TC NOTES

PRACTICAL **LEADERSHIP**
AND **GUIDANCE** FROM
TORONTO CENTRE

LESSONS FOR SUPERVISORY AUTHORITIES FROM CRISIS SIMULATION EXERCISES

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LESSONS FOR SUPERVISORY AUTHORITIES FROM CRISIS SIMULATION EXERCISES

> "There are no mistakes in life, only lessons.
>
> There is no such thing as a negative experience, only opportunities to grow, learn and advance.
>
> From struggle comes strength. Even pain can be a wonderful teacher."
>
> — Robin Sharma

Introduction[1]

Financial crises are expensive, not only in terms of lost income and wealth,[2] but also because of their negative impact on financial inclusion[3] and gender equality.[4] It is therefore important to manage and resolve financial crises as effectively as possible.

This Toronto Centre Note is based on Toronto Centre's wide experience in running crisis simulation exercises. Toronto Centre ran its first crisis simulation exercise in 2008 and has run over 120 exercises since then.

Crisis simulation exercises are important for financial supervisors, across all sectors. They provide supervisors with experience in:

- managing a crisis, and taking decisions and actions in the heat of a crisis;
- communicating with all relevant parties, including other authorities, the media, financial institutions and the public; and
- cooperating and coordinating with other authorities, both nationally and internationally.

These experiences provide opportunities for supervisors and supervisory authorities to learn lessons, so that they are better prepared if and when a real crisis occurs. These lessons include how individuals and authorities may operate in a crisis; the issues that are likely to arise; the decisions that may need to be taken; the adequacy of the powers and tools available to supervisory and other authorities; and whether these powers and tools can be used effectively at very short notice and outside normal working hours.

This Note discusses a range of learning experiences. Each section covers what is being tested in crisis simulation exercises; what typically happens in Toronto Centre crisis simulations; and typical lessons learned.

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[1] This Note was prepared by Clive Briault.
[2] Sufi and Taylor (2021) and Cerra and Saxena (2017) present estimates of a permanent fall in real GDP of between 5 and 10 percent.
[3] See Čihák and Sahay (2020).
[4] See UN Women (2014).

This Note is part of a series of Toronto Centre Notes relating to crisis preparedness.[5] The series covers contingency planning for financial crises; crisis binders; designing a systematic financial crisis management simulation; business continuity planning for a supervisory authority; recovery planning; exit policy; and resolution.

Types of crisis simulation exercise

Toronto Centre designs its crisis simulation exercises to be as realistic as possible, using a range of country circumstances and crisis scenarios.

Different types and drivers of crises – these range from the traditional failure of a financial institution because of poor credit or underwriting decisions to the impact of cyber attacks and other operational failures, pandemics, and climate change. In some cases, there may be operational and other impacts on the supervisory authority itself.[6]

Different designs for the crisis setting – crisis simulation exercises can be generic, tailored, or bespoke.

- Generic exercises are based in plausible and realistic settings, but not in a real country.
- Tailored exercises are based on a generic exercise, but with the inclusion of some real-life country specific features (for example, for the structure of the financial sector, or the institutional structure and powers of the relevant authorities).
- Bespoke exercises are based as much as possible on country-specific features – they are designed to reflect the actual financial system, institutional framework, and crisis management powers and tools in the specific country or countries where the crisis simulation exercise is run. Such exercises are designed to be targeted stress tests of the countries' financial crisis preparedness.[7]

Different players – the participants in a crisis simulation exercise may be real-life crisis management teams or more junior programme participants from the same authorities; or the participants may be drawn from a range of different countries.

Different scope – the only "active" team in a crisis simulation exercise may be a single authority (which might be the supervisor of a single sector, or an integrated supervisory authority responsible for more than one sector), with other authorities and stakeholders played by role players. Or there may be multiple "active" teams, representing different authorities (for example, not just a single supervisory authority but other supervisory authorities covering different sectors, the central bank, the resolution authority, and the deposit or insurance protection agency).[8] These multiple active teams are usually located within a single country, but they can also be located across multiple countries.

