.

EIOPA notes that indirect holdings of crypto-assets are often categorized as equity type 2 due to challenges in applying look-through in the absence of specific treatment of the underlying asset and as a default investment category. This results in a 49% stress on the value, benefiting from diversification effects.

<u>Assessment of crypto-assets risks</u>

The warning of the ESAs on the risks of crypto-assets of 2022 highlighted several risks associated with crypto-assets that should be captured in the standard formula capital requirements: extreme price movements, market manipulation, lack of price transparency, and low liquidity. Additional risks such as misleading information, absence of consumer protection, product complexity, fraud and malicious activities, hacks, and security issues are expected to be addressed under the prudent person principle for investments and the Insurance Distribution Directive for the conduct aspects. Operational associated risks, such as cyber-risk are anticipated to be covered under the Digital Operational Resilience Act framework.

For all crypto-assets, whether held directly or indirectly, the risks to be captured by the standard formula capital requirement include potential loss of value and liquidity risk affecting the ability to realise value. Where investments are made on behalf of policyholders, the impact of the risks on the own funds of the undertaking may be lower.

ECB Economic Bulletin, Issue 5/2019[13] identifies three main sources of risk for crypto-assets: First, since crypto-assets lack underlying claims, they lack fundamental value, leading to speculative valuation and extreme price movements, exposing holders to significant losses.

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[13] Understanding the crypto-asset phenomenon, its risks and measurement issues (europa.eu)

Second, crypto-assets can be unregulated meaning holders may lack legal protection, making them vulnerable in cases of bankruptcy or hacking of service providers. Third, the decentralised nature of distributed ledger technology complicates risk management and addressing operational risks such as cybersecurity and fraud.

Historical performance of selected crypto-assets

- Bitcoin and Ethereum

The historical performance of Bitcoin and Ethereum is analysed using a rolling one-year window at date 20 June 2024. These were selected due to their relatively longer data histories compared to other crypto-assets and their large market capitalisation.

However, there are important data limitations, inter alia the absence of data series exceeding 14 years and the fundamentally new character of these kinds of instruments, which should be considered when interpreting the results. Historical data analysis for Bitcoin and Ethereum provides some insight into the behaviour of established crypto-assets. However, it is uncertain whether the time series reflects a 200-year event that needs to be captured in the capital requirements. Furthermore, they do not capture the risks associated with less capitalised and more volatile crypto-assets. In particular there are examples of crypto-assets which failed and produced losses of 100% of the investment. The results can therefore only provide a lower limit of the capital requirements.

The empirical 99.5% Value at Risk (VaR) for Bitcoin and Ethereum is respectively 75% and 89% and the lowest annual return range from -82% to -91%.

Table 2. End date 20 June 2024

	Bitcoin	**Ethereum**
Largest Observed Annual Loss	-82%	-91%
Annual Empirical VaR	-75%	-89%
Pricing Start Date	19/07/2010	03/01/2017
Available Price History (years)	13.9	7.5

Source: Bloomberg Finance L.P., own calculations

The above results and prudential considerations suggest that the Solvency II stress for intangible assets (i.e., 80 % stress) underestimates the risks associated with these assets.

- Stablecoin and EMTs

Stablecoins are distinct within the realm of crypto-assets because they are typically backed by specific assets or basket of assets, such as national currencies like the US dollar. This backing mechanism is designed to maintain a stable value related to the chosen assets, in contrast to other crypto-assets that lack such backing and are therefore more volatile.

The two largest stablecoins are USD Tether and USD Coin, are pegged to the US Dollar. Despite generally having lower volatility than other crypto-assets, historical depegging events have been observed, including for USD Tether and USD Coin. Additionally, they have been instances of stablecoin failures[14], such as Terra UST[15] in May 2022.

The first EMTs were authorised under MiCAR only recently and there is limited experience about their performance. While stablecoins may be considered as a potential proxy for authorized EMTs under MiCAR, there are limitations in making such comparison. MiCAR's authorisation requirements enhancement of the stability of EMTs compared to other stablecoins won't be captured.

In summary, while stablecoins provide a practical example for understanding EMT framework under MiCAR, caution is necessary due to the lack of empirical evidence on authorized EMT.

Policy options

Policy Option 1 is no change.

Policy Option 2 proposes stressing crypto-assets at 80% without diversification, regardless of how they are accounted on the balance sheet or whether the investment is direct or indirect. This approach aligns with the treatment of intangible assets.

Implementing policy option 2 could include amending Article 203 of the Delegated Regulation to clarify that crypto-assets exposures fall under the intangible asset module and amending Article 168(3) of that Regulation to exclude all assets covered in the intangible asset module.

Policy Option 3 proposes stressing crypto-assets 100% without diversification, also regardless of their balance sheet treatment or direct/indirect investment status. Amendments to Article 203 and Article 168(3) of the Delegated Regulation could be performed to implement policy option 3.

Policy Option 4 proposes that tokenized assets, including EMTs authorized under MiCAR, are subject to look through and stressed according to the underlying assets' risk. Implementing this option would, at the very least, require clarifying that Article 84 of the Delegated Regulation could extend its application to tokenized assets. It may also be necessary to further refine Article 203 and Article 168(3) of the Delegated Regulation to exclude those particular categories of crypto-assets, referencing the CRR definitions.

Policy option 4 reflects MiCAR's establishment of a regulatory framework for European crypto-assets, acknowledging potential variations in risk among different categories of crypto-assets. It aligns with the transitional treatment in CRR to allow look-through for tokenized assets. Due

[14] List of stablecoin failures to date: https://chainsec.io/failed-stablecoins/
[15] https://www.moodys.com/web/en/us/about/insights/data-stories/stablecoins-instability.html

to MiCAR being in its early stages, EIOPA considers appropriate to monitor developments in this area and does not recommend option 4.

