

## INTERNATIONAL BANKING

## Expert Analysis

# Systemic Risk of Another Kind: Influenza Pandemic?

As if international banks did not have enough to worry about regarding the global economic troubles and their own balance sheets and capital needs, along comes Influenza A (H1N1), referred to initially in the press as the “swine flu.”<sup>1</sup> While as of May 8, 2009, there were 896 confirmed cases of the H1N1 Flu in the United States, and 2,384 confirmed cases in the world in 24 countries, the numbers of those infected are expected to rise before concern eases.<sup>2</sup>

As most readers are aware, much has been written lately about systemic risk due to the current economic situation. But the H1N1 Flu outbreak poses a systemic risk of another sort. While increasingly electronic, the world’s monetary system, such as in the area of international payments, still needs people to run it. And, if those people are sidelined by their own illness or that of their family, or cannot get to work because the government has shut down businesses or roads or ordered a quarantine, a collateral consequence could be the disruption of the international payment system, which could make an already fragile global economy even more precarious, and leading to a systemic risk different than those currently being discussed, but just as relevant and capable of having a real impact on the banking system.

There is much interdependence among the international banks in making the international banking system work. If key parts of the chain break down due to illness or the closure of offices or national borders, then there is systemic risk to the entire system. This month’s column will remind banks, especially international banks, as to what they could be doing now to minimize the possible impact of a pandemic on their operations.

### Background

My January 2008 column discussed then-recently issued advice for banking

By  
**Kathleen A.  
Scott**



organizations in the United States regarding pandemic planning, in light of the threat of an avian flu pandemic. The U.S. Federal Financial Institutions Examination Council (FFIEC) issued an Interagency Statement

An international bank is much more likely to have customers visiting the U.S. office who are from outside the United States.

on Pandemic Planning, recommending that banking organizations incorporate into their business continuity plans a plan to minimize the adverse effects of a pandemic. The plan should at a minimum provide for:

- A preventive program to reduce the likelihood of significant disruptions to operations in the event of a pandemic;
- A documented strategy that links specific steps to be taken as a pandemic may spread;
- A comprehensive framework of facilities, systems or procedures that will enable continuation of the bank’s critical operations;
- A testing program to ensure that the program works;
- An oversight program to ensure ongoing reviews and updates so that the plan remains viable and effective.<sup>3</sup>

### What to Do Now

The advice to develop and review pandemic planning procedures is even more relevant today and while as of May 7, 2009, the U.S. regulators had not issued any new statements on pandemic planning, other regulators have done so. The UK Financial Services Authority issued a statement on May 1, 2009, noting that “regulated firms should be assessing their contingency plans to consider what steps they may need to take to address possible issues.”<sup>4</sup>

Because by definition international banks operate internationally, they face a greater risk of being affected by a pandemic than banks that operate within a smaller geographic area.

The H1N1 Flu can affect international banks through their customers, their service providers and their own personnel. Thus a plan should cover all three areas of possible impact.

### The Customers

An international bank, especially one headquartered outside the United States, but with direct branches or agencies in the United States, is much more likely to have customers visiting the U.S. office who are from outside the United States. For example, a Mexican bank with a branch in New York is likely to have customers from Mexico coming to use the banking facilities. While there may be no need to evaluate each customer who comes into the bank for signs of infection, the bank should be aware of the risk of the spread of infection from travelers from countries where there has been an outbreak of the H1N1 Flu, and the possibility that there may be customers who need banking services but are too ill to get to the bank.

The bank may want to consider offering delivery services of cash and documents to customers (whether in the United States or elsewhere), carried out in a manner calculated to protect all parties from further infection. In addition, improved secure computer access to accounts and the

ability to effect transactions remotely may be critical if healthy people in a particular area have been cautioned not to go out, as happened in Mexico recently. With such electronic tools, customers can be assured that their ability to access banking services remains unimpeded even if they are temporarily confined to their homes.

### The Employees

Many international banks headquartered outside the United States but with direct offices in the United States hire expatriates to fill some positions at their U.S. offices. These employees may often travel to the bank's home office or other bank offices or bank clients around the world on business, and unconsciously become a carrier if exposed to disease in those distant locations. Or, as happened in Hong Kong, travelers could be quarantined in a country and be unable to return home for an extended period of time. Moreover, schools could be shut down, leaving parents with having to arrange for emergency child care while still needing to get work done at the office.

