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# Do we need new statutory powers?

Report of the Task Force on Major  
Operational Disruption in the  
Financial System

December 2003



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## Foreword

Events in recent years have demonstrated regrettably that we have to be prepared for the possibility of major operational disruption in the financial system. Effective planning and preparation are crucial; the question of whether new statutory powers might be needed to handle the aftermath of these events is an important element of such preparation. The Task Force I was asked to chair has, since the summer, looked carefully at the range of complex issues relevant to deciding whether such powers would be helpful.

The balance of all these arguments has led us to the belief that new powers would not in fact be helpful. This is a view that we have reached after considering the responses to HM Treasury's Green Paper and after careful discussion with a range of public and private sector parties. Importantly our work drew on input both from the markets and from the legal profession, in particular on the excellent work of the Financial Markets Law Committee which published its own report today.

The Task Force covered much ground in reaching its conclusions. Underlying them were three generic issues. Firstly one needs to consider the likely conditions if an event of this nature were to occur. Apart from communication problems there could be confusion, distress, and an inability to conduct decision-making in a normal environment. This places a premium on having taken necessary measures in advance that will provide some element of predictability in coping with the problems. A fundamental difficulty about new powers is that in order to use them, further decisions would have to be taken at an already difficult time as to how they might be deployed or whether they were justified, and yet the actual process for taking such decisions could be in disarray.

Secondly, we were struck by the evidence of the way in which communities have coped with crises of one sort or another when they do actually strike. In New York, for example, after the sad events of 9/11, there was an overall determination on the part of all the participants to act pragmatically with the common purpose of getting the system up and running again as fast as possible. The initial instinct was above all to get moving again, without the need to have to focus on complex legal issues. Naturally one cannot rely on such mutual support under all circumstances. However, we think it is fair to place some reliance on this. A combination of the need for simplicity and to act in a pragmatic manner in times of difficulty has weighed in our conclusions.

And thirdly we need to consider the international environment in which we operate. In today's wholesale financial markets, contracts increasingly straddle national boundaries and transactions have legs in a number of jurisdictions. Consequently, an attempt to assert powers which would bear on the single jurisdiction of the UK, could in fact give rise to additional problems rather than adding to predictability or assisting due performance of contracts within the UK.

I would like to stress, however, that our conclusions that new statutory powers are not needed does not leave room for complacency. Statutory powers are just one element of the necessary response package, which involves a number of complementary and inter-linked measures. A large amount has been done to mitigate problems. But there are still some areas where more needs to be done, and our conclusions were based on the premise that more would be done. Accordingly we have made a series of recommendations together with suggestions as to how and when they can be implemented. It is important that they are followed up. I am pleased that the Tripartite Standing Committee on Financial Stability will take on the task of monitoring progress in meeting these recommendations and will report in October 2004.

This has been a significant exercise, demonstrating the necessary interaction between the public and private sector. I would like to thank the members of the Working Groups, and in particular the three chairmen, as well as those we have consulted more broadly who have devoted considerable time to this important subject and facilitated this dialogue. I hope that this cooperation continues as we work together to meet the recommendations.

**Sir Andrew Large**

*Chairman*

*Task Force on Major Operational Disruption in the Financial System*

3 December 2003



## Executive summary

E.1 The objective of the Task Force was to examine whether there was a case for new legislative responses to deal with the threat of major operational disruption in the UK financial system. Building upon HM Treasury's Green Paper and the responses to it, the Task Force examined the need for:

- powers to suspend financial obligations;
- powers of direction over financial markets;
- powers to prohibit financial transactions;
- powers to declare a bank holiday;
- emergency powers under the Civil Contingencies Bill; and
- powers to waive statutory requirements during a crisis.

E.2 The Task Force concluded, on balance, that no new statutory powers are needed. It acknowledges the importance of the existing focus on contractual methods of dealing with emergencies, on market infrastructure rules, and on creating an environment where there is a co-ordinated approach to contingency planning. The conclusion was reached following a detailed analysis, by the Task Force and its three Working Groups, of a range of complex legal issues. This report summarises the Task Force's findings. Further background on the study and the Working Groups' individual reports can be found in the Annexes to this report.

E.3 In reaching its conclusion the Task Force considered whether an extension of statutory powers would add usefully to existing arrangements for dealing with operational disruption — in particular, whether it would:

- maintain incentives for market infrastructures and participants to plan for business continuity<sup>1</sup>;
- help keep markets open;
- increase legal clarity;
- enable the orderly resumption of financial markets;
- build on market-based solutions wherever possible; and
- use established decision-making processes where possible.

E.4 An essential foundation for this analysis was the identification of certain key features of the London markets:

- their scale and complexity, which suggests that those closest to the markets are likely to be in a better position to understand the impact that a decision in one area might have on others;
- the speed of structural change in markets, which means that statutory responses from the public authorities risk becoming out of date quite quickly; and
- the speed with which markets react to events, which means that decisions have to be taken in a flexible manner.

Given these characteristics, the Task Force worked from the premise that, while the authorities have an important role to play, the primary responsibility for dealing with operational disruption rests with the financial markets themselves.

E.5 The Task Force noted the international and interconnected nature of many of the UK's financial markets and the need to ensure that approaches taken in the UK were compatible with those taken elsewhere. This was an important factor in considering the potential impact of statutory powers.

E.6 Having clarified its objectives and assessed relevant aspects of the financial environment, the Task Force reviewed the measures already in existence to minimise the impact of major operational disruption. In particular, it sought to identify the extent to which provisions in private sector contracts and in the rules of market infrastructures represented best practice and were actually implemented.

E.7 In respect of the first, a wide range of defensive measures and risk management provisions can be used to help mitigate the consequences of major operational disruption. Although the provisions vary from contract to contract, this should not be seen as a weakness, rather as reflecting differences in the characteristics of markets and in the contracting parties' priorities. For example, although *force majeure* provisions may provide a useful mechanism for addressing the impact of major operational disruption, their inclusion in contracts is not always appropriate and their absence should not *per se* be seen as a cause for concern.

E.8 The Task Force concluded that the contractual risk management mechanisms currently available generally allow contracting parties to address and

<sup>1</sup> In this report the word "infrastructure" is used to denote financial market infrastructures such as stock exchanges and not to physical infrastructure such as electricity or telecoms infrastructure.

manage risks appropriately, though it makes some suggestions for improvement as to how these are implemented. This conclusion is in line with the outcome of similar reviews in the US.

E.9 In respect of the second, it examined whether key market infrastructures — payment systems, exchanges, clearing and settlement systems and financial infrastructure service providers — have suitable rules in place to deal with major operational disruption. UK infrastructures generally appear to have well-developed plans for business continuity, with a range of powers within their rules to deal with major operational disruption. These are principally triggered by broadly drafted *force majeure* clauses or similar provisions that allow for specific steps to be taken in crisis situations. These powers include the power to amend rules, to suspend trading, clearing or settlement and to suspend participants. Some infrastructures have “catch all” powers to take any appropriate action in a crisis.

E.10 The Task Force concluded that the rules which market infrastructures have in place to deal with major operational disruption are on the whole sufficient, though it also makes some suggestions for improvement.

E.11 It was against this background that the Task Force examined whether new or amended statutory powers might be needed. In doing so, it considered whether there were any identifiable gaps in existing powers, whether the potential remedies were feasible to implement, and whether they would help to promote clarity and legal certainty.

E.12 The potential benefit of a **power to suspend financial obligations** would be to provide a “breathing space” for markets in the immediate aftermath of major operational disruption by deferring certain legal and financial obligations. Aside from any other objections to a general power of suspension, however, the Task Force found that there were significant difficulties in being able to clarify, with the required level of precision, the obligations which would be subject to the power (even if the power were to be exercised only on a temporary basis in extreme conditions). Moreover, in internationally-interconnected markets it is difficult to treat obligations in isolation. Many obligations are connected to others — such as in hedging contracts (which may be subject to the laws of another jurisdiction) — and there would be practical problems if some obligations were suspended while other related ones were not. In such circumstances, intervention

could compound the problems created following major operational disruption rather than reduce them.

E.13 A **power of direction over financial markets** — to order closure or to modify rules — would not suffer the same definitional problems, but its efficacy would be limited if it applied only to UK-based infrastructures, when many transactions which “occur” in UK markets rely on infrastructures based overseas.

E.14 A **power to prohibit financial transactions** would go beyond the powers envisaged by HM Treasury in the Green Paper, and would also raise similar definitional issues and limitations as are referred to above in the context of powers of suspension.

E.15 A **power to declare a same-day bank holiday** could be beneficial by signalling to market participants that the day in question was not to be treated as a normal business day. Similar benefits can, however, be obtained by informal means, such as by a statement from the financial authorities; and this might also avoid the practical confusions about the “traditional” aspects of bank holidays eg whether there was, or was not, an expectation that staff would receive an additional day of paid leave. The legal consequences of declaring a bank holiday are not straightforward. It might require market infrastructures to close where they had defined their business days in relation to bank holidays, when the objective should be to keep them open wherever possible.

E.16 The **emergency powers in the Civil Contingencies Bill** which is due shortly to be introduced into Parliament would be available where there is a declaration of a state of emergency. These powers would be capable of being applied to the financial services sector, though the Task Force could not readily identify ways in which they might be used constructively to deal with the legal issues surrounding major operational disruption considered in this report.

E.17 A **power to waive statutory requirements during a crisis** is not necessary. The FSA has already made provision that a person will not be in contravention of its rules when compliance with those rules is impracticable as a consequence of an emergency.

E.18 The Task Force concluded, on balance, that no new statutory powers are needed. It prefers to rely on the existing approach adopted by market participants and the financial authorities, namely to focus on

contractual methods of dealing with emergencies, and on appropriate market infrastructure rules, against a background of co-ordinated contingency planning. It believes that this approach is best suited to the particularly international and interconnected nature of UK markets. It recognises the fact that the laws of countries other than the UK also govern contracts in London's markets, which would not, or might not, be subject to the provisions of UK legislation.

E.19 The Task Force's conclusions are in line with the approach taken by the US authorities following 11 September 2001. They minimise the risk that the exercise of new powers would be incompatible with rules prevailing in other major financial centres and the risk of new powers impeding rather than promoting the orderly resumption of financial markets.

E.20 The Task Force's conclusions are also in line with those of the Financial Markets Law Committee's (FMLC) Emergency Powers Legislation Working Group which found that there were no significant legal gaps which required new legislation. The FMLC report describes many of the issues dealt with here in further detail.