Impact of the policy options

Option 1: No change		
Costs	Policyholders	If exposures to crypto-assets increase in the future, this option would not fully capture the risk of the assets with possibly a detrimental impact on policyholder protection.
	Insurance and reinsurance undertakings	No material costs
	Supervisory authorities	The current treatment is inconsistent across undertakings and would need to be further clarified.
	Other	No material costs
Benefits	Policyholders	No material benefits
	Insurance and reinsurance undertakings	No material benefits
	Supervisory authorities	No material benefits
	Other	No material benefits
Option 2: All crypto-asset exposures, whether direct or indirect, are stressed at 80% without diversification, irrespective of balance sheet treatment		
Costs	Policyholders	No material change - although this could be for some exposures a larger stress than currently applied, the relative size of the exposures means that there would be immaterial costs for policyholders. If exposures to crypto-assets increase in the future, this option would not fully capture the risk of the assets with possibly a detrimental impact on policyholder protection.
	Insurance and reinsurance undertakings	No material change – these exposures are already being separately identified for reporting purposes, so the need to apply a separate capital treatment should not be overly burdensome.
	Supervisory authorities	No material costs

	Other	No material costs
Benefits	Policyholders	No material benefits
	Insurance and reinsurance undertakings	Clarity on the appropriate treatment of such exposures.
	Supervisory authorities	Clarity on the appropriate treatment of such exposures.
	Other	No material benefits
Option 3: All crypto-asset exposures, whether direct or indirect, are stressed at 100% without diversification, irrespective of balance sheet treatment		
Costs	Policyholders	No material change - although this would generally be a larger stress than currently applied, the relative size of the exposures means that there would be immaterial impact on policyholders.
	Insurance and reinsurance undertakings	No material change – these exposures are already being separately identified for reporting purposes, so the need to apply a separate capital treatment should not be overly burdensome.
	Supervisory authorities	No material costs
	Other	No material costs
Benefits	Policyholders	The capital requirements would fully capture the risk of crypto-asset with a positive impact on policyholder protection in case there are material exposures in the future.
	Insurance and reinsurance undertakings	Clarity on the appropriate treatment of such exposures.
	Supervisory authorities	Clarity on the appropriate (and properly calibrated) treatment of such exposures.
	Other	No material benefits
Option 4: Allow look-through to the underlying assets in the case of tokenized assets, including EMTs authorized under MiCAR.		
Costs	Policyholders	No material change - the relative size of the exposures means that there would be limited impact on policyholders.

	Insurance and reinsurance undertakings	No material change – these exposures are already being separately identified for reporting purposes, so the need to apply a separate capital treatment should not be overly burdensome.
	Supervisory authorities	Uncertainty as to the appropriate treatment of tokenized assets.
	Other	
Benefits	Policyholders	
	Insurance and reinsurance undertakings	Clarity on the appropriate treatment of such exposures.
	Supervisory authorities	Clarity on the appropriate (and properly calibrated) treatment of most exposures.
	Other	

Comparison of policy options

Investment of (re)insurance undertakings in crypto-asset is currently immaterial and their prudential treatment is not sufficiently clear. At the same time crypto assets are high risk investments which may result in total loss of value. Therefore, the prudential treatment of crypto assets should be harmonized, sufficiently prudent and proportionate: <u>Option 3 is recommended.</u>

The risks associated to crypto-assets risk does not depend on the method of investment. It is crucial to clarify that exposures to crypto-assets should be uniformly treated, whether invested directly or indirectly. The current situation, where the Delegated Regulation have resulted in divergent treatment of similar exposures (type 2 equity for exposures held indirectly and intangible for exposures held directly), needs to be addressed and resolved.

Given the limited available evidence to support assumptions about diversification, it is prudent to assume no diversification. There is no indication that exposures to crypto-assets diversify against other risks. Therefore, the most efficient approach to ensure a consistent treatment of crypto-assets is to include such exposures within the intangible asset module.

Based on the analysis of the historical performance for major crypto-assets, an 80% stress to the value of crypto-asset exposures does not appear sufficiently prudent. A 100% stress is more appropriate and aligns with one of the approaches to the transitional treatment of crypto-assets under CRR.

Although CRR permits a look-through approach in the transitional treatment of tokenised assets, MiCAR is in its early stages. Currently, there is currently insufficient evidence to ensure that this approach is prudent. Furthermore, in view of the immaterial exposure to crypto-assets the differentiated treatment would introduce unnecessary complexity in the regulation. In line with the proportionality principle, we therefore advocate against introducing an explicit look-through approach under Solvency II for specific categories of crypto-assets. The development of the markets in EMTs and ARTs and the regulatory treatment in other sectors should be reviewed in the future as to whether a specific treatment in Solvency II would be appropriate.

2.7. DRAFT ADVICE

EIOPA advises applying a 100%, undiversified, stress to all exposures to crypto-assets in the SCR standard formula (policy option 3).

This can be implemented by including within Article 203 of the Delegated Regulation a clarification that exposures to crypto assets fall under the intangible asset module with a specific stress of 100%. Article 168(3) should also be amended to explicitly exclude exposures to crypto assets from type 2 equity.

The development of the markets in EMTs and ARTs and the regulatory treatment in other sectors, notably the expected amendments to CRR (cf. Article 501d(1) CRR), should be reviewed in the future as to whether a specific treatment in Solvency II would be appropriate.

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3. Westhafenplatz 1, 60327 Frankfurt am Main, Germany
   fausto.parente@eiopa.europa.eu

Contact details of EIOPA's Data Protection Officer

4. Westhafenplatz 1, 60327 Frankfurt am Main, Germany
   dpo@eiopa.europa.eu

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