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

10. August 2018

Basel Committee on Banking Supervision
Committee on Payments and Market Infrastructure
International Organisation of Securities Commissions

Re: Incentives to centrally clear over-the-counter (OTC) derivatives

Dear Sir or Madam

Following our experience with CCPs, in response to: "**FSB and standard-setting bodies consult on effects of reforms on incentives to centrally clear over-the-counter derivatives**".

Numerous reports by central banks among others have outlined heightened risk of cyclicality due to variation margin. In case of volatility spike, variation margin can lead to liquidation of original market, but also spread to other markets and asset classes. Correlations rise, risk management via diversification is compromised. Volatility feeds further volatility, potential race to the bottom. Last but not least, interdependencies among CCPs increase.

Knock-on effect will be exacerbated with the shift to instant collateral management. So far issue can only be addressed through sensitive variation margin policy, if at all.

Following GFC, M|E|W Consul developed strategic corporate liquidity back-up insurance market structure – called KLF. In case of future market disruptions/fails, volatility events, insured businesses have guaranteed access to HQLA as per BIS definition at pre defined terms and conditions. When outlining KLF structure among others to Bank of England, it was noticed HQLA could also be pledged as collateral. KLF economics only work in emergency situations, not for day-to-day use.

At the core KLF contract is a swaption with physically settled swap. All parts of the insurance structure are market standard since years. And still, no CCP accepts KLF clearing currently.

Legal situation is clear for EU according to Regulation (EU) No. 648/2012. KLF is a standardised OTC derivative and suitable for clearing. But no legal framework, no timeframe and no procedures have been fixed to enforce regulation. We believe CCPs misuse their dominant market position to obstruct entrance of new market participants, structures and innovations. Short-term profit maximisation has priority over general market stability.

Summarised, we believe a more formalised process is required, regulating how innovative OTC derivative structures get access to central clearing. Central clearing in combination with KLF liquidity and collateral back-up insurance will address cyclicality risk of variation margin for good. Working like a firewall, spill-over in case of future market disruptions or volatility events will be reduced massively.