M|E|W *Consul*

December 09, 2021

Committee on Payments and Market Infrastructures
Bank for International Settlements

Basel, Switzerland

Via Email: cpmi@bis.org

Extending and aligning payment system operating hours of cross-border payments

Focus on major structural weakness of financial system, instead of details and segments

Ladies and Gentlemen,

When deciding about changes to payment systems, national and cross-border, basically a good starting point are necessities and transactions in the real economy, non-financial sector. In general purchases of goods and services are the triggers, the first leg, and payments are the conclusions, the second leg. Therefore, the payment system should operate in a way to support non-financial sector, at least not impede the real economy.

Developments during the last two years, under aggravated COVID-19 conditions, have revealed how far digitization in the real economy already has progressed. Although supply chains were disrupted, demand for digital services grew strongly, sometimes exponentially.

Digital services know no limits: either physical borders or time restrictions. And that should be the rule of thumb for payment systems and its safety architecture as well.

In your consultative report "Extending and aligning payment system operating hours for cross-border payments" from November 2021 a number of scenarios and risks are presented. Our assessments and recommendations are based on End state 3 (24/7/365) and fast/instant payment systems, which is closest to the digitized economy.

The main focus of M|E|W Consul is systemic risk management: procyclicality of liquidity, collateral and capital requirements. The overlap with the risks highlighted in your report therefore is significant.

We started looking into counterparty and liquidity risks following 2008 global financial crisis (GFC). It became obvious even to the general public that financial institutions pose a significant counterparty risk. Size is not necessarily a symbol of strength and stability. Lessons learned are one central reason for modernising payment systems and introducing instant payment.

Plus, counterparty risk "bank" for many non-financial corporations (NFC) also meant systemic liquidity risk. Before GFC irrevocable credit lines were central component of strategic safety architecture for many Mittelstand corporations. Currently, NFC and smaller FI are more depending on money market funds (MMF). At the latest following March 2020 disruptions it is known that MMF is providing an illusive safety standard.

Today, when looking at heightened counterparty and liquidity risk due to End state 3 instant payments to us they seem less to be new risks, but already existing risks becoming more urgent and transparent.

<u>Central difference, disruptions in a digital world can spread within minutes, not days or weeks as in the past.</u>

Markets are always cyclical, and so are business models of banks, non-bank financial institutions (NBFI), etc. Regulation such as stronger liquidity and capital standards, central clearing and collateralisation are reinforcing procyclicality of banks, NBFI and other market participants.

<u>In summary, we believe it is not possible to address the issue of cyclicality via cyclicality reinforcing regulation.</u>

Currently the only meaningful institutions acting countercyclical are central banks. They assume the position of buffer, absorbing shocks in the financial system, volatility events in general. But that comes at significant cost, as it is becoming very clear.

We believe, what are needed are countercyclical buffers, acting as automatic stabilisers. And modernising the payment system is the right time to implement, since as mentioned above in a real-time payment environment central bank policy will be far less effective, since measures can not be fully automated.

Following structural features of automatic stabiliser are essential for any approach:

1. Because we do not know what will trigger the next volatility event/payment disruption, we also do not know the timing – no active management possible, it has to be an insurance structure,

2. Because we do not know what will trigger the next volatility event, we also do not know who will be affected – insurance has to be suitable for financial institutions, NBFI and NFC, large and small,

3. Because we do know that in a digital, instant payment system volatility events can spread in real-time, the payout under the insurance has to be instantaneous as well, 24/7/365,

4. Since markets are cyclical, automatic stabilisers have to be market independent (fully capitalized), plus

5. Insurance = automatic stabiliser itself guaranteed to never become a systemic risk itself (decentralised).

The answer is actually not difficult since digitization defined as true innovation is allowing new solutions: structures and way of execution.

M|E|W Consul has discussed the above structural issues of cyclicality, instant spreads and systemic weaknesses with various central banks over the course of the last several years, plus has participated in numerous regulatory consultations. The result two completely new automatic stabilisers as **embedded solutions** have been developed:

1. **KLF** - liquidity back-up insurance, plus

2. **RCR** - regulatory capital reserve facility.

In case of future disruptions, KLF will provide insured businesses (FI/NFC) with HQLA in real time – 24/7/365. HQLA liquidity can be guaranteed by central bank without taking credit risk or moral hazard. Insured businesses will have similar protection as major FI. New safety architecture protects insured businesses from financial system disruption. KLF automatic stabiliser allows addressing challenges of real time FMI, including instant payments and MMF.

RCR was developed addressing risks especially of systemically relevant banks (G-SIB) and FMI provider (CCP and CSD), providing automatic capital injections in case of emergency. Naturally RCR also fully automated with execution in real time - 24/7/365. RCR easily to be integrated into existing resolution regimes.

Automatic stabilizers such as KLF and RCR by M|E|W Consul are in line with recent BIS objectives as outlined in the Quarterly Review December 2021 "Widening the regulatory circle for non-bank financial firms". Crucial differences:

1. Our solutions covering financial institutions, NBFI, FMI providers and NFC, 2.

Privately organised and private capital based solutions, no moral hazard, and

3. Ready to address special challenges of digital economy and financial system.

Precondition to implement automatic stabilisers is access to financial market infrastructure. Hence gatekeeper position of large FI has to be eliminated, true innovation fostered:

1. Supporting innovation directly via innovation hub/centre, even against the interest of established market participants, and
2. Protection against malpractice, e. g. via standard setting organization (SSO), as FDIC is elaborating.

Additional aspect, objective of FDIC SSO is to support innovation focussing on smaller FI and NFC. So far large FI are dominating financial product development, limiting progress to their economic interests and their major clients. It is apparent, that the interests of smaller FI and NFC are not sufficiently taken into consideration.

In summary, our recommendation for policy action, seize this opportunity and prepare for digital future:

1. **Focus on major structural weakness of financial system, instead of details and segments**
2. **Incorporate new architecture and new developments, which are already in the planning**
3. **Foster digitization and true innovation, against resistance of existing market participants**
4. **Recognize U. S. certification in other jurisdictions/introduce certification internationally**
5. **Support adoption of automatic stabilizers globally, hence address new digital challenges**