

How to Include the Management of Financial Crisis in the BCP

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Abstract

A conventional BCP is formulated by keeping incidents like natural disasters, loss of critical infrastructure etc in mind but it is usually not enough. Any event which can lead to the loss of business should be considered as part of the BCP. In this report, we will be discussing the latest financial crisis which has affected most of the economic institutions around the world. Some of the suggestions as remedies, immediate credit, liquidity response plans, maintaining templates for known financial crisis etc have been made.

1. Introduction

1.1 Aim of the Project

Our aim of the project is to discuss whether the normal business crisis management framework and its elements are applicable for financial crisis as well or how different BCP of operational crisis is with financial one. What enhancements are required to include financial crisis within existing BCP. The methodology followed in case of operational crisis have many similarities with the financial one since at the end of the day the common objective is ensuring the continuity of services and to keep company's reputation intact.

1.2 Financial Crisis

The concept of financial crisis normally applied to different situation, but mostly it is used to mean when an individual or a company abruptly lose their asset or their worth. Predominantly Economists' associate the financial crisis with bank panics. Especially the one that has been happening since 2008 is biggest issue still now. The solutions which were proposed and implemented to tackle back the situation not yet adequate enough. In United States of America in 2008, The Congress approved \$700 billion to support those businesses which were in trouble; but the provision was not enough to heal the market. Due to that, the Federal Reserve additionally bail out organizations and markets with the amount of \$1.3 trillion by planning to

invest in possessions which they thought they were in risk thus including banks and insurance companies. [6]

There are wide varieties of financial crisis based on the behavior of the organization, banking crisis, bubbles and crashes, currency crisis, economic recessions and depressions are some to mention.

1.3 Business Continuity Planning (BCP)

Business continuity planning (BCP) is a methodology used to create and validate a plan for maintaining continuous business operations before, during, and after disasters and disruptive events. BCP has to do with managing the operational elements that allow a business to function normally in order to generate revenues. Business continuity has to do with keeping the company running, regardless of the potential risk, threat, or cause of an outage. [1]

Why is BCP formulated? Some of the reasons are:

- 1) To identify business oriented processes which are critical to the mission in case of any disruption
- 2) How much acceptable downtime to be tolerated in terms of data, operations, finance, reputation etc
- 3) to have some back up plan to continue with the critical operations in terms of major disaster and quick recovery of normal set of operations.

This not only applies in the case of natural hazards but also in the case of financial crisis like for example if business operation is halted the operations of other business partners are also affected. As per the results of the Financial Crisis Effect on Business Continuity survey conducted by Business Continuity Consultancy & Management (B.C.C.Management) North America and Middle East with the support of BusinessContinuityindex.com. [2] Majority (70%) answered that there is a big relationship between financial crisis and business continuity and that the business continuity is highly dependent on the financial aspect of the organization.

So coming to our report, some of the problems we will be facing and addressing them and why we feel it as interesting:

- What policies lead to financial crisis? The focus of our area will be monetary policy, banking rules, housing boom etc
- The averting reforms adopted by the management in response of potential financial crisis
- Well as we go through different articles we noted that there is no standard procedure so far, while dealing with financial crisis. So how to plan a standard BCP against such crisis like in the case of natural disasters.
- Interestingly, it has been noted that the institutions which lead to major crisis will be bailed out while the global financial meltdown will affect rest of the connected world. So what policies are adopted to counter this?
- The role of management and the budget during the time of crisis.
- Lessons to be learned from this crisis, and what kind of precautions should be taken.

1.4 Method of the Project

Our method to approach this report is literature survey by reading various topics in multiple books relevant to BCP and articles and what BCP strategies were adopted by different companies to coup with this issue as an aim of our project.

First we have to correctly identify the institutions which were most affected by the latest financial crunch around the world for e.g. Banking sector, insurance companies, marketing companies, real estate business, I.T companies, supply chain but we will try to be more specific to certain institution like banks.

So, we will be discussing financial crisis, their counter remedies to coup such kind of crisis by including them as a part of BCP. Also we will discuss a case study of Euroclear group, who adopted financial crisis into their BCM.

