



Information Paper

Pandemic Planning

October 2006



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Introduction

Recent international developments with respect to the spread of avian influenza have heightened the risk of a human outbreak of influenza or other disease emerging in a manner that affects the operations of Australian financial institutions. The Australian Prudential Regulation Authority (APRA) believes it is prudent for financial institutions and their regulators to ensure that Australia's financial system is as prepared as practically possible for a potential pandemic. Without overstating the likelihood of a pandemic actually arising, APRA's interest is in ensuring that regulated institutions have conducted prudent and reasonable planning to meet core obligations to depositors, policyholders and other beneficiaries and to maintain their financial viability even in such an unlikely scenario.

In 2006, APRA began meeting with a number of larger Australian and foreign banks, insurance companies and superannuation administrators regarding their pandemic planning activities. APRA is also considering how its own operations could be affected by a pandemic and is implementing measures to ensure it can continue to fulfil its public mission. This document summarises the issues arising from these activities.

There are many sources of information about pandemic risks. The World Health Organisation (WHO) has issued a pandemic planning model involving six phases, which is widely used by businesses and governments in pandemic planning in Australia and abroad. In mid-2006, the Australian Government issued a *National Action Plan for Human Influenza Pandemic* and an updated version of the *Australian Management Plan for Pandemic Influenza*.

The Joint Forum, an international association of financial regulators, has also released the final version of a guidance paper entitled *High-Level Principles for Business Continuity*. APRA participated in the development of this paper and endorses its principles, which focus on planning for the impact of a major operational disruption on national financial systems. The principles are relevant to pandemic planning and APRA encourages institutions to consider them in their planning activities.

Prudential practice guide

In conjunction with this information paper, APRA is publishing a prudential practice guide to pandemic planning and risk management. This practice guide is based on APRA's discussions and reviews of pandemic planning at regulated institutions to date. The guide covers areas such as pandemic project governance, business continuity management, the typical content of pandemic plans, definition of critical functions, the range of external factors that need to be considered and potential financial impacts. The practice guide supports compliance with other APRA prudential requirements, notably those relating to business continuity management, but does not constitute minimum or expected practices for all institutions. APRA expects all institutions to consider pandemic risks, but does not mandate any particular operational approach. The highlights of the prudential practice guide and good practices are summarised below.

Pandemic continuity planning

Revising existing business continuity frameworks to encompass pandemics is a significant component of current pandemic planning efforts among financial institutions. Many of the larger banks and insurance companies, particularly those with international operations, began formally addressing pandemic risks in the second half of 2005. APRA is now assessing pandemic continuity planning as part of its routine on-site operational risk reviews. Further details of common practices that APRA has observed are provided in APRA's prudential practice guide.

A common and important theme from APRA's discussions is that few institutions viewed their existing business continuity plans (BCPs), no matter how generic, as adequately coping with a pandemic scenario. This is not to say, however, that existing BCPs cannot be effectively revised to address pandemic risks. Many institutions are also developing pandemic-specific plans, often staged according to the six WHO pandemic phases.

In discussions about pandemic planning, APRA asked institutions to identify those functions that would be continued with highest priority, and those that could be deferred or operated at significantly reduced capacity. There was a range of approaches institutions used in identifying critical and essential functions and as a result there was less consistency than might be expected across institutions. APRA believes that as part of their pandemic planning activities, institutions should be identifying those critical functions that they would endeavour to continue with highest priority, based on criticality to the financial soundness of the institution, the functioning of the financial system and the well-being of customers. APRA's prudential practice guide provides examples of the types of functions that APRA would expect to be considered critical for most institutions.

Institutions are also incorporating procedures for business areas to deal with pandemic-affected customers. Institutions need to factor different patterns of customer behaviour into their resource planning. This may give rise to greater need for customer support and communication, for example.

Some institutions are developing scenarios under different assumptions of what impacts might result from a pandemic to assist in planning, both financial and operational. Certain industry associations, such as the Australian Bankers' Association, have convened working groups to develop common plausible scenario assumptions to promote consistent planning across major parts of the financial sector. For example, APRA has observed that many institutions are planning for reductions from normal staffing of 25–50 per cent over an extended period, up to 18 months in some cases.

