Proposal: 1628 (AF21) Regs. Q, WW - Changes to Applicability Thresholds for Regulatory Capital and Liquidity

Description:

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From: Manfred E. Will

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Subject: R- 1628 - Regs. Q, WW - Proposed Changes to Applicability Thresholds for Regulatory Capital and Liqu

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Comments:

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Ladies and Gentlemen

Regarding the agencies Proposed Changes to Applicability Thresholds for Regulatory Capital and Liquidity Requirements, please allow me to introduce KLF - strategic corporate liquidity back-up insurance, and DRCR - Dynamic Regulatory Capital Reserve. Insurance structures mitigate the problem of inadequate liquidity coverage and capital ratio.

If all risks were known and quantifiable, and level of liquidity and capital can be adjusted instantly according to external changes, financial institutions are always safe. In reality, market environment is dynamic, while liquidity and especially capital adjustments are 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. Plus, 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 margin adjustment, CCP variation margin should guarantee protection against known/unknowns and unknown/unknowns, as long as market participants are always capable of making additional contribution. We have taken this concept one step further with our insurance structures, to cover liquidity and regulatory capital: KLF - strategic corporate liquidity (collateral) back-up insurance, and DRCR - dynamic regulatory capital reserve for financial institutions in general. Plus, both will also loosen CCP-bank nexus BIS is very concerned about.

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.

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 corporation access to HQLA as per BIS definition. KLF insurance is market based, part of digitization, HQLA are allocated in real time 24/7/365. KLF has been presented to various regulatory authorities, central banks, rating agencies, FMI providers, public and private banks, etc. in Europe, can be executed within existing regulatory framework.

For CCPs and financial institutions in general insurance structure was adapted: DRCR payments of HQLA to be made with regulatory capital: contingent convertible or perpetual bond or preference shares. In case of volatility spike or market disruption, insured CCP/financial institution liquidity and capital ratio are automatically strengthened, 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 at least medium term 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.

Insurance structures are fully developed, ready for execution. No regulatory changes required. Last hurdle missing, cooperation of financial market infrastructure (FMI) providers to clear insurance contracts.

To avoid any misunderstandings, both insurances do not replace day-to-day risk management or existing rules & regulation, etc., pp, instead are supplement, strategic back-up facilities, providing corporate management and authorities enough time to implement lasting solution/regulatory measures.

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

Kind regards
Manfred E. Will
Founder & CEO

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