2. Financial Crisis: Historical view

The time we are having since early 1970 is extraordinary in instability of commodity prices, currency exchanges, real estate companies and in stock markets. [6] Let us look at what happened in Japan after 1985s, Japan has faced a gigantic inflation in real estate and stock markets, within the same period of time In Finland, Sweden and Norway the price of real estate and stock market ridiculously increased even faster than Japan. During the period after 1995s United States has passed through bubble in market although the newly born industries like Information technology were victim of that crisis. [7]

Bubbles normally involve the fluctuation of price on the commodities or in cash flow. The collapse of the asset value bubble in Japan ran to the huge catastrophe of many banks and other categories of monetary companies and more than a period of lethargic financial progress. The bubble which happened in Thailand fired contamination and led to fall down all over the area in market price. Other bubble happened in US market in 2000 let them weakening in market value for the consecutive years.

Devaluation of foreign exchange values of the country currencies during that specified period of time was unbelievably outsized. At early 1970s, due to extraordinary inflation frequency in US led the foreign exchange price weakened by 10 to 12 percent which is bigger than what happened in Germany and in Japan in preceding ages. [7] US lost its gold equality of \$35 an ounce in 1971. In the following years there were a couple of uncertain surges in the US gold parity though the US Treasury would no longer purchase and vend gold. In 1970's US dollar abandoned extra half of its worth compared to Germany mark and Japanese yen. [7] In beginning of 1980's there were enormous foreign exchange disaster, For instance crisis knocked the door of Mexican Peso, the Brazilian cruzeiro, Argentinean peso, and of course other developing countries were attacked by the storm. In 1992, the Finnish markka, the Swedish krona, the British pound, the Italian lira and the Spanish peseta also lowered the exchange rate in six month epochs, compared to Germany mark, the above listed currencies reduced their rate by 30% in the specified period.

Item	Price \$			
	At the beginning of 1970's	At the end of 1970's	At the end of 1980's	At the end of 1990's
Gold an ounce	\$40	\$1000	\$450	\$283
Crude Oil a barrel	\$2.50	\$40	*\$40	\$21.62

* The price became \$40 again because Iraq invaded Kuwait in specified period.

Table 1. Fluctuation of Commodity price from 1970-2000 [7]

The bank letdown occurred in 1980-1990 was pretty larger than other periods. In early 1970's Franklin National Bank In New York and Herstatt AG in Cologne, Germany did wagers on variations in currency standards and unfortunately both banks lost the bets as the result they were forced to shut down their business due to odd fatalities. The biggest bank which was owned by government in France, Crédit Lyonnais determined to quickly upsurge in size made exaggerated loans as a consequence put extra burden of \$30 million in French taxpayers. More than 3,000 US saving and loan firms and other similar organizations botched in 1980s, with victims to taxpayers of further \$100 billion. [7]

During 1980s and 1990s the financial failure which happened to most banks was universal and it comprises different financial firms from every corner of the world. The good example for this is what happened in Japan real estate and stocks. At the same time the banks in Finland, Norway and Sweden went insolvent when the bubbles in their real estate and stock markets collapsed. Many banks which owned by government experienced huge credit losses. Mexican banks were also victim due to devaluation of peso. The storm also hit Thai and South Korean Banks as well virtually all Asian countries after 1997. [7]

Top ten historical financial bubbles

1. The Dutch Tulip mania in 1636
2. The south Sea company bubble 1720
3. The Mississippi Bubble 1720
4. The stock value bubble from 1927-29
5. The rush in bank mortgages in Mexico and other economically emerging countries in 1970s
6. Real estate and stock bubble in Japan from 1985-89
7. Real estate and stock bubble in Finland, Norway and Sweden during 1985-89
8. Real estate and stock bubble in Thailand, Malaysia, Indonesia and other Asian countries during 1992-97
9. The rush in foreign venture in Mexico 1990-1993
10. United states housing bubble during 1995-2000 [7]

2.1 Causes of Financial crisis

We can see financial crisis in two different stages, the global macro strategies distressing fluidity and by a very poor supervisory outline.