The bank needs to demonstrate its commitment to the health and safety of its employees and make it clear to all personnel that if they are sick they need to stay home and away from work. In the meantime, international banks operate globally and there will be critical banking operations that must be able to continue, and need some level of human intervention to either facilitate transactions or monitor ongoing systems. For example, payment systems must be able to continue to operate in order to process the trillions of dollars of funds transfers that circumnavigate the globe every business day. People are needed to monitor these systems to ensure there are no disruptions.

The bank should as much as possible be able to enable its employees who may have to work to be able to do it from home through a secure computer network. If certain bank locations need to be closed because of local health conditions, then perhaps back-up facilities could be used by healthy employees to manage the crisis (even from other countries), with people confined at home being able to link in remotely.

Moreover, any disruptions to a bank's information technology (IT) system could pose a dangerous risk to the bank and thus the IT staff should have whatever tools are necessary, both inside and outside the office, to keep the bank operating. International banks also may want to consider installing secure technology in the homes of some of its senior officers and operational personnel in order to ensure that banking operations around the world can continue to run smoothly no matter

what conditions may be that prevent people from reaching the office.

### Service Providers

Banks may outsource many of their back office operations such as IT and data processing. Many of these functions are performed thousands of miles away from the bank's location. A bank should ensure that its service providers have contingency plans in case they are unable to access the work location and require the service providers to demonstrate to the bank specifically how they will continue to fulfill their contractual duties so that the bank can in turn continue to service its customers.

The time and resources that a bank may have put into its operations to ensure smooth running in a crisis will be for naught if its back office cannot function effectively because the service provider was ill-prepared when many of its employees could not make it to work. Banks should review a service provider's business continuity program as part of their service provider oversight responsibilities generally, and at this time should make sure that such business continuity plan provides a strategy for dealing with a pandemic. There should be a contingency plan on the part of the bank (in having a back-up service provider) and/or its service provider (in having multiple locations or technology to ensure no disruptions in service) that would be activated in the event of a pandemic.

A pandemic is not an event that is within the control of the bank; the best it can do is to have a workable contingency plan in place to ensure that operations continue, customers can be served and employees can be protected.

### Real or Hype?

A pandemic is not an event that is within the control of the bank; the best it can do is to have a workable contingency plan in place to ensure that operations continue, customers can be served and employees can be protected. As of this writing, it is difficult to tell if the H1N1 Flu outbreak will develop into a pandemic, although the number of cases and countries affected has been rising every day. All that banks can do is to continue to monitor the situation and be ready to implement their pandemic contingency program if necessary.

### Finally

For those readers who cannot get enough of the various theories and proposals to address systemic economic risk, there are two new papers that might be of interest. The Bank for International Settlements recently issued a Working Paper entitled "A Framework for Assessing the Systemic Risk of Major Financial Institutions" in which the authors discuss measuring systemic risk by analyzing the price of insurance against large default losses in the banking sector, using as a measure the spreads on certain credit default swaps.<sup>5</sup> In addition, the International Monetary Fund devoted its April 2009 Global Financial Stability Report to "Responding to the Financial Crisis and Measuring Systemic Risks."<sup>6</sup>

.....●.....

1. Following the lead of the World Health Organization (WHO) and the U.S. Centers for Disease Control, this column will use the term H1N1 Flu for reference.

2. This information is current as of May 8, 2009, 6:00 GMT. Please check the WHO Web site for the most current information at <http://www.who.int>.

3. See FFIEC IT Examination Handbook, "Business Continuity Planning," March 2008, which can be accessed at [http://www.ffiec.gov/ffiecinfobase/booklets/bcp/bus\\_continuity\\_plan.pdf](http://www.ffiec.gov/ffiecinfobase/booklets/bcp/bus_continuity_plan.pdf).

4. See <http://www.fsa.gov.uk/pages/Library/Communication/Statements/2009/flu.shtml>.

5. Bank for International Settlements, "A Framework for Assessing the Systemic Risk of Major Financial Institutions" by Xin Huang, Hao Zhou and Haibin Zhu, Working Papers No 281, issued April 29, 2009, which can be accessed through the BIS Web site at <http://www.bis.org/>.

6. International Monetary Fund, April 2009 Global Financial Stability Report, which can be accessed through the IMF Web site at [www.imf.org](http://www.imf.org).