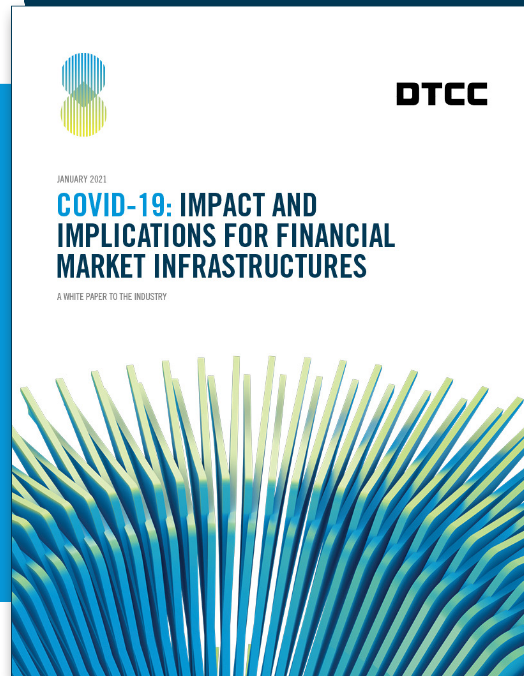
COVID-19 & FMIs

DTCC

COVID-19: IMPACT AND IMPLICATIONS FOR FINANCIAL MARKET INFRASTRUCTURES

DTCC's white paper shares our insights through the lens of FMIs to provide perspectives that are both different and pertinent, yet somewhat underreported, against the wealth of analyses that have already been published on this topic.


DTCC

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COVID-19: IMPACT AND IMPLICATIONS FOR FINANCIAL MARKET INFRASTRUCTURES

A WHITE PAPER TO THE INDUSTRY

WHITE PAPER HIGHLIGHTS

Click the sections below for an overview of this paper's key topics.

1. INITIAL IMPACTS ON FINANCIAL MARKETS AND SECURITIES PROCESSING
2. LONGER-TERM IMPACTS AND CHALLENGES
3. RISK MANAGEMENT IMPLICATIONS

"The market stress that materialized in March 2020 was a real-life test of FMI risk models and also provided valuable data with respect to margin procyclicality, a topic that continues to be in focus. As COVID-19 continues to run its course, FMIs should constantly reassess clearing members' available liquidity, which can change quickly in times of stress.

While these are just a few key implications emerging from the current pandemic, we are looking forward to continuing an ongoing dialogue with our regulators, our peers and our clients on additional ways to better prepare for further challenges.

We intend to engage with our clients, policymakers and other key stakeholders in the coming months to raise awareness of the topic, solicit feedback and guidance and foster collaboration and information sharing. We hope you take time to read the paper, and we look forward to your feedback."

ANDREW GRAY
MANAGING DIRECTOR,
DTCC GROUP CHIEF RISK OFFICER

INITIAL IMPACTS ON FINANCIAL MARKETS AND SECURITIES PROCESSING

SPIKE IN VOLATILITY & TRADING ACTIVITY

Global volatility led to surging trading volumes and triggered several market-wide circuit breakers.

SUBSTANTIAL MARGIN INCREASES

During the initial stages of the pandemic, margins rose substantially due to the combined effect of higher trade volumes and elevated volatility.

FMIs PERFORMED AS EXPECTED

While a global surge in trade volumes and margin calls tested market participants and FMIs alike, the risk management frameworks, systems, and margin models of CCPs around the world generally worked as intended and reacted appropriately to surging levels of volatility.

CYBER SECURITY CONSIDERATIONS

In response to the pandemic, many financial institutions were forced to make significant changes to their cyber security practices in a very short period of time.

PHYSICAL SECURITIES PROCESSING WAS DISRUPTED

The pandemic illustrated the ongoing operational risks associated with physical securities processing and highlighted the need to continue long-standing industry-wide efforts to fully dematerialize the U.S. financial markets.

LONGER-TERM IMPACTS AND CHALLENGES

MACROECONOMIC ENVIRONMENT

The COVID-19 pandemic has caused the most significant macroeconomic shock since World War II. While massive government stimulus and other public sector initiatives have provided considerable short-term support, the further evolution of the economic recovery remains highly unpredictable.

SYSTEMIC VULNERABILITIES

High levels of global indebtedness and elevated asset valuations are two examples of systemic vulnerabilities that were highlighted before the COVID-19 outbreak and that may be exacerbated due to the pandemic.

REGULATORY & LEGISLATIVE

Regulatory and legislative agendas have shifted in response to the pandemic. As regulators and legislators continue to monitor developments, they make take additional steps to support and maintain financial stability.

FINANCIAL SERVICES INDUSTRY

Many financial services firms are expected to reprioritize their project pipeline and even change their operating models, which may also impact concentration and interconnectedness in the financial ecosystem.

RISK MANAGEMENT IMPLICATIONS

PANDEMIC IS REAL-LIFE STRESS TEST

The impact of the pandemic on markets was a real-life stress test for FMI risk models. It illustrated the importance of having sufficient model performance monitoring, strategies and governance to timely identify and address emerging model risk issues.

SECTOR-SPECIFIC APPROACH TO MANAGING CREDIT RISK

Credit risk assessments need to include a sector-specific lens, with a focus on firms with the greatest concentration of risk.

ONGOING REASSESSMENT OF MEMBERS' LIQUIDITY

FMIs need to ensure their clearing members can meet margin calls at all times, given that the availability of liquidity or funding can quickly evaporate in a crisis.

MARGIN PROCYCLICALITY

FMIs can mitigate the risks associated with excessive margin procyclicality by developing tools that allow their members to better understand their risk models and accurately project margin requirement increases under a wide range of circumstances.

NEW OPERATIONAL RISKS

An extended WFH environment and the development of return to office plans that may include a change in staffing models creates the need to develop and implement new capabilities that allow for effective identification, monitoring and managing of the associated risks.