E.21 The conclusion that no new statutory powers are needed is based not only on the work that has already been undertaken to address business continuity issues but also on the need for further improvements. In particular, the Task Force has put forward eight recommendations to help further improve the resilience of UK financial markets:

**Recommendation 1:** *Market participants and the financial authorities should continue to place a high priority on business continuity planning.*

**Recommendation 2:** *Market participants and their trade associations should work to ensure that private contracts are reviewed to take account of major operational disruption. A useful starting point for such reviews is the "contracts checklist" put forward in the FMLC's report on emergency powers.*

**Recommendation 3:** *Market infrastructures should ensure that they have specific rather than general powers to deal with major operational disruption. They should also ensure that the mechanism for invoking these powers is flexible enough to be operated successfully in a crisis.*

**Recommendation 4:** *The UK financial authorities should continue to contribute to international efforts to develop recognised good business continuity practice for systemically important market infrastructures. Their application in the UK should recognise that the prime responsibility for business continuity planning rests with the senior management of firms and market infrastructures.*

**Recommendation 5:** *Participants in significant markets should consider whether there would be benefits from further defining the principles on which to base claims arising from the delayed performance of contracts following major operational disruption.*

**Recommendation 6:** *The financial authorities should aim to clarify further, and publicise, their respective roles in the event of major operational disruption.*

**Recommendation 7:** *The financial authorities should consider with market participants the need for a high-level committee to help ensure co-ordination across financial markets in the event of major operational disruption.*

**Recommendation 8:** *The UK financial authorities should continue to promote international co-operation and co-ordination in developing responses to major operational disruption.*

E.22 For each recommendation, the Task Force has suggested how it could be implemented. It also proposes that the Tripartite Standing Committee on Financial Stability comprised of the three financial authorities — HM Treasury, FSA and Bank of England — should monitor progress in meeting the recommendations, and publish a progress report in October 2004 and annually thereafter.

E.23 Finally, it should be stated clearly that nothing in this report is intended to conflict with the wider overhaul of emergency powers being considered in connection with the Civil Contingencies Bill. Some events which could give rise to major operational disruption in the financial services sector could also give rise to urgent human and social requirements which would have to be addressed by the authorities using emergency powers.



## Chapter 1: Need for action?

### Summary

The objective of the Task Force was to examine whether there was a case for new legislative responses to deal with the threat of major operational disruption in the UK financial system. Building upon HM Treasury's Green Paper and the responses to it, the Task Force examined the need for:

- powers to suspend financial obligations;
- powers of direction over financial markets;
- powers to prohibit financial transactions;
- powers to declare a bank holiday;
- emergency powers under the Civil Contingencies Bill; and
- powers to waive statutory requirements during a crisis;

This report summarises the findings of the Task Force and those of the Working Group established to consider the legal issues in detail. Further background on the study and the Working Groups' individual reports can be found in the annexes to this report.

In reaching its conclusion the Task Force considered whether an extension of statutory powers would add usefully to existing arrangements for dealing with operational disruption — in particular, whether it would:

- maintain incentives for market infrastructures and participants to plan for business continuity;
- help keep markets open;
- increase legal clarity;
- enable the orderly resumption of financial markets;
- build on market-based solutions wherever possible; and
- use established decision-making processes where possible.

An essential foundation for this analysis was the identification of certain key features of the London markets:

- their scale and complexity, which suggests that those closest to the markets are likely to be in a better position to understand the impact that a decision in one area might have on others;
- the speed of structural change in markets, which means that statutory responses from the public authorities risk becoming out of date quite quickly; and
- the speed with which markets react to events, which means that decisions have to be taken in a flexible manner.

Given these characteristics, the Task Force worked from the premise that, while the authorities have an important role to play, the primary responsibility for dealing with operational disruption rests with the financial markets themselves.

The Task Force took into account the international and interconnected nature of many of the UK's financial markets and the need to ensure that approaches taken in the UK were compatible with those taken elsewhere.

### Introduction

1.1 The risk of major operational disruption is not a new threat to the UK financial system. Events over the last thirty years — both natural events such as the 1987 hurricane and others — have demonstrated the need for financial markets to plan for business continuity. Whilst the events of 11 September 2001 do not alter the fact that the primary responsibility for dealing with

operational disruption must lie with the financial markets, in the light of the catastrophic nature of those events, it is appropriate to examine whether there is a need for new legislative responses to deal with the threat of major operational disruption in the UK.

1.2 In doing so, the Task Force has sought to build on HM Treasury's Green Paper, *The financial system and major operational disruption*, and the responses from a

considerable number of financial bodies to that paper, to examine a range of potential statutory measures<sup>2</sup>:

- powers to suspend financial obligations;
- powers of direction over financial markets;
- powers to prohibit financial transactions;
- powers to declare a bank holiday;
- emergency powers under the Civil Contingencies Bill; and
- powers to waive statutory requirements during a crisis.

1.3 This report summarises the findings of the Task Force and those of three Working Groups established to consider the legal issues in detail. Further background to the study, including the Task Force's terms of reference and the Working Groups' individual reports, can be found in the annexes to this report.

1.4 Alongside the use of existing and any new powers, it is important to recognise that existing measures available to the authorities would play a central role in dealing with major operational disruption. These include the measures concerned with the:

- collection, analysis and dissemination of information;
- co-ordination and facilitation of private sector responses; and
- the central banking functions of the Bank of England, for example the provision of emergency liquidity to the market to enable payments and other transactions to be settled.

## What constitutes major operational disruption?

1.5 The Green Paper did not contain a definition of major operational disruption but referred to the need to promote order in the financial system following events such as those of 11 September 2001. It clearly envisaged that for an event to be classified as major operational disruption it would need to threaten the stability of the UK financial system. The Task Force believed that this was a sensible general criterion — “major operational disruption” should imply the potential to have an impact on financial stability; and it is this threat to financial stability which would justify public intervention. Such impact might arise either as a:

- **systemic effect:** this would be the situation where

the inability of a market participant or an infrastructure to meet its obligations results in the inability of other market participants to meet their obligations as they fall due. Such a failure could cause widespread liquidity or credit problems and, as a result, could threaten the stability of the financial system as a whole; or as a

- **system-wide effect:** this would be the situation, falling short of a systemic effect, where the failure of a market infrastructure, or a market participant, nevertheless causes widespread disruption because it is widely used and there are no ready alternative means for transactions to be completed.

1.6 The Task Force was of the view that for an incident to be classed as giving rise to “major operational disruption” the following conditions would have to exist<sup>3</sup>:

- there would *potentially* have to be an impact on the financial system as a whole;
- it could affect either retail financial services or wholesale markets (although wholesale markets were, in general, more likely to be systemic);
- the incident would originate from operational disruption rather than a purely financial shock, such as a bank failure; and
- the incident could have a domestic or international origin, but the impact must have significant potential consequences for the UK financial system.

1.7 These criteria, however, are intended to give context to the discussions contained in this report rather than to be suggestions for formulating a specific definition that could be used to define circumstances in which new legal powers would be exercised (when, inevitably, a subjective and immediate judgement would be required).

## Why might public intervention be needed?

1.8 Before considering the need for new statutory powers, it is useful to ask why public intervention might be needed. The starting assumption must be that the participants in major financial markets are better placed to deal with the impact of operational disruption than the financial authorities, but this does not necessarily provide a complete answer.

<sup>2</sup> See Annex 2: Background on the study for further information on the Green Paper and the Task Force.

<sup>3</sup> Ibid.

1.9 One issue is whether the financial system is more vulnerable to operational disruption than other sectors of the economy. The Green Paper identified the importance of both *operational networks* and *financial networks* in this regard, the latter being underpinned by legal instruments such as contracts and market infrastructure rule books. The consequence is that market participants are highly dependent on each other<sup>4</sup>.

1.10 In this context, a number of factors were identified which highlighted the need for major operational disruption to be dealt with quickly<sup>5</sup>:

- **time sensitivity:** the financial markets move large values of assets around very quickly. Assets to settle one transaction are often obtained from the settlement of another. The network-like structure of the system means that disturbances in one part of the system can have a knock-on effect in other parts;
- **the importance of information:** the financial system is highly dependent on information. In a crisis, the normal mechanisms through which information is generated and made available to market participants could break down. If the information asymmetries between participants are too extreme, this may reduce order in the financial system. During major operational disruption, financial institutions would also wish to know how normal arrangements had been disrupted, and what alternative practices were being adopted; and
- **significant ‘externalities’:** decisions made by individual financial institutions might have especially important consequences for other financial institutions. An institution may not have the right information or incentives to make decisions having regard to these wider issues.

1.11 Taken together, all these factors demonstrate the crucial importance of communication and co-ordination between market participants during a crisis. The Green Paper, however, suggested that there could be a number of reasons why such co-operation might be difficult following major operational disruption<sup>6</sup>:

- such approaches rely on readiness to co-operate in difficult situations, including when information may be very limited. This may be undermined by uncertainty about the financial or legal consequences of decisions taken or fear of litigation by stakeholders who may be adversely affected. Individual institutions may also fail to act co-operatively if they fear that they will be disadvantaged as a result of others failing to do so;
- multilateral approaches rely additionally on identifying in advance a group of people who are representative of the participants in the relevant network, with sufficient authority to take decisions and promulgate these in the reasonable expectation that other market participants will abide by them; and
- different market-based initiatives may come up with different answers to the same, or related, questions.

1.12 These issues were considered by the Task Force during the course of its study. It envisaged the following potential problems in the aftermath of operational disruption:

- the difficulty of co-ordinating private sector responses, and co-ordinating them with the responses of the financial authorities;
- the difficulty of complying with existing statutory or regulatory requirements during a crisis;
- the threat of litigation after a crisis preventing speedy decision-taking during the crisis; and
- the complexity of resolving compensation claims following a crisis.

### Constraints on public intervention

1.13 In examining the need for new powers, the Task Force was conscious of the constraints, and potential adverse consequences of public intervention. An advantage of a market-based approach is that it helps to maintain the incentives for market participants to invest in their own business continuity arrangements. It is important to ensure that any public intervention does not damage such incentives.

1.14 The Task Force believes that in assessing the desirability of new statutory powers, or other measures to

<sup>4</sup> HM Treasury Green Paper, paragraph 2.5.

<sup>5</sup> Ibid paragraph 2.7.

<sup>6</sup> Ibid paragraph 3.15.

deal with operational disruption, the key issues are whether they would:

- help keep markets open, where possible, and permit orderly closure where necessary;
- not adversely affect the orderly resumption of financial markets;
- rely on market-based solutions wherever possible; and
- use established decision making processes for the financial system where possible.

1.15 In addition, any new powers would need to provide the greatest possible clarity about their impact both in advance, and at the time of major operational disruption, whilst being sufficiently flexible to permit the most appropriate response at the right time. This is necessary even if the nature of the event leading to major operational disruption may be inherently unpredictable.

