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Dear Sirs,

RE: CP19/32 – Building operational resilience

The Investment Association (IA) welcomes the opportunity to comment on these proposals.

The Covid-19 pandemic this year has had a significant effect on the industry; indeed it extended this consultation. Overall the investment management sector responded effectively to the crisis and maintained levels of service to consumers and counterparties during highly volatile times, both operationally and in capital markets. The principles outlined in the paper proved to be effective ones for firms to consider and the industry's associated preparations ensured that, overall, the sector proved itself capable.

However, resiliency is not something that can be 'achieved' and considered complete, and so the IA and its members look forward to working with you throughout the implementation of the regulations on the common goal of improving resiliency and outcomes for consumers.

We hope that the feedback outlined in our full response is useful and welcome continued further involvement in future discussions on this topic.

Yours faithfully

JA

John Allan
Senior Operations Specialist

Response to consultation

CP19/32 Building Operational Resilience

About the Investment Association

The Investment Association (IA) champions UK investment management, a world-leading industry which helps millions of households save for the future while supporting businesses and economic growth in the UK and abroad. Our 250+ members range from smaller, specialist UK firms to European and global investment managers with a UK base. Collectively, they manage £7.7trillion for savers and institutions, such as pension schemes and insurance companies, in the UK and beyond. 40% of this is for overseas customers. The UK investment management industry is the largest in Europe and the second largest globally.

Executive summary

Resilience has been at the forefront of everyone's thinking this year in ways we have never witnessed before. The UK regulators are entitled to feel justified in starting the conversation on this topic ahead of the crisis and bringing about progress within the financial services arena.

We are supportive of the proposed regulations and the overall objective of building a financial system better able to deal with disruptive events when they occur. As the Covid-19 pandemic demonstrated, the investment management industry has a high level of resiliency built upon many years of 'business continuity' planning and developments in part prompted by the earlier discussion paper ('DP').

However, should the effects of Covid-19 be longer-lasting than anticipated, it would be of value to understand the regulatory expectations on firms' operational resilience; for instance if the trend of working from home continues, there will be more reliance on the telephony and broadband infrastructure of the UK. It would be helpful to have more insight into the role of the UK authorities in ensuring the resilience of UK broadband infrastructure and likewise the regulatory expectations for firms' ensuring the resilience of staff working from home arrangements.

Firms have benefitted from the regulator's clear provision of notice and signposting of these changes, given the DP and the clear inclusion of the subject as an important priority in key communications with industry.

The application of a risk-based approach as well as proportionality in the regulator's thinking via the focus only on firms who are more likely to have an impact on other parties or market stability is a very welcome move. We do not necessarily agree that using a firms' SM&CR status as a proxy for this is the most appropriate mechanism, but nevertheless welcome the principle.

The outcomes-based nature of the proposed regulations are also welcome as firms are best-placed to understand their own internal business models, products and customer types. Additionally, the proposed transitional arrangements allow firms time to make the necessary changes to test their ability to remain within their impact tolerances for each of their important business services in the event of a severe but plausible disruption to its operations. Such changes may be significant in size especially where service provider or IT change is needed, and so this additional time allowance is welcomed.

As the proposed regulations are not prescriptive, there is naturally a lack of explicitness in some areas. As we have shown, we are keen to continue to work with you on supporting our members by establishing best practices guidelines in areas such as the definition of investment sector-specific important business services.

Finally, we do not agree with the draft requirement that time duration is always a measure within impact tolerances. We explain that there are areas where other metrics are more appropriate, and believe that if firms are able to demonstrate this, they should have the ability to choose another metric as the measurement.

FURTHER INFORMATION

For further information, please contact: John Allan

1. Do you agree with our proposal for firms to identify their important business services? If not, please explain why.

We agree that focusing on business services is an effective way for firms to understand the impact on consumers in the event of disruption. It enables senior leaders and the board to view their services from the end consumer's angle rather than their own. Similarly, it allows firms to effectively prioritise these important services with regard to investing in resiliency and helps inform decision making.

We agree that it is useful for firms to regularly review their business services to check whether any changes have occurred since the last review point. The requirement for an annual review at the minimum is reasonable and in line with the associated requirement to keep the self-assessment document updated.

We think it is sensible that the concept of 'business services' be applied using the FCA's well-established concept of risk-based proportionality and according to the bespoke risk profile of each respective firm[1].

