

'A PRACTICAL GUIDE
FOR THE C-SUITE'

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MODEL OFFICE

Operational Resilience Unwrapped



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Ensuring the UK financial sector is operationally resilient is important for consumers, firms and financial markets. Operational disruptions can cause wide-reaching harm to consumers and pose a risk to market integrity, threaten the viability of firms and cause instability in the financial system. The disruption caused by coronavirus (Covid-19) has shown why it is critically important for firms to understand the services they provide and invest in their resilience.

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THE FCA March 2021

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EXECUTIVE SUMMARY

The Covid-19 pandemic has shown business that resilience matters. The move to a remote working new normal and a post new normal 'smart working' (home and office) has meant that we now live in very different times and placed business resilience right at the forefront of governance, risk and compliance management.

In this, our latest 'unwrapped' white paper, we cover the FCA's operational resilience publications and incoming rules set for **31st March 2022**. In essence retail investment adviser firms will be required to:

- Identify their **important business services** that if disrupted could cause harm to their consumers (retail and wholesale) or market integrity
- Set **impact tolerances** for each important business service (establish metrics to determine the thresholds for maximum tolerable disruption to help achieve consumer protection and market integrity)
- Identify and document the **people, processes, technology, facilities and information** that support their important business services (mapping)
- **Test** their ability to remain within their impact tolerances through a range of severe but plausible disruption scenarios
- Conduct **lessons learnt exercises** to identify, prioritise, and invest in their ability to respond and recover from disruptions as effectively as possible
- Develop internal and external **communications plans** for when important business services are disrupted
- Create a **self-assessment document**

Headline messages



Flexibility: The new rules are designed to give firms flexibility and proportionality in applying the rules and guidance in interpretation



Transitional arrangements: The regulator has offered a 1-year implementation period to **31st March 2022** for firms map and scenario test and a 3-year transitional period to **31st March 2025**, with firm's ideally remaining within their impact tolerances throughout.



Incident prevention and response: The regulatory benchmark is firmly about having systems and controls to stand the best possible chance for preventing incidents along with documented response activities for when failures happen



Collaboration: Silo activity creates risk; thus the regulator is encouraging market participant collaboration to drive good practice with industry bodies such as **TISA** and **IA** already producing relevant pan industry working groups



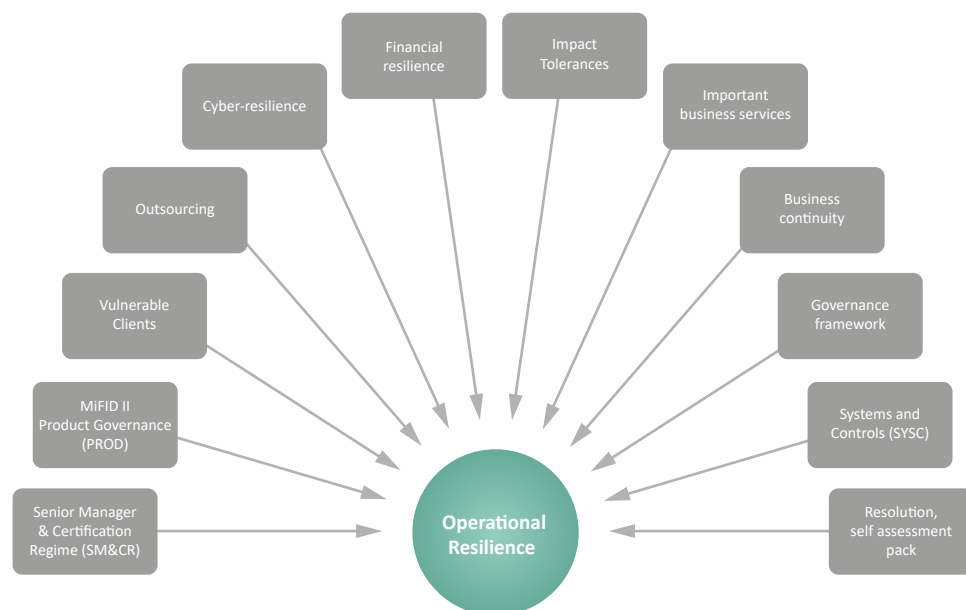
COVID-19 Pandemic: As mentioned, with a high focus on resilience across operations, finances and cyber-security, firms need to ensure they are well prepared for other severe disruptions

Operational Resilience – taking a holistic view

As you can see from figure 1, the new operational resilience rules are all encompassing, with many regulations overlapping and influencing a firm’s operational resilience.

