UK Financial Sector

Market Wide Exercise 2006 Report

FSA

HM TREASURY

BANK OF ENGLAND

Tripartite Deputies' foreword to the Market Wide Exercise Report

This year's Market Wide Exercise was the largest of its kind anywhere in the world. No other country has undertaken such a thorough test of its financial sector's resilience to pandemic influenza. We had two main objectives: firstly, to provide each of the participants with an opportunity to test the effectiveness of their plans for responding to a flu pandemic; and, secondly, to assess whether there were any sector-wide issues which might need to be addressed in order to strengthen the capability of the financial sector to cope with a pandemic.

We are in no doubt that the exercise has been a major success. The post-exercise feedback from participants, summarised in this Report, overwhelmingly confirms that the exercise presented them with a genuine challenge which has already prompted many of them to make adjustments to their business continuity plans. Many organisations are now re-evaluating long standing business continuity strategies and policies in areas such as human resources, third party dependencies, outsourced ancillary services, suppliers, operational priorities and communications. Certainly the Bank of England, HM Treasury and the FSA have learned a great deal both as individual participants and working together as the Tripartite authorities.

In addition, this Report describes a number of sector-wide issues which were identified for further consideration such as the constraints on home working and the pressures a pandemic would exert on the retail financial services sector. We will be taking these and other issues forward with the industry through a series of follow up workshops and seminars.

The unusual nature of the exercise has meant that we depended more than ever on the close partnership between Tripartite and sector this year. We would like to express our deep appreciation and thanks to all those who contributed to its success.

Hector Sants	Jon Cunliffe	John Gieve
Managing Director	Managing Director	Deputy Governor
FSA	HM Treasury	Bank of England

Executive Summary

Introduction

A flu pandemic is currently considered by government to be one of the leading risks to the UK. Thus, for this year's exercise, rather than simulate a sudden impact event (which had already been rehearsed several times), we decided to model the first wave of an influenza pandemic.

The exercise ran for six weeks, from 13 October to 24 November simulating 22 weeks of a pandemic. Seventy organisations from across the financial sector took part including some that extended the exercise to include their overseas offices; in total around 3500 people were involved.

To gauge the success of the exercise we asked all participants to complete a detailed feedback questionnaire. Sixty-three of the seventy participants did so which gives us a high level of confidence in the reliability of the responses.

The key objectives of the exercise were: firstly, to improve the sector's preparedness by providing each of the participants with an opportunity to review, test and update their plans for managing a pandemic threat; and, secondly, to assess whether there were any sector-wide issues which might need to be addressed collectively in order to improve the capability of the financial sector to cope with a pandemic. The feedback from participants has told us unequivocally that these objectives were overwhelmingly met.

High-level Findings

The distinguishing feature of a pandemic is that its main impact is upon the availability of personnel rather than on physical assets. In order to simulate that impact the scenario modelled a gradual increase in the overall level of absenteeism, rising from 15% at the start of the exercise to a peak of 49% at the height of the pandemic – with 'clusters' of absence taking the peak rate up to 60% in some business units.

The main impact of these absence levels was to move firms' personnel management policies to centre stage and subject them to increasing stress as absence levels rose. The issues raised were wide-ranging and forced firms to examine a whole range of their polices including repatriation of staff from overseas locations, quarantine rules, certifying

sickness, use of vaccines, absence due to caring for children (following the closure of schools and crèches), voluntary absence, (the 'fear factor'), bereavement counselling, dealing with financial hardship and the fungibility of staff across business units.

The home working strategies of firms were also tested and many issues surfaced in relation to ensuring effective compliance and control over remote activity, IT security considerations, maintaining IT support capabilities and health and safety issues. The exercise also raised the question of whether the telecoms infrastructure would be able to support large-scale home working for a prolonged period when staff shortages in the telecoms sector progressively eroded maintenance capability.

Across the financial sector as a whole, not surprisingly, the heaviest impact of the pandemic was upon the more labour-intensive parts, notably the provision of customer-facing retail financial services.

The scenario set the distribution of cash across the country as an early challenge for the industry and the Authorities to respond to. Although no overall cash shortage emerged during the exercise, there were bottlenecks. In addition, growing staff shortages forced the high street banks to close an increasing number of branches, which reduced the availability of retail banking services to the public, including ATMs. A clear lesson learned from the exercise is that there would be much to be gained from developing a coordinated strategy for responding to these challenges.

In relation to the use of debit and credit cards some participants were able to extend expiry dates as a workaround to the difficulty of issuing new cards due to postal delays, but not all were able to do this. Again, this is an issue we intend to follow up.

In the wholesale markets, firms responded to the growing shortages of front, middle and back office staff by reducing trading volumes. Proprietary activity was sharply cut back as firms concentrated their resources on fulfilling customer-driven business and maintaining strong liquidity positions. Throughout the scenario virtually all trading was conducted on-site as firms were not comfortable that they would be able to maintain a sufficient level of compliance and control to allow trading from home on a prolonged basis. Financial infrastructure providers produced regular updates on their operational status to the market throughout the exercise. Due to the high level of automation of their processes it appears that only very high levels of absenteeism would threaten their critical functions.

Despite the sharp fall in activity the universal feedback from firms was that it was important to keep the markets open, even if on reduced hours. There was some appetite to establish an additional forum to discuss practical and operational difficulties faced jointly by the banks in relation to credit and liquidity risks.

The scenario appeared to be less testing for insurance sector participants than for the others but they would clearly face a major challenge in processing the surge of claims they would face during a pandemic. In response to that challenge insurance firms considered a number of mechanisms for expediting the payment of retail claims, including, for example, making payments direct to the credit or debit cards of claimants where those cards had been used to pay the premiums. We will explore these and other issues with representatives from the insurance sector.

Next Steps

Individual participants were given an unparalleled opportunity to test thoroughly their plans for responding to a pandemic. Clearly, the main responsibility for embedding the lessons learned lies with them. However, as noted above, there were a number of cross-sector issues which the Tripartite authorities will be taking forward through a series of workshops and seminars with participants in the first part of 2007, details of which will be communicated in the near future.

- Do the various concerns raised by firms about reliance on home-working undermine its potential role in a pandemic?
- What arrangements can be made to make cash distribution more resilient to a pandemic?
- Can improvements be made to coordination between high street banks to enhance the availability of branch networks and ATMs to consumers during a pandemic?
- Can improvements be made to other parts of the retail payments system to make them more robust?
- What would be the most appropriate forum for addressing credit and liquidity issues in the wholesale markets during a pandemic?
- What are the impacts of disruption or closure of exchanges or infrastructure providers?
- In what areas, and when, would firms be seeking regulatory forbearance during a pandemic?

Lastly, although a number of overseas regulatory agencies contributed to scenario planning it was not possible during the exercise to include them in any 'live play'. Clearly, in a real event, close coordination of cross-border regulatory responses would be essential to an effective response to the developing situation. We will, therefore, be discussing with our regulatory counterparts the key issues involved in ensuring cross-border regulatory coordination to keep financial markets operating in a pandemic.