It is also welcome that firms have the scope to decide what set of circumstances should trigger an ad-hoc review. Firms are best placed to decide whether a change is 'relevant'[2] in the context of their own business model.

2. Do you agree with our proposed guidance on identifying important business services? Are there any other factors for firms to consider?

We welcome the fact that you have put the onus onto firms to decide what their important business services are, rather than imposing an industry-wide taxonomy. This outcomes-based approach reflects that firms are best placed to understand their own business models and immediate customer base.

Firms reported to us that they would benefit from more clarity regarding identifying important business services. We, as a trade association, were well-placed to support firms in this and welcomed your acknowledgement of the role that TAs can play in helping achieve consistency in this area within financial sectors.

We have carried out some work in this area[3] and discussed the outcome with you in both December 2019 and June 2020. This covers both the types and the likely range in number of important business services an investment firm may have, depending on their product and client types, and operating model.

On the numbers, our analysis has found that it is important to determine the right level of granularity to avoid a dilution of impact. For example, identifying a large number of services (ie >15) would restrict the impact that reporting to senior management may have, and an understanding of where investment could have a meaningful impact. Our work with members has found that it would be rare for a firm to have more than 10.

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[1] CP19/32 page 32 para 8.10

[2] We note that the consultation paper uses the word 'material' whereas the rules use the word 'relevant' (draft handbook text SYSC 15A.2.2.R (1))

[3] IA: *Important Business Services* June 2020

Nevertheless, it is important for firms to assess this on their own account. Using the guidance in the consultation paper and the IA's own work, assessment methodologies are being applied by firms within their own governance arrangements. This approach ensures accountability within firms, robust processes and internal oversight.

We are keen to continue to liaise with you on this important work as the regulatory process continues.

3. Do you agree with our proposals for firms to set impact tolerances? If not please explain why.

We welcome the concept of setting impact tolerances and in particular the fact that you have again not been prescriptive, and have focused on the overall objective. It is useful that the tolerances levels have not been imposed on industry and that firms can decide for themselves, using knowledge of their business models, customer types and product types. We recognise that the aim is to ensure that boards and senior management make informed decisions on making their businesses more resilient.

We agree that it is useful for firms to regularly review their impact tolerances to check whether any changes have occurred since the last review point. The requirement for an annual review at the minimum is reasonable and in line with the associated requirement to keep the self-assessment document updated.

It is also welcome that firms have the scope to decide what set of circumstances should trigger an ad-hoc review. Firms are best placed to decide whether a change is 'relevant'[4] in the context of their own business model.

The guidance provided in section 5.12 is useful for assessing a disruptive event's potential impacts. In most cases we expect that firms in the investment sector would not have the potential to affect wider financial stability nor market integrity. Consumer harm is the most relevant consideration. Again, we are working with members to develop industry good practice on how this translates into the investment sector and key potential harm areas.

An additional complication that firms may face is the reliance and interconnectedness of outsourced service suppliers. It could prove problematic for firms if outsourced service providers have incompatible or inconsistent tolerances to them, and they may lack the ability to change these, or in extreme scenarios change their supplier. Service providers may face challenges if clients make differing or contradictory requests of them. Over time this inconsistency may be resolved by evolving and iterating contractual arrangements but until that point there is a risk of incompatibility. It is noted that, as discussed later, there are transitional arrangements that provide for flexibility in this area and firms may utilise this.

It should also be recognised that different firms have different capacities to mitigate against risk issues that could arise from a dependency on a limited number of crucial third party service providers, such as transfer agents, payment networks, market data providers, index providers or news feed providers. For many of these services, it is not viable to operate a second provider, and migration from one to another can take many years. We

[4] We note that the consultation paper uses the word 'material' whereas the rules use the word 'relevant' (15A.2.6R (1))

would ask that this continue to be taken into account when the regulations are being supervised.

We agree that it is the responsibility of each firm to manage the risk governance of its third-party providers. We support the FCA's sentiment that, 'in all outsourcing or third-party service provision scenarios, regulated firms retain full responsibility and accountability for discharging all their regulatory responsibilities. Firms cannot delegate any part of this responsibility to a third party.'[5]

We welcome the FCA's restatement on the requirements and guidance for outsourcing and third-party provision, that:

> 'The requirements and guidance include appropriately identifying and managing the associated operational risks throughout the life span of third-party arrangements from inception and on-boarding, through business as usual operation and exit or termination of the arrangements. Our approach is risk-based and proportionate, considering the nature, scale and complexity of a firm's operations. Firms should take account of the principle of proportionality when complying with their obligations for outsourcing and third-parties. The proportionality principle focuses on the characteristics of the firm eg the firm's size and complexity, including those related to outsourcing and use of third-parties, and aims to ensure that the objectives of the regulatory requirements are effectively achieved.'[6]

The principle of risk-based proportionality should continue to take account of – on a case-by-case basis – the relative relationships different firms have with their third-party providers.

