Marc Bayle de Jessé

Chief Executive Officer, CLS Group

COVID-19 and the importance of resilient financial market infrastructures

The current financial market volatility arising from the spread of COVID-19 has reinforced the need for adequate planning and rapid response by governments and central banks. Stress testing by global systemically important banks is the best example of such planning, requiring adequate capital to withstand sudden shocks while continuing to intermediate credit to households and businesses.

An overlooked lesson of this crisis is the system's reliance on strong, well regulated, and resilient financial market infrastructures (FMIs). Banks, fund managers, corporations and other users rely on FMIs for a variety of critical – if unglamorous – functions that are absolutely necessary to the functioning of financial markets: payments, custody, clearing, and settlement. Such services reduce risks for users (e.g., credit, liquidity) and offer operational efficiency. Simply put, financial markets could not operate smoothly without the key services provided by FMIs.

CLS settles foreign exchange transactions for the largest banks in the world on a payment-versus-payment basis. It thereby reduces settlement risk associated with FX transactions by ensuring that the final settlement of a payment instruction in one currency occurs if, and only if, settlement of the payment instruction for the other currency being exchanged is also final. The funding required to settle is determined on a multilaterally netted basis, reducing the amount of liquidity required for settlement by approximately 96 percent.

During the recent period of extreme volatility in March, CLS volumes increased sharply. The average value of payments settled daily totalled approximately USD7 trillion - about 20 percent higher than normal. CLS processed the added volumes with no issues or delays. As seen in the 2008 crisis, banks turned to CLS knowing their FX trades would settle on time and with finality.

The current crisis is not just a financial test, but also an operational, staffing, and resilience planning one. In the case of CLS, we took early steps to segregate key operational employees, direct other employees to work from home and use technology to maintain the high quality of service our users expect – while communicating regularly with employees, clients, vendors, and regulators.

This crisis is still ongoing, and deriving final conclusions is premature. But some tentative implications can already be drawn. Here are three:

1. Importance of resilience, redundancy and planning

FMIs must not only be operationally efficient, they must be resilient with multiple backups to diversify against a range of scenarios that might affect premises or staff. For example, CLS is diversified across multiple continents, but also has redundant capability. Diversification must be well planned with adequate testing and staff drills to help ensure the service can be delivered without any degradation of service users expect.

2. Introduction of new technologies

In recent years innovations such as blockchain, distributed ledger technology (DLT) and tokenization, among many others, raised the possibility of re-engineering the payments, clearing, custody and settlement space. As service providers and regulators review such technologies, they will want to assure that excitement about potential efficiency gains do not obscure or in any way degrade current levels of resilience and diversification. Indeed the recent environment will reinforce the need for new technologies to demonstrate at least the current level of resilience – and ideally enhance it – before FMI boards and regulators permit the introduction of such technologies for systemically critical services.

3. Expecting the unexpected

Banks typically plan for financial events or physical outages, but the current crisis is directed at human capital. The next crisis might be very different still. Hence, key financial market players, whether banks, asset managers or FMIs are likely to be pushed to plan for an expanded list of scenarios including some that may appear very, very remote. But then, a scenario that has shut down most of the global economy also seemed remote not very long ago. ●