[5] See Toronto Centre (2015, 2019, and 2020a–f).
[6] Toronto Centre (2020b and 2020c) discuss the impacts of a crisis on a supervisory authority.
[7] Toronto Centre (2020a) discusses the design and implementation of such bespoke exercises, including in a cross-country context.
[8] Even in a bespoke exercise, some stakeholders may be played by role players, for example the media, financial institutions, and any authorities not represented as active team players in the exercise.

Lessons learned from different types of crisis simulation exercise

- Valuable lessons can be learned from different types of crisis simulation exercise. Indeed, supervisors and supervisory authorities can benefit from participating in many different types of exercise, using a range of scenarios.
- Where the crisis simulation exercise is bespoke – involving all the relevant authorities (supervisory authorities, resolution authority, central bank, Ministry of Finance) across relevant countries, and based on real financial sectors and institutional structures and on scenarios tailored to the country circumstances - the simulation is in effect a stress test of crisis management arrangements. The lessons learned from such an exercise should be more specific and concrete in terms of institutional arrangements, decision-making, legal powers, policy and resolution tools, policy coordination, and communication.
- Important lessons can also be learned from generic and tailored crisis simulation exercises. Experience in running a range of crisis simulation exercises has shown that, at least at a general level, the lessons learned are similar across different types of simulation.
- This is reinforced when participants in a generic exercise are imaginative in thinking about how their experiences might read across to their own supervisory authority. For example, if there is a missing or unclear power in a generic exercise, what powers might be missing or unclear in your own national circumstances? Or if there were difficulties in cooperating and coordinating with other authorities in a generic exercise, could similar issues arise in your own country?
- Generic and tailored crisis simulation exercises can also highlight areas that could be tested in subsequent exercises that are based more closely on real-life circumstances.

Experiencing a crisis

Irrespective of the detail of a crisis simulation exercise, Toronto Centre simulations are designed to provide participants with an experience of what a crisis feels like. Participants have to work under tight time pressures, deal with a large and evolving volume of information and events, face multiple questions from a range of stakeholders, take multiple decisions, and generally try to “make order out of chaos”.

Participants are always enthusiastic and work hard during a crisis simulation exercise. They almost always report back afterwards that the exercise was overwhelming, tiring, confusing, required a lot of decisions to be made on the basis of too little information (or alternatively that there was too much information to digest in the time available), felt very time-constrained, and was sometimes made even more difficult when the exercise was conducted in a participant’s second language. They also report back that they learned a lot from the exercise.

All these characteristics of a crisis simulation exercise are familiar to those who have experienced a real crisis.

Lessons learned from experiencing a crisis

- Keep practicing and learning – gaining experience of what a crisis feels like should make a real crisis feel less daunting and less difficult to handle and manage.
- These experiences can also enable supervisory authorities to put mechanisms in place (clarity of responsibilities, availability of different types of knowledge and expertise, delegation, prioritisation, etc) to make the handling of crises more efficient and effective.
- Recognize and work within time constraints. Some decisions have to be made, or actions taken, during a crisis within a tight timescale and on the basis of seemingly inadequate information. Crisis simulation exercises provide scope to practice taking such decisions, so that they feel less difficult during a real crisis.
- Recognize that crises evolve – they may turn out to be deeper and more prolonged than first expected; new risks may emerge; and there may be many impacts on a supervisory authority's mandate and objectives, including financial stability and financial inclusion.

Understanding the context

In both a real-life crisis and a crisis simulation exercise it is important to understand the types of risk that might materialize; the financial system of the country (or countries) affected; and the institutional structure of the country (or countries). This should be easier in a real-life crisis or where a bespoke crisis simulation exercise is based on real countries, whereas participants in generic crisis simulation exercises circumstances have to rely on whatever background information is provided to them.

The risks that might materialize – either to initiate a crisis in the financial sector or as a result of a crisis – include current and prospective macro-economic developments; financial or operational failures in one or more financial institutions (and also operational failures within a supervisory and other authorities); financial instability; climate-related risks; civil and political upheaval; terrorist attacks; and pandemics. The lessons learned from crisis simulation exercises will differ depending on the scenarios used, which is itself a good reason for running a range of exercises.

