

O.R.X Scenarios

Key takeaways from pandemic discussions with subscribers

Introduction

The [ORX Scenarios](#) team have held a series of discussions with subscribers on pandemic scenarios in response to the Covid-19 outbreak. The below is a summary of the key points of those discussions. Further work is being undertaken to produce a pandemic scenario stereotype that can be used as a base for developing your own pandemic scenario, for review/challenge of the assumptions in your current scenario and to support internal discussions.



Overall points

- **The COVID-19 outbreak is re-writing the assumptions to be considered in pandemic scenarios**
The current situation itself can potentially be considered as a base scenario, particularly with the pace COVID-19 has spread in all regions and the government reactions to curb it.
- **Pandemic scenarios developed so far by financial institutions are now seen as not severe enough**
They were usually limited to a given region of the world and considered mainly from the direct impact to the firm's employees.
- **Pandemic scenarios are likely best developed at group level as opposed to legal entity level**
The current situation shows that they can have a group-wide impact, crossing multiple regions and lines of business.
- **Similarly, for other risks, pandemic scenarios should be dynamic and built by considering key risk drivers**
In this way, the final impact can be scaled by "playing" with key factors such as the duration of the outbreak, absentee rate or IT infrastructure capability.
- **Pandemic scenarios developed for risk management purposes could take into consideration "knock-on" changes in the operational risk profile**
For example, increases in fraud, cyber, technology failure, reputational damage and conduct risks.
- **The cost of "going back to normality" is something most firms never considered in their pandemic scenarios**
In the current situation the industry is experiencing, we are seeing changing risk appetites, with some controls being relaxed or removed to keep the business running. What is the cost of putting controls back in place?

O.R.X Scenarios

Key takeaways from the pandemic discussions with subscribers

Storyline

The challenge for pandemic scenarios is how to capture an event that is sufficiently severe and global in nature, with specific assumptions incorporating government, firm, third party and societal responses and reactions.

Cause

- The view was that the scenario needs to be built as a global pandemic, capturing the effect of the way and the speed the virus has spread, as well as people's behaviour.
- It needs to cover multiple countries and business lines being affected at the same time.
- Some firms are linking the increase of the numbers of pandemic events to the climate change the world is witnessing.
- The cause of pandemic events does not fall under the firm's responsibility, given that it cannot be managed or mitigated by the firm. For this reason, some institutions tend not to clearly define the cause of the pandemic event.

Event

- Three main aspects need to be considered when describing the potential event:
 - ✓ Government measures (e.g. total lockdown, stopping travel etc.)
 - ✓ Firm specific actions (e.g. all employees working from home, deep cleaning etc.)
 - ✓ Third party/supply chain implications (e.g. reduced capacity etc.)
- Office, branches and data centre closures are a key part of the storyline.
- Timescale is important for shaping the event and quantifying the impact – the virus spread speed and how global it is in nature will lead to different firm and government actions to contain it and to support operations and employees.
- Employee or on-site visitor infections within the firm's premises could exacerbate the impact of a pandemic event. Although it may bring minor legal expenses, the firm's reputation may suffer.

Risk drivers

The discussion highlighted the most significant risk drivers to consider in this type of scenario:

- **Senior leadership/key personnel absenteeism**
This can be influenced by:
 - ✓ Contagion rate
 - ✓ Mortality rate
 - ✓ Average absenteeism rate (usually lower in key personnel)
 - ✓ Family care
- **IT Infrastructure capacity**
Technology capacity:
 - ✓ Can the VPN handle the demand and what is the potential of not being connected to network?
 - ✓ Is the infrastructure in place to support the changing work environment?

Key takeaways from the pandemic discussions with subscribers

Customer capacity – an increased volume of customer transactions and interactions:

- ✓ Using more online banking/online services and increased online shopping due to the inability to go to branch
- ✓ Deferring mortgage/lowering fees – call centre capacity
- **Public infrastructure:**
 - ✓ Electricity outage
 - ✓ Network outage
- **Number of customers affected**
- **Number of operations that cannot be performed**
- **Market volatility:**

Linked to trade and sales processing errors, market volatility may increase the size of the loss.

Impacts

Impacts deriving from pandemic risk appear to be wide ranging and often link to the length of the event. They range from the initial business disruption, risks from operating in a different way, to longer-term impacts, such as people, as well as secondary risks such as increases in fraud, cyber and conduct.

The following list summarises what have been widely described as direct impacts applicable to any kind of financial business.

Direct Impacts

- **Unplanned IT investment**

Any costs incurred for the pandemic related to IT expenditure that was unplanned and has been caused by the pandemic. This can be split into:

 - Increased spend on enabling most staff to work remotely (e.g. IT equipment, increasing network capability)
 - Transferring services that would usually be performed in person in a branch to digital platforms
- **HR costs** – including:
 - sick pay,
 - additional employee benefits,
 - training and hiring temporary staff for the duration of the pandemic
 - staff overtime to support for duration of pandemic
 - PPE (personal protective equipment) and support as required
 - Cancelled holidays
- **Sanitisation costs**

Cost of deep cleaning buildings where staff have tested positive for virus
- **Building expenditure**

Moving to secondary site and costs to split the workforce
- **Legal costs**

Firm may be held liable for actions if they don't take appropriate measures to protect employees and customers (e.g. Employees or on-site visitors that get infected within the

O.R.X Scenarios

Key takeaways from the pandemic discussions with subscribers

firm's premises may decide to sue the firm or employees get infected on their journey to the office using public transportation)

Additional impacts, not necessarily considered *direct impacts* by the majority of financial institutions, have also been identified as key consequences of a pandemic event.