So, it is important for businesses to assess what has already been completed across other regulations and how they interrelate with operational resilience. For example, firm’s will already have completed good work around Senior Managers and Certification Regime (SM&CR), in particular roles and responsibilities and Senior Manager Functions (SMF) as below:

Figure 1: Operational Resilience a holistic view



All Firms (some exceptions)	Core and Enhanced Firms
SMF 16 – Compliance	SMF 1 – Chief executive
SMF 17 – Anti-Money Laundering Reporting	SMF 3 – Executive director
	SMF 9 – Chair
	SMF 27- Partner
SMF 29 – Limited scope function – Limited scope firms only	
Enhanced Firms only	
SMF 2 – Chief finance officer	SMF 4 – Chief risk officer
SMF 5 – Head of internal audit	SMF 7 – Group entity senior manager
SMF 10 – Chair risk committee	SMF 11 – Chair audit committee
SMF 12 – Chair remuneration committee	SMF 13 – Chair nomination committee
SMF 14 – Senior independent director	SMF 18 – Other overall responsibility
SMF 24 – Chief operations	

INTRODUCTION

Operational resilience is the embedding of capabilities, processes, behaviours and systems which provide the ability for firm to carry out its services in the face of disruption regardless of its source. With the COVID-19 Pandemic, we have witnessed this in action with many retail financial service organisations having to adapt to remote working and servicing clients through challenging social and market conditions.

Currently, the FCA assess firms’ operational resilience capabilities against their Operational Resilience Framework, which defines industry practices aligned to our existing rules and expectations. The new requirements expand on these practices.

As soon as reasonably practicable after **31 March 2022 and no later than 31 March 2025** a firm will need to have:

- performed mapping and testing so that a firm can remain within impact tolerances for each important business service
- made the necessary investments to enable a firm to operate consistently within their impact tolerance.

Firms will then be required to work through a programme to ensure certain systems and controls are in place as per below:

Figure 2: Implementation period operational resilience procedures (pre 31 March 2022)

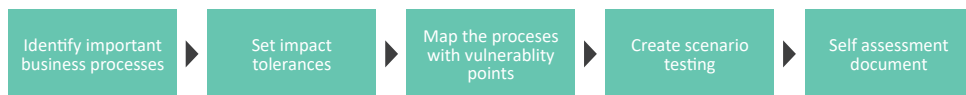


Figure 3: Transitional period operational resilience procedures (01 April 2022 - 31 March 2025)

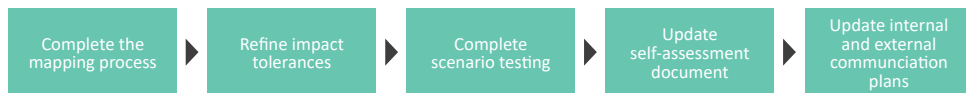
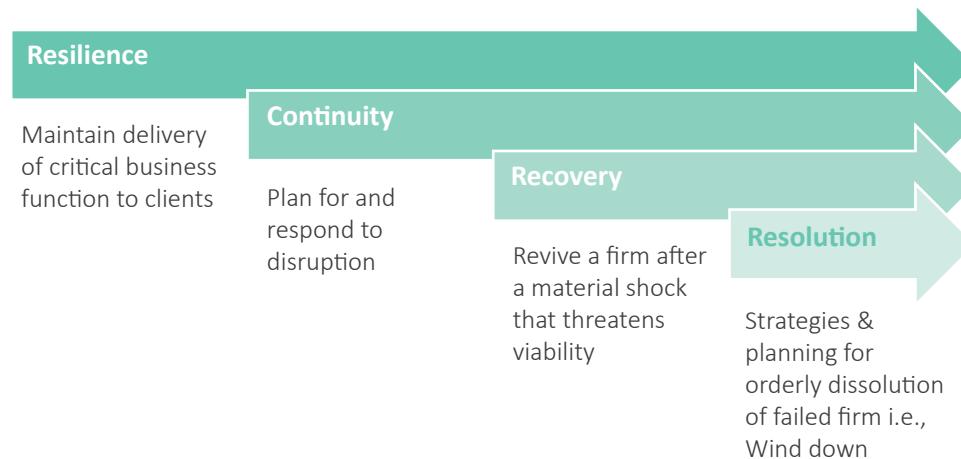


