

Redenomination contingency planning

Impacts and considerations for banking,
capital markets and asset management
organizations if a country were to leave
the Eurozone

Why consider the possibility of an emergency redenomination?

In the face of an extreme set of challenges, the Eurozone countries are working to create a stable platform for recovery for all member states. However, with the level of uncertainty currently being experienced there remains the possibility of an exit from the Euro by a member state and the resulting redenomination of currency. While redenominations are not unheard of, they are usually planned, and impacted organizations often have many months or years to prepare.

It is unclear what exact circumstances would lead to redenomination. However, it is important to consider the more challenging scenarios and form a view of potential impacts on business and operations, and the appropriate responses.

The departure of a country from the Euro is currently thought to be difficult because there is no provision for this scenario in the European treaties. Secession of a member state would also be extremely costly and fraught with legal complexity. While European Union treaty changes can take considerable time (not least because of the need for ratification by all countries), financial markets are impatient, and we should not discount the possibility of an emergency redenomination that would leave far less time for preparation and response than may be afforded by a more orderly and planned change.

If such an event were to occur, how well prepared are your business and operations? What preparations should be made? Institutions should form a view of potential impacts and have contingency plans in place now.

The commercial impact is only part of the problem statement

While the commercial challenges in this scenario are significant in their own right, and some organizations are likely to already be considering the implications for parts of their business, there is potential for wide-reaching impact across the whole enterprise.

Commercial

- ▶ **Business models** – how will your businesses operating in the impacted region be affected? Does such an event represent an opportunity for your business to take advantage of market dislocation?
- ▶ **Market risk** – how will you hedge your currency exposure if underlying assets are denominated in a new currency? And how will this impact VaR models?
- ▶ **Credit risk** – what impact will a redenomination have on counterparty and customer credit ratings, as well as your own?

- ▶ **Liquidity risk** – if “runs on the bank” are seen as inevitable in this scenario, how will this impact your models, reporting and liquidity position? What if the FX markets close?
- ▶ **External parties** – how will you reassure your key stakeholders, including customers, clients, market participants and suppliers, that your organization has taken steps to prepare for this scenario?

Operational

- ▶ **Sizing the problem** – have you established which accounts and transactions will be impacted by redenomination (including those that are “in-flight”), and determined what will need to be (and could be) unwound if necessary?
- ▶ **Operations** – what changes will be required to payments and settlements infrastructure and processes? How would you handle a sudden rise in manual processing volumes and still meet your external obligations?
- ▶ **Staff readiness** – how prepared are your internal and externally facing employees?
- ▶ **Legal and documents** – to what extent will contracts need to be reviewed and clients re-papered? How will your legal team cope with the volume and complexity of matters that arise?
- ▶ **Accounting** – are you clear on the accounting and disclosure implications for impacted legal entities and transactions?
- ▶ **Compliance** – how will this impact your ability to execute KYC, anti-money laundering, financial crime, trade surveillance and transaction monitoring?

IT

- ▶ **Management information** – how prepared is your business for an increase in the amount of data requested by management if redenomination is increasingly probable?
- ▶ **Currency and instruments** – if you have to update systems to include additional currencies and instruments, have you considered the full extent of this work? How would changes to business logic be defined and written, and systems and processes tested front-to-back?
- ▶ **Third-party software** – if you use third-party software packages and data providers, are you confident they could deliver timely solutions?
- ▶ **Connectivity** – are your third-party platforms (banks, exchanges, clearing houses, and clients), industry infrastructure and payment schemes ready to be tested?

Most cross-border organizations will be widely impacted

The impact of a redenomination will transcend most sectors and industries. Some sector-specific impacts include:

Investment banking	Retail and corporate banking
<ul style="list-style-type: none">▶ Market/client connectivity▶ Market data▶ Order and execution▶ Hedging▶ Risk and liquidity models▶ Volume spikes▶ Settlement breaks▶ Algorithmic trading▶ Legal and documents, ISDA agreements▶ Ad hoc reporting requests	<ul style="list-style-type: none">▶ Physical and digital channel changes▶ Integration with corporate client back office▶ Point-of-sale and ATM changes▶ Payments and card processing, including application of FX▶ Credit decisions▶ Fees and charges▶ Statementing and advising▶ Regulatory impacts, e.g., treating customers fairly, payment service directive▶ Cash and coin logistics
Asset managers	Asset servicing
<ul style="list-style-type: none">▶ Poor performance▶ Significant fund outflows▶ Inappropriate trading and fraud▶ Trading volume spikes▶ Counterparty exposure and collateral management▶ Risk management and modeling	<ul style="list-style-type: none">▶ Conflicting customer expectations▶ Safekeeping of customer assets▶ Fiduciary duties (trustee/depositary)▶ Redenomination execution▶ Exceptions spike versus customer contractual key performance indicator▶ People "stretch"▶ Resource conflicts with other parts of parent group

What should you be doing now?

Financial services organizations can help to protect themselves by taking action now to plan for such scenarios.

Practical steps include:

1. Define your response governance structure
2. Create working groups, with representatives from impacted functions, asset classes, divisions and geographies
3. Conduct scenario planning sessions to work through how an emergency redenomination plan may play out
4. Execute impact assessments to determine how your organization will be affected
5. Establish the current validity and coverage of your data, with particular focus on country reporting
6. Determine practical action plans, considering:
 - ▶ What needs to be done prior to the announcement of redenomination to manage risk and prepare
 - ▶ Actions that would be taken between the announcements and "Day 1"
 - ▶ Day 1 and beyond activities, including the prioritization of "mission critical" changes
7. Define your communications plan (internal and external)

How Ernst & Young can help

While we make no predictions about what the future holds for the Eurozone, businesses need to carefully consider the implications on their business and operations if a country were to leave the Euro and ultimately how they would respond.

Ernst & Young can help you consider the challenges to minimize the impact that a country leaving the Eurozone could have on your business and operations. With our extensive global network, our experienced financial services professionals have the capabilities to help you prepare for the unknown. By working with you to map out scenarios and build robust strategies, we can help you prepare for a more secure future.

Some of the ways we can help you include:

- ▶ Advising on appropriate governance measures
- ▶ Facilitating scenario planning workshops using our subject matter resources to help you quickly size the impact on your business and prepare response plans
- ▶ Accelerating planning through use of our enablers, including our "Expected impacts" log
- ▶ Executing impact assessments, front-to-back, or with specific functions, business units or asset classes
- ▶ Reviewing system, process and model reviews to understand likely issues and bottlenecks
- ▶ Providing independent, objective readiness assessments of your current management information and contingency planning
- ▶ Documenting procedures to follow if redenomination appears increasingly likely
- ▶ Providing practical support throughout the preparation phase, and remediation support thereafter
- ▶ Mobilizing your response team, stakeholder engagement and governance setup

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EYG no. EK0075



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