The Investment Association

MEMBER GUIDANCE

Operational Resilience: Important Business Services

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Foreword

The recent COVID-19 pandemic and its impacts on day-to-day operations in our sector has highlighted the importance of operational resilience more than ever. The publication of the joint PRA-FCA-Bank of England Discussion ('DP') and Consultation Papers over the course of the last few years have been timely in providing a framework to assist firms in making resiliency preparations and help adjust to new ways of working. The IA has been working with members on the concept of identifying their important business services and post-crisis, it was felt to be an opportune time to review our previously issued guidance in light of those events and the publication of the draft regulations which will come into effect shortly.

Identifying a firm's important business services is a crucial step on firms' journeys to optimise their operational resilience. The Business Services Working Group was formed under the IA's Operational Resilience Committee, focusing on identifying a firm's important business services in line with the proposed regulations. This group was reconvened in May, working with Baringa Partners LLP, to determine whether the previous guidance remained fit for purpose. A group of more than twenty firms shared their insights of their experiences of COVID-19 and what services they had prioritised during the shift to remote working and whether the publication of the FCA's Consultation Paper 19/32 ('CP') had impacted their definitions of important services. Firms also anonymously shared their lists of important services with the IA to ascertain if there had been any major changes. This document intends to guide members through the process taken in identifying a firm's business services and the recent developments in the Working Group's thinking. Whilst this guidance provides members with a methodology by which to identify their important services, members should adapt it as necessary to suit the needs of their individual business models.

Our future plans include looking more closely at appropriate governance arrangements in firms and setting impact tolerances. The IA is committed to supporting its members through the process of regulatory change. Stay up to date with our activity via theia.org/operational-resilience.

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Background

The FCA's Consultation Paper 19/32 ('CP') has helped focus firms' attention on the measures to reinforce their resiliency. It should be noted that the CP is of most relevance to SM&CR enhanced investment firms and that the PRA papers will also apply to those who are dual-regulated. Overall, there was little deviation in content from the initial 2018 DP, but rather the CP expanded and built on these concepts. The CP indicated that firms should improve their operational resilience through identifying their important business services, mapping underlying systems and processes, setting impact tolerances at the first point at which a disruption would pose an intolerable level of harm and continuously investing in and remediating resiliency gaps identified through testing.

'We want firms to consider the impact of disruption which can come in many forms. For example, technology failures, cyber-related and other operational incidents, including those outside of a firm's control, can all have an impact on the people and businesses (and financial markets) that rely on their products and business services. Operational disruptions and the unavailability of important business services that firms provide, have the potential to cause wide-reaching harm to consumers and market integrity, threaten the viability of firms and cause instability in the financial system.' (FCA, 2019)

The main elements of CP 19/32 indicate that firms should:

- 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**

They also include a section on outsourcing, recognising the implications of a reliance on third party suppliers and market concentration. They make clear that all firms remain responsible for the management of their outsourcing and third-party relationships. Dual-regulated firms may also be interested in the PRA's separate consultation on Outsourcing.

Regulatory developments

The consultation response deadlines have been delayed from 3 April until 1 October and they have released a new timeline for the implementation of the rules. We can expect a policy statement to be issued in 2021 and an implementation date in 2022, also marking the beginning of a 3 year transition period for compliance with impact tolerances.

IA activity

The IA's Operational Resilience Committee was formed to address the proposals outlined in the DP and is committed to supporting members with the practical implementation of operational resilience through the CP process and into implementation. Defining important business services is a critical first step on the road to achieving compliance with evolving regulatory expectations on operational resilience and enables firms to look in more depth at the dependencies on people, facilities, IT and outsourcers, and then at setting appropriate impact tolerances.

In the autumn of 2019, the IA convened the Business Services Working Group of more than twenty firms under the Operational Resilience Committee. This Group worked with Baringa Partners LLP to help investment management firms in the process of defining their important business services. The Group worked to produce a guidance document in December 2019 identifying six typical important business services and establishing a methodology to map underlying systems and processes supporting these. The intent was for firms to be able to use this as a starting point and adapt it to their own internal business.