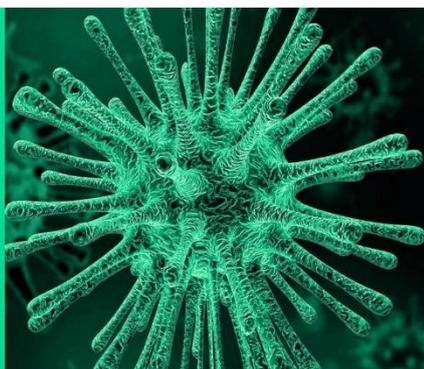
Other impacts

- **Conduct risk**
Due to the lack of supervision, lax of controls due to different working arrangements, sub-optimal customer support.
- **Processing errors**
Increased pressure on staff or relaxed controls may lead to increases in processing errors, e.g. working from home, overworked due to absenteeism, increase in client/customer support volumes.
- **Business disruption**
Some operations cannot be performed remotely.
- **External fraud and cyber fraud**
Phishing attempts referring to a pandemic event can increase the success rate of such attacks. Also, a relaxed control environment may lead fraudsters to take advantage of a difficult situation (e.g. customer identification can be difficult).
- **Loss of business**
Being unable to perform operations may lead to opportunity costs.
- **Data/system controls**
Weaker data/system controls as a result of staff needing to work from home and the potential for people to access systems, they would not normally be able to. This could also result in data leakage, fraud (internal and external), conduct risk etc.
- **Third party risk**
There may be costs associated with either having to support third parties to continue operations and/or replacing third parties if they are unable to operate. In some cases, third parties widely used by multiple financial institutions, may lead to systemic risk if they are not able to provide the service during the pandemic event.
- **Reputational risk**
If the firm fails to respond promptly to the pandemic risk compared with competitors' actions this may lead to loss of customers.

Coronavirus in operational risk

News round-up

O.R.X News



www.orx.org

Copyright ©ORX2020
Commercial in Confidence

O.R.X Scenarios

Key takeaways from the pandemic discussions with subscribers

Finally, it was highlighted how different lines of business are exposed to different kind of impacts. ORX discussions focused on retail banking, investment banking and insurance:

Retail Banking

- **Regulatory penalties**

Potential regulatory fines can be linked to:

- Customer treatment (e.g. temporary mortgage payment holidays may not be properly communicated to customers or customers may not be correctly assessed for eligibility to access the payment holiday)
- Suspicious transaction reporting (e.g. the lack of staff may result in failures of reporting suspicious transactions to the regulator)

- **Loss of productivity**

Particularly for branch operations with high levels of manual processing. Where opening hours are reduced, or branches are closed, the number of operations may be reduced (e.g. opening current accounts or approving credit line). Plus, some products may not be offered when employees are working remotely.

- **Call centre additional staff**

With branches being closed, the number of call centre operations is expected to increase massively. Therefore, the number of call centre staff needs to increase correspondently.

Investment Banking

- **Transaction errors**

Pressure on staff that leads to mis-booking trades or input errors.

- **Critical vendors failures**

A number of vendor platforms being unavailable (e.g. risk analysis or hedging booking systems) may reduce the number of business operations or stop them being performed.

- **Orders executed at unfavourable price**

Staff absenteeism or business disruption may delay the execution of client orders and settle them at an unfavourable price (e.g. losses from trades not completed due to disruption in trading operations due to Covid-19).

- **Regulatory fine**

The temporary way of executing orders remotely may lead to regulatory fines (e.g. traders not recording orders made via telephone or risk of conduct issues linked to market manipulation due to lack of oversight).

Insurance

- **Claim backlog**

The reduced number of claim settlers may lead to several claims not being paid on time. This leads the firm to pay additional money as interest.

- **Regulatory pay-out**

Regulator may force insurance company to:

- Cover pandemic-related claims, even if explicitly excluded from the insurance policy
- Reimburse motor insurance policy for the lockdown period

O.R.X Scenarios

Key takeaways from the pandemic discussions with subscribers

- **“Humanitarian” costs**

Insurance companies that sell their product through an intermediate channel (agents), may decide to keep supporting the agent business and pay them humanitarian help during the lockdown period. The purpose is to keep the agent’s business alive even in a period of no-commissions.

Next steps

- Based on conversations with scenario subscribers, ORX will produce a Scenario Development Handbook on pandemic by the end of May.
- In addition, this paper and a stereotypical scenario on pandemic will be distributed to all ORX Scenarios subscribers and to all ORX members.
- This paper will be presented during the April Scenario Working Group.

Contacts:

Steve Bishop, ORX Head of Risk Information & Insurance: Steve.Bishop@orx.org

Giuseppe Aloï, ORX Scenarios Programme Manager: Giuseppe.Aloi@orx.org

Lily Loneragan, ORX Assistant Manager: Lily.Loneragan@orx.org



ORX Scenarios

- ✓ Industry-leading scenario library
- ✓ Global scenario practitioner network
- ✓ Scenario practice benchmark studies
- ✓ Scenario development handbooks
- ✓ Risk intelligence packs

[Find out more](#)