



# **FX's role in support of cross-border investment and importance of risk mitigation to China's financial system**

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# The role of FX in support of cross-border investments

## Financial market integration builds on cross-border flows

- Requires payment infrastructures supporting cross-border transactions

## IMF and the Working Group of the Capital Markets Consultative Group (CMCG) highlighted factors determining investment in a country

- Availability of efficient infrastructure – particularly transportation, telecommunications and financial services
- A transparent and enforceable legal framework, and rule of law

## China has made a significant commitment to internationalize and integrate its financial markets

- One Belt, One Road (OBOR) and Asian Infrastructure Investment Bank (AIIB)
- Stock Connects (Shanghai-Hong Kong and Shenzhen-Hong Kong)
- Bond Connect
- CIPS

# Key risks in FX

Market risk

Pre-settlement risk (replacement cost risk)

Principal risk (also known as settlement risk and Herstatt risk)

Legal risk

Liquidity risk

Operational risk

# Regulatory response to mitigating FX related risks



## FX related risks

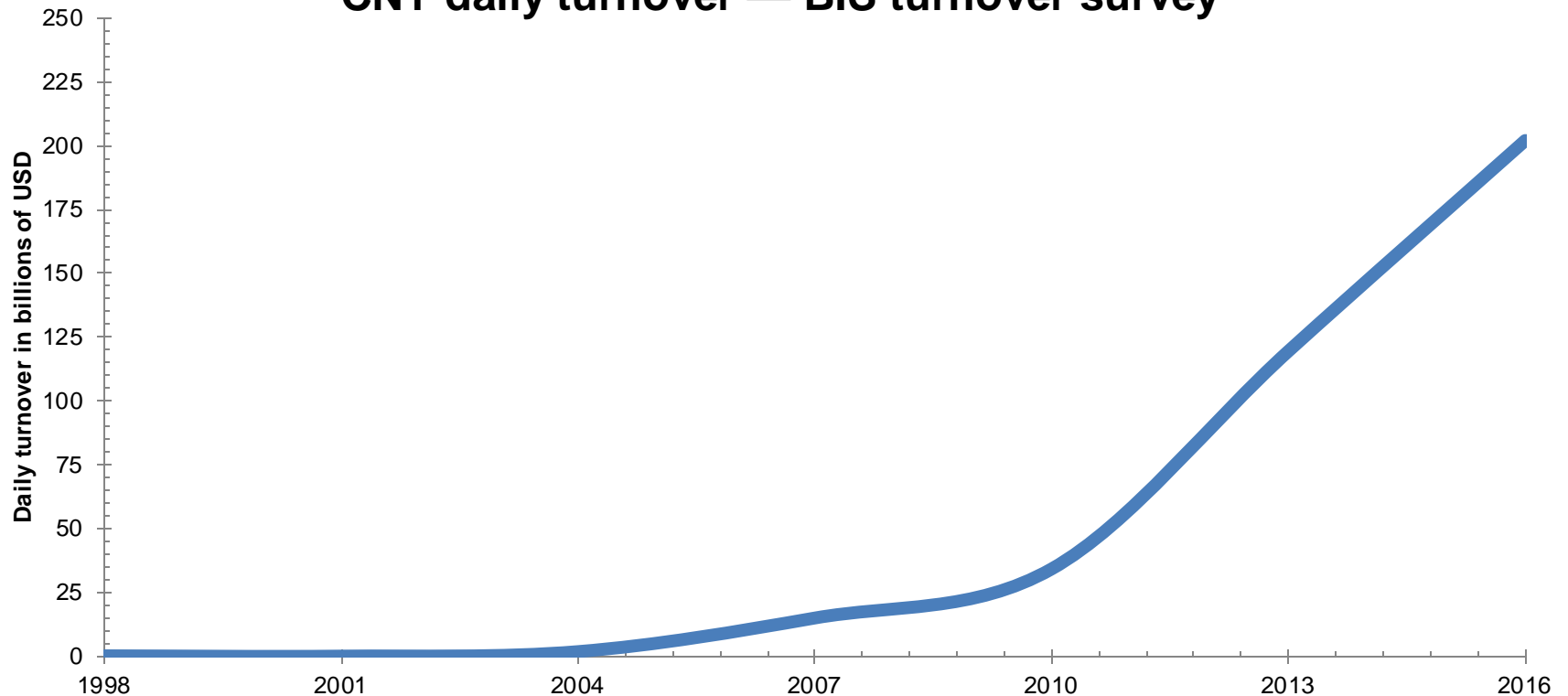
- Some can be mitigated unilaterally or bilaterally
- But some must rely on multilateral solutions involving multiple market participants and be supported by regulatory cooperation mechanisms and international coordination

## International and multilateral coordination structures

- Allsopp report in 1996
  - Industry groups should develop the FX settlement risk-reducing multi-currency services
  - Central banks should promote the prompt improvement in the FX settlement risk reduction in the private sector
- Basel Committee on Banking Supervision (BCBS) and its “Supervisory guidance for managing risks associated with the settlement of foreign exchange transactions”
  - Promote the use of PvP arrangements through Financial Market Infrastructures

# The importance of CNY trading is growing

## CNY daily turnover — BIS turnover survey



Source: Triennial Central Bank Survey, Global foreign exchange market turnover in 2016.

# Importance of FX settlement risk mitigation to China

China's risk profile is increasing as it continues the path to global financial integration

## Importance of payment infrastructures supporting China's financial markets and the renminbi

- Development of CIPS and a network of renminbi clearing bank across major trade and financial hubs in the world, including New York

## Common standards in multilateral global payment infrastructures address differences in

- RTGS systems, operational and messaging standards
- Legal systems

# Final thoughts

**No single jurisdiction can solve settlement risk on its own because addressing settlement risk requires cross-border collaboration**

- CIPS and clearing banks define a renminbi-specific infrastructure facilitating cross-border payments
- Residual settlement risk remains because of the absence of PvP for the countercurrency (usually USD)

**The renminbi is the only currency included in the SDR that currently is not eligible for PvP settlement through a global settlement system in central bank funds**

- The BIS's December 2016 Quarterly Review emphasized that because market participants are not being able to settle renminbi payments PvP
- It may act as one of the practical constraints in terms of further and broader international acceptance of the renminbi