Figure 4: Resilience testing



Reporting an incident: Under **Principle 11 of the FCA’s Principles for Business**, firms are required to deal with the regulator in an open and cooperative way and disclose to the FCA appropriately anything relating to the firm that the FCA would reasonably expect notice. **SUP 15.3** sets out additional rules and guidance on when to report such material incidents such as;

- Significant data loss
- Unavailability or control of IT systems
- Affects a large number of customers
- Results in unauthorised access to information systems

So there is plenty for firms to now plan and action prior to March 2022 to ensure the operational resilience foundations are in place as we shall see.

1. IMPORTANT BUSINESS SERVICES (IBS)

Firms need to identify its important services as per [SYSC15A.2.1-2R](#) and review annually, plus follow the definitions of IBS meaning a service provided by a firm or a person on behalf of the firm to one or more clients of the firm, which if disrupted could;

1. Cause intolerable levels of harm to any one or more of the firm's clients or
2. Pose a risk to the soundness, stability or resilience of the UK financial system or the orderly operation of the financial markets

Key considerations in identifying IBS:

- All (in scope) firms will have at least one important business service that may impact the firm's safety and soundness
- [SYSC15A.2.4G](#) sets out factors that firm should consider when identifying its IBS including;
 - The nature of the client base including any vulnerabilities that would make a person susceptible to harm or disruption
 - The ability of clients to obtain the service from other providers
 - The time critically for clients receiving services
 - The number of clients to whom the service provided
 - The data sensitivity
 - Potential to inhibit the UK financial system
 - Impact of the firm's financial position
 - A firm's reputational damage and risk to soundness and stability
 - Potential legal or regulatory breach
 - Unintended consequences and knock-on effects
 - Importance of services to the UK financial system
- Assess IBS annually and after material changes to the business (e.g. starting / stopping activities, starting new outsourcing arrangements)
- Business services need to be documented and communicated clearly and at a level of granularity which enables impact tolerances to be applied
- Firms who are members of a group should identify important group business services

Mapping business services

Once the key business services had been identified, by taking an end-product perspective the systems and processes involved in delivering this service should be mapped across:

- Identify main systems and processes involved in contributing the output and any underlying dependencies
- Identify what is critical to the continuing delivery of the service
- Maintain awareness of third parties involved in the value chain and any interdependencies
- Understand the services and underlying systems needed to keep the business running on a day-to-day basis and therefore deliver the entire important service
- Understand the digital dependencies involved in delivering a business service for instance internet connectivity and IT systems
- Identify single points of failure across services such as underlying IT software
- Maintain a holistic perspective to ensure the end-to-end provision of the services critical to the firm and its customers are accounted for

