Implications of the Covid-19 crisis for the financial sector

Michael West

President, Moody's Investors Service

Coronavirus exposes global financial market vulnerabilities

Global credit conditions are deteriorating because of the coronavirus outbreak and oil price shock, which will likely lead to an increase in rating downgrades and defaults in the coming months. The economic turmoil, along with significant financial market volatility, is creating a severe and extensive credit shock across many sectors, regions and markets. The combined credit effects of these developments are unprecedented. The sectors with the largest exposure to the coronavirus outbreak are those that are most sensitive to consumer demand and sentiment, including global passenger airlines, lodging and cruises, automotives, and segments of the oil and gas sector, as well as certain commodity exporters. Negative credit effects will be the largest for companies and governments with high debt levels, heavy reliance on external financing and weaker credit profiles. Speculative-grade companies and governments represented close to 40% of all Moody's-rated debt in 2019, up from 16% in 2009.Moody´s expects the G-20 economies to experience a major shock in the first half of this year and will contract in 2020 as a whole, before picking up in 2021.

Nevertheless, there remains sizeable downside risk to our forecasts given the significant uncertainty as to the length and magnitude of the coronavirus outbreak. The monetary and fiscal response has been significant and continues to grow, and we expect it to help cushion the economic and financial market impact of the shock. In some cases, these policy measures will allow for a faster recovery once the shock recedes. Fiscal stimulus will also lead to further increases in sovereign debt, which is already high in many countries, including in the European Union. Emerging market currencies have sharply depreciated vis-a-vis the US dollar because of safe-haven flows, increasing vulnerabilities for emerging countries that are dependent on external financing.

While the European Union has been slow to devise a coordinated response, one is emerging that may start to employ some of the policy tools devised during the euro area sovereign debt crisis. However, more broadly, global policy responses have thus far been disjointed, favouring more nationally focused approaches.

Even before the coronavirus, global economic growth was slowing as a result of cyclical and structural factors, including aging populations, weak productivity, global trade tensions and geopolitical risks. A lasting trade deal between the US and China will remain elusive, with disputes extending into technology, investment and geopolitics. The outcome of US-EU trade talks, potential auto tariffs and Brexit-related uncertainty also remain risks. Lower-for-longer interest rates also increase financial stability risks and weigh on profitability for banks and insurers. They encourage risk taking as investors reach for yield that may have contributed to high financial volatility and sharp asset declines in recent weeks. Low rates can encourage excessive borrowing as evidenced by elevated corporate leverage in the US and Europe.

Many high-yield companies took advantage of easy market access and have successfully weakened investor protections. The increase in low-rated companies with weaker credit profiles will likely lead to more defaults and lower recoveries even if the current downturn were to be milder than the one in 2008. High levels of Baa-rated corporate debt globally increases the risk of downgrades to speculative grade in a recession, although this risk in and of itself is not likely to disrupt the high-yield market. The market for leveraged loans and collateralized loan obligations (CLOs) has expanded significantly, which poses risks during periods of tight credit conditions. In Moody's view, junior tranches of CLOs would be at risk of significant credit quality deterioration under a severe downturn scenario. However, senior tranches would likely avoid impairments because of credit enhancement and other structural features. Investors are increasingly incorporating climate and cyber risks into their decision-making. Moody's expects these areas to become bigger credit considerations that in some cases will weigh on credit availability, putting further pressure on carbon-intensive sectors. ●

Jean Lemierre

Chairman, BNP Paribas

Covid-19: banks are part of the solution

The Covid-19 pandemia is a worldwide public health issue, which has brought a large part of the world's population and economy to a complete stop, leading the global economic activity to decline on a scale we have not seen since the Great Depression, with a drop of 6.1% in GDP for the advanced economies, as estimated by the IMF.

After the deep economic and financial 2008 crisis, and ten years of unprecedented regulatory and institutional overhaul to strengthen financial stability, the European Union is now confronted, with the outbreak of the CoVid-19, and its potential social, economic and financial consequences, to its first pan-european systemic crisis, affecting all Member States albeit with different timing and intensity, and all sectors of the economy.