1.16 The need for clarity is crucial. Vague and unworkable provisions would not be acceptable. The powers would, by their very nature, have to be exercised in a period of uncertainty. The extent of the incident and its impact on the financial system may be unclear at the outset. In such circumstances, any new powers would need to have simplicity and flexibility if they were to be of practical use to individual market infrastructures and participants, and not exacerbate the situation.

1.17 In considering potential statutory solutions, the Task Force was also aware of the international dimension to many of the UK's financial markets and the practical constraints that this imposed on the effectiveness of taking action only under UK law. This issue was referred to in the Green Paper and by many of those who responded to it<sup>7</sup>:

The UK financial markets have a strong international component. There are many

cross-border transactions starting or ending in the UK. Foreign financial institutions and companies operate in the UK. Contracts and assets referring to actions in the UK may be governed by foreign laws. Conversely actions abroad may be governed by UK law. This raises the question of which financial dealings would be affected by the powers — those under UK law, or those which took place in the UK?

1.18 Many financial transactions involve also a number of different infrastructures in different countries<sup>8</sup>. The Task Force took into account the interconnected nature of many of the UK's financial markets and the need to ensure that approaches taken in the UK were not incompatible with those taken elsewhere.

### General approach

1.19 In balancing the competing factors in favour and against new statutory powers, the Task Force's starting point is that the primary responsibility for dealing with operational disruption rests with the financial markets. There are a number of reasons for this:

- the scale and complexity of London's financial markets means that those closest to the markets are in a better position to understand the impact that a decision in one area might have on others;
- the dynamics of the markets mean that statutory responses from the public authorities risk becoming out of date quite quickly; and
- the speed with which markets react to events means that decisions have to be taken in a flexible manner.

1.20 The next chapter examines the response of the private sector to the threat of major operational disruption and the extent to which provisions in private sector contracts and in the rules of market infrastructures adequately provide for such disruption.

<sup>7</sup> Ibid paragraph 5.18.

<sup>8</sup> A trade in London between a US and a UK bank, could be carried out over the Amsterdam stock exchange, cleared through Clearnet in Paris, and settled in the Netherlands with payment made via a TARGET transfer. Even this relatively simple transaction involves interconnected contracts under the laws of a number of different countries.

## Chapter 2: Current legal situation

### Summary

The Task Force reviewed the measures already in existence to minimise the impact of major operational disruption. In particular, it sought to identify the extent to which provisions in private sector contracts and in the rules of market infrastructures represented best practice and were actually implemented.

In respect of the first, a wide range of defensive measures and risk management provisions can be used to help mitigate the consequences of major operational disruption. Although the provisions vary from contract to contract, this should not be seen as a weakness, rather as reflecting differences in the characteristics of markets and in the contracting parties' priorities. For example, although *force majeure* provisions may provide a useful mechanism for addressing the impact of major operational disruption, their inclusion in contracts is not always appropriate and their absence should not *per se* be seen as a cause for concern.

The Task Force concluded that the contractual risk management mechanisms currently available generally allow contracting parties to address and manage risks appropriately, though there is room for some improvement. This conclusion is in line with the outcome of similar reviews in the US.

In respect of the second, it examined whether key market infrastructures — payment systems, exchanges, clearing and settlement systems and financial infrastructure service providers — have suitable rules in place to deal with major operational disruption. UK infrastructures generally appear to have generally well-developed plans for business continuity with a range of powers within their rules to deal with major operational disruption. These are principally triggered by broadly drafted *force majeure* clauses or similar provisions that allow for specific steps to be taken in crisis situations. These powers include the power to amend rules, to suspend trading, clearing or settlement and to suspend participants. Some infrastructures have “catch all” powers to take any appropriate action in a crisis.

The Task Force concluded that the rules which market infrastructures have in place to deal with major operational disruption are on the whole sufficient, though there is also room for improvement.

### Background

2.1 The Task Force examined the adequacy of existing private sector legal measures to minimise the impact of major operational disruption. The importance of such market-based approaches is that they maintain strong incentives on market participants to continue to plan for business continuity and should help ensure that they are not unduly dependent on the financial authorities in a crisis. In practice, they are most likely to produce the best outcome.

2.2 In particular, the Task Force sought to identify current market practice for private contracts and for the rules of market infrastructures and determine the extent to which they:

- represented best practice;
- had appropriate coverage; and
- were actually adopted and implemented.

2.3 The Task Force also sought to:

- determine the degrees of similarity and diversity of practice across different markets and infrastructures and the reasons for any differences;
- highlight any market failures such as gaps in preparedness or weaknesses in current market practices that need to be resolved; and
- identify the details of measures in other key jurisdictions to deal with major operational disruption and to consider whether there were any useful lessons for the UK.

### Contractual arrangements

2.5 In examining the scope for contractual arrangements to mitigate the effects of major operational disruption, the Task Force considered the specific contractual provisions in a range of common market contracts as well as the broader context of how contractual issues are dealt with under English law.

## General principles of English contract law

2.6 It is a principle of English contract law — the doctrine of contract continuity — that parties voluntarily entering into a contract should be bound by that contract, even if circumstances change after the contract is entered into<sup>9</sup>. In contrast to the provisions in many other jurisdictions, English law does not have a general doctrine of *force majeure* which excuses the non-performance of contract terms in exceptional circumstances, such as might arise during major operational disruption. In other words, where operational disruption prevents a contracting party from performing its contractual obligations then this may constitute a breach of contract unless the contract contains specific provisions for dealing with such circumstances.

2.7 The English law doctrine of frustration — where in exceptional circumstances a court may declare a contract at an end and release the parties from future obligations — does not provide a reliable safeguard in the event of contract terms not being fulfilled following major operational disruption. This is because the application of the doctrine can be considered by the courts only after the event. Such consideration is on a case by case basis and so the precise scope and impact of the doctrine is uncertain in advance.

## Contractual provisions: the available tools

2.7 In order to avoid the potential legal consequences of a breach of contract, contracting parties may adopt a range of contractual provisions. For example, parties may adopt *force majeure* provisions that are triggered by an event outside a party's reasonable control which makes it impossible, or at least impracticable, for it to perform its obligations. A list of the possible categories of events is generally included but it is usually open-ended.

2.8 The consequences of triggering of a *force majeure* are varied depending on the specific provisions put in place. It could:

- excuse a breach of contract resulting from major operational disruption; or
- suspend the obligations of the party concerned for a period while it endeavours to mitigate the *force*

*majeure* event; or

- eliminate or mitigate the specific consequences of such a breach. For example, it could allow a party to: terminate the contract; withhold its own performance of certain obligations; or liquidate or exercise other rights over collateral it may hold in respect of the contract.

2.9 The key risk that is usually addressed by contractual provisions is the liability to pay indeterminate amounts of compensation for losses suffered as a result of the breach of contract. This risk, however, does not exist in all circumstances. For example, there is no general right to claim damages in respect of delayed payment. In such circumstances, the principal remedy is a claim for contractual or statutory interest to compensate for the delay in payment, making the extent of the liability predictable and consequently more manageable than an indeterminate liability. The risks can also be addressed through contractual measures which either prevent or excuse the breach or which exclude or limit the defaulting party's liability to compensate for the breach.

2.10 There are a wide range of other defensive measures and risk management provisions that can be used in contracts to help mitigate the consequences of major operational disruption (see Box 1). This range of techniques reflects, in part, the need for different approaches in different circumstances. The common theme across all the measures, however, is a clear specification in the contract of both the trigger mechanisms and the resulting compensation or penalties that will then apply. It remains, of course, for the parties concerned to decide whether or not to use any or all of the provisions.

2.11 The Task Force also considered contractual provisions in retail financial services. It is clear that retail financial services firms can, and do, include provisions in their consumer contracts which provide for non-performance caused by a major operational disruption. In turn, consumers may be able to rely on provisions, such as business day definitions, where they are unable to meet their own obligations following major operational disruption. In addition, their rights are protected through a variety of measures, including: the FSA's code of conduct for firms; consumer protection legislation; industry codes of conduct; and the Financial Ombudsman Service.

<sup>9</sup> FMLC report, paragraph 3.1.

### Box 1: Contractual provisions to deal with major operational disruption

- **business day provisions:** many financial contracts are structured so that performance of contractual obligations is required only on a day which qualifies as a “business day”, or some equivalent concept. Typically, “business day” is defined by reference to whether banks, markets, exchanges and/or settlement systems are open and whether payments or other deliveries are made or capable of being made;
- **settlement or performance disruption provisions:** some agreements contain specific provisions addressing disruption to the expected means of settlement or performance;
- **changes in circumstances provisions:** some contracts contain provisions that enable a party to excuse itself from performance because the circumstances prevailing at the time performance is due differ from those which prevailed when the contract was entered into;
- **market convention override provisions:** major operational disruption could have an impact on a party's ability to comply with obligations that must be met in accordance with the rules of an exchange or with market conventions. These clauses provide a degree of flexibility in dealing with such risks;
- **grace periods:** one of the most important techniques for managing the consequences of non-performance, grace periods provide a means of mitigating the immediate impact of a default;
- **exclusions or limitation of liability:** where non-performance could expose a party to potentially significant damages claims, parties may seek to exclude or limit liabilities; and
- **rate/price determination provisions:** a disruption could result in the situation where a day was a “business day”, because infrastructure is open and operating, but a particular rate used in contracts to determine the amount of an obligation cannot be determined because, for example, insufficient firms were trading to fix a reliable level. Many contracts provide an “objective” fall-back mechanism for establishing a rate or price when the primary mechanism is not available, and some also provide a “subjective” fall-back should this secondary mechanism also be unavailable.

2.12 In considering a broad range of standard market contracts, the Task Force has not identified significant gaps in contractual arrangements to support business continuity. Although the provisions vary from contract to contract, this reflects differences in the characteristics of different markets and differences in the parties' priorities, including differing attitudes to taking on risk. For example, although force majeure provisions may provide a useful mechanism for addressing the impact of major operational disruption, their use is not always appropriate and their absence should not be seen as a cause of concern *per se*. In particular, *force majeure* clauses may be undesirable in essential service contracts such as disaster recovery services and contracts for telecommunications, data and other electronic communication services when parties should make sure they have fall-back arrangements in place to ensure services can be maintained.

2.13 The Task Force concluded that the contractual risk management mechanisms currently available

generally allow contracting parties to address and manage risks appropriately. This conclusion seems in line with the outcome of similar reviews in other jurisdictions. In particular, it would appear consistent with the views of the US Securities Industry Association in their assessment of the impact on the US securities industry of the 11 September 2001 attacks<sup>10</sup>.

