Operational resilience challenges from potential power outage disruption

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The renewed emphasis international regulators have placed on operational resilience following the pandemic has led many financial institutions to dedicate significant resources to understanding the risks within the services they provide, and to take actions to address any weaknesses.

Heightened interest in the role of third-party suppliers and financial market infrastructure providers (FMIs) widened the scope of affected firms, as regulators recognised the risk that failures in systems or processes could create for the marketplace. Identification of critical business services, assessment of their resilience and remediation planning for any identified weaknesses has become an essential "to do" for boards and risk committees.

While initially painful to embrace, the working-from-home revolution initiated by the pandemic has largely been seen as a positive development. The wellbeing benefits — including greater flexibility and autonomy for employees — have been well-publicised, but working from home also appears to have had the unexpected consequence of improving resilience.

It removed much of the location risk (building outage, transport network failure, bad weather disruption) as it reduced the concentration risk of having employees in one place. It federated this risk across employees' individual homes rather than concentrating it all in one place. This may have created other challenges — such as supervisory oversight or cyber-security concerns — but it reduced the historical business continuity planning (BCP) risks from building outages.

Energy crisis

The energy crisis now brings this shift in working behaviour sharply back into focus, however, as firms must ensure that their employees have access to a stable and consistent power source. The question is will a network exist that allows access to systems. It also exacerbates some of the location risks that exist within supply chains, where access to power becomes a national interest for governments as natural resources becomes politicised.

Both the UK Prudential Regulation Authority and the European Central Bank have outlined their expectations that banks must have plans in place to cope with disruption, although experts doubt that firms are prepared for outages of more than a few days. Even where they do have localised plans, such as reducing consumption in offices and having back-up generators in place, this will not cover the impact on third party suppliers — particularly those whose location footprint may be in developing countries that are heavily reliant on fuel imports.

Bloomberg reported that Pakistan has been materially affected by the fuel crisis, with supplier cancellation of contracts causing planned 12-hour blackouts in parts of the country. There is fear that this could spread to other countries that are faced with similar challenges. Losing power for sustained periods of time within regions where large concentrations of support staff are located will inevitably cause disruptions for the financial services industry worldwide.

Considerations for firms

Faced by this new, unpredictable risk of power shortages, firms need to understand how this will affect their ability to support the services they provide. They must also examine their own supply chains (and the second or third order impacts that may lurk within those supply chains) to assess what risks this presents and understand how they can be offset. In particular, firms may wish to consider the following areas of focus.

- *Return to office* — Power supplies will be easier to control through a centralised location than through people's homes. Firms should expect to see scenarios modelled out where critical staff are brought into a central location rather than working remotely. "Return to region" scenarios may be re-thought to take into account sustained power outages in an offshore region. Nor should firms discount the risk of localised blackouts with regards to critical market cut-offs, even within the developed world, as critical person dependencies will never be completely offset.
- *Third-party suppliers* —The pandemic revealed a lack of resilience on the part of certain suppliers who took some time to get staff operational within a working-from-home environment. These supply chains will now need to be re-assessed; specifically, where operational stability is more vulnerable to power outages due to country-specific risk. Diversification of footprint will also become important for a supplier; for instance, how quickly they can cut over from one location to another in the event of sustained power outage. The "where" is also as important as "how" in this regard; a multi-site strategy in one country or region may not be as stable

as one which can cut seamlessly from one continent to another. Service providers should be expecting calls from clients, asking them to outline their contingency planning.

- *System "fail-over/fail-back" procedures* — Most financial systems are processing around the clock — either needing to be online to provide access (withdrawing cash, accepting client orders, providing trading liquidity) or running end-of-day routines. Most data centres have tried and tested plans to switch from grid to generator, but experience shows these events do experience occasional glitches. This can result in data being lost, or trading activity missed. If this becomes a recurring theme, maintaining data integrity will become a major challenge, affecting client statements and balances available to withdraw, or leading to missed or duplicated orders being filled by a trading desk. Most firms run end-of-day integrity checks — typically, batch-driven reconciliations — but these processes are not dynamic, nor able to be run at will. Firms should be assessing how they will maintain this integrity, or making plans to offset data loss caused by a system outage.
- *Liquidity buffers* — Where outages occur in connection with market cut-offs or affect time-sensitive processing, reserve liquidity may well be required to offset payment or settlement failures. Regulators may encourage contingency in the event of market-wide failures by infrastructure providers (delaying deadlines or extending processing) but this will be unlikely to be invoked for individual participants who have a problem. Firms should be stress testing or scenario modelling these situations and have clear plans which set out how they will manage this risk should it arise.

Expect the unexpected

If the financial services industry learned nothing else from the pandemic, it was to expect the unexpected.

Management committees should ensure that they have considered the risk that unexpected power outages may create for their businesses. As it is often the more remote or second order impacts that can have more serious repercussions, some of the more obvious risks will typically tend to attract the most attention.

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