4. Do you agree that duration (time) should always be used as one of the metrics in setting impact tolerances? Are there any other metrics that should also be mandatory?

We do not agree that any one metric should be mandatory.

We accept that time duration is often the most appropriate metric to be used as this is easy to understand, measure and report. Measuring downtime is a universal metric that is readily understood across firms. However, it should be noted that a time-based metric is not always relevant, or the most appropriate measure to use. For instance, when making payments to customers, time is not always the most important metric for quantifying harm; one payment may be exceptionally important to a customer for onward transmission reasons and as such it may be of more benefit to set a tolerance based on the risk category of the payment, rather than time taken.

Therefore, while it is useful that firms will have the ability to select a different type of metric, the way the rules are currently drafted means that firms do not have the flexibility to discount time duration entirely, even when it is irrelevant. We would encourage you to state instead that an impact tolerance should take material account of time duration, but not impose it mandatorily.

[5] CP19/32 page 32, para 8.14
[6] CP19/32 page 32, para 8.10

Firms have multiple ways of measuring risk and a simple time duration measure may be incomplete and lead to unsatisfactory outcomes. Enforcing time duration as the measure for all metrics is not appropriate.

Indeed, the proposed regulations[7] seem to accept this point, to the extent that the appropriate threshold fluctuates based on the time of day or cyclical patterns. It is our view that as long as a firm has a robust and consistent way of measuring, recording and reporting an alternative type of metric for a particular service, they should be allowed to use this, in place of time duration.

5. Do you agree with our proposal for dual-regulated firms to set up to two impact tolerances and solo-regulated firms to set one impact tolerance per important business service?

Dual-regulated firms are required to cater for slightly different definitions of some of the key concepts within the operational resilience consultation papers. It is not ideal to be working with different definitions for the same initiative, such as on important business services[8]. While it is logical to set impact tolerance different requirements given the different considerations of each regulator and their underlying responsibilities, we would urge regulatory cohesion as far as possible to mitigate against any unnecessary burden on firms. For these larger firms, it is important to recognise that there may be a variety of services with different levels of harm and therefore different impact tolerances. Moreover, there may be additional complexities such as if a dual-regulated firm had boards regulated by different entities.

Similarly, we believe it is important to try and achieve regulatory alignment across jurisdictions to alleviate any potential friction for international firms. It is welcome that the UK is leading the way internationally on resiliency, but there is a risk of jurisdictional divergence. In particular, any added costs relating to regulatory disjunction could be to the detriment of a firm's investment in their resilience. We urge you to work closely with international partners to establish a worldwide standard.

6. Do you have any comments on our proposed transitional arrangements?

We welcome the proposed transitional arrangement as firms will need time to implement the necessary changes, which, as the Treasury Committee heard[9], cannot always be effected quickly. We agree that the three-year transition period should, in most cases, be a sufficient timeframe for firms to evidence mapping, reconsider tolerances and definitions of important business services as well as the time for board members to gain the necessary insights to make knowledgeable and informed decisions. Additionally, we support the fact that new firms authorised in the period will be able to make use of the transitional arrangements. However, given the possibility there could be further disruption from Covid-19 or other significant events, we would request that this be kept under review.

We note that the transitional arrangements apply solely to ensuring a firm can remain within its impact tolerances for each important business service in the event of a severe but plausible disruption to its operations[10]. We conclude that your objective is for firms to

[7] Draft regulation SYSC 15A.2.8 G
[8] CP19/32, page 66, versus UK authorities joint paper, page 7
[9] Treasury Committee report 2019: *IT failures in the Financial Services Sector* para 85
[10] Draft regulation SYSC 15A.2.9R

be making incremental progress towards setting appropriate impact tolerances throughout this period. It follows that it is your intention that the impact tolerances set should be sufficiently challenging that firms will not be meeting them for at least two years.

However, it may be that firms, having set their tolerances at the ‘intolerable level of harm’ threshold rather than aiming for continuous improvement, have already achieved compliance for ‘severe but plausible’ events well within the timeframe and therefore would not be expected to take additional steps. In this case we assume that a statement in the self-assessment document would be a sufficient action.