Contrary to the sub-prime crisis, banks are not the problem, they are part of the solution. A prompt, coordinated and powerful response to this unprecedented challenge has been designed at EU and Member States level. Banks are called to support the economy, and are doing it in every geography and business lines.

Time will come to learn the lessons of the crisis, and to build the foundations of the recovery which is needed in the years to come.

Banks are at the core of public policies, to avoid the massive bankruptcies that characterized previous crisis, with their dire consequences on job losses. Hand in hand with authorities, banks are the backbone of the financing of the economy, to support short term temporary liquidity needs, and to facilitate the recovery. Our staff is mobilized to address clients needs, every day, in branches, business centers, back-offices, risk management units, data centers. Banks are open for their clients, and the financial infrastructure works: payments, settlements, client orders, are processed in millions, across the globe so the economy can function. As an example, Swift transactions are close to their peak in March and April, with a 16% increase y/y. Moratoria and new loans are discussed with clients and granted with an accelerating process in most EU countries. In France, 3 weeks after the implementation of the State-guaranteed loans, 150 000 companies have received approval, for a total of 22 bn€, and the framework is ramping up quickly.

The massive financing that banks will provide to the economy is supported by the liquidity provided by the ECB, and by State Guarantees provided by Member States. Regulators are implementing the flexibility embedded in existing regulations, and, at the margin, adapting regulations to international standard setters guidance. This contracyclical approach is at the core of financial stability: build capital and liquidity buffers in good times, to be well prepared to weather bad times.

Time will come to learn the lessons of the crisis, and to build the foundations of the recovery which is needed in the years to come. Policy makers will also have to adapt the regulatory framework where rigidities may have dampened timely responses to the crisis.

But for the moment, our energy should be fully devoted to fight the virus and its economic consequences, hand in hand with the authorities. ●

José Antonio Álvarez

Chief Executive Officer, Santander Group

This time it's different. Let's keep it that way.

As I write this, many parts of Europe are in their second month of living with the COVID-19 corona virus. To many, the economic disruption and volatility in financial markets recalls the uncertainty and instability of the 2008-9 financial crisis and the Great Recession that followed it, or even the Great Depression of the 1930s.

But we know this time around is very different. In this crisis, triggered by a public health emergency, we in the financial community – banks and other financial institutions, monetary authorities, regulators and supervisors, our customers and employees and shareholders - are very much on the same side. We have all been rowing in the same direction. So far that has enabled us to mobilize huge resources for the economy. It will be very important in the coming months to maintain that shared vision and solidarity, which could come under pressure as the public health crisis wears on. So it is a good time to remind ourselves of some guiding principles as we go forward. We must always remember that our purpose is to support people and businesses, in difficult times as well as good times.

In the last two months, central banks and other authorities have been very quick to act in unleashing huge amounts of liquidity into the system. They did this through market operations and through prudential relief, eliminating the capital and liquidity buffers put in place while economies were growing to make banks more resilient when they are not.

Recognizing that monetary policy could not be the only answer, governments have put in place a series of fiscal and social measures that include direct support for SMEs and other companies, employment and wage protection and loan guarantees and moratoria. Banks, in most instances, are the transmission mechanism for these programs. All this happened in the first weeks of March. Not surprisingly, many of these initiatives took a few days to be activated, but they were mostly activated.

The close coordination among banks, supervisors, monetary authorities, governments and other key actors have led to quick preventive and corrective actions. On issues ranging from accounting and prudential flexibility the eligibility of collateral, I have seen authorities act quickly when the industry has raised concerns. In turn, banks have responded when concerns were raised over dividends and other measures to conserve capital.

Our collective learning curve has been steep. Here are some of the lessons we learned at Banco Santander, both for authorities and ourselves, which may be useful as we continue to navigate this crisis.