2.14 Although the contractual options available to market participants seem adequate, the Task Force found that they have not necessarily been implemented in all relevant contracts and some contracts have not been updated to reflect developing practice. This issue together with recommendations for improvement is considered further in Chapter 4.

### Market infrastructures' rules

2.15 The Task Force considered both the “normal” rules and regulations of market infrastructures and those which could apply in the context of business

10 <http://www.sia.com/research/pdf/RsrchRprtVol3-2.pdf>

continuity and disaster. It focused on those infrastructures which were clearly identifiable as being key to the UK financial system:

- **payment systems:** CHAPS, EBA Euro 1, BACS and CLS Bank International (for foreign exchange settlements).
- **exchanges:** London Stock Exchange, Euronext.liffe, International Petroleum Exchange, London Metal Exchange and virt-X.
- **clearing and settlement systems:** LCH, CREST, Euroclear, and Clearstream.
- **financial infrastructure service providers:** SWIFT.

### Business continuity procedures for market infrastructures

2.16 UK infrastructures appear to have well-developed and rehearsed plans in place to cope with the immediate aftermath of major operational disruption. Best practice techniques for dealing with such disruption include:

- clear decision-making structures for dealing with contingency issues such as market closure or transferring operations to contingency sites;
- nominated deputies (and deputies' alternates) who can take decisions should key personnel be unavailable, with no single point of dependency in any function or team;
- disaster recovery sites located in a different region, potentially, overseas;
- cascade lists for dissemination of decisions to staff;
- specific plans for dealing with the media;
- "decision trees" to help decide what actions need to be taken; and
- regular testing of plans.

2.17 Infrastructures typically have a range of powers enshrined within their rules to deal with major operational disruption. These are generally triggered by broadly drafted *force majeure* clauses or similar provisions that allow for specific powers to be invoked in any unusual circumstance. These powers include: the power to amend contracts or rules immediately; the power to suspend trading, clearing or settlement systems or to operate standby procedures and systems; the power to close the infrastructure; the power to vary the daily timetable; the power to suspend participants; and "catch all" powers to take any appropriate action.

2.18 Infrastructures have taken a number of steps in recent years to improve business continuity arrangements as highlighted by the best practices described above. In addition, most market infrastructures' contingency plans are overseen by the financial authorities and some infrastructures have been designated by the relevant authorities under the Settlement Finality Directive which ensures the finality of their transactions by preventing unwinding following any financial failure of their participants.

2.19 However, as with contractual arrangements, the Task Force found that there was room for improvement in certain areas and this is discussed further in Chapter 4.

## Conclusions

2.20 The Task Force found that there are a range of measures that market participants can use to ensure that infrastructures' rules and private contracts adequately provide for the consequences of major operational disruption. The implications of this in relation to the need for new or amended statutory powers are discussed in the next chapter.

## Chapter 3: Potential statutory powers

### Summary

In examining whether new or amended statutory powers might be needed, the Task Force considered whether there were any identifiable gaps in existing powers, whether the potential remedies were feasible to implement, and whether they would help to promote clarity and legal certainty.

The potential benefit of a **power to suspend financial obligations** would be to provide a “breathing space” for markets in the immediate aftermath of major operational disruption by deferring certain legal and financial obligations. Aside from any other objections to a general power of suspension, however, the Task Force found that there were significant difficulties in being able to clarify, with the required level of precision, the obligations which would be subject to the power (even if the power were to be exercised only on a temporary basis in extreme conditions). Moreover, in internationally-interconnected markets it is difficult to treat obligations in isolation. Many obligations are connected to others — such as in hedging contracts (which may be subject to the laws of another jurisdiction) — and there would be practical problems if some obligations were suspended while other related ones were not. In such circumstances, intervention could compound the problems created following major operational disruption rather than reduce them.

A **power of direction over financial markets** — to order closure or to modify rules — would not suffer the same definitional problems, but its efficacy would be limited if it applied only to UK-based infrastructures, when many transactions which “occur” in UK markets rely on infrastructures based overseas.

A **power to prohibit financial transactions** would go beyond the powers envisaged by HM Treasury in the Green Paper, and would also raise similar definitional issues and limitations as are referred to above in the context of powers of suspension.

A **power to declare a same-day bank holiday** could be beneficial by signalling to market participants that the day in question was not to be treated as a normal business day. Similar benefits can, however, be obtained by informal means, such as by a statement from the financial authorities; and this might also avoid the practical confusions about the “traditional” aspects of bank holidays eg whether there was, or was not, an expectation that staff would receive an additional day of paid leave. The legal consequences of declaring a bank holiday are not straightforward. It might require market infrastructures to close where they had defined their business days in relation to bank holidays, when the objective should be to keep them open wherever possible.

The **emergency powers in the Civil Contingencies Bill** which is due shortly to be introduced into Parliament would be available where there is a declaration of a state of emergency. These powers would be capable of being applied to the financial services sector, though the Task Force could not readily identify ways in which they might be used constructively to deal with the legal issues surrounding major operational disruption considered in this report.

### Introduction

3.1 The Task Force examined a range of statutory powers that might be helpful in dealing with major operational disruption:

- powers to suspend financial obligations;
- powers of direction over financial markets;
- powers to prohibit financial transactions;
- powers to declare a bank holiday;
- emergency powers under the Civil Contingencies Bill; and
- powers to waive statutory requirements during a crisis;

3.2 In examining these powers as potential options, the Task Force had in mind three key questions:

- were there identifiable gaps in existing powers available to deal with major operational disruption?;
- would the powers be feasible to implement and not subject to significant disadvantages?; and
- in particular, would enacting such powers help in an event of major operational disruption to keep markets open, or where markets had to close, not adversely affect the orderly resumption of market activity?

## Powers to suspend financial obligations

3.3 The purpose of a suspension power as envisaged in the Green Paper would be to provide a temporary “breathing space” to markets in the immediate aftermath of major operational disruption by deferring certain legal and financial obligations. This could help give firms sufficient time for example to effect necessary repairs, gather and analyse intelligence before reopening, etc. In legal terms, a market-wide suspension of obligations could be akin to inserting a compulsory *force majeure* provision into all financial contracts that fell within its scope.

3.4 A precondition for recommending the enactment of such a power would therefore be the ability to define in a satisfactory way the obligations to which the power might be applied. Without this, the Task Force considers that enacting such a power is likely to cause uncertainty, even if it was made clear that the power would be exercised only in extreme circumstances.

3.5 The Task Force considered whether it would be possible to formulate a clear and workable definition by reference either to the markets or the types of obligation to which the power could be applied. However, whilst it is possible to identify markets such as the OTC derivatives market in general terms, it is much more difficult to produce a workable legal definition in the context of a proposed suspension of legal obligations. A more specific reference to types of obligation might be more practicable, but would be of doubtful feasibility given the large range of contracts in use in the markets<sup>11</sup>. Another possibility mentioned in the Green Paper, namely to limit the suspension power only to those contracts affected by the operational disruption would increase uncertainty as parties would not be clear which contracts had been affected and which had not. The other possibility of naming specific contracts or parties to which the suspension applied would have obvious practical limitations.

3.6 Significant difficulties would also be likely from the international nature of UK markets, relating, for example, to the applicable governing law and place of performance of contractual obligations. If suspension powers operated only on contracts governed by UK law then business transacted in the UK but governed by the laws of other jurisdictions would be excluded. Such an approach would risk imposing an unbalanced partial

“solution” on markets with many inter-linked elements. In such circumstances, intervention could compound the problems created following major operational disruption rather than reduce them.

3.7 Defining the scope of the proposed powers by reference to the place of performance of the relevant obligation also raises difficult legal issues because the place of performance of financial obligations can be difficult to pinpoint in strict legal terms, risking uncertainty over which contracts, or obligations, had been suspended.

3.8 With the possible exception of Finland, no other national authorities appear to have powers to suspend all types of financial obligations including OTC derivatives. The Task Force doubts that such a power is either feasible or desirable.

3.9 In summary, the Task Force believes there are significant difficulties inherent in a direct power of suspension. In the event of major operational disruption, the objective should normally be to ensure that those who can perform their contract do so. **The Task Force therefore concluded that powers of suspension, as set out in the Green Paper, would not be desirable.**

## Powers of direction over financial markets

3.10 The Task Force considered whether powers of direction — either those already available to the FSA and the Bank of England or new powers to enable HM Treasury to issue instructions to market infrastructures as envisaged in the Green Paper — would be helpful in dealing with major operational disruption.

3.11 Under the Financial Services and Markets Act 2000, the FSA has limited powers of direction over certain market infrastructures<sup>12</sup>:

- a recognised investment exchange to halt trading in one stock or the market as a whole;
- a recognised investment exchange to extend settlement periods; or
- a recognised clearing house to suspend settlement operations.

3.12 The powers of direction only extend to recognised bodies and do not, for example, apply to OTC

<sup>11</sup> These issues are discussed further in paragraphs 119-128 of Regulatory and Statutory Powers Working Group Report.

<sup>12</sup> Financial Services and Markets Act 2000, s296.

transactions. The powers are limited in that they only apply where the exchange “has failed, or is likely to fail, to satisfy the recognition requirements, or has failed to comply with any other obligation imposed on it” under the Act. This may not necessarily be the case following major operational disruption. The Task Force doubted whether the powers could be relied upon to deal with such circumstances.

3.13 The Bank of England also has powers under the Bank of England Act 1946 to request information from, and make recommendations to, “bankers”. In practice, these powers are severely limited and have never been used. They may only be used following a direction from HM Treasury where the bankers concerned have been given an opportunity to make representations, the Treasury has authorised the recommendations and a banker has been previously designated as such by a Treasury Order. If the Treasury had not declared anyone to be a “banker”, these powers could not be used until it had done so. Given the cumbersome nature of these procedures, the Task Force concluded that the Act was unlikely to be relevant in dealing with the consequences of major operational disruption.

3.14 The Green Paper discussed whether a broader power of direction for all UK infrastructures would be desirable. It suggested that such a power could be used to close or open infrastructures or to modify their rules. The Task Force considered that whilst such a power would not suffer the same definitional problems as the proposed power to suspend contractual obligations, its efficacy would be limited if it could only be applied to UK-based infrastructures. Many transactions which “occur” in the UK’s markets rely on non UK-based infrastructures for completion, and these infrastructures would not be subject to UK law. Furthermore, the degree of linkage that now exists between UK clearing and settlement systems and their continental European counterparts raises questions, at least in some cases, as to whether it would be desirable to take a unilateral decision to close UK markets following major operational disruption.

3.15 In the US, the authorities have wider powers to direct trading suspensions, but such powers are subject to significant restrictions. The powers of the Securities and Exchange Commission (SEC) only apply to national securities exchanges and do not take effect unless the SEC has notified the President of its decision and the President has notified the SEC that he does not

disapprove of the decision. Like the FSA, the SEC does not have powers to direct a suspension of trading in OTC markets.

