

14 April 2003

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The Financial System and Major Operational Disruption  
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Dear Mr Lambeth

## **THE FINANCIAL SYSTEM AND MAJOR OPERATIONAL DISRUPTION**

This letter and attachment comprise the London Stock Exchange's response to HM Treasury's Green Paper on the desirability of legislation to cater for major operational disruption in the financial services industry.

Business continuity is becoming increasingly important to protect the overall resilience of financial services. Contingency planning continues to develop across the industry in line with the changing level of threat and risk. The London Stock Exchange therefore welcomes this consultation by HM Treasury which we feel highlights a number of important issues requiring further consultation and consideration as described below.

### **London Stock Exchange response to key elements of Green Paper**

The Green Paper proposes the introduction of new government powers to *direct* or *suspend* financial market operations to supplement market-based approaches for promoting order in the financial system during periods of severe disruption. The Green Paper proposes powers of direction for the closure of financial markets and suspension of existing contractual obligations and further describes the key advantages of such powers as providing a breathing space to address operational problems. We understand that these powers would not be used in the event of financial crisis but would be used only in the event of severe operational disruption from a natural or man-made disaster. Any use of these powers would, whenever possible, be undertaken following consultation by the authorities with the private sector.

On this basis, the Exchange is broadly supportive of the proposals outlined in the paper. We believe that suspension of obligations would bring welcome temporary relief to parties unable to fulfil contractual obligations and any authorised direction to close or suspend markets would enhance clarity, certainty and legitimacy across markets in times of crisis.

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The Green Paper recognises a number of potential disadvantages and areas requiring further clarification with the proposals. In particular, the international and complex nature of financial markets potentially makes the introduction of UK-specific legislation difficult to implement successfully without corresponding and complementary measures in other jurisdictions. The Green Paper notes that not all contracts in the UK are subject to UK law and that not all contracts subject to UK law are in the UK. It therefore discusses the merits of a geographical 'location' of contract. We believe there would be difficulties interpreting and enforcing legislation based on location and would strongly recommend that legislation is applied only to contracts subject to UK law. We feel further consultation and analysis is required to ensure that the international considerations are fully and properly addressed prior to the introduction of any legislation in the UK.

We have responded to each of the consultation questions in the attachment and would summarise some other key points in response to this consultation as follows:

#### When the powers should be used

The consultation states that the powers would not be used in the event of a financial crisis, but only in the event of severe operational disruption from a natural or man-made disaster. There will still be a subjective element to any decision making and we anticipate the Government could come under pressure from certain parts of the industry to use the powers to deal with events that would not universally be viewed as 'major operational disruptions'.

In order to introduce more certainty as to the circumstances in which the powers might be used, it would be helpful to define explicitly what would constitute a 'major operational disruption'. We would also suggest making invocation of powers dependent on a specific request from either a recognised body or the Financial Services Authority.

#### Extent of the powers

Whilst the nature of contingency planning means that it is impossible to predict precise circumstances, we would encourage HM Treasury to draft secondary legislation or guidance for consultation to include suspension or direction scenarios that might be envisaged and to use and share these scenarios to assist in wider disaster planning activities.

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#### Unilateral action by recognised bodies

It is important that recognised bodies should continue their own operations, in line with the recognition requirements governing RIE or RCH status, and not be inhibited from taking unilateral action ahead of (or pending) the implementation of direction powers during any operational disruption.

#### **Wider issues for consideration**

In addition to our comments on the proposals outlined in the Green Paper, we believe there are a number of other issues that require further consideration which, together with the Green Paper proposals and the work of the Tripartite Standing Committee, would provide a more cohesive UK financial services response to the continued threat of disruption through terrorist activity or any other disaster.

#### Co-ordination of business continuity initiatives

Companies across the financial industry are increasingly aware of operational risks and are generally improving business resilience through better contingency planning. Partly as a result of the long-standing threat of terrorism in London, unilateral business continuity plans for many companies are relatively sophisticated. The increased threat and anticipated nature of widespread disruption potentially caused by international terrorism (particularly since 11 September 2001) has heightened industry focus on this issue and has driven increased bilateral and multilateral planning.

Industry planning is already being progressed on a number of fronts. The Tripartite Standing Committee has initiated a sub-group for disaster recovery planning. Under the auspices of this sub-group there are various industry specific fora reviewing business continuity arrangements and associated improvements relevant to their market sectors. These groups include MERLIN (exchanges and clearing houses), SIBCMG (key market participants) and various trade associations and committees (such as LIBA, ISDA, TBMA). These fora are helping to raise awareness of business continuity and are providing a vehicle for developing contingency plans beyond unilateral approaches.

However, our experience indicates that there is a general desire within the financial community for a more focused, authoritative leadership role to co-ordinate these various initiatives and to ensure industry thinking is applied comprehensively across all components of the infrastructure. This would enable industry best practice standards to be developed and to be applied more widely and would encourage improvements to both unilateral contingency plans and effective integration and testing of plans across multiple interfaces within the industry.

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Clearly, business continuity arrangements need to be defined and implemented as appropriate to individual businesses but we believe there is a good case for a central body to take a more prominent role in determining best industry standards, co-ordinating the multiple initiatives already in progress and influencing the approach taken at individual company or market sector level. We feel that the Bank of England is best placed to provide the required level of informed, industry-wide leadership. Such an arrangement would improve the general standard of review and advice on good practice across the full range of market participants and would provide a focal point to lead new initiatives and address matters of wider concern such as the resilience and recoverability of utility and telecommunications services.

#### Ability to communicate in a crisis

It is widely recognised that the most likely failures in reacting to significant events will occur in the “golden hour” immediately following any incident. The key operational impact to inhibit effective business recovery is likely to be derived from an inability to communicate either internally, with staff or satellite offices, or externally with other organisations and the authorities. We would therefore suggest that, as part of the increased role to be played as proposed above, HM Treasury should consider delegating a central communications function to the Bank of England, which would be capable of being accessed by infrastructure providers and key market participants in the event of any severe operational disruption. Whilst we understand the thinking behind HM Treasury’s wish to focus resource on proposing solutions and that it would prefer individual companies to await contact from the relevant authorities, we do not feel this is appropriate. It will be critical for industry participants to understand what current action is being taken by the relevant authorities and to be in a position to pass on any information that might influence the decision-making process. It is unrealistic and undesirable to expect organisations affected either directly or indirectly by operational disruption to wait to be contacted by the authorities before applying their own operational recovery plans. It is imperative that early, clear and co-ordinated instructions are provided across the affected markets to ensure contingency actions are properly synchronised.

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In summary, therefore, we would broadly support the proposals outlined in HM Treasury's Green Paper. We recommend further action on the additional issues outlined above in order to enhance current arrangements and to provide a coherent and co-ordinated UK response to the increasing demand for efficient resilience across the financial system.

Please let me know if you require any further information or explanation of the issues outlined above or contained in the attachment.

Yours sincerely

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Enclosure