Understanding the financial system of a country requires knowledge of the size, nature and structure of the financial system, including each sector within the system (banking, insurance, pensions and securities); the presence of financial conglomerates and mixed financial groups; the foreign subsidiaries and branches of domestic financial institutions; the local subsidiaries and branches of foreign financial institutions; financial market infrastructures (clearing, payment, trading and settlement systems); unregulated financial activities (which may be of growing importance as a result of the expansion of digital finance); systemically important financial institutions; the connectedness of financial institutions within and across sectors, and cross-border; large exposures of financial institutions; and any other indicators of the vulnerabilities of the financial system.

Three issues typically arise here. How up to date are the information and data? Are the information and data readily accessible in a crisis? And who, in practice, has access to the information and data – does this include one or members of the crisis management team (CMT), or at least a resource that is immediately available to the CMT? In both real-life crises and crisis simulation exercises participants often simply assume that any required information and data exist somewhere, and can be easily accessed, whereas in practice they may not exist or be difficult to access at short notice and outside normal working hours.

The institutional structure may appear to be a relatively simple set of arrangements that can be quickly and easily understood. In practice, however, there is often a lack of precision and clarity (sometimes even where it is set out in legislation) about the mandates, objectives, roles and responsibilities, and powers of each authority. This may become more complicated where decisions must be taken jointly among authorities, where an authority has to consult other authorities before taking a decision, where some supervisory actions require approval from a court, and where financial institutions operate in more than one country.

Lessons learned for understanding the context

- Keep practicing and learning – consider ahead of (and again after) a crisis or crisis simulation exercise the information and data that might be useful and how it could be accessed in practice.
- Run different crisis simulation exercises, using a range of scenarios.
- Recognize that risks, the financial system and the institutional structure all change over time, so the understanding of these needs to be updated accordingly.
- Some form of "crisis binder" (see Toronto Centre (2019)) could be a good place to hold some of this information, but this will become outdated unless it is well maintained, and it remains important that a crisis binder can be readily accessed by the CMT during a crisis (senior management are not always highly competent in knowing where and how to access detailed information and data).

Crisis Management Team

Some crisis simulation exercises may be played by a real-life crisis management team (CMT) that is practicing how to work together during a real crisis. In other cases, a group of Toronto Centre programme participants may play the CMT, either for the authority they work for or for a fictional authority. Either way, the key question here is how well the CMT manages the crisis.

Where a real-life CMT is playing itself, it should be easier to establish internal reporting and decision-making structures within the CMT, and to delegate some actions to clearly identified subject specialists within the CMT (for example, to a supervisor of a specific sector, a head of media, or a general counsel who is a member of the CMT). However, even in these circumstances the CMT may not have operated before as a team – in either a crisis simulation exercise or a real crisis – or the membership of the CMT may not have been updated as the senior management of a supervisory authority has changed.

It is more difficult for participants playing a fictional CMT to organize themselves effectively, and to delegate actions to specialists within the CMT, because they are not so familiar with each other or with the context of the crisis simulation exercise. In such cases the CMT typically ends up – at least in the early stages of the crisis simulation – dealing with everything as a committee, which is not always efficient and effective, rather than by appointing subject specialists, dividing tasks among members of the team, or creating sub-teams.

Lessons learned for crisis management teams

- Keep practicing and learning – all teams need to practice working together so that they can operate as effectively and efficiently as possible, both individually and collectively.
- Supervisory authorities need to designate a crisis management team (CMT). This requires:
  - a clearly identified senior level CMT;
  - different skills within the CMT, including supervision, policy, legal, media, accounting and auditing, human resources, and IT;
  - clear procedures for who can call a crisis and how the CMT is activated;
  - clear procedures for changing the composition of the CMT in response to the circumstances of the crisis (different skills, knowledge and experience will be needed in different circumstances, for example where a crisis includes cyber attacks or other IT failures);
  - clearly designated deputies for each individual, because members of the CMT may be unavailable when a crisis occurs, and because members of the CMT may need to be substituted during a crisis as fatigue sets in;
  - clear procedures for how the CMT will operate, including its relationships with the senior executive team, the board of the supervisory authority, and the CMTs of other key authorities; and
  - clear procedures for creating and activating a multi-authority combined CMT, should the circumstances of the crisis require this.
- Crisis simulation exercises may reveal how different individuals behave in crises – the best performers in a crisis may not be the best performers in more normal circumstances. The composition of the CMT may need to reflect this.