There are autonomous dynamics that let this crisis occurred. Financial turmoil by itself is not independent rather it is the result of the misrepresentations and inducements shaped by old policy activities. [6]

In banking area, there is common word to express financial crisis called bank run. Bank run is the situation when there is run in huge number of bank customers to withdraw their deposit by thinking the bank is incapable of handling them. When such kind of situation happen the bank gets tough to pay back money hurriedly, further the condition leads the bank to bankruptcy. When a number of banks pass through same situation banking panic formed. [9]

In US the following gears triggered the crisis which happened in 2004. [6]

- Zero impartiality Mortgage became practical during Bush Administration. The proposal aids low-income citizens to gain mortgages.
- Big capital obligation became compulsory and balance sheet controlled by the Office of Federal Housing Enterprise Oversight (OFHEO), this opened the gate for banks to approach a large number of low-income mortgages.
- International bank rule document called Basel II Accord was published. The aim of the document which published in 2004 is to formulate international standards which are important to banking regulators. This regulation helps to decide how much capital the bank needs to put on to survive from financial risk that could happen. The document created chance to hurry up off balance sheet deeds.
- The US Securities and Exchange Commission (SEC) decided to let Investment Banks (IB's) freely benefit from directive changes to achieve their risk by calculations under the 'consolidated supervised entities program'. [Financial Crisis causes 2004]
- Globalization has accelerated financial crisis and let it spread all around.
- The interference of central banks during old time was successful to bind the blowout.
- It is hard to predict right now that financial crisis will bring wider penalties.
- The response from regulators is slow when it compares to fiscal revolutions.

2.2 Remedies for Financial crisis

The normal trend to tackle back financial turmoil is to bailout markets with huge amount of money. Of course, it is one means to overcome the problem but there are also other strategies should be used to effectively hail the situation. [6]

To start with the simple one, privatizing the depository firms of the unsuccessful business holding firms and merely let the main companies and all other unsuccessful organizations drive bankrupt and default on their credit default swaps (CDS). Then the private banks emerge again to the market and start to loan as usual. Apart from this the responsibility of regulating parity in borrowing businesses in default on their loans and successfully privatizes them to be well functional. [8]

Shared appreciation mortgages (SAMs) could be used as a solution for the real estate and mortgage crisis. If the defaulting mortgagors allowed refinancing with SAMs, it would decrease their expenses in return for the loaning organizations getting a part in the upcoming appreciation on the home. The SAMs could be used to reduce legal costs and as well it makes a subordinate market for them. There would be interest in investors who want change on real estate. Less number of homes would be out to sell if SAMs is implemented; it has further advantage to reduce the price of real estate. [6]

Any bailouts of manufacturing companies like car industries would finely be knotted to the releasing of the credit values of those firms for determinations of funding new acquisitions. With extra volume and huge gross profit margins in several trades (like Car industries and real estates), credit would fairly be approved to any consumers whose predictable value of default losses were only about 3% less than the gross profit margin (after all variable costs) received from the auction. [6]

Another strategy that improve effectiveness and help to overcome the financial crisis would be to have cases of default on tenable buyer mortgages which outcomes conceivable renegotiation of both the loan terms and security in a solely technique. Example for this, instead of recapturing cars of defaulting car credit debtors, the low-priced car could be presented in argument for the prevailing, more treasured warranty, and the mortgagor would have lesser, hypothetically more controllable reimbursement as upshot. [6]

For such companies suffering from both internal and external liquidity disaster but having a firm worth additional to their obligations, enforcing strict regulation would bring great solution without bailing out the companies. If the company has internal liquidity it results fall down or bankruptcy. [6]

3. Case study

We will discuss the case study of Euroclear group whose business continuity management framework contributed effective counteract while dealing the latest financial crisis as they adopted the same methodology which was normally followed in cases of natural disasters. Before we discuss the case let us talk something about the Euroclear itself. Euroclear is one of the leading companies, having more than 1400 clients worldwide, provides finance for international and local bonds, funds relevant to equity, money market etc. They had a financial crisis test exercise to check their BCM framework just before the fall of Lehman Brothers in 2008, which triggered the financial crisis worldwide, but Euroclear managed it successfully when crisis actually happened mainly due to their prior testing and valuable experience gaining from it [13].

3.1 Business Continuity Management (BCM) framework

Euroclear followed the same strategy and method in their Business continuity Management Framework (BCM) like in the case of natural disasters which affects operational capabilities, IT, infrastructure etc. Operational crisis normally revolves around the infrastructure, IT and its people so these elements were replicated by credit crisis procedures and liquidity contingency plans.

Euroclear first identifies and understands the critical business elements through their BCM framework, whose disruption may result in a disaster. For the same, they divided their BCM's crisis management into three level structures. [13]

- Gold level is the strategic level for strategic decisions, external communication and where policy is determined.
- Silver level is the tactical level for impact assessment, recovery plan, managing and where results are finished.
- Bronze level is the operational and implementation level of client's operational, credit and liquidity response plans [13].