3.16 The Task Force considers that any public intervention should, wherever possible, be directed toward facilitating the continuing operation or recovery of financial markets and that directing closure under new powers could only be contemplated in rare and extreme circumstances. But it is unlikely that there would be many circumstances where the financial authorities would be better placed to make a decision than the infrastructure provider itself. The Task Force believes that it is most unlikely that the financial authorities would wish to direct a system to close if its management wished it to remain open. Neither the financial authorities nor the infrastructure bodies themselves supported the suggested power. For these reasons, **the Task Force concluded that powers of direction, as set out in the Green Paper, would not be desirable.**

### Powers to prohibit financial transactions

3.17 Section 2 of the Banking and Financial Dealings Act 1971 gives HM Treasury a general power to prohibit certain financial transactions. In effect, it includes to a greater or lesser degree both powers to suspend obligations, and powers to direct infrastructure. The Treasury may order the suspension of banking and building society business, foreign currency dealing, dealing in gold or silver, commodity futures dealing, and stock exchange dealing with respect to a specified day if it is in the national interest. Where a person is prevented from complying with an obligation because of an order under the section, for example because the banks are closed that day, he is deemed to have complied if he does so as soon as practicable afterwards. This provision would therefore override contractual payment clauses.

3.18 The scope of the power reflects the markets that existed in 1971. Even if such a power were considered helpful in dealing with major operational disruption, there are obvious omissions in its scope. It is unclear for example whether the powers extend to LIFFE, and generally its potential application to the operation of the OTC derivatives market is unclear. The question therefore arises whether section 2 should be brought up to date. If this course were to be adopted, similar definitional issues as mentioned above in connection

with the proposed general power of suspension would have to be resolved.

3.19 The Task Force notes that the powers have never been exercised. The Green Paper expressed the view that the prohibitive powers went considerably beyond the kind of power envisaged as useful in responding to major operational disruption. The emphasis is strongly on prohibition, whereas the Green Paper is rightly concerned to facilitate continued operation. **The Task Force concluded that the section 2 powers in the Banking and Financial Dealings Act 1971 to prohibit certain financial transactions are unlikely to be helpful in dealing with major operational disruption, and does not recommend the amendment of the section.**

### Powers to declare a bank holiday

3.20 The potential benefits of declaring a bank holiday are similar to those that could arise from a power of suspension — the creation of a “breathing space” to allow markets to recover, and a signalling effect to market participants that the day in question was not being treated as a normal business day.

3.21 Whether a bank holiday does create a breathing space in the legal sense depends on the consequences of a declaration. In this regard, the effect of a declaration might either be considered mandatory or permissive:

- a **mandatory bank holiday** would result in the automatic postponement of payment and other obligations to the next working day. It would, in effect, override existing contractual provisions that required payment or other obligations to be met on the day in question.
- a **permissive bank holiday** would result broadly in payment or other obligations due on a bank holiday being postponed unless the parties’ contract required them to be met on that day.

3.22 So far as the markets are concerned, the Task Force considers that a power which overrides contractual provisions would be retrogressive and unnecessarily prohibitive. On this basis, it is not in favour of enacting any new power to declare a mandatory bank holiday in the sense of an automatic postponement of payment and other obligations.

3.23 On the other hand, declaring a permissive bank holiday would work within contractual provisions and not override them. As regards the existing powers

available to the UK authorities to declare a bank holiday, the effect in respect of the financial markets is best considered permissive, but the legal position is not completely unambiguous (see Box 2).

3.24 If a power to declare a permissive bank holiday was seen as desirable, the question arises whether the existing powers under UK law are adequate to be used in the case of major operational disruption. The Green Paper highlighted the potential practical difficulties of using the powers in the Banking and Financial Dealings Act 1971 in an emergency, in particular, the need for a proclamation by the head of state and because it seems that a bank holiday cannot in practice be declared for the day of the proclamation.

3.25 The Task Force notes that in the State of New York, the power to declare a bank holiday is wider than in the UK in a number of significant respects:

- it can be declared same-day;
- it does not require a proclamation by the head of state; the State Governor can make the declaration;
- by specific provision, it can be declared in the event of an emergency;
- upon a proclamation, banks may close their places of business in the holiday area, but are not required to do so; and
- what seems to be implicit in UK law is more explicit in New York law, namely that if a contract requires the payment of money on a given date, such payment may be made on the next succeeding business day, *unless* the contract expressly or impliedly indicates a different intent.

3.26 If declaring a permissive bank holiday is seen as helpful, modernisation of the bank holiday powers presently set out in the Banking and Financial Dealings Act 1971 would clearly be desirable. In particular, amendments would have to be made along the lines of US legislation so that a bank holiday could be declared on the same day, could be declared specifically in the context of an emergency, and did not necessarily require a proclamation by the head of state if the circumstances of the emergency made this impossible.

3.27 This leads to a consideration of whether the declaration of a bank holiday would in fact be helpful as a means of dealing with major operational disruption, or whether the advantages are outweighed by disadvantages.

## Box 2: Impact of declaring a UK bank holiday

The impact on financial markets of declaring a bank holiday is, as the Green Paper notes, not completely unambiguous. A key issue is whether or not it automatically postpones payment, or other obligations, to the next weekday. Section 1(4) of the Banking and Financial Dealings Act 1971 Act specifies the effects of a bank holiday:

No person shall be **compellable** to make any payment or to do any act on a bank holiday under this Act which he would not be compellable to make or do on Christmas Day or Good Friday; and where a person would, apart from this subsection, be compellable to make any payment or to do any act on a bank holiday under this Act, his obligation to make the payment or to do the act shall be deemed to be complied with if he makes or does it on the next following day on which he is compellable to make or do it.

As regards the financial markets, there is a generally held view that compellable means compellable by *legal process* such as a court order. In other words, postponement does not apply where a party to a contract is *contractually* bound to perform his obligation on the day in question.

On the basis that this view is correct and a UK bank holiday is permissive in nature, its effect would seem similar to that under New York law where the payment obligation is postponed “unless the contract expressly or impliedly indicates a different intent”.

The impact of declaring a UK bank holiday depends on the provisions of particular contracts, whether contracts are to be settled in sterling or in other currencies, and on other location-specific matters. In practice, most financial contracts do not define “business day” by reference to bank holidays. Instead, the term is defined by reference to whether banks, markets, exchanges and/or settlement systems in fact are open and whether payments or other deliveries are in fact made or capable of being made.

However, some infrastructures include in their definition of business days a reference to bank holidays. For example, under its current rules, CREST is not open for business on a bank holiday. Consequently, contracts which are conditioned on market infrastructures being open could be impacted by the declaration of a bank holiday.

3.28 There are a number of possible disadvantages:

- **compulsory closure** of infrastructures intraday where their rules provide for closure on a bank holiday may leave some market participants unexpectedly short of liquidity. As the business day lengthens, it is increasingly likely that the holiday would have to be declared intraday<sup>13</sup>.
- **limited effect** in that the declaration of a bank holiday in the UK would probably not operate to affect payment obligations in US dollar-denominated contracts in which case the relevant “business day” may be the New York rather than the London day.
- **acceleration of payment obligations** might occur as regards contracts which provide that where an act is to be performed on a non-business day, performance will be accelerated to the immediately

preceding business day. This would be the reverse outcome to that desired.

3.29 More generally, the Task Force notes that currently the declaration of a “bank holiday” triggers provisions in numerous other UK statutes, and the consequences may be unexpected and undesirable. Acts affected include the Bank of England Act 1998, the Arbitration Act 1996 and the Bills of Exchange Act 1882 in addition to a whole range of other statutes<sup>14</sup>. There are also economic consequences, such as in relation to staff holidays and wage costs that would need to be avoided in the context of declaring a bank holiday to deal with major operational disruption.

3.30 The Task Force notes that the power to declare an emergency bank holiday was invoked in New York on 11 September 2001. However this does not necessarily

<sup>13</sup> CREST opens on a Monday at 01:30 UK time, and CLS Bank is open all week — from around 22:00 on Sunday evening to 02:00 the following Saturday morning — with critical processing activities running through each weeknight from 23:00 until 11:00 the following day.

<sup>14</sup> See Annex 4E.

mean that it would be necessary or desirable to deal with disruption in London in the same way since the nature of the markets is not identical in the two centres.

3.31 In addition, there are specific reasons under New York law for declaring an emergency bank holiday which do not arise under English law in the same way. Under New York law, where a banking organisation decides to close its offices, it must provide the services at another office unless there has been a proclamation of an emergency, or it has obtained the prior approval of the Superintendent of Banks. Banks also face potential liabilities if they fail to meet certain deadlines for the crediting of payments to customers' accounts, requirements which do not apply in the event a bank closes during an emergency<sup>15</sup>. In the UK however, banks do not require regulatory approval to close, and there are no general legal requirements on the timing of credits to customers' accounts.

3.32 The Task Force believes that the main benefit of declaring a bank holiday in the case of major operational disruption in the UK would be the signalling effect to market participants. Legally, the effect would depend upon the provisions of particular contracts and whether contracts were to be settled in sterling or in other currencies, and other location-specific matters.

3.33 On balance, **the Task Force concluded that the power to declare an emergency bank holiday would not provide sufficient assistance in dealing with major operational disruption to justify the modernisation of the powers in the Banking and Financial Dealings Act 1971**. Its conclusion is in keeping with the philosophy underlying this report, namely that the most effective method of dealing with disruption is likely to be market led, and that action taken by the Government cannot substitute for effective, practical contingency planning.

3.34 The Task Force also considered whether there would be benefits from having a formal power to declare, for example, a "day of major operational disruption". However, unlike a bank holiday, such a declaration would be unfamiliar to market participants in the UK and abroad. There was no evidence that it was something that the markets wanted. The Task Force decided not to pursue this issue. For similar reasons, the Task Force did

not pursue the possibility of a statutory declaration of "non-business days" or "non-trading days". In this regard, it noted that similar benefits in terms of a signalling effect to market participants that the day in question was not being treated as a normal business day can be obtained by informal means, such as by a statement from the financial authorities.

## Emergency powers under the Civil Contingencies Bill

3.35 In considering the need for specific powers to deal with operational disruption in the financial services sector, the Task Force also examined whether general legislation for dealing with emergencies might be relevant. Such legislation is commonly found internationally, and in this respect the UK is no exception.