A range of external factors will also affect the pandemic planning activities of supervised institutions. Many of these are outside the direct control of institutions, but nevertheless should be factored into pandemic plans. For example, in discussions with APRA, many institutions noted that, their actions will depend significantly on the activities of the Government with respect to actions such as quarantine or social distancing measures, as well as any provision of safety-net income assistance to people in need. National and local Government plans outline measures that might be taken.

Financial institutions have also identified telecommunications infrastructure capacity as an area requiring further analysis to help determine the effectiveness of remote work arrangements. Institutions have also noted the need to ensure financial infrastructure providers (including, for example, local and overseas markets and exchanges and payment system operators) are also taking adequate measures to ensure they can continue to operate critical functions in a pandemic scenario.

Assessing potential financial impacts

APRA has also been assessing the methods that institutions are using to analyse potential financial impacts of a pandemic scenario. Financial impacts could arise from risk insurance coverage for pandemic-related claims, through the impact on borrowers who may become unable to repay loans or from macroeconomic impacts more generally. Some insurers have begun financial modelling of claims under different types of policies. The more significant exposures appear to be likely to arise in life insurance, business risk insurance (including business interruption), workers' compensation, disability and unemployment insurance, and consumer credit insurance. In particular, business insurance in Australia is reportedly more likely than in some other countries to include business interruption coverage related to infectious diseases.

APRA is currently conducting a stress test of insurance companies based on several pandemic scenarios in order to gauge overall levels of potential pandemic-related insurance exposures. APRA is providing consistent assumptions that are only indicative of potential impacts and are necessarily highly simplified. Institutions need to monitor research and medical developments and adjust their scenario assumptions accordingly. APRA has focused on the financial impacts on the insurance sector (rather than, for example, banking), as the pandemic impacts on other sectors are likely to be much more indirect and therefore difficult to estimate. However, APRA has not ruled out conducting a stress test of other sectors at a later date if circumstances warrant. Depending on the comparability and reliability of information received, APRA may publish summary information from these stress tests.

Some larger lending institutions have begun to consider less direct potential impacts. This could include, exposures to industries considered to be most at risk of a downturn as a result of a pandemic, including, for example, tourism and agri-businesses. Banks and other lenders could be expected to exercise some degree of forbearance for pandemic-affected customers, including capitalising interest for a period; similar measures are commonly allowed for customers affected by natural disasters. APRA recognises that such behaviour, while helping to minimise overall economic disruption to the community, could lead to a (possibly temporary) increase in loan arrears.

With respect to superannuation, a pandemic might lead to some increase in eligible individuals electing to commence benefits and an increase in requests for early release of benefits. It is important that administrators of superannuation funds and other managed investment funds have considered how they would maintain basic operations if their staffing levels or service providers were to be affected in a pandemic.

Good practices

Financial institutions are significantly advanced in their pandemic planning efforts, and APRA has observed some emerging good practices through discussions with major institutions. These may not be applicable to all institutions depending on the size and scope of their business. Additional details are provided in the prudential practice guide. Examples of good practices include:

- establishment of an internal pandemic committee representing support and business areas, reporting regularly to executive management, crisis management or risk committees during the development of the pandemic planning approach;
- strong co-ordination processes between group and regional management through group-wide pandemic policies and planning processes;
- explicit consideration of pandemic risks in strategic and business plans and group-wide risk management frameworks;
- explicit identification of critical functions and operations and how these would be delivered through the phases of a potential pandemic;
- early recognition that traditional BCPs generally do not cater for pandemic scenarios involving sustained reduction in staffing over an extended period;
- development of a pandemic plan, which links directly to BCPs, crisis management, communications, liquidity and other plans;
- clear trigger points for escalation within the plan linked to WHO phases or other triggering information;
- consideration of a range of measures, both technology-based and other work arrangements, to ensure available staff can continue critical operations;
- consideration of strategies to accommodate potentially increased customer use of electronic channels or access to funds and credit;
- developing models and assumptions to assess potential direct and indirect financial impacts on assets, liabilities and capital from a range of reasonable pandemic scenarios;
- preparation of forbearance policies for pandemic-affected customers and quantification of likely impacts of such policies on the institution;
- proactive assessment and understanding of critical service providers' pandemic preparations, particularly telecommunications;
- preparation of Q&As for affected employees, customers, counterparties and service providers for issuance in case needed; and
- procedures to notify APRA immediately in the event of a major disruption causing a closure of an office, service or business unit and to keep APRA apprised of any other pandemic impacts on the institution or its beneficiaries.

