CIBC MELLON

How Canada's financial system handled the toughest days of market volatility

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CAN YOU WALK US THROUGH THE RESPONSE TO COVID-19 AS IT UNFOLDED IN CANADA?

The Bank of Canada (BoC) response to Covid-19 – applying the lessons learned from the 2008 financial downturn – was fast and comprehensive.

The BoC provided several rate cuts and also launched a series of large-scale asset purchase programs. The result of the support – alongside the extensive measures in the wider economy enacted by the Canadian government – was that Canada's financial system remained stable and continued to function.

When the pandemic struck, a flight to safety saw big spikes in flow to cash and away from equities. Ultimately a lot of clients were confident in the strength and resilience of Canada's economy, meaning that across the board – both government bonds and other securities – we saw high flows. I think this was also an expression of confidence in the Canadian financial system, in part due to how we had handled the global financial downturn of 2008.

WHAT IMPACT DID THESE SUDDEN FLOWS HAVE ON INVESTMENT OPERATIONS?

It's very important to stress at this point that, throughout the toughest days and weeks, we saw no disruptions to investor payments or any other investor activities.

Throughout the most challenging weeks, we saw showcases of this resilience everywhere. Since June, we have crossed three month-ends and today we are working completely normally under these circumstances, and the speed and effectiveness of this transition is a testament to our strong financial services sector.

The market correction that followed from Covid-19 saw tremendous volatility and extremely high volumes of investment operations during the peak period in March. To bring it into context, this was at a time of flux as financial institutions were adapting and expanding remote work environments and resiliency models while also handling an unusually high spike in volume. The magnitude of the flows – everything was up 40 to 50 per cent in that period – including in securities lending, meant that failures created a cascade effect, rapidly creating a big backlog of exception events. We particularly saw significant outflows from investors in March, leading to a ripple effect. CSDs and other industry entities around the world required continuous timeline extensions to cope with the volumes. It took two or three weeks before the market found a stable point, volatility fell and there was a return to something approaching normalcy.

WHAT SPECIFIC CHALLENGES DID YOU FACE AND HOW DID YOU RESPOND?

During the period of particularly high volatility it became clear that our existing thresholds for exception reviews were not applicable. In the early days, we spent a huge amount of time maintaining bond tolerance built for fluctuations of around 2 per cent in a market that was shifting as much as 10 per cent. We soon realized that to react quicker, we would need a new monitoring tool.

While Canada's CSD continued to operate, the concentration of source dependencies created a backlog of settlements, thanks to what was, in effect, a perfect storm when it came to fund accounting: an exceptionally high volume of trading and a very high volume of pricing exceptions at end of day when it came to the process of finalizing client fund NAVs. Add to that the challenge of pricing vendors having vastly different models in place, this led to discrepancies and variances in pricing.

Our teams stepped up to the challenge – we were responsive and moved decisively, engaging frequently with clients on fair value reviews and sharing business updates on our operations and industry.

HOW DID YOU ADDRESS THE SPECIFIC FUND ACCOUNTING CHALLENGE?

Based on the volumes of trading and exceptions and the resulting time crunch, it was clear that this would take longer than usual, creating delays in when we could expect to receive prices for bond or other derivative-type securities.

These delays obviously put us under a huge time pressure to apply the correct pricing to our clients' funds. Clearly, it was essential that we take the time for a thorough application of our due diligence checks to support accurate pricing, and our team worked with great commitment to confirm that all the necessary controls were completed before the NAVs were released at end of day.

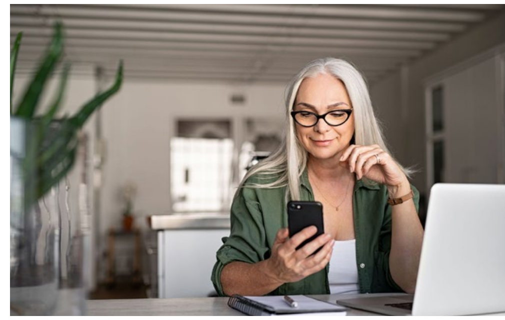
But it was also very important to manage our clients' expectations about when the work would be complete – as well as to determine fair values and the right price sources - and this meant constant communication with them throughout the period.

HOW DID YOU ADDRESS THE REQUIREMENT FOR EMPLOYEES TO WORK FROM HOME?

Everyone in the market – our clients, dealers, asset managers, infrastructure providers – was facing operational environments that were a long way from normal and therefore had to shift into resilience mode. Some fared better than others.

