

Business Continuity Management *Case Study*

**Euroclear Bank applies the BCM
framework to manage the impact
of the collapse of Lehman
Brothers**



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Euroclear Bank Case Study

The BCI are grateful for the support of Laure Molinier AMBCI, Risk Management – Business Resilience, Euroclear SA/NV in the development of this case study.

Executive summary

The collapse of Lehman Brothers in September 2008 occurred just two months after Euroclear Bank had run a major exercise to test such an occurrence. Euroclear's application of the Business Continuity Management framework, specifically the tools and exercise methodology, to its core financial business contributed to an effective response to the impact of this financial crisis.

The Euroclear group

Euroclear is a leading provider of settlement services for domestic and international bond, money-market, equity and fund transactions. Euroclear Bank's clients comprise over 1,400 financial institutions, located in more than 80 countries. The total value of securities transactions settled by the Euroclear group is in excess of 570 trillion Euros per annum, while assets held for clients are valued at more than 18 trillion Euros.

Of the companies within the Euroclear group, the international central securities depository, Euroclear Bank, faces unique challenges in relation to managing credit and liquidity risks. The other entities, which do not have a banking status, operate as the central securities depositories of Belgium, Finland, France, Ireland, Sweden, the Netherlands, and the UK.

Like most financial institutions, all companies of the group are already well prepared to face "nuts and bolts" crisis scenarios such as loss of infrastructure, staff, premises and IT systems. However, Euroclear Bank management and the Belgian regulator agreed that the bank needed to get to the same level of preparedness to manage a financial crisis.

One of the questions raised by Euroclear's management was whether the Business Continuity Management (BCM) framework and its elements, such as the crisis management structure, would be appropriate to deal with a financial crisis. Laure Molinier was the one tasked with this analysis.

The extension of the Business Continuity Management framework

Ms Molinier had earlier experience with the banking side of the business at Euroclear Bank, so with banking risk and operational risk sharing the same reporting structure under corporate risk management, she was well placed to lead the analysis.

Many similarities exist between the methodology used to manage an operational and financial crisis. Indeed, for operational scenarios, the focus of the impact assessment will be on premises, IT and/or people; for financial scenarios, it will use the same methodology to assess the credit and liquidity impacts on critical activities. Specific response plans, such as facilities, IT disaster recovery and/or human resources were developed on the one hand for operational crises, and for financial crises, credit crisis procedures and liquidity contingency plans existed.

In both cases, there is a common objective - to ensure continuity of services foremost and to thereby preserve the company's reputation.

Euroclear applied the BCM framework to analyse its critical activities and to understand the business impact of a disruption to these activities. The key transferable element was the adoption of BCM's crisis management structure. This structure consists of three levels:

- Gold level is the strategic level where policy is determined.
- Silver level is the tactical level, where decisions are made.
- Bronze level is the operational "do" level.

The essential role of the BCM practitioner is to ensure that this process works to support the overall BCM programme objectives. Euroclear detailed specific responses expected from each level where Gold would focus on strategic decisions and external communication; Silver would work on impact assessment, recovery plan coordination and monitoring; and Bronze would be activated to implement Euroclear's client, operational, credit and liquidity response plans.

The next phase of this project was, in line with good BCM practice, to organise a large-scale exercise to test the effectiveness of the response plans. This was intended to increase the awareness and confidence levels of Euroclear management and the Belgian regulator in the company's preparedness to manage various types of financial crises.

The exercise

Euroclear Bank sought an extreme scenario for the exercise, one that analysed not only the impact on the Bank but on other financial institutions, payment systems and financial markets in general. The scenario detailed the failure of a large multi-market bank, which was both an important supplier to and a major client of Euroclear Bank. The exercise included interaction with other banks, and financial infrastructure providers, and assumed a rapid degradation in financial market conditions as the scenario unfolded. It also took into account the uncertainty around the timing and direction of regulator responses.

Euroclear Bank organised the crisis response teams into two streams during that exercise run on 1st July 2008. The 'tactical' Silver crisis team was led by the Head of Banking. The 'strategic' Gold team was headed by the CEO and was also responsible for working with the regulatory authorities.

The real crisis

On September 15th 2008, Lehman Brothers collapsed.

At the time of the collapse, Euroclear senior managers along with many others were at SIBOS, a major financial services conference held that year in Austria. Communication was therefore more complex. However, business continuity planning had accommodated such an eventuality and the relevant crisis committees were available to work in virtual mode with the aid of their Blackberry PDAs.

Lehman Brothers was in fact a medium-size customer of Euroclear Bank. The impact of a client failing, such as Lehman Brothers, is that Euroclear Bank is faced with a credit exposure on that failed entity. As credit extensions are fully secured by Euroclear Bank, it has the right to liquidate the collateral taken against the credit extension in the event the client is bankrupt or goes into administration. This collateral is typically taken in the form of securities. In the case of Lehman Brothers, Euroclear Bank was able to liquidate the collateral to safeguard its position.

The realistic and plausible scope of the exercise scenario had proved to be an invaluable learning experience for the team of experts who were able to draw on this work to good effect during the Lehman Brothers crisis. The result was that Euroclear Bank came through the crisis unscathed.

Key learnings from the crisis

Euroclear's use of the BCM framework continued after the crisis was contained by undertaking a thorough review and analysis of its crisis procedures.

On the positive side, it was noted that human behaviour observed during the real crisis was very similar to that seen during the exercise in July, which of course would be different from behaviour under "normal" conditions. This was a clear benefit of investing in the exercise and adapting procedures to reflect the unusual circumstances.

The real life crisis highlighted areas where improvements would further enhance Euroclear's response to financial crises.

- Although the exercise had analysed some indirect impacts of a large client failure, the real life situation revealed additional issues. Some Bronze-level response procedures are now being updated to build on that experience and ensure faster execution in the future.
- The Lehman crisis involved the Silver team heavily for more than a week and showed the importance of designating and training deputies for core team members. Key decisions should also be communicated rapidly after each meeting of internal stakeholders to avoid Silver team members becoming overwhelmed with phone calls and to ensure that deputies are kept in the loop.
- More generally, external communication could also be streamlined and Euroclear is developing response templates to a certain number of identified crisis scenarios, both to provide their client-facing staff with clear guidance and to communicate rapidly to clients the status and impact of the crisis on their business with Euroclear.

Ms Molinier's role now is to co-ordinate all the actions with the business to ensure the improvements are adopted and implemented. Euroclear Bank shared the conclusions of the exercise and the additional lessons from the real life experience with the Belgian regulator in December 2008.

Further testing, at each level of the crisis structure, is planned in 2009. This will include another major financial crisis scenario analysis and exercise.

The BCI view

Although this case study was primarily focused on financial institutions, it demonstrates that tried and tested BCM methodologies can be adopted for business crises well beyond the loss of infrastructure. Other industries can use BCM to assess the impact and develop responses to the potential failure of a key supplier, business partner or client.

Lyndon Bird FBCI, Technical Director, The Business Continuity Institute.

About the BCI Partnership: The BCI Partnership was formed in 2007 to provide organizations with a forum to share best practice and provide corporate leadership on Business Continuity Management.

About The Business Continuity Institute (BCI): Based in Caversham, United Kingdom, The Business Continuity Institute (BCI) was established in 1994 to “promote the art and science of business continuity management” to assist organizations in preparing for and surviving minor and large-scale man-made and natural disasters. The Institute enables members to obtain guidance and support from their fellow practitioners, as well as offering professional training and certification programmes to disseminate and validate the highest standards of competence and ethics. It has more than 4,500 members worldwide in more than 85 countries. www.thebci.org.