Since this Working Group's conclusion in December 2019, the Committee's 2020 work plan is focused on responding to the operational resilience consultation papers. In addition, we will establish working groups addressing:

- **Governance**: looking at governance arrangements and how to ensure effective oversight of resiliency efforts as well as supporting SMF24s/equivalents in their roles
- **Impact Tolerances & Mapping**: utilising the same fictional firm as with the Business Services Working Group, the IA will produce guidance to support members in mapping their services and then setting, monitoring, testing and adjusting impact tolerances for their key business services.
- **Outsourcing and Supply Chain Risk:** in conjunction with the Cyber Resilience Committee, this group will look at the identification, management and monitoring of supply chain & outsourcing risks.

The IA will continue to work closely with **regulators** to represent investment management industry views through ongoing meetings and roundtable discussions and encourage the regulators to adopt a proportionate supervisory approach.

Previous Work

A fictional firm's operating model, aiming to be broadly representative of members', was created to help the group walk through the identification process. The high-level functions of the firm were first identified. The sample services identified were deemed to be the fundamental functions underpinning the delivery of investment services to the end consumer, whether that is a retail or institutional client.

Investments	The ultimate business service for the industry. The ability for a firm to trade on its portfolios when and how it wants within the constraints of its mandate and market liquidity. There is clear time criticality to the execution of both discretionary or fiduciary trading. An investment firm that cannot invest cannot function.
Payments In	The ability to receive, allocate and reconcile incoming payments to funds and portfolios from all counterparty types. Disruption to payments in causes significant problems throughout products and affects the firm's viability.
Payments Out	The ability to issue payments, being settlements or distributions to customers or counterparties is a key function. It is easy to see how an inability to provide payments to retail customers can create intolerable harm. The contractual settlement date requirement provides time criticality and large values will be particularly harmful if not made.
Valuation	The accurate valuation of products at their pre-defined regularity. All transactions and dealing-window processes require this prior to completion. Investors and external parties require this data to provide their own valuations and reporting.
Custody	The safeguarding and accurate records of all assets held and due. Keeping your client's investments safe and knowing the precise composition of the portfolio at all times. Not delivering this service effectively additionally risks being unable to trade when required or breaching investment mandates.
Client & Regulatory Communications	The ability to issue documentation, reporting and other data internally and to investors, counterparties and regulators in the format and when required. Any disruption could cause: investors/counterparties to be unaware of transactions on their account or receive other disclosures; for internal teams to be unsighted on risk metrics; or for regulatory and other reporting to be unfulfilled.

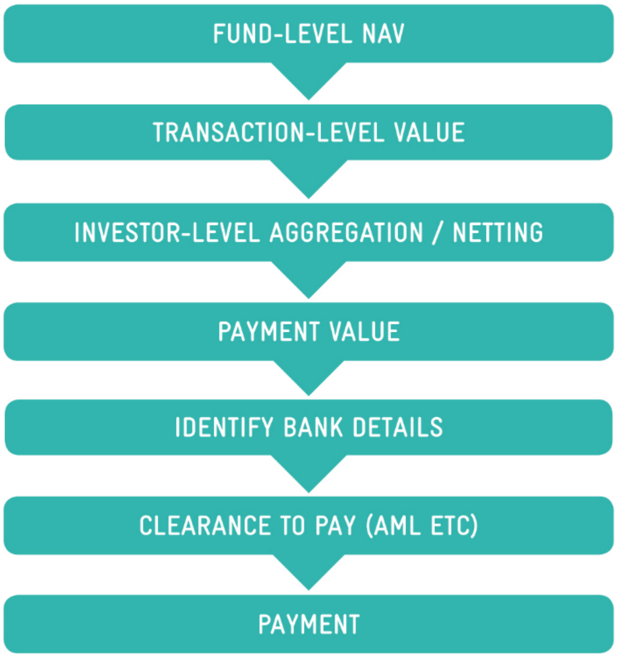
An additional collection of services, which we identified as 'Internal Support Services', was also included, even though it didn't provide any customer-facing output because it underpinned the delivery of a number of other services, such as Human Resources, the Technology Management capability, Treasury, Corporate Security etc, and was therefore critical to the firm's operations.