Service dependencies

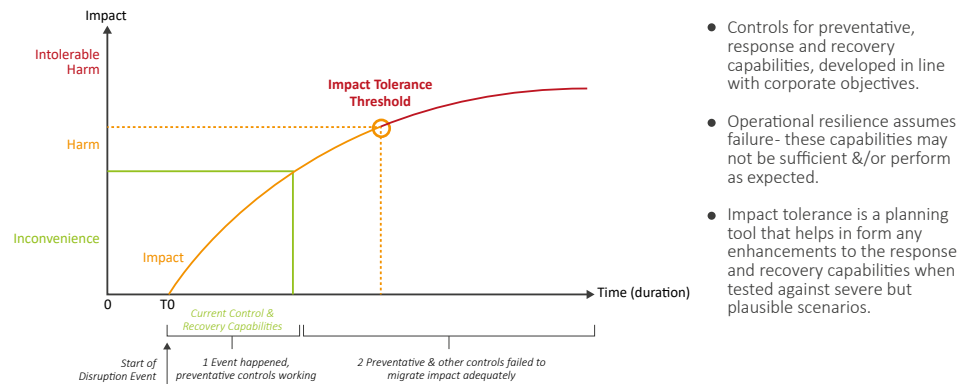
It is also good practice to map out IBS dependencies for example outsourcing IT systems, facilities, departments, people and teams.

2. IMPACT TOLERANCES

Those events that can cause **intolerable harm** (harm which clients cannot easily recover) need to be addressed as per **SYSC15A.2.7G** and managed by metrics to measure time, duration, group and reviewed at board level. The Operational Resilience Collaboration Group's (ORCG) diagram below shows how metrics can help:

Figure 5: ORCG impact tolerances Industry Standard October 2020

The diagram below shows how a disruption event unfolds and its associated on clients, markets and firm (orange and red line)



Importantly, once firms have set impact tolerances also need to ensure they apply **SYSC15A.2.9R** ensuring that it can remain within its impact tolerances for each IBS.

SYSC15A.2.11G stipulates Principle 11 (relations with regulators) where the FCA expects to be notified of any failure by a firm to meet an impact tolerance.

Vulnerable customers are front and centre of impact tolerances **SYSC15A.2.4/7G(1)** where they are more susceptible to firm failures, so firms need to ensure IBS and impact tolerances reflect this.

In the case of multiple disruptions, firms need to set impact tolerances to a single disruption rather than aggregated disruptions due to multiple business services may rely on one common operational asset and/or one single event effects multiple assets e.g. cyber-attacks.

Steps to setting impact tolerances

1. Identify IBS and map underlying processes: identifying and documenting underlying processes that support each IBS including people, technology, resources, departments
2. Gather baseline data: Ensuring existing data is utilised to establish baseline day-to-day functioning requirements of the IBS
3. Set impact tolerance: Using a data led approach can ensure evidence-based practice as below

Figure 6: Setting impact tolerances



The FCA required firms to consider ten factors when setting impact tolerances:

1. Nature of the **client base**, including a consideration of vulnerability
2. **Number of clients** that may be adversely impacted
3. Potential **financial loss to clients**
4. Potential **financial loss to the firm** where this could harm the firm's clients or pose a risk to the resilience of the UK financial system
5. Potential level of **reputational damage** to the firm where this could harm the firm's clients or pose a risk to the resilience of the UK financial system
6. Potential **impact on market or consumer confidence**
7. **Risk of contagion to other business services, other firms or the UK financial system**
8. **Potential loss of functionality or access for clients**
9. Potential loss of **confidentiality, integrity or availability** of data
10. Potential **aggregate impact of disruptions** to multiple important business services

¹ FCA, Finalised Guidance FG21/1 Guidance for firms on the fair treatment of vulnerable customers, (Feb 2021).

3. MAPPING

As per **SYSC 15A.4.1R** a firm must identify and document the necessary people, processes, technology, facilities and information required to deliver its IBS. This includes outsourcing where third parties provide its resources.

Firms should map the IBS with the aim of; identifying and remedying vulnerabilities and enabling firms to conduct scenario testing.

It is expected that IBS maps are updated as a minimum at least once per annum or post material change to the business.



4. MAPPING SCENARIO TESTING

Scenario testing is the testing of a firm’s vulnerabilities and ability to remain within its impact tolerance for each IBS in the vent of severe disruption. In carrying out the scenario testing, a firm must have a testing plan (**SYSC15A.5.1R**) identify an appropriate range of adverse circumstances of varying nature, severity and duration relevant to its business and risk profile and consider the risks to delivery of the firm’s important business services in those circumstances.

