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THE FINANCIAL SYSTEM AND MAJOR OPERATIONAL DISRUPTION: WORK DONE BY THE FINANCIAL AUTHORITIES TO PROMOTE THE RESILIENCE OF THE UK FINANCIAL SECTOR

THE ROLE OF THE AUTHORITIES

The UK's financial authorities are HM Treasury, the Bank of England and the Financial Services Authority. They work together, under a Memorandum of Understanding ([Financial Stability: Memorandum of Understanding](#)), towards the common objective of financial stability. As set out in that MoU, there is a tripartite Standing Committee on financial stability, comprising senior representatives of the three authorities. This meets monthly to consider issues relevant to financial stability.

Following the events of September 11th 2001, the Standing Committee set up a sub-group on resilience and contingency planning to co-ordinate the work being done by the authorities and by other bodies in this area. Recognising that the primary responsibility for contingency arrangements lies with the private sector, the authorities' aim was to share information and facilitate work to address any overlaps or gaps.

ISSUES

The authorities identified a number of issues to address on financial sector contingency planning, which fall into the following broad areas: effective co-ordination; improving communications (including about the authorities' own plans); the adequacy of firms' contingency arrangements, and resilience of the physical infrastructure including telecoms.

Co-ordination

Where possible, existing fora were asked to address the issues on which the sub-group identified a need for further work. However, in some cases the sub-group took the initiative to set up new groups to take work forward. In general, the sub-group has sought to bring together relevant parties within both sectors to the extent that this is necessary in order to address particular issues effectively.

The authorities also set up a central point of information about work on contingency and business continuity planning of relevance to the UK financial sector, by launching on 29 April 2002 a joint website (www.financialsectorcontinuity.gov.uk). The website gives an overview of the main initiatives and organisations involved.

Working with the private sector

The sub-group works with a wide range of bodies within the three key areas of exchange-traded markets, over-the-counter (OTC) markets and financial infrastructure.

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Exchange-traded markets allow member firms to trade instrument such as equities and derivatives via a trading platform, whether physical or electronic, and are generally regulated by the FSA. Examples include the London Stock Exchange and the International Petroleum Exchange. In these markets, there was some pre-existing machinery for determining how trading and settlement should be adapted in response to disruption. Therefore, the sub-group saw the role of the financial authorities in relation to these markets as establishing what contingency planning was in place, and then co-ordinating and communicating plans as necessary. The FSA has set up a sub-group of the Markets and Exchanges Regulatory Liaison Information Network (MERLIN), which brings together recognised exchanges, clearing houses, and their supervisors, to examine and co-ordinate business continuity planning issues. This sub-group has, for example, looked at the geographical distribution of primary and back-up sites to assess concentration risk, has exchanged emergency contact details and has carried out walk-through exercises.

OTC markets have no physical exchanges, so they have no central body that might direct their response to a crisis. The following groups, chaired by the Bank of England, have taken on a co-ordination role in respect of contingency planning:-

- the Foreign Exchange Joint Standing Committee, covering participants in the London foreign exchange and foreign currency money markets, which has created an operations sub-group to focus on technical operational issues including contingency planning;
- the Money Market Liaison Group, which performs the same role in the sterling money markets;
- the Stock Lending and Repo Committee, covering the stock lending and repo markets.

In addition, there are a number of trade associations for participants in OTC markets, which would have an important role in co-ordinating their response to a disruptive event – for example the International Swaps and Derivatives Association and The Bond Market Association. The financial authorities also maintain close liaison with other groups of market participants such as the gilt-edged market makers.

The financial infrastructure consists of the payment, clearing and settlement systems. Payment systems carry out transactions for both retail and wholesale markets. Clearing and settlement relate to the securities and derivatives markets. For clearing houses, and settlement systems, work on contingency planning is co-ordinated through the MERLIN sub-group as noted above. For payment systems, the Bank is the overseer and works with individual systems and the Association of Payment Clearing Services (APACS), which acts as the co-ordinating body for a number of the major systems. All the payment, clearing and settlement systems have their own contingency plans, including mechanisms to communicate in a crisis with member firms and the authorities.

The sub-group also liaises with other trade associations, such as the London Investment Banking Association (LIBA) and the British Bankers Association (BBA), The sub-group

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also liaises with other trade associations, such as the London Investment Banking Association (LIBA) and the British Bankers Association, as well as industry groups established specifically to address contingency issues, notably the Securities Industry Business Continuity Management Group. The BBA has issued a Guide to Business Continuity Management for financial services.

Working with the public sector

Within the wider public sector, the work of the sub-group is overseen by the Ministerial Group on Consequence Management and Resilience, which is a Cabinet Committee chaired by the Home Secretary that handles the government's strategic planning for dealing with the consequences of terrorist attacks and other disruptive incidents. The Civil Contingencies Secretariat (CCS) in the Cabinet Office supports this work.

