

MEW CONSUL, MANFRED WILL

Proposal and Comment Information

Title: Request for Information and Comment on Reserve Bank Payment Account Prototype, OP-1877

Comment ID: FR-2025-0083-01-C23

Subject

Docket No.OP-1877

Submitter Information

Organization Name: MEW Consul

Organization Type: Organization

Name: Manfred Will

Submitted Date: 01/15/2026

Ladies and Gentlemen,

dear Matt,

Please find attached M|E|W Consul's contribution regarding Federal Reserve System "Request for Information and Comment on Reserve System Payment Account Prototype" (Docket No. OP-1877).

Kind regards,

Manfred E. Will

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M|E|W Consul

St Johann
Brückengasse 1b
78462 Konstanz
Germany

January 15, 2026

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N. W.

Washington, DC 20551, USA

Via Email: publiccomments@frb.gov

Docket No. OP-1877

Run-risk, cliff risk and first-mover-advantage

Ladies and Gentlemen,

M|E|W Consul (MEW) is honored to contribute to Federal Reserve System's "Request for Information and Comment on Reserve Bank Payment Account Prototype" (Docket No. OP-1877).

Objective

It is MEW's understanding, objective of newly introduced Payment Accounts is the promotion of innovation and support of new payment participants, e.g. stablecoins, while at the same time to safeguard the stability of the US payment system.

If executed as outlined, stablecoins sponsor will invest supporting assets in two distinct asset classes: (1) HQLA as per definition by the GENIUS Act, and (2) reserves with the Federal Reserve using newly created Payment Account.

MEW agrees, the Payment Account will support smooth operation of stablecoin payments in stable environment.

Run-risk

But we would also like to emphasize, Payment Account will not help mitigating the already identified "run-risk". The stablecoin run-risk is similar to the risk banks and investment funds are subject to, namely, during times of stress or loss of trust holders exiting fast, potentially triggering chain reaction leading to wide spread redemption requiring fire sale of supporting assets leading to overwhelming public markets and therefore causing systemic risk.

Cliff-risk

The access of newly created Payment Accounts to already existing Federal Reserve emergency funding facilities such as the Discount Window is explicitly ruled out. In case of doubts by stablecoin holders regarding stablecoin stability, they are incentivised to act even faster, and reduce their counterparty risk as long as Payment Account is still liquid. Once it dried up the risk profile changes to HQLA. Therefore, additionally, we now have a **first-mover-advantage** and highly dangerous cliff-risk.

liquidation point of view might look limited initially, if we take an analogue perspective. Considering the new digital world with nine second guaranteed money transfer via FedNow and bank-runs measured in minutes going forward, according to Governor Barr, t+1 settlement of sold HQLA is a considerable stretch of time. Even longer taking bank holidays, weekends, etc. into account. Tokenised trading and atomic settlement won't be the solution either, since faster trading means less market depth and therefore bigger price impact. Hence, the cliff-risk is real and significant.

That is why banks have direct access to central bank emergency funding. Regarding investment funds, different strategies have been developed to address the cliff-risk, such as gates or variable pricing. None is convincing, the risk profile is changing but not the overall risk level. In case of stablecoins, none of the developed strategies is feasible since all would undermine credibility of stablecoins as safe money alternative and USD price peg.

Liquidity insurance

As requested by Governor Barr, an additional tool has been developed ready for execution – liquidity insurance.

Liquidity insurance, as designed by MEW, guarantees stablecoins access to additional HQLA as per GENIUS Act at pre-defined terms & conditions, in real time and without making use of public markets.

As a result, during times of stress or loss of trust, stablecoins will get over collateralised, providing additional confidence to holders. Especially since insurance structure (front-end) will be regulated pre-launch, guaranteeing stablecoin holder first access of supporting assets vs. insurance capital providers, all remaining doubts will be eliminated.

Plus, liquidity insurance should gain access to Federal Reserve emergency lending such as standing repo facility, secured and fully automated via pre-launch certification of insurance operations (back-end). Repo transactions enable stablecoin sponsors to top up the Payment Account in real time without having to access public markets.

Regulation/certification mean standardization, which leads to commoditization, which leads to wide utilization.

The brave new world

In the brave new world of real time digital processes preparedness is key, the time where central banks could just react following disruption is over. There will be no time to analyze or to develop measures in case of emergency, all decisions and procedures have to be in place, execution at best fully automated, human factor is neutralized. The same is true regarding stablecoins. The adoption of properly designed liquidity insurance is the easiest, fail-safe and still most economic back-up solution possible.

Conclusion

With introduction of Federal Reserve Payment Accounts, day-to-day operations of stablecoins is strengthened.

Already recognized “run-risk” on stablecoins, similar to what banks and investment funds are exposed to, is still unchanged.

Plus, “cliff-risk” and “first-mover-advantage” are added, since the assets supporting stablecoins will be invested in two distinguished asset classes: (1) HQLA as per definition by the GENIUS Act, and (2) reserves with the Federal Reserve using newly created Payment Account.

All three, run-risk, cliff-risk and first-mover-advantage, are manageable with the adoption of liquidity insurance. Precondition, regulation of insurance structure (front-end) and certification of operations (bank-end).

Best regards,

Manfred E. Will
Founder & CEO