- **Be safe:** The first concern of any institution must be the well-being of its employees and customers. Working from home, protective guidance for branches and mental health support all help to keep people well. Maintaining their jobs is fundamental.
- **Be fast.** You can't rescue a company after it has gone under. Banks and authorities have had to work very closely together to get support where it needs to be, quickly.
- **Be big.** Monetary and fiscal measures work best when markets see they are of the scale required to address the problem. Make sure what you do is enough and the conditions are right. Half-way treatments don't work.
- **Be simple.** Applying for loans or benefits should be as paper-free and non-bureaucratic as possible. Include clawbacks and affidavits, if needed, rather than try to impose upfront conditions on support.
- **Be inclusive.** Guaranteed loan programs and moratoria should be for all types of loans and segments of customers, large and small, based on clear criteria.
- **Be ready.** Even as we are implementing the last measures, we have to look forward to the next stage – and the stage after that – to consider how the needs of our customers and governments and authorities may change and be ready.
- **Be open.** Fluid communications with our stakeholders, including authorities and governments, have been essential to our ability to manage so far. That will remain the case.

Going forward, the highest priority for banks will be to manage risk prudently to keep our balance sheets strong. Strong balance sheets will enable us to continue to support people and businesses. Banks must distinguish between what is near-term or transitory, related to the COVID pandemic, and what is not. This distinction, between transitory disruption and long-term unviability, is essential to make sure banks themselves stay healthy. Also, as the transmission mechanism for the public sector, we must assure that public resources are allocated fairly and justifiably, keeping in mind we are lending, not providing subsidies.

At some point, as we emerge from the lockdown phase - I hope in the near future - the financial community will need to work together to revive the economy and support people. This will likely be a gradual process, with many decisions and challenges, as some sectors and segments return to work faster than others. I am convinced that the close coordination we have maintained so far, with the private and public sectors working closely towards the same goals, will be crucial in making sure banks can perform their duty in the coming recovery. ●

José Viñals

Group Chairman, Standard Chartered Plc.

How banks respond to the crisis now is critical to the global recovery

The COVID-19 pandemic has triggered a global public health and economic crisis. Human and societal costs are already significant, and governments have taken unprecedented steps in an attempt to weather the economic impact. Many predict 2020 will see the worst peacetime performance for the global economy since the Great Depression. The International Monetary Fund projects a sharp global economic contraction of –3% in 2020, much worse than during the 2008–09 Global Financial Crisis.

The present crisis is like no other in the extent and severity of its shock, the uncertainty over its duration, and the strength and shape of an eventual rebound. Whereas previous crises required economic policies to stimulate activity, much of the present economic impact is attributable to necessary containment measures. Banks can and have been playing an important role in alleviating the immediate liquidity issues. By providing a reliable source of financing to corporates and individuals, and by being a conduit for delivering many of the public policy measures, we have been helping bridge the cash flow needs of our clients and communities.

In addition, many banks are taking their own initiatives to fight the impact of this virus. At Standard Chartered for instance, we've announced $1billion of financing at cost for companies that provide goods and services to help the fight against COVID-19. And we have launched a $50m COVID-19 assistance fund with $25m allocated to emergency relief in the most affected markets and $25m to help communities' recovery from the medium-term economic impact of the virus.

This crisis, however, has reminded us that financial markets can go through episodes of 'market illiquidity'. They quickly exhibit extreme volatility as some market participants must sell down their positions to meet their financial obligations. Corporates are also seeking to increase their liquidity buffers to manage their working capital needs, leading to an overall hunt for cash. The European Central Bank has decisively responded to those challenges, including unveiling the Pandemic Emergency Purchase Programme with an overall Euro 750bn envelope to buy government and corporate bonds. To address the global risk of dollar shortages the Fed has put in place, among other measures: dollar swap lines for a number of central banks; and, a special dollar facility for many central banks.