The Ministerial Group on Consequence Management and Resilience also oversees a sub-committee dedicated to London resilience, which is of particular relevance to the financial sector. This comprises representatives from the emergency services, utilities, transport, local authorities and the NHS, and is chaired by the Minister for Local Government and the Regions. Both the Treasury and the Bank are members of this sub-committee. It established the London Resilience Team (LRT), which is responsible for assessing the level of resilience of the capital's infrastructure and for co-ordinating initiatives to maintain and develop that resilience. The LRT has, for example, set up a sub-group that has agreed plans for dealing with the impact of transport disruption.

The Standing Committee's sub-group also liaises with a number of other authorities such as the police and the emergency services. Given their particular relevance to the financial sector, the sub-group also maintains contacts with bodies such as the Corporation of London and the Canary Wharf Management Group. These wider contacts, together with those which are maintained with CCS and other parts of central government that have key responsibilities for dealing with actual and potential major disruption, provide vital channels of information and communication in case of a major incident affecting the financial sector.

Effective Communications

A basic requirement is that the authorities hold accurate and up-to-date contacts information. This has been set up for the major firms and financial infrastructure providers in the UK, and work is progressing on achieving a similar quality of contacts information for key personnel in OTC markets.

Effective communication also requires a knowledge of who does what. To this end, the financial authorities have developed and publicised a robust framework to enable the Standing Committee to manage the financial sector effects of a major disruptive event. This framework covers:

- information-gathering

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- assessment of the situation
- decision-taking
- action and monitoring
- dissemination of decisions and information.

The framework is designed to facilitate a response whatever the precise nature of the incident that triggers its use, and is flexible enough to be used even if one or more of the authorities themselves should be severely affected. Given the crucial importance of gathering information on the situation speedily, to inform the decisions that will need to be taken, the key contacts details for the private and public sectors are kept up to date so that key players can be contacted at all times.

The authorities have recently taken steps to test the robustness and effectiveness of the framework by conducting, with the active participation of private sector firms, a scenario test of the relevant procedures aimed at simulating the possible repercussions on the financial system of a disruptive event.

Firms' contingency arrangements

As the regulator, the FSA works on their contingency planning with individual firms. It has been engaged on a substantial programme of work in this area since 2001, guided by a set of high-level regulatory principles for financial sector business continuity which can be summarised as follows:-

- primary responsibility rests with firms' senior management, who should be able to demonstrate that the relevant issues and risks have been identified and addressed;
- the FSA will not take a prescriptive approach but will facilitate market solutions to issues and risks wherever possible;
- there will be ongoing dialogue with firms' management about their continuity arrangements, with a frequency and intensiveness determined by the FSA's judgement of the potential impact on consumers' interests and on the financial system of disruption to a firm's activities;
- there should be sufficient information and transparency about the facilities offered by external providers of business continuity services for firms to be able to make sound judgements about the likely adequacy of their back-up facilities;
- the FSA will focus in particular on the adequacy of contingency arrangements in the event of potentially systemic disturbance, with the ability of the financial system as a whole to continue to operate as its the principal concern.

The highlights of the work done to date are:-

- a Working Paper on Business Continuity Management (BCM) was issued in April 2002, exploring the issues without offering formal guidance or formally seeking views;

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- following on from this, the FSA reviewed BCM practice at twelve major financial groups. The major purpose of the review was to establish the preparedness of firms for major disruption but it also identified examples of good practice and included a BCM matrix in the report of the review published in September 2002;
- in November 2002, the FSA followed up that review with a letter to the CEOs of major firms asking them to benchmark their firm's contingency plans against the BCM matrix and report the outcome back to the FSA. The responses have been reviewed and are being followed up as part of the FSA's ongoing supervision of each firm;
- as part of a formal consultation on the management of operational risk, in its paper CP142: "Operational risk systems and controls," issued on 30 July 2002, the FSA included a section on BCM together with some draft BCM guidance. A summary of responses received, and the FSA's feedback on them, was provided in a policy statement issued on 24 March 2003. As a result, revised draft guidance on BCM is due to be published in the second half of 2003 in time for its implementation in 2004;
- steps have been taken to increase the amount of emergency contact information which the FSA holds on firms and to ensure that this is regularly updated without creating excessive demands on firms. A database of 24 hour contact details for key personnel at the major firms has been compiled and an electronic platform set up to prompt updating, so that compliance staff in firms automatically receive updating requests and have access enabling them to update the database directly. The system includes an automatic request to confirm updated details are correct.

Physical infrastructure

The London Resilience Team leads work on assessing the level of resilience of the capital's infrastructure and co-ordinating initiatives to maintain and develop that resilience. In addition, many issues of resilience in connection with basic infrastructure such as electricity supply are best discussed directly by firms with the relevant utility provider. However, the financial authorities identified a need to take a different approach to the telecoms infrastructure in the financial sector, given both its critical importance to the functioning of financial markets and the interdependencies between telecoms suppliers and firms.

The authorities have therefore established a group of the financial and telecoms authorities and service providers, chaired by the Treasury, to examine the specifics of telecoms infrastructure as it relates to the financial sector. This group is in the process of gathering detailed information as the basis for an analysis of that infrastructure, to be followed by the issue of a report later this year with recommendations for improving financial sector telecoms resilience. The Treasury held a conference on telecoms infrastructure and the work of the telecoms group in this area, in May this year.

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