3.36 Major operational disruption may fall within, or be caused by events which fall within, the definition of an "emergency" as it exists under general law, but will not necessarily do so. In any case, in the UK, unlike a number of other jurisdictions, the power to proclaim a state of emergency is seldom used. Proclamations of emergency tend to be associated with very serious civil and industrial unrest. Whilst the Crown is considered to have emergency powers under the royal prerogative, particularly in time of war or invasion, these powers are generally too uncertain for government to rely on and there are no recent peacetime examples of their use.

3.37 Under the Emergency Powers Act 1920, which is due to be repealed by the Civil Contingencies Bill, the Queen may issue a proclamation of a state of emergency. Emergency regulations may make provision for a range of purposes "essential to the public safety and the life of the community". It would appear that such regulations could be used in an emergency to regulate the financial sector (even though the legislation does not contain specific reference to powers over the financial sector).

3.38 The proposed Civil Contingencies Bill makes specific reference to the threat to economic stability and to the activities of banks or other financial institutions in defining an "emergency". It allows for regulations to be made for the purpose of preventing, controlling or mitigating a serious aspect or effect of the emergency. The draft Bill includes a wide list of the kind of things

<sup>15</sup> Under the NY enactment of the Uniform Commercial Code. The UCC provides that if a banking organisation closes following a proclamation of an emergency then the day is neither a "full business day" nor a "banking day" for all purposes of the Code. See TC Baxter & S Heller, *How does the commercial law respond when the unthinkable happens? September 11th in retrospect*, Uniform Commercial Code Law Journal, Fall 2002. Vol 35 #2, page 1.

for which regulations may make provision. As well as the protection of human life, health and safety, the list includes matters potentially relevant in the financial sphere such as protecting or restoring property, electronic or other systems of communication and transport.

3.39 The emergency powers proposed in the Bill are so extensive as to be capable of covering financial sector issues, but it does not follow that in the event of a proclamation of an emergency under the Civil Contingencies Bill, the exercise of emergency powers covering the financial services sector would be appropriate. The Task Force could not readily identify ways in which the powers might be used constructively to deal with the legal issues surrounding major operational disruption considered in this report. For reasons discussed previously, powers of suspension, direction or prohibition may be difficult, or undesirable, to implement in practice, whether in the context of the proclamation of an emergency or not.

3.40 As regards the financial sector, the Task Force did not see the proposed Civil Contingencies Bill as a major departure from the existing law. **The Task Force saw no case for a “carve-out” for the financial services sector.** In certain situations the powers might be helpful in the financial services sector in the same way as in other parts of the economy in the extreme circumstances in which they would be available.

### Powers to waive statutory requirements during a crisis

3.41 One of the concerns expressed by market participants in response to the Green Paper was the difficulties they might face in complying with existing regulatory and statutory requirements during a crisis. They suggested that there might be a need for the FSA to be granted powers to issue regulatory waivers in the aftermath of major operational disruption.

3.42 The FSA has already made specific provisions allowing for the non-compliance of firms with regulatory requirements during an emergency. Specifically, the FSA Handbook provides that a person will not be in contravention of the FSA's rules to the extent that compliance with specific rules is impracticable as a consequence of the emergency<sup>16</sup>. Such an exemption applies only for so long as:

- the consequences of the emergency continue; and
- the person can demonstrate that it is taking all practicable steps to deal with those consequences, to comply with the rule, and to mitigate losses and potential losses to its clients (if any).

3.43 These emergency provisions in the FSA Handbook provide potentially valuable relief to firms which are unable to meet FSA rules in an emergency, such as might arise following operational disruption. The provisions are self-executing in the sense that they apply in the event of an emergency and do not need to be formally invoked by the FSA. However, the provisions that require firms to notify the FSA may be too formal for use in a major emergency and could usefully be reviewed to ensure that firms must only notify “as soon as practicable”. **The Task Force concluded there would be benefits from the FSA ensuring its notification requirements for emergencies were flexible enough to be used during major operational disruption.**

3.44 At a broader level, the Task Force considered whether market infrastructures should have statutory immunity for any decisions taken to deal with major operational disruption. This was in response to a suggestion that their ability to take decisions in a crisis might be undermined by fear of litigation by stakeholders adversely affected by a closure or suspension decision. However, UK-based market infrastructures seem well protected from liability arising from decisions taken in good faith:

- through their contracts with their members and users;
- by provisions in their rules;
- by section 291 of the Financial Services and Markets Act 2000 which provides safeguards to recognised bodies in the exercise of their regulatory functions; and
- as a result of the *Shearson Lehman v Maclaine Watson* case in which a decision by the London Metal Exchange in 1985 to suspend the tin market and to impose an emergency rule change was, following a challenge, held to be legal<sup>17</sup>.

3.45 Some market infrastructures felt that further safeguards were needed in relation to statutory provisions which might, potentially, affect their powers set out under their rules and in contracts. In particular, they expressed concern about the Unfair Terms in

<sup>16</sup> FSA Handbook, Rule GEN 1.3.2 R.

<sup>17</sup> [1989] 1 All E.R. 1056, [1989] 2 Lloyd's Rep. 570.

Consumer Contracts Regulations 1999 which are relevant to participants who are consumers and about section 3 of the Unfair Contracts Act 1977 which is relevant to standard-form contracts and rules governing the relationship between an infrastructure provider and a business participant. In light of this, some market infrastructures suggested the infrastructures should be given statutory immunity for decisions taken in response to major operational disruption. They argued that this would assist market infrastructures to give priority to what was in the interests of the market as a whole, unfettered by residual concerns that contractual provisions might not protect them from liability should any loss be suffered as a consequence of the action taken.

3.46 The Task Force recognises the concerns of the market infrastructures on this issue. However, it considered that there were a number of safeguards available to market infrastructures. Under section 291 of the Financial Services and Markets Act 2000, recognised investment exchanges and clearing houses already have immunity for activities done in the discharge of their regulatory functions. These functions are defined broadly and mean the functions of the recognised body “so far as relating to, or to matters arising out of, the obligations to which the body is subject under or by virtue of the Act”. The FSA, the lead qualifying body for considering complaints from consumers concerning unfair contract terms relating to most kinds of financial services, has indicated that it would not regard contract terms allowing infrastructure providers to take action they consider to be necessary to

deal with major operational disruption as unfair, so long as the terms provided to consumers and to others are similar in effect. Furthermore, where market infrastructures’ rules make specific provision for actions that might be taken to deal with major operational disruption, wide as those powers may need to be to cope with a range of eventualities, the Task Force did not consider that such actions, provided they were taken in good faith, were likely to be open to successful challenge. **The Task Force concluded that it was not clear that further statutory immunity to market infrastructures was required.**

3.47 The Task Force also considered whether the FSA might need any specific powers to deal with major operational disruption. In comparison to the position of the SEC in the US, the FSA has fewer direct powers in an emergency. The SEC can, by order, summarily take action to alter, supplement, suspend, or impose requirements or restrictions with respect to any matter or action subject to regulation by the SEC or a self-regulatory organisation<sup>18</sup>. Although subject to significant limitations, the effect of these provisions would seem to be to give the SEC wide powers to suspend market trading and regulatory requirements in an emergency. Neither power was, however, exercised in the aftermath of 11 September 2001. The FSA did not itself indicate a need for further powers. **The Task Force concluded that there was no need to give the FSA, or another public authority, powers to suspend any other statutory or regulatory requirements during major operational disruption.**

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<sup>18</sup> Such action must be necessary in the public interest and for the protection of investors to maintain or restore fair and orderly securities markets, or to ensure prompt, accurate, and safe clearance and settlement of transactions in securities.

## Chapter 4: Conclusions and recommendations

### Summary

The Task Force concluded, on balance, that no new statutory powers are needed. It prefers to rely on the existing approach adopted by market participants and the financial authorities, namely to focus on contractual methods of dealing with emergencies, and on appropriate market infrastructure rules, against a background of co-ordinated contingency planning.

The Task Force's conclusions are in line with the approach taken by the US authorities following 11 September 2001 and also with the conclusions of the Financial Markets Law Committee's Emergency Powers Legislation Working Group. They minimise the risk that the exercise of new powers would be incompatible with rules prevailing in other major financial centres and the risk of new powers impeding rather than promoting the orderly resumption of financial markets.

The conclusion that no new statutory powers are needed is based not only on the work that has already been undertaken to address business continuity issues but also on the need for further improvements. In particular, the Task Force has put forward eight recommendations to help further improve the resilience of UK financial markets:

**Recommendation 1:** *Market participants and the financial authorities should continue to place a high priority on business continuity planning.*

**Recommendation 2:** *Market participants and their trade associations should work to ensure that private contracts are reviewed to take account of major operational disruption. A useful starting point for such reviews is the "contracts checklist" put forward in the FMLC's report on emergency powers.*

**Recommendation 3:** *Market infrastructures should ensure that they have specific rather than general powers to deal with major operational disruption. They should also ensure that the mechanism for invoking these powers is flexible enough to be operated successfully in a crisis.*

**Recommendation 4:** *The UK financial authorities should continue to contribute to international efforts to develop recognised good business continuity practice for systemically important market infrastructures. Their application in the UK should recognise that the prime responsibility for business continuity planning rests with the senior management of firms and market infrastructures.*

**Recommendation 5:** *Participants in significant markets should consider whether there would be benefits from further defining the principles on which to base claims arising from the delayed performance of contracts following major operational disruption.*

**Recommendation 6:** *The financial authorities should aim to clarify further, and publicise, their respective roles in the event of major operational disruption.*

**Recommendation 7:** *The financial authorities should consider with market participants the need for a high-level committee to help ensure co-ordination across financial markets in the event of major operational disruption.*

**Recommendation 8:** *The UK financial authorities should continue to promote international co-operation and co-ordination in developing responses to major operational disruption.*

For each recommendation, the Task Force has suggested how it could be implemented. It also proposes that the Tripartite Standing Committee on Financial Stability comprised of the three financial authorities — HM Treasury, FSA and Bank of England — should monitor progress in meeting the recommendations, and publish a progress report in October 2004 and annually thereafter.

## Introduction

4.1 The Task Force concluded, on balance, that no new statutory powers are needed. It prefers to rely on the existing approach adopted by market participants and the financial authorities, namely to focus on contractual methods of dealing with emergencies, and on appropriate market infrastructure rules, against a background of co-ordinated contingency planning. It believes that this approach is best suited to the particularly international and interconnected nature of UK markets. It recognises the fact that the laws of countries other than the UK also govern contracts in London's markets, which would not, or might not, be subject to the provisions of UK legislation.

4.2 The Task Force's conclusions are in line with the approach taken by the US authorities following 11 September 2001. They minimise the risk that the exercise of new powers would be incompatible with rules prevailing in other major financial centres and the risk of new powers impeding rather than promoting the orderly resumption of financial markets.

