Simulation Exercises

The actual or potential spread of the global financial crisis to our client countries has triggered concerns about the capacity of local authorities to effectively and efficiently handle the resolution of systemically important financial institutions to mitigate the impact of their eventual collapse on the rest of the financial system and on the real economy.

Simulation Exercises have been used for many years in different contexts, such as military “war games”, business strategies, and all sorts of critical situations (natural or man-made disasters, the collapse of power plants or communication networks, medical emergencies, etc.). Not surprisingly, given the current circumstances, financial authorities around the world have become increasingly aware of their potential usefulness in their field.

As one component of the World Bank Group’s response to the global financial crisis, the Financial Crisis Global Expert Team (FC GET), in collaboration with the Financial and Private Sector Development Network’s Financial Systems Department (FPDFS), has developed the internal capacity, leveraged with experienced individual consultants and consulting firms, to deliver Simulation Exercises focused on handling the typical events present in most crises—progressive destabilization of financial institutions of different size, unresponsive management, aggressive press, conflicts of interest, political influences, etc.

What are Simulation Exercises for?

Simulation Exercises are powerful tools to diagnose what is not working in existing crisis-management arrangements (the legal and/or operational framework, information sharing and coordination among relevant agencies, communications with key stakeholders and the public, etc.). They are also particularly useful to provide training (“learning by doing”) in the use of otherwise conceptually adequate crisis-management arrangements.

While FC GET and FPDFS are presently focusing on the use of Simulation Exercises for institutional diagnostic purposes, we expect financial authorities to consider incorporating them as regular training tools for their core staff. Moreover, some practitioners in other fields strongly believe that Simulation Exercises can also be used as powerful prediction tools. Consequently, it would not be surprising to see some financial authorities eventually using them with that purpose too.

What kind of Simulation Exercises?

While there are several alternative ways of simulating situations that demand critical decision-making, FC GET and FPDFS have chosen to deliver “role playing” exercises. Although the practice is quite ancient, the term “role playing” seems to have originated in the 1920s, in the research of Jacob L. Moreno, a Viennese psychiatrist who observed that his patients did better by acting out their problems than by just talking about them.

Conventional assessments of crisis preparedness typically are based on talks about the existing legal and operational framework for financial
supervision and insolvency resolution between decision makers and external experts. In a role-playing exercise, external experts recreate the scenario that decision makers must handle and, after the exercise is completed, assess the concrete actions that have been taken and provide appropriate feedback, including recommendations for improvements to law, policy, procedures and institutional arrangements.

How do we prepare and deliver Simulation Exercises?

FC GET and FPDFS identify and contact authorities potentially interested in country-specific Simulation Exercises through regional FPD staff, or regional Crisis-Preparedness events organized jointly with Toronto Center around the world, typically including a simulation exercise in a troubled, virtual financial system.

After the scope of a country-specific exercise and its financing has been arranged, frequently in collaboration with the FIRST Initiative financial sector technical assistance facility, Bank staff and consultants work together with a locally appointed team to prepare an appropriate, plausible scenario for the specific country’s risk profile (i.e., the sequence of events that the authorities and their core staff will have to handle during the exercise).

The delivery includes Bank staff and consultants who act as role players (representing authorities not participating in the exercise, bankers, journalist, politicians, etc.), and the use of a communications platform specially designed to capture all written and verbal exchanges among participants (the authorities and their staff), as well as among these and the role players.

Immediately after the exercise, Bank staff and consultants debrief the participants and later prepare a detailed diagnostic report and associated recommendations. This eventually leads to requests for technical assistance to address perceived weaknesses.

Experiences

Bank staff and/or consultants have so far delivered Simulation Exercises in ten countries, of which Morocco, Colombia, and Guatemala have requested follow up technical assistance to address the issues identified during their respective exercises. Bank supervisors in Guatemala also promoted a Central American exercise, addressing coordination issues among several national jurisdictions facing common shocks, which took place in the Dominican Republic in July, 2010. Mexico has already performed three runs of a particular scenario developed by senior officials of four Government agencies, and new exercises are being planned in the near future. Additionally, Bank staff members have participated as role players in regional Toronto Center events held in Toronto, Pretoria, Kingston, Kuala Lumpur, Stockholm, and Montevideo.