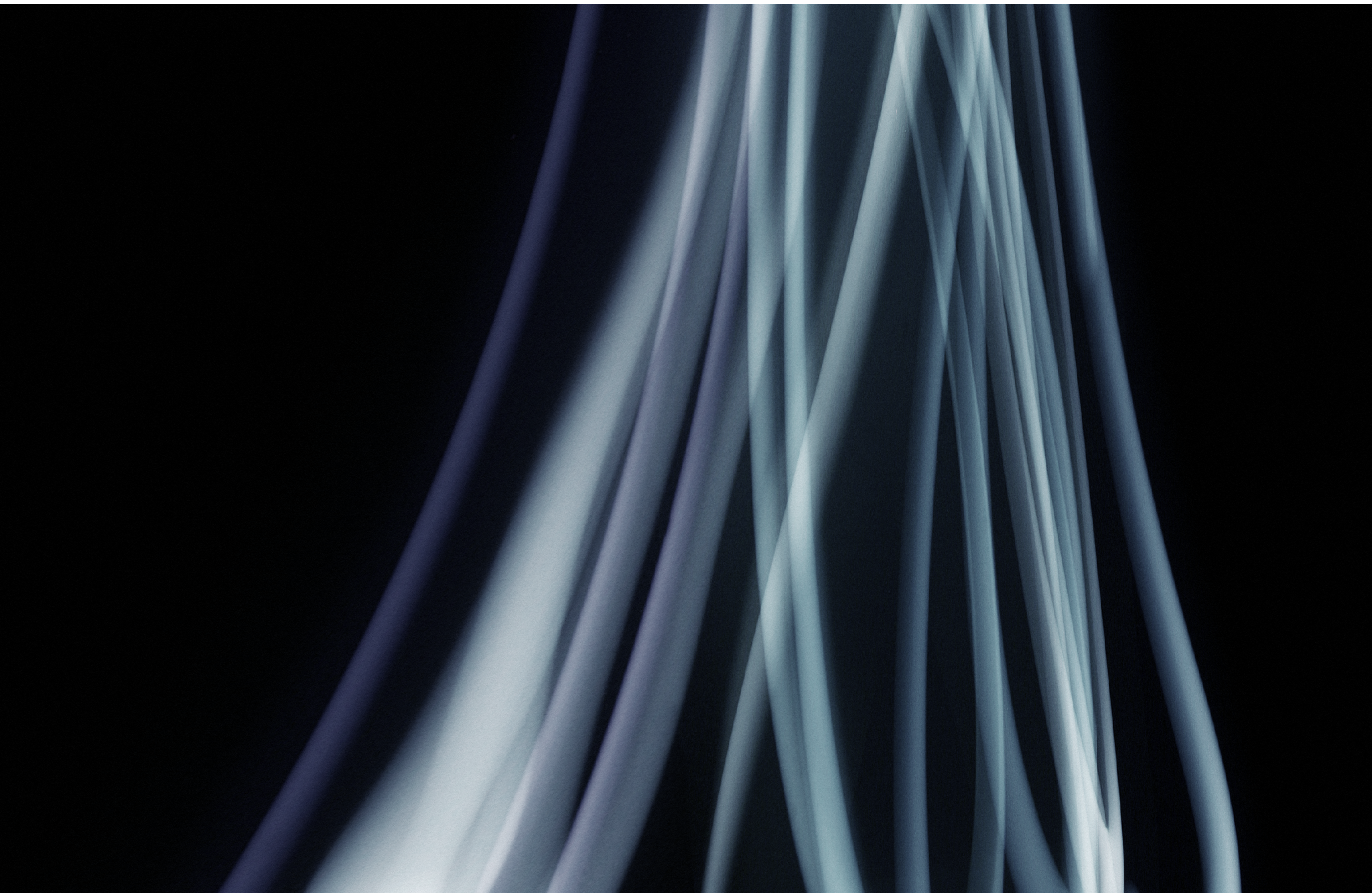
GETTING READY:
CHALLENGES TO MEETING THE UK OPERATIONAL RESILIENCE REGULATION



> *The PRA retains the view that operational resilience is at least as important as financial resilience*
>
> – BoE PRA Operational Resilience Policy Statement March 2021 PS6/21

Firms across financial services with regulated UK legal entities are focused on how to address the new Operational Resilience regulations, issued by the Bank of England, Prudential Regulatory Authority (PRA) and Financial Conduct Authority (FCA) at the end of March 2021.

