

internal control reasons for financial firms to maintain processing sites near financial markets and their own headquarters. The agencies also recognize that achieving the sound practices could be a multi-year endeavor for some firms and that it is not necessary or appropriate to prescribe any specific technology solution or limit a firm's flexibility to implement the sound practices in a manner that reflects its own risk profile. The sound practices discussed in this paper supplement the agencies' respective policies and other guidance on business continuity planning.

Post-September 11 Business Continuity Objectives

During discussions about the lessons learned from September 11, industry participants and others agreed that three business continuity objectives have special importance for all financial firms and the U.S. financial system as a whole:

- Rapid recovery and timely resumption of critical operations following a wide-scale disruption;
- Rapid recovery and timely resumption of critical operations following the loss or inaccessibility of staff in at least one major operating location; and
- A high level of confidence, through ongoing use or robust testing, that critical internal and external continuity arrangements are effective and compatible.

The events of September 11 underscored the fact that the financial system operates as a network of interrelated markets and participants. The ability of an individual participant to function can have wide-ranging effects beyond its immediate counterparties. Because of the interdependent nature of the U.S. financial markets, all financial firms have a role in improving the overall resilience of the financial system. It therefore is appropriate for all financial firms to review their business continuity plans and incorporate these three broad business continuity objectives to the fullest extent practicable. In striking an appropriate balance between the new set of risks posed in the post-September 11 environment and the costs involved in planning for wide-scale disruptions, financial firms should incorporate these new and continuing risks into their assessment of their unique characteristics and risk profiles. Firms also should continue to improve upon short-term measures that have been instituted since September 11 and develop longer-term business recovery plans where gaps are identified.

Definitions

The resilience of the U.S. financial system in the event of a "wide-scale disruption" rests on the rapid "recovery" and "resumption" of the "clearing and settlement activities" that support "critical financial markets." Some organizations, namely "core clearing and settlement organizations" and "firms that play a significant role in critical financial markets," present a type of "systemic risk" to the U.S. financial system should they be unable to recover or, in some instances, resume clearing and settlement activities that support those markets. These terms and organizations are defined below.

Wide-Scale Disruption. A wide-scale disruption is an event that causes a severe disruption or destruction of transportation, telecommunications, power, or other critical infrastructure components across a metropolitan or other geographic area and the adjacent communities that are economically integrated with it; or that results in a wide-scale evacuation or inaccessibility of the population within normal commuting range of the disruption's origin.

Systemic Risk. Systemic risk includes the risk that the failure of one participant in a transfer system or financial market to meet its required obligations will cause other participants to be unable to meet their obligations when due, causing significant liquidity or credit problems or threatening the stability of financial markets.³ Given the complex interdependencies of markets and among participants, thorough preparations by key market participants will reduce the potential that a sudden disruption experienced by one or a few firms will cascade into market-wide liquidity dislocations, solvency problems, and severe operational inefficiencies.⁴

Critical Financial Markets. Critical financial markets provide the means for banks, securities firms, and other financial institutions to adjust their cash and securities positions and those of their customers in order to manage liquidity, market, and other risks to their organizations. Critical financial markets also provide support for the provision of a wide range of financial services to businesses and consumers in

the United States. Certain markets, such as the federal funds and government securities markets, also support the implementation of monetary policy. For purposes of this paper, "critical financial markets" are defined as the markets for:

- Federal funds, foreign exchange, and commercial paper;
- U.S. Government and agency securities;
- Corporate debt and equity securities.

Core Clearing and Settlement Organizations. Core clearing and settlement organizations consist of two groups of organizations that provide clearing and settlement services for critical financial markets or act as large-value payment system operators and present systemic risk should they be unable to perform. The first group consists of market utilities (government-sponsored services or industry-owned organizations) whose primary purpose is to clear and settle transactions for critical markets or transfer large-value wholesale payments. The second group of core clearing and settlement organizations consists of those private-sector firms that provide clearing and settlement services that are integral to a critical market (*i.e.*, their aggregate market share is significant enough to present systemic risk in the event of their sudden failure to carry on those activities because there are no viable immediate substitutes).

Firms that Play Significant Roles in Critical Financial Markets. Firms that play significant roles in critical financial markets are those that participate (on behalf of themselves or their customers) with sufficient market share in one or more critical financial markets such that their failure to settle their own or their customers' material pending transactions by the end of the business day could present systemic risk. While there are different ways to gauge the significance of such firms in critical markets, as a guideline, the agencies consider a firm significant in a particular critical market if it consistently clears or settles at least five percent of the value of transactions in that critical market.

Recovery and Resumption of Clearing and Settlement Activities. The rapid recovery and resumption of critical financial markets, and the avoidance of potential systemic risk, requires the rapid recovery of clearing and settlement activities for the purpose of completing material pending transactions on their scheduled settlement dates. These clearing and settlement activities include:

³ The use of the term "systemic risk" in this paper is based on the international definition of systemic risk in payments and settlement systems contained in "A glossary of terms in payment and settlement systems," Committee on Payment and Settlement Systems, Bank for International Settlements (2001).

⁴ Under adverse market conditions or in the event of credit concerns about institutions, liquidity dislocations of the type experienced immediately after September 11 could be seriously compounded.