Decision-making

Many decisions have to be made during a crisis. In a typical Toronto Centre crisis simulation exercise participants may receive between 50 and 100 “inputs” in various forms, many of which ask for a response. These inputs arrive from a wide range of stakeholders and cover a wide range of issues, of varying degrees of criticality.

The data and information available to participants varies in both quantity and quality, and may be both imperfect and conflicting (where it arrives from different sources). There may be scope for participants to extend the data and information available to them, but because of time constraints they often have to use whatever information is already available to them.

Participants in crisis simulation exercises are encouraged to undertake good and careful analysis, and to consider and evaluate the options available to them. But this must be done on a proportional basis, taking into account the criticality and importance of the decision that needs to be made. Failure to make some decisions can have serious consequences. Being inconclusive could lead to a worse outcome than making a less than perfect decision.

Supervisory authorities may need to establish different decision-making processes and procedures that can be used in a crisis – decisions may need to be made very quickly by the CMT (or by smaller groups, or even individuals), and it may not be possible to use the normal structures for delegated authorities, committees and upward referrals.

Participants in Toronto Centre crisis simulation exercises are usually good at making more technical decisions that are within their experience and comfort zone. However, their capacity to analyze and respond to the issues posed by the simulation tends to vary inversely with the complexity of the scenarios, perhaps reflecting the inherent difficulty of more complex issues and participants' unfamiliarity with the issues that tend to arise during crises.

Similarly, participants are often not comfortable taking decisions that relate to trade-offs among the mandates/objectives of a supervisory authority (for example, allowing a financial institution to continue operating at below the minimum required capital, solvency, or liquidity requirement rules in order to preserve financial stability or financial inclusion).

More generally, most crisis simulation exercises reveal examples where:

- Time management and prioritization were weak, resulting in some important decisions not being made, or made too late.
- Decisions were made that were not clear, and/or were not communicated clearly to relevant stakeholders, leading to confusion.
- Participants over-analyzed a situation or sought ever more information before being prepared to make a decision, resulting in "analysis-paralysis".
- Important decisions were made, but without having considered and evaluated alternative options, and/or without some form of impact assessment or cost-benefit analysis.
- Decisions were made without consulting (or sometimes even informing once the decision had been taken) key stakeholders, such as other domestic authorities or overseas supervisory authorities, even when legislation required the decision to be made jointly with another authority, or that another authority should be consulted before the decision was made.
- Decisions focused solely on a financial institution(s) in trouble, with inadequate consideration given to market-wide issues such as safeguarding financial stability and calming markets when multiple markets are under stress (for example the interbank market, money markets, payment systems, equity and bond markets, and foreign exchange markets), or to financial inclusion issues.

Lessons learned for decision-making

- Keep practicing and learning – experience of making decisions during a crisis simulation exercise may prove invaluable in a real crisis.
- Establish in advance decision-making processes and procedures in a crisis.
- Establish in advance a clear framework for making the key decisions that are likely to arise in a crisis. For example, in dealing with a failing financial institution, consideration could be given in advance to difficult issues such as:
    - is there a preference for seeking a private sector/market solution where possible?
    - are there any considerations relating an overseas acquiror?
    - what are the perceived advantages and disadvantages of other solutions?
    - under what circumstances might some form of public sector support be provided (and has this been discussed in advance with the Minister of Finance)?
    - what difference does it make if the failing financial institution is systemically important?

- who will bear the losses? If losses have been made, they have to be borne by someone – they do not just disappear through the use of tools such as a bridge bank, or good/bad asset separation.