These measures are being used by banks to channel liquidity to the economy thus preventing a liquidity-driven crisis. While the magnitude of the impact of the COVID-19 crisis on financial stability in the medium term is difficult to assess at this stage, the dramatic fall in economic activity and the increase in both public and private sector debt will likely have a significant impact on the financial sector and on banks. For example, the fall in economic activity could contribute to the deterioration of asset quality of banks, leading to a vicious circle of reduced lending, poor profitability and negatively impacting the economy. This is not a new problem in the EU, which faced similar issues following the 2012 EU sovereign debt crisis, leaving banks at the periphery with high-level of non-performing assets and endemic lending. Yet European banks face the present crisis from a much stronger situation, reflected in substantially higher capital ratios, liquidity buffers and improved risk management frameworks. Low profitability nevertheless remains a concern and is likely to become even lower, at least in the short term.

We can look to the past for useful lessons.

While the present crisis resembles no other since World War II, we can look to the past for useful lessons. In particular, few would argue against the idea that concerted and decisive action is essential now and to prevent the occurrence of a significant "second wave". International cooperation is required in the easing of lock-down measures to harmonise travel restrictions, enable supply chains to operate and facilitate trade. A coordinated global response is also key to adequately allocate protective equipment and medical supplies, collect funds for vaccine research and provide access to all once a vaccine is found.

There is a related, but equally important, need for a paradigm shift to one where we appreciate that no one truly wins unless everyone is helped. We have already seen some of this in the way governments have responded to the crisis. What risks we, as a society, choose to share, and how generous the safety net is that we choose to create for this and future generations, are, of course, some of the key questions that lie before us in the coming weeks and months. ●

Markus Ronner

Group Chief Compliance and Governance Officer, Member of the Group Executive Board, UBS

Decisive action for a strong European banking sector

The COVID-19 pandemic is hitting the European economy and our financial sector at an already challenging time. Economic growth in many European markets has already been relatively subdued even before the pandemic, while sovereign debt levels in many countries are elevated, if not even at record levels, and monetary policy room to manoeuvre is limited due to low rates and quantitative easing. Authorities across the continent have nevertheless pulled off a remarkable set of economic stabilization measures to instill confidence to employees, corporations, financial markets and society at large. The current economic crisis is also an important test for the European banking sector. It's certainly too early to make a final call but there are some meaningful observations that can be made already today.

Strong and effective collaboration among regulators and authorities has been key to mitigate the effects the pandemic has on the economy to the extent possible. This includes temporary reliefs on capital and liquidity requirements to allow banks to serve the real economy. However, banks will need to demonstrate prudent lending practices and avoid adding on low credit quality. This is particularly important as many European banks are still struggling to adapt their business models and operate a sustainably profitable business, due also to structural issues as well as the expansive monetary policy, which has severely impacted a main income stream of the banking industry for a prolonged period of time.

In other words, the European banking industry enters the COVID-19 crisis period having not even fully digested the consequences of the financial crisis. The longer-term implications of the short-term stabilization measures need to be considered carefully. UBS research shows that only around 25% of the 40+ largest European banks would have earned their cost of capital if you were to adjust their 2019 return on tangible equity for the average loan-loss-provisioning rate of the years 2000-2005. And the 2019 ZEB European Banking Study forecast that, already in the baseline scenario which assumed that interest rates, profit margins and loan loss provisions would remain at 2018 levels, Europe's top 50 banks were expected to see their RoE halve over the next five years, mainly due to higher regulatory requirements.

Particular attention is therefore required in the following areas:

- Expansive monetary policy will add further pressure on the banking systems' Net Interest Income (NII) in an environment where Eurozone NII at the beginning of 2020 was already 45% lower than in 2007.
- Loan losses will be smoothed by public stabilization measures and some adjustments to accounting standards. However, banks, especially those banks with sizable non-performing loan portfolios, must avoid loading their balance sheets with low credit quality and associated future losses, which would further weaken their profile. There will need to be a fine balancing act between supporting the real economy and due risk management in such a highly uncertain environment.
- While central bank liquidity support is needed and welcomed, it should not be the main determinant of bank lending in the short- to medium-term. In an environment in which the ECB's term facilities have been funding around 15% of bank lending in some jurisdictions, this will require a significant broadening of funding sources for many European banks, potentially at a higher cost than that which is currently available.