Other issues

Some of the key issues APRA has observed to date that would benefit from further consideration include the items listed below.

- Greater consistency across industry sectors in identifying critical functions would ensure a more consistent and predictable approach to pandemic preparedness. The Government has a strong interest in ensuring that the core financial sector functions are operational across a wide range of institutions to support the community and its confidence in the stability of the financial system.
- Recognition of the critical role of maintaining essential financial services (such as cash supply) in promoting public confidence is also important to ensure they would receive adequate priority in a pandemic scenario. For example, the Government's *National Action Plan for Pandemic Influenza* identifies banking and finance as core functions and services in the business and general community.
- Telecommunications capacity is a critical issue raised by most institutions, given the likely increased reliance on broadband and similar services to support alternate work arrangements and customer service.
- Existing industry associations are, in some cases, becoming active in providing pandemic-related guidance to their member institutions and developing industry-level communications strategies. Further work to identify the appropriate role of industry-level bodies in coordinating industry-level activities, including, for example, identifying potential industry-wide operational issues, would be beneficial.
- Industry-wide tests or coordinated cross-institution exercises of various types may also be useful in understanding interdependencies between the pandemic plans of individual financial institutions. Financial institutions and regulators in a number of countries have conducted or are planning such tests.

Pandemic planning at APRA

APRA is currently developing its own pandemic plan, which covers staff welfare as well as operational matters. Even in a pandemic, APRA would continue to be responsible for implementing the prudential regulation framework to ensure the financial soundness of supervised institutions, as well as advising the Government on appropriate actions. However, with constrained resources, APRA would need to focus on addressing more critical issues for regulated institutions and industries. As a result, depending on the particular circumstances, a number of routine supervisory activities would most likely be suspended or deferred.

Basic supervision functions could continue to be conducted either at APRA premises or at alternate work sites through activities such as:

- analysis of standard statistical reports and other information routinely provided by supervised institutions to verify financial soundness and compliance with key prudential requirements;
- continuation of high-priority supervisory activities currently in progress;
- progressing key enforcement and policy activities where critical deadlines or impacts could arise; and
- monitoring the overall condition of the financial system.

In a severe pandemic scenario, APRA would focus its resources on managing the crisis. Crisis management activities would be likely to include the following:

- off-site monitoring of the operational and financial status of supervised institutions through regular telephone and email contact with institutions;
- liaison with other regulators and Government;
- management of institutions in wind-up or statutory administration; and
- operation of APRA's Contact Centre, including early release of superannuation benefits.

APRA recognises that a regulated institution's ability to comply with the full range of requirements within laws and prudential standards might be affected if its operations were substantially disrupted. APRA could use its powers to waive, suspend or defer these requirements temporarily in a variety of ways, depending on the particular requirement and circumstances. At the same time, APRA strongly believes that supervised institutions should not rely on regulatory forbearance as a business or financial continuity planning strategy. APRA invites feedback on potential areas where institutions would anticipate the need for regulatory forbearance.

Conclusion

APRA is aware that many financial institutions are taking seriously the risk of an influenza pandemic occurring in Australia. Institutions have structured plans underway to develop, implement and refine their pandemic preparedness arrangements. Most institutions recognise that pandemic planning goes well beyond updating business continuity plans. Institutions that are further ahead in their planning tend to be those that identified pandemic risks early on as an overall business issue, rather than solely a business continuity issue.

A number of reasonable steps can be taken in the near term without incurring excessive costs to existing operations; many of these are outlined in APRA's prudential practice guide to pandemic planning. Smaller institutions may not have the resources to establish alternate work arrangements on the same scale as larger institutions, but still need to recognise that a pandemic could have a significant impact on their operations and customers. APRA will continue to engage with industry to ensure that financial institutions are as prepared as reasonably practical for a potential pandemic.

APRA welcomes feedback on this paper and the prudential practice guide, which should be provided to:

Ms Heidi Richards
General Manager, Industry Technical Services
Supervisory Support Division
Australian Prudential Regulation Authority
GPO Box 9836
Sydney NSW 2001
Email: pandemic@apra.gov.au

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Telephone
1300 13 10 60

Email
contactapra@apra.gov.au

Web site
www.apra.gov.au

Mail
GPO Box 9836
in all capital cities
(except Hobart and Darwin)