- Consider in advance how the key decisions that may need to be taken in a crisis can be prioritized, how they can best be taken with imperfect or incomplete information, and how less important issues can be recognized and dealt with accordingly.

Stakeholder analysis

In a crisis, each authority will need to consider a long list of stakeholders, each of which may be potentially valuable as (i) a source of information and data; (ii) a joint decision-maker or an input to decisions; (iii) a provider or facilitator of solutions; and (iv) someone who needs to be communicated to, proactively or reactively, to influence their actions and behaviours.

The list of relevant stakeholders is likely to include at least:

- Other national authorities – supervisory authorities for different sectors, resolution authority, central bank, Ministry of Finance and any other relevant government departments, and depositor, policy holder and investor protection agencies.
- Relevant foreign authorities, depending on the nature and details of the crisis.
- Financial institutions and financial market infrastructure.
- The general public, including depositors, policy holders, investors, and members of pension schemes.
- The media – not only the press and TV, but also social media.
- Political bodies and parties/politicians.
- Professional services firms – accountants, actuaries, lawyers, etc.

The typical experience in Toronto Centre crisis simulation exercises is that participants interact with many stakeholders. But there is tendency – reinforced by the pressures of the constant stream of inputs – for participants to communicate with stakeholders mostly reactively, in response to incoming questions and requests.

Participants tend not to initiate proactive contact with stakeholders, even where this might help them to manage the crisis, for example through contacting the media to influence the reporting of a crisis, contacting financial institutions that might be part of a private sector/market solution, and keeping other authorities informed even when there is no legal obligation or agreement to do so.

Participants also sometimes struggle to understand stakeholders' interest and concerns, and how best to influence or persuade them. Stakeholders may have different interests and objectives to the participating authorities, so they may not be persuaded simply by the participants stating what they want to do. For example, a Minister of Finance may prefer to spend taxpayers' money on schools and hospitals than on supporting a failing financial institution.

Supervisory authorities also need to consider the impact of a crisis – and how a crisis is managed – on various stakeholders, in particular where this may affect a supervisory authority's mandate and objectives relating to financial stability, financial inclusion and gender equality. For example, the failure of some financial institutions that are not systemically important (and would therefore normally be allowed to fail) may have a disproportionate impact on financial stability (because of contagion effects) or on financial inclusion and gender equality (for example because small enterprises run by women may deposit or invest in certain financial institutions). Supervisors should be aware of these unintended consequences and coordinate with other responsible authorities to mitigate their impact.

Lessons learned for stakeholder analysis

- Identify key stakeholders, domestically and internationally, ahead of a crisis.
- Analyse stakeholders in terms of:
  - what contact with them might be required in a crisis (by you, or by them) for information sharing, coordination and cooperation, decision-making, communications, and establishing good working relationships;
  - when and how this contact might take place;
  - whether this contact should be proactive or reactive; and
  - the arrangements required to deliver effective working with each stakeholder.
- Identify the names and contact details of key staff and officials in each stakeholder and keep this information up to date and accessible.
- Identify who in the CMT (or in your authority more widely) would be the main point of contact with each of these stakeholders in a crisis.
- Recognize that the set of relevant stakeholders may differ across different types of crises. For example, a terrorist attack or a cyber attack may introduce the police, national security agencies and other specialist committees and agencies to the list of stakeholders.
- Identify where the impact of a crisis – and of how a crisis is managed – may affect various stakeholders, and in particular where this may have an impact on a supervisory authority's mandate and objectives relating to financial stability, financial inclusion and gender equality.

Coordination and cooperation with other authorities

Cooperation and coordination with other authorities (at home and abroad) is important, not least in a crisis. No single authority can manage or solve a crisis on its own.

Bespoke crisis simulation exercises, based on real-life country-specific institutional arrangements, provide an opportunity to test how well real-life coordination and cooperation arrangements between the authorities participating in the exercise might operate in a crisis. In some Toronto Centre crisis simulation exercises this has been extended to include authorities participating from different countries.

