
Financial sector preparations for the Year 2000

By the Year 2000 team of the Bank's Market Infrastructure Division.

Since early in 1998, the Bank of England has been publishing regular progress reports on the preparations of the UK financial sector for the Year 2000. Since these reports began, awareness of the technical and business issues relating to the Year 2000 problem has grown significantly, and most technical remediation and testing work in the UK financial sector has been completed. There is a high level of confidence within the sector that it will be 'business as usual' over the year-end. The Bank's most recent report therefore focused on other topics: preparations in other financial centres; the impact of the Millennium date change on financial market behaviour; and contingency planning and risk mitigation work.

In February 1998, the Bank of England published the first in a series of publications entitled 'Financial sector preparations for the Year 2000', commonly known as the *Blue Book*.⁽¹⁾ The series had three original objectives: to raise awareness of the Year 2000 problem⁽²⁾ within the financial sector; to ensure that information about the specific initiatives of the financial sector is readily available; and to encourage the co-ordination of Year 2000 planning, especially by UK financial infrastructure providers, through this transparent process. Since the series began, awareness of the issues has increased considerably in all sectors and extensive preparations have been made. The principal objective has now increasingly become to build informed confidence about the United Kingdom's preparations, by explaining what has been done and what is planned. The *Blue Book* series, complemented by a Symposium on the topic held jointly by the Bank of England and the Financial Services Authority (FSA) in May, has reported widely⁽³⁾ on these developments—both within the UK financial sector and overseas.

Some of the key issues covered in the most recent (fifth) issue of the *Blue Book*⁽⁴⁾ are summarised below.

UK payment systems and banknotes

The FSA has been monitoring the preparations of individual regulated institutions (which include exchanges, clearing houses and settlement systems), and reports regularly and publicly on aggregate levels of preparedness. The Bank monitors, and reports on, the preparations of some key sections of the UK financial infrastructure not directly regulated by the FSA, including payment systems and major

payment card schemes. In addition, as the issuer of banknotes in England and Wales, the Bank takes a direct interest in the supply and distribution of its banknotes, and also reports on the preparations in Scotland and Northern Ireland.

The Bank has had a close involvement in the work undertaken on the main retail and wholesale payment systems (CHAPS, BACS and the cheque and credit clearing systems), both as a member and as the provider of central settlement accounts. Remediation of these systems, and testing the amended versions for correct operation in a Year 2000 environment, was completed by the end of 1998.

The Bank has also made arrangements to ensure that there will be an ample supply of banknotes to meet the needs over the Millennium period: it is expected that the normal seasonal peak will be higher than usual because of the extra bank holiday and expenditure related to the celebrations. More particularly, the Bank is working with banks, building societies, the Post Office and industry bodies to ensure that this supply will be available in the right place at the right time. The extra supply will be located where it is most likely to be demanded, and the banks are carefully monitoring local demand.

The Bank is not directly involved in the operation of payment cards, but has asked each of the major schemes in the United Kingdom to give details and documentary evidence of its Year 2000 preparations to be summarised in the *Blue Book*. Scheme preparations are now well advanced, with at least 90% of internal and member testing completed by 1 July.

(1) Issues of 'Financial sector preparations for the Year 2000' have been published by the Bank in February 1998, May 1998, October 1998, March 1999 and July 1999. Each of these issues can be seen on the Bank's web site at www.bankofengland.co.uk. To be added to the mailing list for future issues (free of charge), send full contact details to: Bank of England 2000 Admin, Leycol Printers Ltd, 5 Hancock Road, London E3 3DA, United Kingdom, or fax them to 020-8880 6001.

(2) The 'Year 2000 problem' can be summarised as concerns about the ability of computers to process dates correctly due to the Millennium date change and the leap year in 2000, and the implications should a key system fail to do so. For fuller details on the nature of the Year 2000 problem, please refer to the first issue of the *Blue Book*.

(3) The mailing list for the *Blue Book* includes more than 30,000 names.

(4) Published in July 1999.

The British Bankers Association, the Building Societies Association and the Association for Payment Clearing Services are distributing a leaflet that they produced jointly, aimed at reassuring bank and building societies customers that it will be business as usual over the Millennium—including at ATMs.

Financial market behaviour

Most market participants expect the financial markets to operate essentially as normal during the Millennium period, though activity may be reduced, as indeed is usual at year-ends. But participants are planning their operations over the Millennium period with care, because of the residual risk of system problems, or more particularly because of behavioural changes by counterparties, customers or suppliers. One indicator of concerns about the risk of year-end market effects is the Millennium 'spike' in the short-term futures market, which shows the amount by which the interest rate implied by the December 1999 contract differs from the average of the September 1999 and March 2000 contracts. The sterling spike fell steadily from its peak of more than 40 basis points in December 1998, to less than 5 basis points in June 1999. It picked up somewhat in all major financial centres as the year-end came within the six-month trading period, but it remains relatively small at 9 basis points on 22 July, considerably smaller than its peak in December 1998. This suggests that the markets still expect a smooth transition to the new Millennium.

