**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

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Basel Committee on Banking Supervision
Committee on Payments and Market Infrastructures
Board of the International Organization of Securities Commissions

Bank for International Settlements
OICU-IOSCO

Basel, Switzerland
Madrid, Spain

Via Email: **baselcommittee@bis.org**; **cpmi@bis.org**; **consultation-04-2021@iosco.org**

**Review of margining practices**

**Digitized financial system requires automatic stabilisers**

Ladies and Gentlemen,

Collateral management and liquidity management at large is of maximum importance when evaluating financial system and also economic system stability.

We fully agree with your assessments as outlined in your consultative report "Review of margining practices". Due to stronger regulation and higher liquidity standards following 2008 GFC market participants were better prepared during March 2020 volatility event.

But it is equally important to bear in mind that central bank intervention was still critical to neutralize potential feedback loop as a result of higher volatility leading to higher margin requirements leading to forced selling in less liquid market. The problem of pro-cyclicality of collateralization of especially centrally cleared derivative transactions is well understood, has been thoroughly analysed among others by Bank of England et al.

And the introduction of anti-procyclicality measures by CCPs, although taking pressure of, could not address the structural weaknesses.

In summary, countercyclical interventions by central banks are still essential to stabilise the financial system and avoid volatility events from escalating.

Most urgent question: which institution will stabilise the financial system going forward, following digitization?

If I remember correctly, it was former Bank of England Governor Mark Carney who stated that due to DLT/ digitization/instant payment, bank-runs going forward will last only 30 minutes. Any future financial crises, if not contained within four hours, will spin out of control. That requires fully automated response, which central banks can not provide. That is why for example Federal Reserve/FedNow invites private sector to co-operate in building additional back-up system for instant payment.

Naturally, digitization will also impact collateralization, and therefore liquidity management in general.

As outlined in your report, CCPs often calculate variation margin (VM) at the end-of-day (EoD), sometimes intra-day (ITD) and only very limited on ad hoc basis.

In a digitized world there is no "end-of-day", risk due to 24/7 instant payment will change continuously. We are already in transition from static to dynamic environment. Counterparty risk therefore as well has to be evaluated dynamically.

If banks can go bankrupt within 30 minutes it does not make sense to calculate changes to counterparty risk only once every 24 hours.

It seems obvious to us, that collateral management and margin practices have to become dynamic processes as well, constantly adjusting to ever-changing risk, 24/7/365.

We do not believe that all market participants large and small, financial institutions (FI), non-bank financial institutions (NBFI) and non-financial corporations (NFC) among others will ever be capable of dynamic risk and liquidity/collateral management.

Hence we agree with the assessment of the Federal Reserve that additional safety architecture has to established, bridging gap in time between instant risks and slower acting participants.

What are needed are automatic stabilisers acting as countercyclical buffer. Key features are:

1. Fully market independent (100% capitalised),

2. Seamlessly integrated (embedded), to enable

3. Fully automated 24/7/365 real-time coverage.

Such automatic stabilisers have been developed, i.a. by M|E|W Consul (KLF – liquidity back-up insurance and RCR – regulatory capital reserve facility). However, so far none has been executed due to lag of public support.

It is important to emphasize, that automatic stabilisers are complementary to existing margin practices and safety architecture in general. Objective is to give market participants, central banks, regulatory authorities, etc. sufficient time to react in case of future disruptions or volatility events. Side befit, collateral trap as outlined in BIS Working Paper No 565 from May 2016 significantly mitigated at last.

Fortunately, today international cooperation is standard, necessary infrastructure such as BIS Innovation Hub and technical standard for embedded solutions such as ISO 20022 are given, preconditions for implementation of seamless integrated automatic stabilisers.

In summary, the current collateral management system and margining practices are not capable of coping with the challenges of a digitized, real-time financial system. Required is a dynamic system - 24/7/365. And the only solution known are automatic stabilisers, which have been fully developed, but need public support to get implemented. Once automatic stabilisers are established current weakness of margining practices as outlined in consultative report will be mostly mitigated as well.

And we have to keep in mind, that due to COVID-19 pandemic, strict time schedule of FedNow initiative among others the transformation to digitised financial system is happening substantially faster than generally assumed.

Best regards,

Manfred E. Will

Founder & CEO