It is also possible to identify general issues from generic and tailored crisis simulation exercises. For example, if some aspects of coordination and cooperation among authorities did not work well in such exercises this can prompt discussion and analysis of how well this might work in a real-life crisis, and prompt ideas for subsequent exercises to test national circumstances more directly.

In Toronto Centre crisis simulation exercises participants are usually good at recognizing – at least in principle – the importance of coordination and cooperation with other authorities, both domestically and internationally. This is usually stronger on a reactive basis, when other authorities are asking for information or proposing actions.

There is usually less information sharing or discussion with other authorities until something is needed from another authority. Proactive coordination and cooperation is often limited to seeking views from other authorities before decisions are made, either because inputs from other authorities are mandated by legislation or other arrangements, or because other authorities are identified as part of a solution (for example, asking the Ministry of Finance for government support).

Even among authorities within a single country, and even where participants are representing their own authorities and operating under their own country-specific arrangements, there may not be good or natural coordination and cooperation among the relevant authorities. This could be because there is a limited understanding of the powers available to other authorities, and of the information that other authorities need to be able to make their own decisions; or because no framework has been established to govern how the authorities are supposed to operate collectively in a crisis.

Cooperation among authorities may also be difficult because the authorities have different mandates and objectives. Each authority may have a limited awareness of what the concerns, considerations and priorities of other authorities might be. There may not be clear procedures for reaching a consensus on the actions to be taken when authorities disagree with each other. And there may be a need for some flexibility in the application of rules and regulations, or in the criteria determining the use of powers, to maintain financial stability and financial inclusion.

Lessons learned for coordination and cooperation with other authorities

- Identify the key authorities - domestically and internationally - among whom coordination and cooperation will be required in a crisis. This may differ for different types of crises.
- Understand what you may need from these authorities in a crisis; and what they may need from you.
- Understand any formal or informal arrangements in place for how the relevant authorities are supposed to coordinate and cooperate in a crisis.
- Prepare the ground in advance – for example, though consideration of how the relevant authorities would need to cooperate and coordinate in a crisis.
- Establish good relationships with other authorities so coordination and cooperation can work more smoothly in a crisis.
- Keep practicing and learning - test your actual arrangements through crisis simulation exercises in which other authorities participate actively, and identify and address any weaknesses in coordination and cooperation among the relevant authorities.
- Use any form of “financial stability committee” or “steering group” on which relevant domestic authorities are represented to promote crisis simulation exercises and the importance of learning lessons from them.

Communication

Crises trigger the need for effective communication, to maintain confidence and financial stability, and to provide useful information on which stakeholders can base their decisions. Ineffective communication is likely to lead to ineffective crisis management.

In addition to communication among the relevant authorities (as discussed in the previous section), communication to other stakeholders - including to the media (widely defined), the general public (directly, or though the media), and financial institutions - is a critical component of successful crisis management.

Media - the authorities need to be "ahead of events" and "on the front foot" in managing stories in the media. Messages can usually be communicated about what the authorities have done, what they are doing, and what they will do if necessary. In the absence of such messaging, and in the absence of prompt and persuasive answers to questions from the media, stories in the media are likely to run out of control, creating a heightened sense of crisis and triggering unhelpful behaviours by the public and by financial institutions.

General public – in addition to communication through the media, the authorities may try to communicate directly with depositors, policy holders, investors and members of pension schemes. This could take the form of public statements, or if the contact information is available the authorities could communicate specifically with the customers of troubled financial institutions. As with the media, the objective here is to be positive and reassuring, but without promising too much or making misleading statements. Consideration should be given to how to communicate to different audiences based on their location, level of financial literacy, and access to different channels of communication.

Financial institutions – communication with financial institutions (and other market participants) should be part of an almost constant two-way communication during a crisis, in which the authorities are informing financial institutions about what is happening, while also gathering data and information from financial institutions and discussing with them how they perceive the situation in their own institutions and market-wide.

In most Toronto Centre crisis simulation exercises the main communications focus is on the media. There is typically a mixed outcome, with some good statements being made to the media, especially where one or more authorities have taken decisions that are being publicised and explained, or where a depositor, policy holder or investor protection authority is explaining what happens when a financial institution is put into liquidation. This is consistent with participants being most comfortable with technical issues.