Key scenario testing considerations across SYSC 15A.5.3/4R include:

1. Testing a range of severe and plausible scenarios and include those that exceed impact tolerances to learn from them
2. Considering previous incidents or near misses within the organisation
3. Vary the severity of testing for example increasing the number of types of unavailable resources for delivering an IBS or considering a time a resource is unavailable
4. Scenario planning for when an IBS cannot be delivered for example power or IT
5. Frequency of testing has moved from annual scenario testing to; a) material change b) post previous test improvements c) on regular basis

According to the FCA PS21/3: ‘Firms will not need to have performed scenario testing of every IBS by 31 March 2022’

5. GOVERNANCE AND SELF-ASSESSMENT

The FCA paper reiterates the importance of the SM&CR for establishing clear lines of responsibility and accountability for the management of operational resilience. This includes a focus on the Chief Operations Function (SMF24) for firms where this role exists, which is required to have responsibility for managing the internal operations or technology of the firm or of part of the firm.

There is also expectation for a firm's board or managing body in taking responsibility for delivering the policy outcomes and overseeing the firm's approach to operational resilience. This includes approving the IBS and impact tolerances set for each of them along with the written self-assessment.

Key areas for self-assessment:

1. Firms should maintain up-to-date self-assessment document which covers the resilience journey. The document needs to illustrate the firm is meeting their operational resilience responsibilities
2. Self-assessments are not required to be submitted periodically but should be available on request
3. The self-assessment document should include:
 - a. IBS
 - b. Corresponding impact tolerances
 - c. Approach to mapping and identification of resources and how mapping is used to identify vulnerabilities and support scenario testing
 - d. Strategy for scenario testing, including a description of the scenarios used, the types of testing methods and scenarios under which firms could not remain within their impact tolerances
 - e. View of the vulnerabilities that threaten the firm's ability to deliver its IBS within impact tolerances, including actions taken or planned and justifications for completion time
 - f. **SYSC15A.5.8R** lessons learned and **SYSC15A.6.1R** self-assessment and lessons learned exercise documentation
 - g. Methodologies used to undertake the above activities

Firms should apply the principle of proportionality to the document based on their scale and risk profile. The document should be reviewed by the board regularly.

6. COMMUNICATIONS

SYSC15A.8.1R stipulates a firm must maintain an internal and external communication strategy to act quickly and effectively to reduce anticipated harm caused by operational disruptions.