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 could be mapped. The approach taken was to:

- 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

Using the Payments Out example, the process flow was identified as:



The dependencies and underlying functions were identified as

- **IT systems** of the Accounting book of record, the Transfer Agent and the potential payment platforms and banking providers
- **Outsourcers** of Custody, Accounting, Transfer Agency
- **Facilities** across the globe of these entities and internal departments
- **People** and staff of the sub-teams within these departments

Now that the firm had identified its important services, replicated the above end-to-end mapping process for each of them and understood the dependencies at every stage, the firm was in the position of understanding its business service provision from the end consumer’s perspective.

We used the example of a fictional firm in order to facilitate discussion in the group, break down the differences in operating models and explore the area with relatable examples. Firms should replicate the process against their own operating models, customer types and products, in order to identify the correct business services relevant for them.

Current Thinking

The Working Group was reconvened in April 2020 to reassess the guidance previously issued based on recent developments. Given that the guidance was issued prior to the Consultation Paper, COVID-19 and any developments in members' own work, it was deemed that a reassessment was required.

Draft regulatory text

The CP and draft regulatory text offered more clarity on how firms should go about identifying business services. There was a noticeable deviation in language away from 'most important' to emphasising that firms identify and prioritise resiliency efforts on their 'important' business services. It was also clarified that an important business services should be 'clearly identifiable as a separate service, and not a collection of services'. The draft regulations themselves were also helpful in providing the exact text that firms would be held against. However, the contents of the CP document did not provide any further clarity on the number of important services a firm should identify.

Generally, members felt that the draft regulations had not significantly changed their identification of important business services. However, the contents of the CP as well as the PRA's Consultation Paper suggested that internal support services should not be classified as important business services in themselves, but rather they remained crucial when undertaking mapping. In light of this, the Group felt that internal support services should be removed from the guidance document as it was not an important business service in itself and was not in line with the CP.

Experience of extreme disruption

The extreme disruption caused by COVID-19 and the associated market turbulence and rapid shift to remote working proved a real-time test of firms' operational resilience. Overall, the industry has remained remarkably resilient during this trying period.

In part, having identified their important business services previously, firms were able to prioritise these which aided their resiliency efforts when managing the transition to remote working. The situation has also helped focus interest on the underlying processes and dependencies that support firms' important business services. As a consequence, it has helped funding decisions to fill any resiliency gaps.

The experience was also a mixture of different issues – people/health, facilities, and market/economic. Resiliency efforts therefore need to cater for all of these which may be a wider range of areas than previous pure 'business continuity'. We therefore took the opportunity to add detail to some of the services. Overall, the past few months have proven to be a helpful validation exercise to test whether firms' defined services are truly their most important.

Member progress

Separately the IA gathered member feedback on their own identified important business services and circulated it back anonymously to assess whether any firms had identified any different important services.

There were some minor differences in the lists of member's important business services with some add-ons or reductions, or differences in terminology or focus within the topic on specific aspects. It was felt that this largely reflected differences between firm’s operating models or the complexity of products offered by some firms. Overall, most firms had broadly used the previous guidance issued by the Working Group.

In terms of numbers, almost all had opted for a number less than ten, with some others in the low teens. It was felt that a smaller number of services helped focus attention at senior manager and board level while retaining the view of what was important to a firm’s consumers. However, clearly the process of identifying the services should be focused on what is important and not on the numbers. It is important that firms do not underestimate the number of important services they have and that benchmarking the number may not be appropriate in the case of every firm.

Conclusion

The methodology previously identified by the Business Services Working Group remains largely fit for purpose, with these adjustments:

'Internal support services' should no longer be considered an important business service in itself but rather a critical underlying process involved in the delivery of these important services.

The remaining six important services previously identified remains an appropriate number of services for firms to benchmark themselves against, adjusted to their own individual business models.

Likewise, the high-level list of services identified initially (investments, payments in/out, valuation, custody and client and regulatory communications) remains a useful guide for members. See table on page 6 for more detail.

Ultimately, this guidance is aimed at aiding firms establish a methodology to identify their important business services and begin to map these services' underlying dependencies. It remains a guide only and can be easily adapted – firms should assess it against their own operating models, product and client types.

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