> *Decisive action both by authorities and the banking industry will help to translate the threats of the crisis into an opportunity of building a stronger banking industry in Europe.*

In addition to these COVID-19-related factors which need to be addressed if and when the circumstances allow, a number of strategic measures by banks and policymakers can help enhance the resilience of the European banking sector in light of these threefold pressures.

On the one hand, banks will need to accelerate the adoption of new business models and, with the appropriate framework set by policymakers embrace the consolidation of the industry, focus on fostering critical size and enabling necessary investments in new technologies to support structural changes.

Decisive action both by authorities, including regulators and central banks, and the banking industry will help to translate the threats of the crisis into an opportunity of building a stronger banking industry in Europe which is crucial to foster a positive economic development in the post-COVID-19 period. ●

Susan Revell

Deputy Chair and General Counsel, EMEA, BNY Mellon

Thoughts on Covid-19 – the importance of people

When I think of the impact of the current Covid-19 crisis on the financial services sector, I think of three things, business continuity, lessons learnt (and to be learnt), and people. And of the three, the most important is people.

From the perspective of the financial services sector as a whole, one major conclusion from the past weeks is that the system has continued to work. In very challenging circumstances, financial markets, market infrastructures, and market participants have continued to operate, and have been able to manage unprecedented volatility and volumes.

This is highly reassuring, and even – despite the sad and tragic circumstances – satisfying. It shows that the enormous efforts that the sector has made in the past years to ensure business continuity have paid off. I think that if the virus had struck even three years ago the outcome would have been very different.

I have seen the view expressed that it is as if we are going through an enormous stress test. And as with every stress test, there are lessons that we can draw from the experience.

I think that once the situation – the humanitarian situation, as well as the financial market and economic situation – has stabilised, there will be many lessons that we can draw.

We shall look at the areas where frictions have occurred. We shall look at the actions of public authorities and we shall see what worked, what worked less well, and why. We shall need to think about how we can better prepare, and ensure that information is available to all. We shall have to look again at the conditions of access to the ECB's asset purchase programmes, and we shall see that not everybody has equal access. We shall say that fragmentation of European market infrastructure, and differences in market practice, are a problem that becomes more acute in times of market stress.

And there will also be broader lessons. We shall need to look at the resilience of the system as a whole, and at how to increase operational and technological resilience and inter-connectedness.

But the biggest lesson of all relates to people.

In the past weeks, the biggest source of resilience has been people. This is true in society as a whole, and it is also true with respect to financial services. Beyond systems and technology and procedures, all of which are, of course, important, the fact that over the past weeks the financial services sector has been able to continue to process payments, to support the financing of the economy, and to manage radical adjustments in prices and portfolios is due primarily to the adaptability, perseverance and dedication of our people.

> *In the past weeks, the biggest source of resilience has been people.*

As the crisis ends, and as we return to an environment that is closer to our past experience, we shall need to focus on our people. I do believe that the crisis will have shown that we need to focus even more than in the past on the agendas of diversity, inclusion and corporate purpose. ●

Alexandre Birry

Global Head of Research - Financial Institutions, S&P Global Ratings

Covid-19 will expose many of European banks' strengths and opportunities

Beside its tragic human cost, the coronavirus' economic cost will very rapidly translate into substantially higher credit cost for European banks. And that is despite the substantial support provided by the authorities to households and corporates. But the capital and liquidity buffers built by banks over the past decade should, this time around, help banks be used as a conduit to support the authorities' monetary and economic policies to address the crisis. The flexibility granted by supervisors for banks to dip into these buffers will—as originally planned by the regulations—allow banks to contribute to minimise the depth of the crisis and build the foundations for a strong recovery.

That said, once the economic rebound takes hold, banks will not reap the financial benefits of their actions through the crisis. They will face customers that may be prone to deleverage, a cost of risk that will likely be well above pre-crisis levels, and the prospect of lower-for-even-longer rates. This will likely durably dent earnings that were already often feeble at the onset of the crisis.