They face several challenges due, in part at least, to the outcomes-based approach of the UK supervisory authorities which introduces a level of subjectivity into the compliance preparations. We will discuss some of the more significant challenges in this paper as well as outlining some ways to mitigate them. Further information on the Operational Resilience framework that the UK authorities are proposing can be found in Capco's White Paper published on the topic earlier this year.

IT'S NOT WHAT YOU DO, IT'S THE WAY THAT YOU DO IT

Demonstrating Compliance with the Regulation

The regulation is different from much that has been implemented recently in that it is focused on a broad outcome and the approach that firms should take to achieve it, rather than specifying a clearly defined end-state. This is evident in the way the regulators do not expect firms to be able to maintain services in every eventuality; they expect firms to indicate in their self-assessments the scenarios they passed and the ones that they did not. Approaches are harder to evidence in terms of compliance requiring a clear record, at each stage, of the logic behind decisions taken.

A HIGH BAR TO REACH

Do not underestimate the level of proof that boards will require

Legal entity boards are required to sign off their firm's self-assessment confirming that it is operationally resilient. Board members, under the terms of the UK's Senior Manager & Certification Regime (SMCR) and the personal liability that entails, need to demonstrate that they have taken reasonable steps in carrying out their duties. In this case, that means ensuring that the chosen approach is sound.

Non-executive directors, who will only touch the topic in board discussions, will feel this particularly acutely given that any event causing significant disruption is likely to be dissected to a greater extent than, say, a failed business strategy. This raises the bar significantly in terms of the evidence required to demonstrate that the approach taken and the logic behind related decisions at all stages was sound.

It is likely that getting board approval will be an iterative exercise to accommodate refinements requested by board members. This will take time, and that should be factored into the project plan and not left to the last minute. The key message here is to engage boards early on.

ONE SIZE DOES NOT FIT ALL

Every firm will need to do their own analysis

Firms need to identify the Important Business Services (IBSs) that they provide to clients within their wider offering and set impact tolerances. The regulators have explicitly given firms these freedoms and expect a clear logic to be applied when selecting these IBSs and in deriving impact tolerances. While on the surface the offerings of many firms may appear similar, there are critical differences in the details, such as customer types, specific product offerings and geographical coverage. Accordingly, every firm will need to approach this selection process to an extent with the proverbial 'clean sheet'. Sufficient time should be factored into their plans to accommodate this.

THE PROOF OF THE PUDDING

Scenarios need to be selected carefully to make the testing valid

Scenarios used in the testing phase should be severe but plausible and cover a range of events. The regulators do not specify precise scenarios for which firms should be prepared though they do indicate that events that have happened to organisations globally is a good place to start.

Given the role that this testing plays in providing boards with the required level of comfort regarding their firm's operational resilience, this is a key area to get right. The number of scenarios is not stated (though the example diagram in the PRA consultation paper indicates four). Ideally the testing should be carried out by a team that is independent of the one running the process.

PULLING TOGETHER

Delivery processes need to operate seamlessly across internal boundaries

To reflect the customer perspective looking vertically through the firm, responsibility for the delivery process for an IBSs may be split across business functions and reporting lines and across geographies. All stakeholders involved in a specific process, including any third-parties, will need to work together to ensure that an impact tolerance is not breached; this demands a degree of transparency and trust.

In rehearsing the response to disruptive events, clear roles and responsibilities should be defined and codified in preparation for any disruptive event. Where impact tolerances are tight, the risk is that merely standing up the individuals responsible for running the remediation process can take a significant amount of time, exacerbating an already tight situation.

TONE FROM THE TOP

Senior ownership and drive is necessary to achieve the right focus

Regulators are expecting management teams to take the lead in implementing the agreed approach. In the past, when firms have delegated the task to individuals too far down the organisational chain, it has proved a struggle to ensure the required level of focus and spend is committed to meet regulators' expectations.