4.3 The Task Force's conclusions are also in line with those of the Financial Markets Law Committee's Emergency Powers Legislation Working Group which found that there were no significant legal gaps which required new legislation.

4.4 The conclusion that no new statutory powers are needed is predicated not only on the work that has already been undertaken to address business continuity issues but also on the need for further improvements. In particular, the Task Force found that there were a number of business continuity issues that needed to be addressed to help further improve the resilience of UK financial markets:

- the adequacy of existing business continuity planning work;
- whether private contracts' use of *force majeure* and other provisions met good practice standards;
- the need for market infrastructures to have explicit powers to deal with major operational disruption;
- the benefits of defining good business continuity practices for systemically important infrastructures;
- the advantages of agreeing *ex ante* conventions on

compensation principles to be used in the aftermath of major operational disruption;

- the need for good co-ordination and communication in a crisis; and
- the benefits of international co-operation in dealing with major operational disruption.

## Existing business continuity planning work

4.5 Much has been achieved already by market participants and the financial authorities to strengthen the resilience of the UK financial system to the threat of major operational disruption<sup>19</sup>. However, the Task Force's conclusion that new statutory powers would not be desirable and that other measures should deliver an acceptable level of resilience underlines the importance of ensuring that these other measures reflect international best practice.

4.6 The difficulty in planning for major operational disruption is the inherent uncertainty of how events will unfold in a crisis. A high degree of flexibility is therefore needed. One of the clear lessons from the events of 11 September 2001 was that the "extraordinary levels of co-operation by market participants" helped overcome shortcomings in individual firms' business continuity planning<sup>20</sup>. The Task Force believes that firms should have well-developed plans to cope with the practical consequences of dealing with a crisis, particularly to allow communication with, and ensure the availability of, their own staff, and to allow for communication with their market counterparties even when they have relocated to back-up contingency sites.

4.7 The Task Force welcomes the work the FSA has conducted with key firms in establishing their preparedness for major operational disruption. In particular, its review of business continuity planning arrangements at twelve major financial groups and subsequent Working Paper on Business Continuity Management are a very helpful step in the establishment of good practice benchmarks for systemically important firms<sup>21</sup>. Going forward, the FSA aims to provide an annual summary of major firms' progress.

4.8 Some market infrastructures that were overseen by the financial authorities suggested that there was also a need to consider whether the preparations of "quasi

<sup>19</sup> See Annex 3: Summary of existing business continuity planning work.

<sup>20</sup> Federal Reserve, New York State Banking Department, Office of the Comptroller of Currency, Securities and Exchange Commission *Summary of "Lessons Learned" and Implications for Business Continuity* 15 February 2002.

<sup>21</sup> [http://www.financialsectorcontinuity.gov.uk/home/default.asp?expand=3&open=issues/cont\\_arrangements/default.htm](http://www.financialsectorcontinuity.gov.uk/home/default.asp?expand=3&open=issues/cont_arrangements/default.htm)

infrastructures” to deal with major operational disruption should be reviewed by UK authorities. In referring to quasi infrastructure they meant those systemically important firms that played a similar role to market infrastructures in certain financial markets. One example, would be the role some banks play as major custodians in the securities market. The Task Force considers that such quasi infrastructures are already overseen by the FSA and that a specific regime for such infrastructures is not required.

4.9 However, the Task Force thought it would be helpful for the FSA to elaborate on its high-level business continuity planning principles for systemically important firms in the specific areas of recovery times, and testing of business continuity arrangements and their preparedness for dealing with the type of legal issues on major operational disruption that are addressed within this report.

**Recommendation 1:** *Market participants and the financial authorities should continue to place a high priority on business continuity planning.*

### Contractual remedies including *force majeure*

4.10 The Task Force found that there is a sufficiently wide range of contractual risk management mechanisms available to allow contracting parties to take account of, and minimise the impact of, major operational disruption. The absence of *force majeure* clauses within some private contracts is not a concern *per se* and in some contracts, such as essential services contracts, their use may be undesirable.

4.11 Although the contractual options available to market participants seem adequate, they have not necessarily been implemented in all relevant contracts

and some contracts have not been updated to reflect developing practice. There is anecdotal evidence that in some markets not all significant financial transactions are routinely underpinned by written contract. The Task Force believes that firms should ensure that they are making use of the most recent master agreements, where appropriate, and that contracts are checked to ensure they make adequate provision for major operational disruption.

4.12 The Task Force has also found that there may be potential problems with the use of cross-default clauses where there is a risk that a default under one contract could trigger a cascade of defaults under many other contracts. Depending on the scale of the cascade, this could cause significant difficulties across institutions and markets. The Task Force believes that parties to contracts should consider carefully the limitation of the operation of cross-default and cross-acceleration provisions so that in the event of a major operational disruption such clauses do not create or exacerbate difficulties for institutions or the markets. The potential risk of cascades of defaults could be addressed through suitable defence provisions, including:

- use of a narrow definition of the types of default capable of triggering cross-default provisions;
- use of thresholds; and
- use of grace periods.

**Recommendation 2:** *Market participants and their trade associations should work to ensure that private contracts are reviewed to take account of major operational disruption. A useful starting point for such reviews is the “contracts checklist” put forward in the FMLC’s report on emergency powers.*

<b>Recommendation 1:</b> <i>Market participants and the financial authorities should continue to place a high priority on business continuity planning.</i>		
<b>Action required:</b>	<b>By whom:</b>	<b>By when:</b>
Firms should continue to benchmark themselves against good practice.	Market participants	Ongoing
Firms’ steps in achieving good practice standards should be monitored.	FSA	Ongoing
Publication of high-level business continuity planning principles for systemically important firms	FSA	June 2004
Publication of annual summary of progress.	FSA	October 2004

<b>Recommendation 2:</b> <i>Market participants and their trade associations should work to ensure that private contracts are reviewed to take account of major operational disruption. A useful starting point for such reviews is the “contracts checklist” put forward in the FMLC’s report on emergency powers.</i>		
<b>Action required:</b>	<b>By whom:</b>	<b>By when:</b>
Standard market contracts should be checked, in light of this report, whether they make appropriate provision for dealing with major operational disruption (including the operation of cross-default clauses).	Trade associations	June 2004
Summary of progress should be published.	Bank of England	October 2004
Financial contracts should be reviewed as they come up for renewal, or as new ones are entered into, to ensure they make adequate provision for major operational disruption and, where relevant, make use of the most recent master agreements. In relation to existing longer-term contracts, firms should also consider whether a review would be appropriate.	Market participants	Ongoing
Summary of firms’ progress should be published.	FSA	October 2004

### Market infrastructures’ rules

4.13 UK market infrastructures generally appear to have well-developed and well-rehearsed plans for managing operational disruption. However, there would appear to be some significant differences in the powers available to different infrastructures to deal with such disruption. While most infrastructures have specific powers to allow them to deal with major operational disruption, some rely instead on “catch all” powers within their rules or regulations. While the presence of “catch all” powers is reassuring, the Task Force believes that specific powers would provide greater reassurance and help reduce the possibility of successful legal challenge by stakeholders adversely affected by a closure or suspension decision.

4.14 In addition, some infrastructures seem to have inflexible procedures for invoking emergency powers, for example, by requiring decisions by the board of directors for these powers to be invoked. This could create difficulties if communications were disrupted or if a quorum was unobtainable in a crisis.

**Recommendation 3:** *Market infrastructures should ensure that they have specific rather than general powers to deal with major operational disruption. They should also ensure that the mechanism for invoking these powers is flexible enough to be operated successfully in a crisis.*

### Sound practices for systemically important infrastructures

4.15 The Task Force also considered whether there would be merits in issuing best practice standards or guidelines on dealing with major operational disruption to UK market infrastructures. The infrastructures argued, however, that these would not be desirable for a number of reasons:

- standards would be hard to keep up to date;
- the specific circumstances of each infrastructure necessitated a flexible, bespoke approach;
- it would be difficult to strike the balance between standards being either too prescriptive, or so vague as not to be worthwhile; and
- the standards would need to be extremely wide-reaching to be effective, which would be difficult to achieve.

4.16 In the US, the authorities have adopted an Interagency Paper on Sound Practices to Strengthen the Resilience of the US Financial System which appears to have focussed market infrastructures’ attention on planning for wide-scale disruption<sup>22</sup>. Recently, in September 2003, the Securities and Exchange Commission issued a policy statement suggesting that specific “business continuity planning principles” should be applied to certain trading markets<sup>23</sup>.

4.17 Such issues are also being discussed in other jurisdictions and internationally through the G10

<sup>22</sup> <http://www.federalreserve.gov/boarddocs/press/bcreg/2005/20050408/default.htm>

<sup>23</sup> <http://www.sec.gov/rules/policy/34-48545.htm>

**Recommendation 3:** *Market infrastructures should ensure that they have specific rather than general powers to deal with major operational disruption. They should also ensure that the mechanism for invoking these powers is flexible enough to be operated successfully in a crisis.*

Action required:	By whom:	By when:
Review of infrastructure rules and procedures.	Systemically important payment systems and recognised clearing houses and exchanges.	June 2004
Reviews by systemically important payment systems should be monitored and a summary of progress should be published.	Bank of England	October 2004
Reviews by recognised clearing houses and exchanges should be monitored and a summary of progress should be published.	FSA	October 2004

Central Bank Governors' Committee on Payment and Settlement Systems (CPSS) and within the European System of Central Banks (ESCB). For example, the CPSS Core Principles for Systemically Important Payment Systems and the CPSS/IOSCO Recommendations for Securities Settlement Systems both address the importance of business continuity and the need for appropriate contingency arrangements.

**Recommendation 4:** *The UK financial authorities should continue to contribute to international efforts to develop recognised good business continuity practice for systemically important market infrastructures. Their application in the UK should recognise that the prime responsibility for business continuity planning rests with the senior management of firms and market infrastructures.*

### Ex ante conventions on compensation

4.18 The Task Force found that participants in some markets had agreed *ex ante* the compensation arrangements that would apply where major operational disruption led to the closure of a payment or settlement

system. For example, the Money Markets Liaison Group (MMLG) has made a non-binding recommendation that the Monetary Policy Committee's official repo rate should be paid and charged on unintended bank balances and overdrafts following any event that led to market-wide disruption to trading and settlement in sterling money markets.

4.19 Participants in OTC markets may wish to consider whether any other compensation principles might also be helpful in reducing uncertainty amongst market participants following major operational disruption. Market infrastructures may also like to ensure that similar issues — such as the consequences of failure to deliver securities, make payments or perform other obligations — are properly dealt with within their rules and standard contracts.