> *The crisis may reveal the progress banks made after the last crisis in rebuilding their standalone strength.*

One of the longer-term questions that will need to be addressed post-COVID-19 is the extent to which regulatory requirements will again be tightened, and how rapidly. The earnings recovery for banks is unlikely to be as sharp as the GDP rebound. Time, and clarity as to the regulatory path ahead, will be required for investor confidence to be preserved. The crisis will also reconfirm how useful it is for banks and supervisors to routinely carry out stress scenario analysis based on non-traditional risks. Climate-related stress-tests—put on hold during the pandemic—may be revisited with a new vigour.

Also, performance pressure and evolving customer needs (for instance around sustainable finance and fintech to name just two areas) may strengthen the argument for fewer banks with greater scale in terms of size, geographic reach, product offering and technological capabilities. This may reignite the debate around consolidation once the dust settles – the main question being whether it will still lead to predominantly domestic consolidation, or whether we will finally see more cross-border transactions within the European Union. The emergence of pan-European wholesale banks could be key to the success of the Capital Market Union. But it is unlikely to occur in the absence of clear support for this from the national and regional authorities.

Finally, another question will be around the image of banks post-COVID-19, and the perception of their role in the economy. The crisis may reveal the progress banks made after the last crisis in rebuilding their standalone strength. Their resilience through this severe and abrupt crisis would be testament to the substantial transformation they've undergone since the global financial crisis. Their willingness to use it to support customers in times of stress will be scrutinised by many. Therefore, after spending the previous decade strengthening their balance sheets, banks' ability to demonstrate this willingness to support the economy through the crisis and to explain it convincingly will be instrumental in also strengthening their image in the public opinion. ●

Ksenia Duxfield-Karyakina

Government Affairs and Public Policy Manager,
Financial Services Policy Lead, Google Cloud

Resilient cloud: supporting the financial sector in a time of uncertainty with Covid-19

As COVID-19 continues to impact the globe, the financial sector is adjusting to the new reality, both in terms of migration of their own operations into the remote working-from-home environment, and sustaining to provide essential, now exclusively digital, services to their customers. Cloud technology has proved fundamentally important to support this transition in a number of ways.

Remote working

As organisations now rely on remote workforces to maintain productivity, using cloud tools is becoming a newly accepted norm for the industry.

The uptake of remote collaboration technology has been remarkable: Google Meet has been adding more than 2 million new users daily, and they're spending over 2 billion minutes together per day. We also made our advanced Meet video-conferencing capabilities available at no cost to all our customers until the end of September.

We introduced Meet more than a decade ago as a secure, easy-to-use collaboration and productivity service (now known as G Suite), as we envisioned a new way of working in the cloud. These tools have proved indispensable in the time of a pandemic.

Resilience of cloud infrastructure

The need for agile, scalable, secure, and resilient infrastructure is not new, but has been underpinned by the global pandemic. Hyperscale cloud providers that build infrastructure and systems resilient by design are well placed to support business continuity of the financial sector, the operational stability of which is critical to the European economy.

Google maintains comprehensive business continuity practices, and we have taken steps to ensure our readiness for COVID-19 from both a technical and personnel perspective. These steps are from our standard playbooks, which were written and have been tested for exactly this type of scenario, well ahead of the COVID-19 outbreak.

Network and compute resources are central to cloud services. At Google Cloud, we plan for these resources to accommodate normal demand fluctuations, long-term growth, and potential unanticipated shocks on supply or demand. The growth we've seen so far in response to the pandemic is within the headroom we've provisioned, and we don't face or foresee a capacity shortfall for either of these resources at this time.

Similarly, with personnel readiness, thanks to the collaboration tools we are using on a day-to-day basis, and with the distributed culture that we've built across the company over the past decades, our teams remain connected and able to execute in the work-from-home environment.