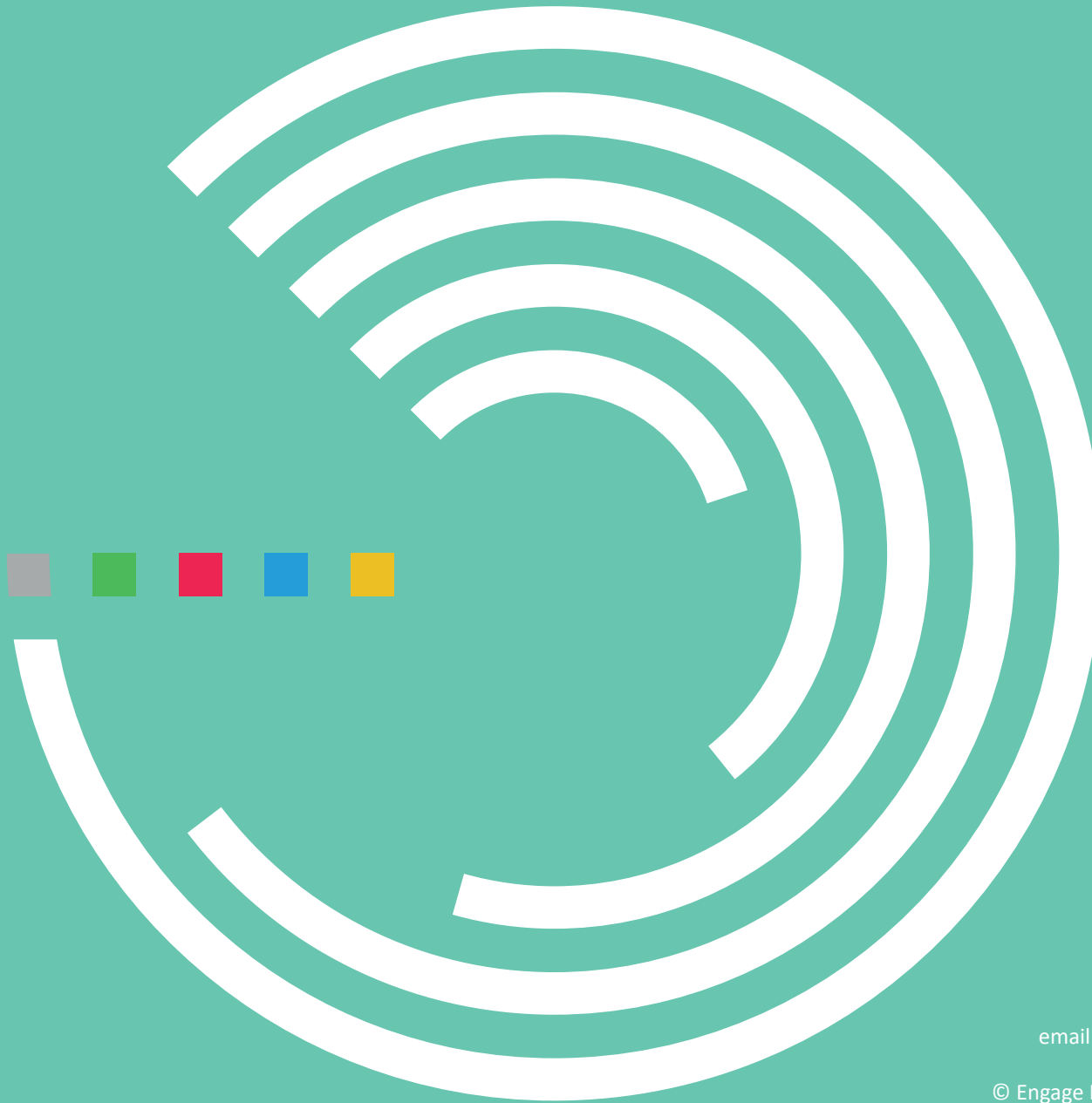
- Escalation paths to manage communications during incidents and identifying the decisions makers along with a clear warning system
- A firm's communications strategy should;
 - Consider, in advance of disruption, how it would provide important warnings or advice quickly to clients and stakeholders, including where there is no direct line of communications
 - Use effective communications to gather information about the cause, extent and impact of operational incidents
 - Ensure that their choice of communication method takes account of the circumstances, needs vulnerabilities of their clients and stakeholders
- As **SYSC15A.8.1R** a firm must provide clear, timely and relevant communications to stakeholders in the event of an operational disruption

SUMMARY

As we have seen with the Pandemic, firms have shown their resilience, yet there is much to do to ensure the new FCA rules are complied with before the end of the implementation period and start of the transitional period. The FCA are still concerned and when it comes to financial resilience have sent five (yes five) questionnaires to market participants with the first four surveys resulting in (according to the FCA) up to **4,000** firms are at heightened risk of failure due to the pandemic.

Diagnostic assessment platforms and RegTech can help firms understand their current position and what they need to do to enhance their operational resilience policies and procedures. Model Office has now launched its own operational resilience diagnostic within its 'Your Systems' key and provides heat mapped business functions and a dashboard to help firms plan and action resilience strategy.

It will be those firms who diligently plan, adopt good practice operational resilience systems and controls and learn from the pandemic experience who will comply and continue to compete.



Model Office
50 Liverpool Street
London
EC2M 7PY

Tel: 020 3005 5305

email chris.davies@engageinsight.co.uk

website www.engageinsight.co.uk

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