M|E|W *Consul*

Max-Stromeyer-Str. 116
78467 Konstanz/Germany

Tel/Fax +49 (7531) 363 2918
Email info@mewconsul.de
Internet www.mewconsul.de

08. January 2019

Financial Stability Board
Bank for International Settlements

Re: Financial resources to support CCP resolution and the treatment of CCP equity in resolution

Ladies and Gentlemen

Regarding „Financial resources to support CCP resolution and the treatment of CCP equity in resolution", please allow me to introduce DRCR – Dynamic Regulatory Capital Reserve.

If all risks were known and quantifiable, and level of capital can be adjusted instantly according to external changes, CCPs and financial institutions in general are always safe. In reality, market environment is dynamic, while capital adjustment is fairly crude. Plus, market risk can be divided in known/knowns, known/unknowns and unknown/unknowns. Macro prudential tools, countercyclical buffers, etc. can only address known and quantifiable risks. And should be rule based to be most efficient, according to Federal Reserve Bank of Cleveland "Are the New Basel III Capital Buffers Countercyclical? Exploring the Option of a Rule-Based Countercyclical Buffer" (https://www.clevelandfed.org/newsroom-and-events/publications/economic-commentary/2018-economic-commentaries/ec-201803-countercyclical-capital-buffers.aspx).

CCPs use initial margin, from a risk management point of view similar to capital. But they also use variation margin, as a quick response tool. With instant financial market infrastructure (FMI) environment, and automated, real time variation margin adjustment, CCPs variation margin should guarantee protection against known/unknowns and unknown/unknowns, as long as market participants are capable of making additional contributions.

Last missing piece to complete all around safety infrastructure: automated and instant DRCR - dynamic regulatory capital reserve for CCPs, in case of for example failed variation margin calls or wrongly calculated margins or market failures, to loosen CCP-bank nexus.

The market distinguishes active manageable and latent risk. Active manageable risk is the responsibility of market participants. In general, risk management is done on short-term basis, adjusted regularly. In contrast, latent risk is not managed actively, instead covered by insurance. DRCR - Dynamic Regulatory Capital Reserve insures latent capital shortfalls, guarantees CCPs and financial institutions in general instant access to additional regulatory capital and HQLA as per BIS definition whenever needed.

Following GFC and introduction of stronger regulatory standard, M|E|W Consul developed KLF corporate liquidity back-up insurance. In case of future market disruptions KLF guarantees insured non-financial corporation (NFC) access to HQLA as per BIS definition. KLF insurance is market based, part of digitization, HQLA are allocated real time when needed. KLF has been presented to various regulatory authorities, central banks, rating agencies, FMI providers, public and private banks, etc., can be executed within existing regulatory framework.

NFC acquires HQLA paying for with corporate debt. For CCPs and financial institutions insurance structure is adapted, payment of HQLA to be made with contingent convertible (COCO) bond or preference share or perpetual bond. In case of volatility spike and resulting huge variation margin call, insured CCP or financial institution capitalisation automatically extends, mitigating CCP-bank nexus.

As a result, risk will no longer be concentrated with few CCPs and financial institutions. Insurance is secured as long as insurance/capital providers have longer investment horizon, to be locked in at inception. Plus, insurance/capital providers have to have capability to built diversified portfolio. Precondition therefore, participation of well rated non-financial corporations (NFC) as KLF liquidity insurance takers.

KLF insurance structure is fully developed, ready for execution. No regulatory changes required. Last hurdle missing, cooperation of financial market infrastructure (FMI) providers. Other financial institutions are exploiting market position, blocking FMI providers from KLF clearing.

Summarised, CCPs already use concept of variation margin. DRCR – Dynamic Regulatory Capital Reserve is going one step further, introducing concept on capital level. Base version can be implemented within existing regulatory framework. DRCR does not replace day-to-day risk management or existing rules & regulation, etc., instead is a supplement, strategic back-up facility, providing management and authorities time to implement lasting solution/regulatory measures.

Further information about KLF NFC liquidity insurance and CCP/FI DRCR - Dynamic Regulatory Capital Reserve can be found here https://www.mewconsul.de/en and provided on request.