However, participants seldom get "ahead of events" by making proactive statements about what they are doing to manage a crisis, and indeed they often fall "behind the curve," even when in reactive mode, by answering questions from the media too late or not answering them at all.

When questions from the media are answered, participants sometimes go too far in an attempt to maintain public confidence or calm markets, for example by stating or implying that no financial institutions are in trouble or will fail, or that "all depositors are safe", not just those covered by a deposit protection scheme. Statements to the media are also not always well coordinated across the relevant authorities, with the risk of contradiction or confusion.

Lessons learned for communicating to the media

- Consider how your supervisory authority can develop a more proactive external communication policy to be used in a crisis. There is usually scope to talk about the process – the current situation, where you want to be, and possible tools to get there – even when there is nothing to communicate about decisions and actions.
- Consider - in advance of a crisis - statements that could provide confidence inspiring but truthful and realistic communications to the media and the general public. Such statements will need to address the questions that always arise in a crisis, for example “are my deposits safe?”
- Develop a set of pre-prepared sample documents for a range of possible circumstances – press releases, formal statements, legal documents to activate powers, etc. These can be amended as necessary to reflect specific circumstances in a crisis but having something ready in advance can save a lot of time.
- Consider how communications can address wider financial stability issues, not just issues relating to individual financial institutions.
- Consider how best to communicate to and through social media.
- Speak with one voice as an authority, and across relevant authorities. This may require some centralization of communications to avoid mixed messages. It may also be necessary to coordinate with other stakeholders, for example financial institutions.
- Stay patient and consistent.

Powers

In a crisis, supervisory (and other) authorities are likely to want to use a range of tools and powers to manage and resolve the crisis. This requires knowledge and understanding of:

- The powers that are available to each authority.
- The criteria and conditions that govern the use of these powers - some actions may be subject to criteria or decision-making processes that govern their use.
- Which powers require joint decision-making, or consideration of formal input from other authorities, and what procedures are in place to resolve any differences of view among the relevant authorities.
- Which powers require a court order or similar processes involving the legal system.
- The practicalities of using powers, especially at short notice and outside normal working hours.

Key powers to consider for crisis management - in particular for dealing with failing financial institutions - are likely to include the following:[9]

- Requiring a financial institution to activate its recovery plan, or otherwise to improve its financial or non-financial resources.[10]
- Initiating an independent third-party valuation of a financial institution to assess its solvency.
- Appointing a special manager to run a financial institution on a temporary basis.

[9] Some of these powers may not be available in all jurisdictions.
[10] See Toronto Centre (2020e).

- Placing a failing financial institution into liquidation, administration or insolvency proceedings.
- Placing a failing financial institution into resolution.[11]
- Replacing all or some of the directors and senior management of a failing financial institution.
- Replacing an external auditor.
- Taking control of a failing financial institution.
- Overriding the economic and/or control rights of shareholders.
- Forcing the sale or transfer of (some or all) assets and liabilities of a financial institution to a third party, or other restructuring.
- Writing down (or converting into equity) claims of creditors.[12]
- Providing capital, guarantees, or liquidity assistance from the government or the central bank.
- Temporarily suspending payments to creditors and other customers of a financial institution.
- Imposing a temporary stay on the exercise of early termination rights by counterparties of a financial institution.
- Introducing new regulations at very short notice, without the usual consultation processes.

In Toronto Centre crisis simulation exercises, participants often have inadequate knowledge and understanding of the powers available to the various authorities involved, who can use these powers (and in what circumstances), and the practicalities for activating these powers (for example during a "crisis weekend"). This is understandable where participants are operating in a generic exercise, but in some cases this has proved to be a weakness even where participants in an exercise are representing their own authority.

Even where powers are reasonably clear, issues often arise in crisis simulation exercises about when and how these powers should be used.