**Recommendation 5:** *Participants in significant markets should consider whether there would be benefits from further defining the principles on which to base claims arising from the delayed performance of contracts following major operational disruption.*

**Recommendation 4:** *The UK financial authorities should continue to contribute to international efforts to develop recognised good business continuity practice for systemically important market infrastructures. Their application in the UK should recognise that the prime responsibility for business continuity planning rests with the senior management of firms and market infrastructures.*

Action required:	By whom:	By when:
UK financial authorities to publish a summary report on international efforts to develop sound practices on business continuity for systemically important infrastructures.	Bank of England FSA	October 2004

**Recommendation 5:** Participants in significant markets should consider whether there would be benefits from further defining the principles on which to base claims arising from the delayed performance of contracts following major operational disruption.

Action required:	By whom:	By when:
Market participants and infrastructures to review, in light of the work of the Money Markets Liaison Group, whether any other markets would benefit from agreeing compensation principles that could be applied in the event of major operational disruption.	Trade associations Market infrastructures	June 2004
Summary of progress should be published.	Tripartite Standing Committee	October 2004

## Communication and co-ordination in a crisis

4.20 The importance of communication and co-ordination in a crisis cannot be overestimated. It is essential in maintaining or restoring confidence following major operational disruption and in getting the financial markets back to “business as usual”.

4.21 Some market participants considered that it was desirable for a single organisation to become the focal

point for both *ex ante* preparations for major operational disruption and *ex post* responses. They suggested that the creation of such a “ring master” would be a public demonstration of London’s commitment to planning for major operational disruption.

4.22 The Task Force agreed with the emphasis placed on communication and co-ordination. It also understood market participants’ natural desire for a single point of contact. However, it believed that this

### Box 3: Standing Committee on Financial Stability’s Event Response Framework

The Event Response Framework concentrates on the first few hours after an event, when the potential for confusion is likely to be greatest and a pre-defined Framework most useful. The initial timeline in the Framework (with *indicative* timings) is:

- an early (by T+1 hours) Standing Committee Deputies’ discussion to share information, co-ordinate initial responses and, in particular, agree and issue public announcements. Full use would be made of available communication channels (media, website, information line) to provide reassurance and clarification. Depending on developments, further meetings might need to be arranged to agree updated announcements ahead of a first full Standing Committee meeting;
- a process for gathering and exchanging information with regular sharing of information via the Committee’s Sub-Group on Resilience and Contingency Planning; and
- when appropriate, a full Standing Committee meeting (around T+3 hours) to review the situation, agree any collective actions and announcements by the authorities and delegate tasks to specific authorities, with further meetings at appropriate intervals thereafter.

Not all decisions and collection of information will fit into this pattern and the Framework itself is subject to regular review in light of developments. Some of the most important information would already have been shared and some quick decisions, perhaps on a trilateral basis, made on an ad hoc basis before the three-hour mark. Discussions and meetings would largely be via teleconference. In practice, the authorities would have to adapt their plans to the nature of the incident and the availability of staff and facilities.

Some decisions will be for the three authorities to consider collectively whilst others will be for authorities individually. The balance will depend upon responsibilities, the urgency required for decision-taking and the ease of communication between the authorities.

was not compatible with the different responsibilities and powers of different financial authorities. For example, issues surrounding the operation and settlement of payment systems would have to be dealt with by the Bank of England while a firm's concern about its compliance with regulatory requirements would need to be dealt with by the FSA. Nonetheless, the Task Force acknowledged that more could be done to explain the role of the Tripartite Standing Committee on Financial Stability in bringing together the three financial authorities in the event of major operational disruption<sup>24</sup>. For example, the Standing Committee has developed an Event Response Framework that outlines the process the financial authorities would follow in the event of a major incident, such as a terrorist attack, in the UK (see Box 3).

4.23 The Task Force also agreed that more could be done to explain the different roles and responsibilities of the three financial authorities. The recent updating of the Tripartite financial sector continuity web site to provide such further information is a helpful development (see Box 4). The Task Force emphasised the importance of information on the authorities' roles to be provided on an on-going basis.

**Recommendation 6:** *The financial authorities should aim to clarify further, and publicise, their respective roles in the event of major operational disruption.*

4.24 Several infrastructures also highlighted the need for co-ordination of business continuity arrangements between different infrastructures, particularly given their increasing interdependency. The Task Force agrees that high-level co-ordination will be essential in the

aftermath of major operational disruption. It noted that the US authorities had made considerable efforts to determine *ex ante* how co-ordination between key market participants could be maintained in a crisis following the helpful role that the Payments Risk Committee played in the aftermath of 11 September 2001.

4.25 A number of individual markets have helpfully established standing arrangements for decision-taking based on market consultation in the event of a major market disruption. For example, the MMLG has established a framework for managing operational problems in the sterling money markets involving market participants, APACS and CREST. The Task Force welcomes such arrangements and believes that it is important to ensure that membership of such groups is sufficiently senior to enable them take binding decisions in the event of major operational disruption.

4.26 The Task Force believes that it would be helpful to consider whether there is a need for a higher level committee or other arrangements to enable co-ordination across the range of markets located in London and across market infrastructures following major operational disruption. This might involve senior executives from systemically important firms and infrastructures who also had detailed business and operational knowledge of financial markets.

**Recommendation 7:** *The financial authorities should consider with market participants the need for a high-level committee to help ensure co-ordination across financial markets in the event of major operational disruption.*

<b>Recommendation 6:</b> <i>The financial authorities should aim to clarify further, and publicise, their respective roles in the event of major operational disruption.</i>		
<b>Action required:</b>	<b>By whom:</b>	<b>By when:</b>
Review of information provided on <a href="http://www.financialsectorcontinuity.gov.uk">www.financialsectorcontinuity.gov.uk</a> web site.	Bank of England	April 2004
Arrange a survey of market participants' knowledge of, and views on, web site.	Tripartite Standing Committee	October 2004
Continue business continuity roundtables for key market participants.	Tripartite Standing Committee	July 2004 & then at least annually
Produce annual progress report on business continuity planning.	Tripartite Standing Committee	October 2004 & annually thereafter

<sup>24</sup> It comprises the Chancellor of the Exchequer, the Governor of the Bank of England and the Chairman of the FSA. Their Deputies are the Managing Director of Finance, Regulation and Industry (HM Treasury), the Deputy Governor, Financial Stability (Bank of England) and currently the Managing Director of Deposit Takers and Markets (FSA).

<b>Recommendation 7:</b> <i>The financial authorities should consider with market participants the need for a high-level committee to help ensure co-ordination across financial markets in the event of major operational disruption.</i>		
<b>Action required:</b>	<b>By whom:</b>	<b>By when:</b>
Consider the need for a high-level co-ordination committee or other arrangements.	Tripartite Standing Committee with market participants	April 2004
Ensure that existing responsibilities for decision-taking are clear and that relevant committees have the appropriate level of representation.	Tripartite Standing Committee together with relevant committees	April 2004

## International co-ordination

4.27 The Task Force noted that some of the infrastructures used by UK market participants are incorporated overseas and regulated in their home country. This means that decisions taken in the UK could be affected if contrary decisions were taken in other financial centres. Consequently, it would be important to ensure active co-ordination of countries' approaches to major operational disruption, within Europe but also on the wider international front.

4.28 The Task Force noted that much work had already been done in this area including, for example, the development within the EU of a Memorandum of Understanding on high-level principles of co-operation between banking supervisors and central banks in crisis management situations.

**Recommendation 8:** *The UK financial authorities should continue to promote international co-operation and co-ordination in developing responses to major operational disruption.*

<b>Recommendation 8:</b> <i>The UK financial authorities should continue to promote international co-operation and co-ordination in developing responses to major operational disruption.</i>		
<b>Action required:</b>	<b>By whom:</b>	<b>By when:</b>
UK financial authorities should inform their international counterparties of the findings of this report.	Bank of England FSA HM Treasury	December 2003
UK financial authorities to publish a summary of efforts to promote international co-operation and co-ordination.	Bank of England FSA HM Treasury	October 2004 & annually thereafter
The financial authorities should seek to discuss this issue in the Financial Stability Forum.	Tripartite Standing Committee	March 2004

#### Box 4: The role of the financial authorities in the event of major operational disruption

In the event of major operational disruption to the financial system, the authorities' main objectives would be to:

- keep financial markets open and functioning except where this is impractical or where by so doing there would be a material threat to financial stability; and
- facilitate an early return to normal trading, for example by seeking to ensure the availability of reliable information.

In general, important decisions affecting financial markets (e.g. changes in the timetable for clearing or market opening) should be discussed and agreed by the relevant private sector participants; the authorities would be ready to facilitate or respond to market initiatives, and help co-ordinate collective action where this is necessary.

The main role of **HM Treasury** would be to ensure that ministers are kept up-to-date on developments so as to be able to take key decisions without delay. In addition, HM Treasury would be responsible for ensuring coherence between measures taken in the financial sector and the operation of public sector continuity arrangements more generally. HM Treasury would have specific responsibility for:

- liaising with other UK government departments and authorities, including law enforcement agencies; and
- maintaining contact and liaising with the DMO, particularly on the state of the gilts market.

The main role of the **Bank of England** would be to ensure the orderly functioning of the UK's financial markets, including the maintenance of adequate liquidity. The Bank of England would have responsibility for:

- maintaining, as banker to the banking system, operational contacts with market participants so as to monitor and, as necessary, facilitate the functioning of UK markets; this may include, if the circumstances warrant it and after consultation with HM Treasury and the FSA, the provision of emergency liquidity assistance.
- monitoring and facilitating the functioning of payment systems, alongside its operational role of providing settlement facilities for Real Time Gross Settlement (RTGS); and
- assessing, with the FSA, the systemic implications of any operational disruption.

The main role of the **FSA** would be to monitor the health of individual institutions which fall within its regulatory remit and ensure continuing compliance with regulatory standards. The FSA would have responsibility for:

- monitoring firms and market infrastructure providers within the framework of the FSA's four statutory objectives; liaison will usually be via normal supervisory contacts.
- working with regulated firms to resolve any problems that may prevent them from operating normally or from acting on their own or either customer's behalf in accordance with usual regulatory requirements.

In terms of how firms should act when a crisis develops, the authorities would advise that they:

- use their normal contacts within the particular authorities to gather and to provide information on the developing situation. Major firms and other key institutions can in any event expect to be contacted swiftly by the authorities to provide information about the impact of the incident on them;
- look to the media and Tripartite web site for messages about the financial authorities' position and intentions, and to the Tripartite web site for more specific information about how the authorities are handling the incident;
- make use of the Financial Sector Continuity Information Line for summary information about what the financial authorities are doing; and
- make preparations for possible participation in an early conference call using the Financial Sector Continuity Conference Call Facility. This is likely to be a key part of the information-gathering and decision-making process employed by the financial authorities with key market participants.