Impact on the use of AI and automation

During times of uncertainty, having access to insightful data is more important than ever. Financial institutions are turning to data analytics and AI to help them make smarter decisions, improve their business operations, and help their customers. Here are a few ways they're doing just that:

- Understanding data with analytics and AI tools to make better decisions in the trading portfolios during the market downturn, improve internal risk management, liquidity, and capital analysis;
- Using data and AI to streamline back office operations, such as trade processing and document management;
- Implementing AI-based agents in call centers to alleviate pressure.

There is a similar trend in the use of these tools by financial services regulators.

Thinking post COVID-19

It is expected that economic recovery will be a continuous process, with many lessons to be drawn across the industry and the regulatory community. These are just a few themes that we anticipate emerging:

- Infrastructure modernisation with public cloud in the financial sector will increase as a key enabler in improving sustainability and reducing operating costs.
- Remote work combined with broader reliance on online platforms are here to stay, encouraging innovative work cultures based on agility and flexibility.
- Today's end-to-end automation could lead to data and AI tools being further embedded in daily operations. This is a positive trend, but regulators would need to think through governance implications.
- Valuable, applicable learnings from other sectors will prevail, including the ability to scale on demand - similar to retailers, or tele-finance advice - similar to the advances in tele-medicine. Increased computational research, importance of data insights, and use of ML will be critical in this space as well.
- Financial services regulators have been increasingly looking into their own cloud-first and multi-cloud strategies, and the current crisis might also accelerate this transition.
- As financial services move online, it will be more important than ever to think about populations already underserved by banks and ensure inclusion. Reskilling, further investment in digitisation, and support for SMEs and innovative startups, will continue to dominate this agenda, which cloud can support.

This unprecedented period in our history gives financial institutions and technology firms the opportunity to work together to support our employees, customers and the wider community. ●

Cyril Roux

Chief Financial Officer, Groupama

Will the financial center hold in the current economic sudden stop?

After the Great Financial Crisis of 2008, the Financial Stability Forum turned into the Financial Stability Board, established as a permanent organization with a broadened focus reporting to the G20. In the European Union, the Barnier agenda was meant to address the multifaceted weaknesses of financial markets, infrastructures and intermediaries.

Dozens of directives and regulations were established, in an alphabet soup of acronyms: BRRD, MAD/MAR, SFTR, MiFID, EDIS, MMF, and many more. The ESRB worked with ESAs, Central Banks, national supervisors and the European Commission to measure financial stability risks, to design supervisory tools to address them, such as stress testing and remediation plans, and to develop macroprudential supervision.

In the US, the 2010 Dodd-Frank act introduced new federal agencies (CFPB, OFR, FIO and the FOSC) and a great many new financial regulations. The latter part of the decade saw a concurrent effort to roll back in part this recently increased regulatory burden.

In Europe, this was the avowed focus of Commissioner Hill, while in the US, the impetus was given by the Trump administration and Republican Congress. This didn't prevent the completion of Basel III, however. All the while, low interest rates combined with the capital and liquidity requirements imposed on banks led to an increase of the indebtedness of public and private actors, and that of the size of non-bank financing over the decade. Although much was feared about the concentration of risk in CCPs, the strains and imbalances of the market and regulatory structures manifested themselves in the repo market from September 2019, especially in the US.

Then came the sudden economic and financial freefall which started in March 2020 after a decade of growth. It is a very stern test of the sufficiency, or otherwise, of the microprudential and macroprudential regulations and monetary instruments developed since the GFC. As in the GFC, money-market funds are among the very first to be hit by severe liquidity strains – but for reasons affecting the other side of their balance sheets. In the US, the SEC has moved swiftly to relax the prohibition of sponsor financing to enable money market funds to meet the large redemptions they face. In Europe, the ability to deploy swing pricing and redemption gates may be used, despite the stigma which may be attached to these measures.

The current crisis will also test the appropriateness of the CNAV and VNAV bifurcation of money market funds. So will the promise of liquidity underlying the growth of ETFs. ETF redemptions may be met with payment in kind, especially in credit, to the surprise of some subscribers. As in 2008, the CP market has seized, which is only natural when a wave of delinquencies is expected. The rise of counterparty risk in most of the economy, and accompanying credit downgrades, will stress fixed income funds, trigger loan covenants and increase margin calls. Banks would naturally be under critical stress were it not for the unlimited support of Central Banks, together with regulatory relaxation embedded in CRD IV – a relaxation that the European Union singularly failed to provide for under Solvency 2.