We had a particular advantage conferred by the fact that we had digitized our operations a few years ago, which was already providing a degree of transparency and flexibility and it allowed us to be remote-ready. Facilitated by this, I'm hugely proud that we achieved effectively 90 per cent working remotely within two weeks (by late March), and 98 per cent of our workforce working from home by April.

I think an organization like ours succeeds when it is aligned from the top to the bottom and this was particularly visible here. What made it possible for us to complete this shift so quickly and with so little disruption was that we have everyone's buy-in. It is a testament that we were able to achieve the shift while maintaining – and even deepening – the key elements of our company's culture: openness, transparency, communicativeness and mutual respect.



PERCENTAGE OF EMPLOYEES WORKING REMOTELY DURING COVID-19

90%
WITHIN TWO WEEKS (BY LATE MARCH)

98%
BY APRIL

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Clearly this was not a scenario that anyone wanted, but one result has been an enhanced flexibility with which our teams can service our clients. Not only did they show themselves able to provide reliable NAVs in this high volatility environment, but during the period, we successfully took on new clients: our teams showed that they were able to support clients on fund launches. I know that what we have created in terms of the additional flexibility we now provide to our workforce and to our clients means that we are providing a better servicing model across a wide range of key products.

HOW ARE YOU APPROACHING A FUTURE MOVE BACK TO CENTRALIZED WORKING?

Based on the research we have done, it seems we may not be in the position of sufficiently mitigating the risk of Covid-19 until 2022. As we consider a degree of return to the office in the months ahead, it is clear that the first stages of this will progress very slowly.

The worst outcome for our employees – and for our clients – would be to rush back too quickly. Certainly a return to a centralized office can be achieved operationally, but we need to be particularly cognizant of the mental and emotional stress on employees. We all know how much pressure we have faced in our work while managing these high volumes and extreme volatility – let alone in our personal lives, such as the added pressure of having children at home rather than at school.

Our awareness of the health risk – both for employees and for clients – is clearly paramount for how we consider our approach in the coming months. At the time of the outbreak when we relocated our workforce to home-based working, we were questioned about whether we were moving too early. In retrospect both employees and clients appreciate hugely that we did.

Accordingly, the initial stages of our staggered return have been on an opt-in basis for those roles associated with specific requirements or products for which location in a physical office is particularly beneficial. At the moment, we have seen our number of employees working at the office remain extremely low.

I think that's very important as we consider the future, in particular the risk of the outbreak of a second wave of infections – a risk of which we are all very aware. To that end, we could once again see major market swings, which we are well positioned to support. We have demonstrated a clear, well-implemented technology solution that helped our company produce outstanding client servicing at extremely high volumes, which helps to make certain that we have an effective workflow. This technology solution, in combination with being supported by remote operating processes that can handle any increase in volumes, is a vital source of confidence for us and our clients.

WHAT DOES THE COVID-19 OUTBREAK MEAN FOR THE FUTURE OF WORK IN YOUR SECTOR?

When I talk about planning for our return, in effect we are planning for a return to a different office. It is, if you like, the office of the future, in which the lessons we learned are assimilated to the benefit of the future operating environment and the satisfaction of our employees.

One key feature is that we will probably never have more than 50 to 70 per cent of employees in the office at any one time, thanks to flexible work arrangements. Perhaps the largest benefit to this is that the office of the future may not be as tied to the corporate headquarters, with an employee population defined by their proximity to that location.

Take away this dependence of the office on a single physical location and you create a new scope for a more diverse and talented workforce. Consider the province of Quebec, which contains a large number of French speakers who would be hard to find in other locations. Now we can remotely onboard more people – in addition to maintaining an office in Montreal, Quebec – to expand our French-speaking service capabilities while not being fully dependent on a single location.

Then consider Vancouver, British Columbia on the west coast of Canada, far from us here in Toronto, Ontario to the east. It is one of the most expensive cities in the world, one reason that we have not established operations there, despite the time difference – three hours behind Toronto – that creates significant benefits in servicing our clients from Western Canada, as well as staggering our employees' workload. In the office of the future, a workforce based in and around Vancouver will let us balance out our employee activity around the clock by spreading a workforce across the multiple locations.

We are beginning to experience the office of the future right now as our company is growing in Winnipeg, Manitoba. Looking ahead to the post-pandemic work environment, this new location will serve an important purpose, amid flexible remote work arrangements, as a space for colleagues to meet to collaborate and engage with clients.

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