The Bank has made it clear that it will, as always, ensure an adequate supply of liquidity in the sterling money markets during the Millennium period. To help plan its operations, the Bank has discussed with a range of market participants, both individually and via market associations, their own plans. Firms' planning covers liquidity management, collateral holdings, credit limits, relationships with counterparties and clients, and business activity over the period. Firms are reviewing credit relationships to satisfy themselves about the compliance of customers and clients, and are planning their liquidity and business activities to enable them to work through the date change in an orderly way. Subject to these constraints, they intend to maintain business as usual as far as possible over the year-end. Among the constraints that firms face in their planning is the availability of securities eligible for use as collateral in repo operations with the Bank. To ensure adequate availability, the Bank has taken steps to extend the list of eligible securities to include a wide range of euro-denominated securities issued by central governments in the European Economic Area, as well as certain other securities issued by the major international financial institutions. As a result of this process, from 31 August the pool of eligible securities will be enlarged by some £2 trillion, greatly easing collateral constraints.⁽¹⁾ Market mechanisms should therefore ensure that liquidity is distributed normally over the Millennium period to those who have made reasonable preparations and who disclose sufficient evidence of those preparations.

At present, the prospect remains one of orderly markets over the period. However, market participants still need to complete their own preparations and business continuity planning to help ensure this outcome. The Bank will continue to monitor the market closely, and is refining its own contingency preparations so that it can move quickly, if needed, to forestall any market strains.

International preparations

The principal focus of the *Blue Book* is UK financial sector preparations. But there is also much interest in international preparations. The *Blue Book* series has reported on collective efforts by international organisations such as the Joint Year 2000 Council—a body composed of representatives of central banks and supervisors in most major regions of the world, and Global 2000—a group consisting of various members of the global financial community, who have joined forces to address the Year 2000 problem. The most recent issue also reports on preparations in twelve major financial centres.

Although the level of preparedness varies from country to country, those with major financial centres have tended to be among the best prepared. In practice there are relatively few direct connections between different countries' infrastructures, but there are a small number of critical pieces of international infrastructure on which there are separate reports in the *Blue Book*. In addition, countries are linked via common market participants, whose own systems are in many cases connected. A global test of payment systems on 12–13 June provided an opportunity for firms with international operations to test their systems simultaneously on a cross-border basis. None of the systems offering facilities to join this test experienced any problems, and participants reported the exercise to be useful in demonstrating cross-border compliance of their own systems.

Contingency planning

The emphasis of financial sector preparations for the Millennium is now on contingency planning. Although the risks of material disruption are—as a result of extensive testing—now generally considered to be small, it is prudent both for individual firms and infrastructure providers to plan how to maintain business as usual, in case there are glitches in internal systems or knock-on problems from an external source. Contingency planning includes both risk mitigation, to reduce the chances or consequences of something going wrong, and a containment strategy to respond to any difficulties encountered.

Contingency planning for the Year 2000 need not necessarily be done from scratch. Firms can obtain good general advice from a variety of sources, and many firms already have contingency plans in place for other emergency situations, which makes full planning easier. But the unique nature of

(1) For a fuller account of the extension of eligible collateral, see the 'Markets and operations' article, pages 237–52.

the Year 2000 problem means that existing plans must be scrutinised carefully, and not simply assumed to be sufficient. In practice, contingency plans cannot include detailed responses for all conceivable eventualities. They can, however, cover the main possible risks to the institution's critical processes, and a range of options available in different circumstances to deal with them.

One clear conclusion of current planning is that there needs to be a precise decision-making structure of appropriately senior and qualified people available promptly at critical periods, including over the Millennium weekend itself. In addition there should be computing staff on standby over the whole period. The planning process therefore needs to cover not only the action to be taken if problems occur, but also the resources that will need to be available.

A second clear conclusion is that communication is crucial. An agreed process is needed for sharing both routine and exception information, particularly around the key dates. There will be many parties involved in this process, with different interests and responsibilities. In the financial sector, both the Bank and the FSA will act as hubs for receiving information to carry out their own responsibilities. The Bank will be involved in testing payments systems and will, in particular, seek information from other infrastructure providers and from operational counterparties. The FSA will receive reports from regulated institutions. Both the Bank and the FSA will maintain direct contact with other bodies, such as governments and international sources of information. The detailed mechanisms for exchanging relevant information are still under discussion in various

forums, including with the Cabinet Office in the United Kingdom and internationally under the auspices of the Bank for International Settlements in Basel.

There is clearly more work to be completed on contingency planning, and on the logistics of the Millennium weekend in particular. The Bank and the FSA will be working together to encourage information-sharing and the development of a consensus on best practice in this area.

Conclusion

The UK financial sector started to prepare early for the Year 2000, and most testing and remediation work is now complete. With much work already undertaken on planning for the Millennium weekend itself, and on contingency arrangements to ensure continued operation of the financial infrastructure in the unlikely event of any major problems, there is now a high level of confidence within the sector that it will be able to maintain 'business as usual'. But it is important not to relax efforts to plan for the Millennium, and the extent of continuing work in the sector suggests that this is well understood. All financial sector infrastructure providers and participants are, to a greater or lesser extent, dependent on the preparedness of others, both inside and outside the sector, in the United Kingdom and abroad. This is a major aspect of risk mitigation and contingency planning work, and reinforces the need for good communication between individual firms, public and private sector bodies, and the public. It is important that this work continues and that vigilance does not slip, in the knowledge of all the work that has already been done.