3.2 The Test

In order to test the BCM framework, Euroclear had an exercise which focused on the failure of a big bank who happened to be Euroclear client. The exercise followed all the circumstances and analysis after the failure of the client which included communication with other banks, financial substructure providers, and expected a hurried squalor in financial market. How the managers reacted after post crisis events and important timings were kept under a check list. Euroclear Bank prearranged two teams, one for silver and the other for gold level for their BCM framework structure. Silver was under the ‘Head of Banking’ while the CEO was leading the gold team for strategic decisions. [13].

3.3 The Actual Turmoil

When the real crisis took place with the fall of Lehman Brothers, Euroclear Bank came out through the crisis unharmed. The exercise just before the fall proved to be a valuable experience while dealing with the real crisis.

What Euroclear did was that they held back their credit in the form securities since after the fall of Lehman Brothers there was a scare of credit being exposed. They reserved this right to do so in case of a potential failure of any of their client to keep their finance and position save [13].

3.4 The BCI View

Lyndon Bird FBCI, Technical Director, The Business Continuity Institute concluded about this case exercise as that BCM plans can be adopted for financial crisis as well and anyone can use their BCM to evaluate the impact and prepare sound BCP in case of looming failure of any business partner, supplier or client[13].

4. General Discussion

Sound normal business crisis management framework and its elements enhance organizations capability of resilience to assure business assets, its people and important processes. Most of the organizations react only when they face any kind of disaster which actually is too late for them to formulate a quick effective counter strategy to keep their critical business in progress hence they suffer the damage, so BCP is all about planning in advance which is generally over looked by the companies but with changing world as a global village, it is really important for every such company to keep their business and services up, which demands BCP to be in place well in before the crisis struck.

Based on our literature survey we have gathered important findings regarding financial crisis effects on BCP

and how they are required to be managed effectively especially for the organizations which won’t be benefited from the option of bail out:

- First we need to figure out the policies which lead to the crisis and then providing the averting reforms to counter them. Like in banking sector policies like Credit Default Swap (CDS), [8] temporarily suspension of money withdrawn and transparency should be adopted as immediate back up policies as a part of BCM. Shared appreciation mortgages (SAMs) could be used as a solution for the real estate and mortgage crisis. Enforcing strict regulation for the companies suffering from liquidity are some of the policies which you made as part of BCM plan. [7]
- Since there has been no standard procedure to manage financial crisis we suggest a new separate team called Financial Crisis Management Team (FCMT), as a part of BCM which becomes in operation during crisis. The FCMT is responsible for handling financial crisis, and choose the appropriate policies which are relevant to the existed monitory disaster. This team should be headed by business head and the team generally comprises of business analysts just like we have IT technical staff in case of network disaster in a company.
- Operational level response procedures should be updated with the crisis experience and ensure faster execution of the implementation procedures in the future. Operational level here means the credit, liquidity response plans in the case of crisis. [7]
- After devising sound BCP, its testing is important as a good practice. Euro clear group, while working on their BCM project related to financial crisis, organized a large scale exercise to test the effectiveness of the response plans which helped them to increase their confidence levels and general [12].
- It is useful to develop templates and check lists of already identified crisis scenarios to identify them abruptly. Their impact and status to the business should be well known and kept updated. [6]

5. Conclusion

Financial disasters have seen long time ago in 17 century but extensively distressing the globe since 2008 and let several firms go insolvent. We have debated historical financial turmoil happened in the world. The causes and remedies of the crisis are quantified.

In our paper we have studied numerous articles which are written on the existing financial crises and the tragedies occurred. We raised the question that what policies were responsible for the crisis and we concluded that in banking crisis policies like Credit Default Swap (CDS), temporarily suspension of money withdrawn and transparency should be adopted as immediate back up policies as a part of BCM. Shared appreciation mortgages (SAMs) could be used as a solution for the real estate and mortgage crisis. Enforcing strict regulation for the companies suffering from liquidity are some of the policies which you made as part of BCM plan. We also suggested in general discussion that there should be a financial crisis management team (FCMT) handling such policies in the case of financial crisis. We discussed the team composition and their responsibilities.

We have revealed critical concepts to be included in Business continuity planning (BCP) to protect the firm from further damage. Basically BCP is used as a backup plan for a company even if the company is running in the event of disasters.

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