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PERSPECTIVES

Mastering Operational Resilience: An Outlook in to 2025

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In March 2021, after nearly three years of discussion and consultation, the Bank of England (BoE), Prudential Regulatory authority (PRA) and the Financial Conduct Authority (FCA) finalised their guidance and policies on operational resilience. The aim is to improve the operational resilience of firms by implementing requirements such as identification of Important Business Services and the setting of impact tolerances. The implementation deadline passed on 31 March 2022, beginning a three-year transitional period for firms to remain within their impact tolerances as soon as reasonably practicable, but no later than 31 March 2025.

The UK is not the only regulator looking at Operational Resilience. It is also a key focus for regulators across EMEA and globally. In Ireland, the Central Bank of Ireland (CBI) has published its Cross Industry Guidance on Operational Resilience, which is closely aligned with the UK standards, with an implementation date of 1 December 2023. In addition, in November 2022 the EU published its Digital Operational Resilience Act (DORA) with obligations coming into effect early 2025.

Operational Resilience can be described as a firm's (or market's) ability to identify and prepare for, respond and adapt to, and recover and learn from operational disruptions, and can be viewed as an evolution of operational risk and business continuity management; promoting a deeper understanding of the processes and activities involved in delivering important business services and building capabilities to manage risk events when they occur rather than purely focussing on preventing them from happening.

What does this mean for you?

Fundamental to the resilience mindset is the assumption and acceptance that disruptions will occur. Of course, plans and controls to prevent disruptions, in the form of business continuity planning and operational risk measures are important to operational resilience, but purely focussing on prevention can come at the expense of building the ability to respond. Impact Tolerances are a measure of the maximum level or length of disruption to an Important Business Service before intolerable harm is realised and the aim is to ensure this is never breached.

Firms should recognise that not all services they provide may be classified as "Important Business Services" and a set of criteria and analysis should be applied to determine whether disruption to the service could indeed cause intolerable levels of harm to clients, threaten the stability of the financial systems, orderly operation of markets, or pose a risk to the firm's safety and soundness. Firms should demonstrate strong understanding of their clients and the markets in order to determine impacts of disruptions.

Key Challenges

Although a great deal of thought, assumptions and justifications will go into the setting of each impact tolerance, it is difficult to truly know if these are appropriate in the absence of a true sustained, severe and plausible disruption. Impact tolerances are not business-as-usual metrics like RTOs and calibration of these tolerance thresholds is by necessity, based on assumptions and estimates – including impact on clients and markets. Fortunately, most firms will have limited real-life examples of disruptions which have lasted long enough to create the severity of impact envisioned by the regulators' requirements. Without such baselines, firms will need to determine how to test these severe yet plausible scenarios, often through tabletop exercises involving subject matter experts. Firms will be pushed by regulators to go beyond this approach during the transitional period and find ways to further test services, not only internally but also with third party service providers, service receivers and financial market infrastructures to simulate a disruption through the industry.

Benefits to Wealth Managers and Advisors

This body of work should result in firms not only gaining a deeper understanding of their own and their clients' operational vulnerabilities but will also strengthen their capabilities to resolve disruptions that may occur, regardless of the cause. Wealth Managers can take added assurance from the implementation of impact tolerances and the improved resilience this brings to firm's they conduct business with.

Industry Considerations

Currently Operational Resilience requirements do not apply to all regulated firms. If your firm receives services from any other financial institution, it is worth considering whether they are in scope for these operational resilience requirements. Pershing, as an "enhanced" Senior Manager & Certification Regime (SM&CR) firm (UK) and as a Regulated Financial Service Provider (Ireland) is in scope and this may be a key consideration for wealth managers when deciding who to partner with. Firms who are in scope for the requirements may as a result be deemed more resilient and therefore more appealing when considering the range of providers available.

If your firm is in scope for the requirements, then you should also take into account additional factors as you think about your own resiliency. Regulators make it clear that firms are required to consider and understand resiliency and impact tolerances of their third parties, because we are ultimately responsible for meeting the requirements, even where some activities are outsourced.

Recently we participated in market-wide exercises, facilitated by Euroclear UK & International (EUI) (who manage the CREST service) and the Bank of England (BoE) which allowed us and other firms to understand the implications of a significant outages on our business and to develop our business continuity and resilience arrangements within a controlled manner. These types of exercises will ultimately make firms and the markets more resilient, and we view these as an important part of our commitment to impact tolerances.

The Pershing Approach

Pershing benefits from being part of the global BNY Mellon enterprise, which already has extremely well defined and developed policies and procedures in relation to risk, business continuity, incident management and disaster recovery, as well as clear business services frameworks which outline the functional taxonomy, dependencies and mapping related to each Critical or Important Business Service. This allowed us to efficiently implement the UK regulatory requirements and positions us well to react to any future requirements from other in region regulators such as EU or Central Bank of Ireland.

By identifying and clearly understanding the people, processes, facilities, technologies, information and third parties which contribute to the delivery of our Important Business Services and setting Impact Tolerances, we have been able to prioritise plans and investments as required to build resilience and mitigate against large scale disruptions.

We have communicated our approach throughout the implementation period and beyond to our clients through due-diligence events, webcasts, fact sheets and articles on our website. We have had productive conversations with our clients, including those also in scope, around our approach and how we can work together in future to better understand each other's dependencies and tolerances. We'd encourage this level of dialogue to take place between wealth managers and their service providers.

Next Steps

Now that the UK implementation deadline has passed, regulators may request Operational Resilience self-assessment documentation at any stage and review where firms are against requirements to remain within impact tolerances. Regulators have stated that they anticipate seeing best practices emerge over time and should expect impact tolerances to evolve which should be reviewed at least annually. Firms in scope for CBI Cross Industry Guidance on Operational Resilience and EU DORA should continue their implementation for the 2023 and 2025 deadlines.

In scope UK firms are not only expected to evidence that they can remain within impact tolerances by the end of March 2025 but also show how they have matured their approach and sophistication, especially around mapping and testing of important business services.

Putting Insights *Into Action*

If you require any additional information, please reach out to info@pershing.co.uk.

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