Contingency Planning and Crisis Simulations

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Contingency planning for financial supervisors—what is it?

- Planning for events that could destabilise the financial system
  - Financial crises
- Planning for the unexpected
  - Disasters
  - Terrorist attacks
- Focus today on planning for financial crises
Contingency planning for financial crises – why do it?

If you prepare for crises, you will be better able to prevent/mitigate/manage real crises when they emerge

**Objectives:**
- Crisis detection
- Crisis avoidance
- Crisis mitigation
- Crisis management

Caveats

- An actual crisis will be different than the one for which you planned
  - Goal is not to predict the future
- Contingency planning should be undertaken on a regular basis
- Contingency planning can require a significant resource commitment
  - Of staff and senior management time
Benefits of contingency planning outweigh disadvantages

• While the crises you plan for will differ from the crises you experience, the planning will not be wasted; you will be better prepared for any real crisis
• The costs of good contingency planning, while material, pale by comparison to the costs of a banking/financial crisis
• You will supervise more effectively when you are alert to the issues that are likely to arise in a crisis

Elements of a good contingency plan (1)

1. Understanding your financial system and the systemically important pieces
2. Understanding the external and internal risks to your financial system
3. Identifying the parties with whom you would have to work in a financial crisis
4. Reviewing your legal powers and resources for managing a crisis
Elements of a good contingency plan (2)

5. Preparing a crisis plan to guide supervisors and others in managing a crisis
6. Summarising the crisis plan in easy-to-use handbook
7. Simulating crises at regular intervals to test readiness
8. Updating/strengthening legal powers, resources and crisis planning in response to lessons from simulations

Understanding your financial system

- What are the major sectors in the financial system (banking, insurance, securities, pensions, etc.)?
- Which are major entities?
- Which are systemically important (considering size, market share of business lines, linkages)?
- What are major linkages (payment systems, counter-parties, markets, operational, international linkages)?
- What are major exposures (assets, funding)?
**Understanding risks (macro-economic surveillance)**

- Identify and monitor internal and external risks (what could go wrong?)
- Monitor changes in risk areas – look for rapid changes
- Big concerns include rapid growth in credit in any sector, steep escalation in asset values, sharp increases in capital flows
- For most countries: property, property, property
- Conduct regular stress tests to assess potential impact of threats

**Identifying key parties in the financial crisis**

- Other government agencies (finance ministry, central bank, supervisors, deposit insurer, police)
- Media outlets (domestic & foreign)
- Foreign home/host supervisors of parents, subsidiaries, branches of local institutions
- Potential sources of financial assistance (WB, IMF, regional development bank)
- Obtain/maintain names and coordinates of key people
Reviewing your legal powers and resources for managing a crisis

- Prepare a list of main steps in managing a financial crisis (forcing remedial measures, providing liquidity support, taking control, reorganising an institution, taking an ownership stake)
- Review legislation & regulations to be sure powers are adequate, and make needed changes (consider core principles and crisis literature)
- Review adequacy of resources (financial and personnel) to manage a crisis, and develop contingency plans to obtain additional resources on demand (consultants, retired employees)

Preparing a crisis plan

- Research past financial crises in your country and in others
- Develop lists of lessons learned
- Prepare guide for managing a crisis in your country which:
  - Sets out detailed actions for dealing with each stage of a crisis (forcing remedial measures, providing liquidity support, taking control, reorganising an institution, taking an ownership stake, and dealing with media at all stages)
  - Reflects policies/attitudes to failures of FI's, government ownership, foreign ownership
  - Addresses organisational and reporting issues
  - Includes references to legal powers for each anticipated action
  - Contains relevant information on experts whose help may be needed
Summarising the plan in a “crisis handbook”

- When a potential crisis strikes, there is little time to research, read or study
- Key guidance should be summarised in an easy-to-read document (handbook), referenced to the master plan
- The handbook should contain:
  - Abstracts of relevant laws, regulations and policies
  - Identification of respective legal responsibilities of key players
  - Summaries of relevant procedures (consider developing checklists for key activities)
  - Names and coordinates of counterparties to be contacted and external parties/experts whose help may be needed (consultants, lawyers, retired employees)
  - Templates for documents (from legal contracts to press releases)

 Updating legal powers, resources and crisis planning

- Simulations will identify weaknesses in powers, resources, planning and readiness
- Important to follow up and address all weaknesses
- May require changes to legislation, more resources
- Crisis plan and handbook may need updating
- Training of staff will likely be needed
Components of a crisis plan

(1)