> *The economic freefall is a very stern test of financial regulations.*

More generally, the sudden stop of large swathes of the economy is likely to strain most markets and market participants, including corporates and governments. The least and last affected among financials are likely to be mainstream insurers. Provided they haven't invested unduly in riskier assets, nor taken aberrant underwriting risks (such as guaranteed investment returns or failed to exclude pandemic in their casualty coverage), mainstream insurers should weather the economic and financial storm, as long as governments do not default, notwithstanding broken measures of their solvency ratios based on point-in-time volatilities that say precious little about their financial standing. Should that be the case, as it was during the GFC, this would prove once again the futility of EIOPA and IAIS insistence to try to develop for and impose on the insurance sector an additional layer of systemic regulatory burden. ●

Bjørn Sibbern

President, European Markets, Nasdaq

Cooperation Prevails – Through and Beyond Covid-19

While no one with certainty can say when the human and financial impacts caused by the Covid-19 outbreak will start to subdue, it is my sincere belief, and also hope, that we will begin looking toward and discussing our future rather than contemplating our present questions. The financial community across Europe and the world plays an important role in not just mitigating the effects of the current economic downturn – but also when helping the global economy to get back on its feet. And it will get there faster if we work together.

Right now, in the midst of the Covid-19 outbreak, the focus of the financial industry, governments and others are on making sure we are taking immediate necessary actions. For Nasdaq, this means to ensure the health and safety of our employees and also that the markets that we operate stay functional in order to enable investors to get in and out of positions and to provide companies with a possibility to continue raising capital.

Exchanges will also play a key role in the efforts to recover from the effects of Covid-19, as market places but also as hubs for cooperation through our roles as integrated parts of the wider financial and societal ecosystem.

Exchanges are able to facilitate recapitalizing companies through financial markets. More than ever, market financing should be envisaged as a possible tool to solving financing issues. In the Nordics, where Nasdaq operates most of its European markets, many listed small- and medium sized enterprises (SMEs) have been funded through financial markets and have from this way of financing obtained benefits allowing them to grow. And growth is more important than ever before.

Post-Covid-19, we hope that the visibility we support public companies with will allow them to recruit back talent, refinance themselves and in the longer term continue to grow and create more jobs. It is important that the opportunities that exchanges create are fully leveraged to help remedy the adverse consequences of the Covid-19 crisis.

Exchanges can also support recovery by providing financing for initiatives more directly linked to healing the effects of the virus outbreak, for example Covid-19 recovery bonds aimed at recovering the immediate impact of the pandemic on economies and societies. Even in the current crisis, companies involved in Covid-19 research or hospital supplies may need extra capital.

We expect to also continue working together with governments and regulators to discuss actions to help economies recover. States are crucial to provide support for companies and employees affected by the Covid-19 outbreak, and we would also welcome a discussion on changes to the regulatory landscape that supervises the financial markets to remove barriers for recovery and capital raising for primarily SMEs. The unbundling of research and trading that was part of MiFID II and that has led to decreased visibility for smaller companies is one example of such hurdles.

This unprecedented moment in our history could also see already ongoing trends and shifts in our society accelerate. One such trend is sustainability. Today often discussed in terms of the environment, the social and governmental aspects of sustainability may have an enormous impact on companies' ability to recover and better support the societies in which they operate.

At Nasdaq, we try to do our part by enabling and encouraging companies and investors to make more sustainable choices by, for example, supporting sustainability reporting and data distribution, and also introduce initiatives to increase transparency and comparability between different investment products.

As we one day look back on this time in our history, I hope that we at least are able to say that we did our very best to come out of it as well as possible, and that we did it by working together toward a better and more sustainable future. ●

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.

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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. ●