One issue here relates to the timing of the use of powers, and whether legislative or other criteria for their use are met. For example, at what point, and under what conditions, does a supervisory authority decide that a financial institution is insolvent or illiquid, and does this match precisely the criteria for putting a financial institution into liquidation or resolution? There have been cases where the authorities in a crisis simulation exercise might be regarded as having intervened too early and too aggressively, and alternatively cases where powers have not been used when arguably they should have been.

Another important issue is whether a financial institution is deemed to be of systemic importance, and how this designation might change during a crisis. A financial institution that is not deemed to be systemically important in normal times might become systemically important in a crisis, for example if in those more fragile circumstances its failure would trigger significant contagion effects.

[11] "Resolution" refers here to the use of the resolution strategies and powers recommended by the Financial Stability Board (2014). See also Toronto Centre (2020d).
[12] This "bail in" power provides a good example of some key considerations relating to powers: (i) is the power available? (ii) which authority can exercise this power? (iii) has the use of this power ever been tested? (iv) has there been consideration in advance of which creditors might be bailed in, and in what order? (v) how will the amount of bail in be decided? (vi) do systemically important financial institutions have sufficient loss absorbing capacity to enable the power to deliver its objectives? (vii) who holds the debt instruments that would be subject to bail in (who will bear the losses)?

Lessons learned for the use of powers in a crisis

- Understand the powers available to your authority and to other relevant authorities.
- Understand what each power can deliver.
- Understand the conditions and criteria for using each power.
- Understand the practical considerations for activating each power – for example the need to involve other authorities or the legal system, the time it might take to exercise the power, the ability to exercise the power outside normal working hours, and the decision-making making process required to use the power.
- Determine clear policies for the conditions under which different powers might be used, and how any differences in view among relevant authorities might be resolved. Key powers in this respect might include:
    - Emergency liquidity assistance from a central bank
    - Putting a financial institution into liquidation, or triggering resolution
    - Choice of resolution strategy and resolution tools
    - Public support using taxpayers' money (including using a public sector subsidy to facilitate a private sector solution, and burden sharing with creditors).
- Plan for the use of powers and prepare as much as possible ahead of any crisis occurring.
- Use crisis simulation exercises or real crises to identify missing powers, or powers that may be difficult to use in a crisis, and address any deficiencies.
- Consider whether supervisors and other participants have legal protection (providing they act in good faith) when exercising crisis management powers.

Run, learn, repeat

Crisis simulation exercises should not be viewed as "single shot" exercises, in which a single simulation (however complex and however close to real life circumstances) will reveal every lesson that can be learned.

Different crisis simulation exercises will test different things, will reinforce different learning points, and will reveal different lessons. Participating in different exercises on a regular basis can therefore deliver substantial benefits to supervisors and supervisory (and other) authorities.

Lessons learned for participating in crisis simulation exercises

- Participate in a range of crisis simulation exercises, preferably at least once a year, using different scenarios, different levels of complexity, and different active stakeholders.
- Record and discuss what happened in each exercise in an open and positive manner.
- Identify what went well, and what went less well; learn lessons; and make improvements accordingly.
- Over time, practice and learning lessons will improve crisis preparedness.

Conclusion

Good crisis management depends on:

1. Skilled, prepared, well-practiced and informed people, with adequate legal protection and clear decision-making procedures.
2. A comprehensive framework of up-to-date laws, rules, processes and organizational structures.
3. An adequate set of crisis management powers and tools.
4. Effective cooperation, coordination and communication.
5. Learning and improving from regular crisis simulation exercises.

As explained in this Note, Toronto Centre crisis simulation exercises are designed to help participants to better understand:

- the experience of being in the midst of a crisis;
- the need for an effective crisis management team and practicable and clear decision-making procedures;
- the importance of understanding the context and framework within which the authorities and other stakeholders operate;
- the need to understand the powers available to the authorities and how they can be activated during a crisis;
- the need for effective cooperation and cooperation among relevant authorities;
- the benefits of good communication; and
- the need to learn and improve from such exercises.

> "Experience with the exercise has created a tremendous learning opportunity and will require follow up by national and regional authorities to draw on and respond to the lessons learnt"
>
> — From an internal report on a Toronto Centre crisis simulation exercise

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