- Explanation of roles of key parties: supervisor, central bank, deposit insurer, finance ministry, other key ministers
- Explanation of main crisis management steps, including technical aspects:
  - Forced remedial action or “prompt corrective action”
    - Especially raising capital
  - Providing liquidity support (lender of last resort)
  - Triggering deposit insurance coverage
  - Resolution options
    - Closure/liquidation, conservatorship, assisted or forced acquisition, bridge banks, etc.
  - Liquidation

Components of a crisis plan

(2)

- Explanation of crisis roles within supervisory organisation, central bank, deposit insurer
- Discussion of what/who can trigger use of plan
- Responsibility for updating plan
- Chain of internal communications in a crisis
- Extent to which plan is to be shared among supervisor, central bank, deposit insurer, etc.
Components of a crisis plan

(3)

• Legal authorities and drafts of key legal documents (eg: letter taking control of a financial institution)
• Information requirements for financial institutions, including information to be updated regularly, and supplementary information:
  – In-depth liquidity monitoring
  – Major counterparties
  – Structures of corporate groups: holding company and operating subsidiaries, including location and legal jurisdictions
  – Where assets are booked
• Names/positions of key contact persons for various types of information: internal, in financial institutions, other supervisory agencies, external resources

Components of a crisis plan

(4)

Key elements of a Communications Plan:
• Main spokesperson (other back-up)
• Use and role of senior people (head of supervision, Central Bank governor, Ministers)
• Plan for handling large numbers of calls
• Consistent focused message
• Timeliness
• Regular updates
• Need to maintain credibility; requires openness
• Problems should be acknowledged but accompanied by solutions
• Overriding objective: maintain public confidence
Components of a crisis plan (5)

Cross border issues:
• Information on international linkages of financial institutions (locally owned & foreign owned)
• Data on key foreign regulators and central bankers, with contact information
• Information on MOU obligations
• Guidance on when to contact foreign regulators and about what, including who is responsible for such contacts
• Objectives of contact with foreign regulators and central bankers (maintaining confidence, forestalling hasty actions)

Crisis Simulation Exercises
Stages of a CSE

- Selecting the type of simulation exercise
- Selecting the crisis team and supporting staff
- Designing the crisis scenario
- Setting up the logistics
- Running the crisis simulation
- Documenting and evaluating the results

Types of simulation exercises

Alternative approaches:

- Simulation based on “case study” with pre-determined events: participants work in groups, discussing possible actions to take.

- Interactive simulation: participants role-play (their own roles or those of others) and their actions affect outcomes.
The scenario: time

- **Real time**: the actual amount of time devoted to the simulation exercise. Usually one or two days, with participants fully dedicated to the simulation exercise, but it could cover a longer period, with participants participating part-time.
- **Simulation time**: the crisis develops over anything from a few days to several months.
- **Time compression**: (simulation time relative to real time) is the most challenging aspect of exercise design and execution.

The scenario: events

Scenarios can vary in scope and complexity:

- Problem in a small or mid-size institution
- Problem in a large complex financial institution
- Problem that affects non-banks and/or relevant non-financial institutions
- Major operational problem
- A domestic crisis
- An international crisis with domestic impact
The scenario: environment

Aspects of a real crisis:
• Rapid escalation of events
• Lack of time to take quality decisions
• Loss of control—real or perceived
• Important interests at stake
• Intense public/media scrutiny
• Siege mentality
• Lack of information!!!!

Writing the crisis scenario

• Main story line
• Detailed timeline
• Memos/emails
• If scenario is interactive, anticipate likely decisions of participants and develop variations responding to those decisions
• Assemble information to support scenario (simulated market info., newswire info., supervisory reports, financial information)
Supporting staff

Functions to be covered by team members:

• Leadership
• Developing scenario(s)
• Assembling supporting information
• Developing/running technology platform
• Running the crisis (the war room)
• Observers/moderators

Running the simulation

Typical stages in simulation:

• Gathering and sharing information
• Requesting/requiring remedial action
• Providing liquidity support
• Addressing possible solvency issues
  - requiring shareholder support;
  - taking control of intermediaries;
  - forcing the restructuring/sale of intermediaries;
  - nationalizing intermediaries, temporarily or longer term
Evaluation

Note areas where:

- Participants demonstrated weak understanding of key issues;
- Legislation and/or regulatory powers seemed inadequate;
- Coordination between agencies was less than effective;
- Simulation was or was not effective.

Follow up

- Revise financial crisis planning documents;
- Update legislation, regulations and guidelines;
- Revise supervisory procedures to address indicated weaknesses;
- Prepare training programmes to address areas in which participants demonstrated weak understanding of key issues;
- Report to senior management, oversight bodies and Ministers on results;
- Prepare for next simulation!!!
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