Firms should look to have a standing agenda point at meetings of their principal executive committee that covers Operational Resilience in order to ensure it receives the necessary level of buy-in and commitment from senior leadership.

COVID COMPLACENCY

The next event will be different

COVID-19 was unusual as a disruptive event:

1. Firms in the UK had approximately 6 weeks' forewarning that trouble was coming. Normally the first that a firm's leadership team will be aware of an event is after it has happened.

2. While staff were impacted by the virus, infrastructure was less dramatically affected. Provided remote working was possible for a sufficient number of staff (and this was hard for some), then firms were able to cope with the first order effects.

3. Firms were all impacted more or less at the same time in the UK, so the pressure to respond was shared across sectors rather than being concentrated on one firm.

4. The flip side of this was that many locations across the globe were impacted simultaneously, so BCP plans relying on just one disaster recovery location were not sufficient to cope with such widespread disruption.

5. At the start of the year, it was almost inconceivable that individuals might be locked down for such extended periods of time. Hence plans that only envisioned short-term disruption have needed to be rapidly revised.

Fortunately for firms, points 1-3 (amount of notice, minimal infrastructure impact and COVID's universality) mitigated points 4 and 5 (the geographical and duration impact).

Next time a firm is unlikely to face a similar set of circumstances, so surviving COVID-19 does not ensure readiness for the next disruptive event. Plans should therefore be stress-tested to confirm that firms are well positioned to cope with a diverse range of scenarios. Train hard, fight easy is the order of the day.

THE SMALL UK BRANCH SITUATION

Reasons to put the Operational Resilience at the top of the agenda

The FCA regulates well over 1000 legal entities and these will all be covered by the new rules. While many legal entities will be the principal vehicles used by firms to transact business, some will be merely a small part of a larger operation headquartered outside the UK. In such cases, most of their services in the UK will be delivered via the same processes as other services globally. So compliance with UK regulation for what is in effect just a small proportion of their business may seem disproportionate in the eyes of such multinational firms.

This may strike some as a reasonable argument, but there are a couple of mitigating factors to consider. The UK supervisory authorities' approach to Operational Resilience, while rigorous, is well thought out and logical. If applied correctly, it will enhance a firm's resilience with clear lines of sight for management regarding those services that should be protected and the level of protection needed.

Given the cost of disruption, both direct and in terms of potential sanctions, compliance with the proposed regulations will have significant benefits – both at home and beyond. The impact of these UK regulations is undoubtedly being watched carefully by regulators globally and, if deemed effective, are likely to be copied in other markets, albeit with local variations. In short, for multinational firms there are benefits to implementing the UK's approach to Operational Resilience as a standard, since compliance with very similar rules is likely to be required across multiple markets and locations.

TIMING IS EVERYTHING

The deadline is tighter than it appears; firms should develop a sense of urgency now

The UK regulators are expecting firms to have largely completed all preparations by 31 March 2022 and to have prepared an initial self assessment. While firms have until March 2025 to remain within impact tolerances we feel that boards are going to expect that vulnerabilities have been identified by the end of Q1 2022. There is much ground to cover for most firms.

THE KNOWN UNKNOWNS

The amount of work required will only be known half-way through

Until firms have identified their IBSs and set impact tolerances, it will not be possible to get a clear idea of the amount of work required to ensure their delivery processes are resilient. Adding to the pain, remediating vulnerabilities is likely to take the most time to complete of all the required steps. Given the proposed timeline for compliance, firms need to start making strides as soon as possible to set their programmes in motion, with the necessary resources and approach agreed, or risk significant delays.

THE END OF THE BEGINNING

For many firms, there remains a great deal of ground to cover before 31 March 2022. Firms need to tackle their Operational Resilience preparations with a real sense of urgency. The spirit of the proposed regulations encourages an approach to operational resilience that is ongoing and iterative in nature (as indicated by focus on lessons learned and an annual refresh in the consultation papers) to ensure firms are properly prepared.

It is unlikely that firms will get everything right first time. While there may be challenges and even setbacks to navigate in the coming months, what is most important is that boards and management teams adopt a serious and thoughtful stance towards Operational Resilience , exhibit a sense of urgency in tackling the necessary steps and commit the required resources to this undertaking, in line with the expectations of the UK regulatory authorities.

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