We encourage the FCA to consider carrying out, post implementation and as was done in relation to SM&CR reforms, a stock take report of how these operational resilience reforms have played out in implementation. This may allow the industry to benefit from sharing ‘lessons learned’.

7. Do you agree with our proposed approach to mapping? If not, please explain why.

We note that the definition of resources has moved on from the DP, with ‘facilities’ and ‘information’ added to the previous ‘systems, people and processes’ considerations, albeit with ‘technology’ replacing ‘systems’. This seems appropriate given how widespread the reliance on data and physical locations is amongst firms, although we may see the latter reduce in future as result of the recent necessary move to remote working.

However, firms reported to us that they would benefit from more guidance on the appropriate level of granularity firms should take when conducting mapping. We have taken the view that mapping needs to be proportionate to the impact tolerance and criticality of the service to consumers and the market, to understand the level of required detail.

The nature of outsourcing in our sector is significant and so there will be a focus by firms on the equivalent mapping taking place at suppliers, and suppliers to these suppliers. Firms may encounter a differing range of success in terms of the level of detail they can reach in their mapping processes. Fundamentally, we agree that it is the responsibility of each firm to manage the risk governance of its third-party providers, and that the FCA should continue to apply the supervisory principle of risk-based proportionality[11].

We note that in 8.8 you list ‘areas of concern’ to you with regard to outsourcing, most of which we agree with. However, we do not agree with your conclusion that this reflects that ‘the concepts… [of the] CP… are not yet part of all firms’ thinking’.

We support the FCA’s sentiment that, ‘in all outsourcing or third-party service provision scenarios, regulated firms retain full responsibility and accountability for discharging all their regulatory responsibilities. Firms cannot delegate any part of this responsibility to a third party.’[12] This is not new and firms are well used to this approach.

We would, however, encourage the FCA to consider any potential unintended consequences of these new rules. For example, that it could influence firms to insource services which are not within their core competencies. This could erode benefits of scale

[11] CP19/32 page 32, para 8.10
[12] CP19/32 page 32, para 8.14

and industry-wide efficiencies, could increase costs for the end consumer and potentially increase industry-wide operational risk.

8. Do you agree with our proposed approach to testing? If not, please explain why.

While we welcome the fact that firms are able to determine the scenarios to be used in testing, we consider that the nature of outsourcing in our sector and in particular the customer-facing nature of these may require some regulatory input in future.

We support the proposition to test 'severe but plausible' scenarios but the intricacies of these must be better understood. For instance, it is plausible that both a firm and a Transfer Agent could suffer an outage at the same time, yet to go about testing this could itself pose unnecessary risks.

Firms would benefit from further clarity on what the FCA expects on how or if firms should coordinate testing with their key suppliers. Moreover, it would be helpful to gain feedback on the feasibility of such a testing process and whether that in itself could harm the resiliency of the firms and the markets. For example, such testing may need to be scheduled and co-ordinated across industry. Due to the risk of failure involved and the resultant disruption, such an event should not take place without the involvement of the regulator.

We welcome the fact that testing may consist of one or more of 'paper-based, simulations or live-systems' and that firms are able to decide the most appropriate mechanism(s) to satisfy themselves of their resiliency. We take from this that it would be permissible for firms to solely conduct more theoretical forms of testing. However, if theoretical scenario testing is not considered sufficient, it should be noted that using more realistic or live testing would likely introduce risks that regulatory authorities need to be alive to, and potentially involved in.

9. Do you agree with our proposals for communication plans? If not, please explain why.

Communications with customers can, by definition, be difficult in times of disruption. We note that firms are expected to consider how they might get around this but can foresee that firms may have a very limited number of options that will not necessarily work in all situations. Firms will, in nearly all cases, already have internal plans for how to contact key decision makers and other staff to communicate during disruptive events.

You have not asked any questions around governance, so we are including our comments in this question given the inclusion of this topic in the section that this question relates to. We recognise that the individual performing the SMF24 function is, in most cases, the most appropriate position for operational resilience function to be located.

These individuals, with the backing of their teams, will be responsible for enhancing governance and controls, and these will necessarily be nuanced across different firms. We have seen significant interest among members for whom the draft regulations do not apply to apply the principles of the regulations as they see the benefit to their firms and their consumers. Some members voluntarily 'opted-up' their SM&CR status to 'enhanced' previously and now find themselves in scope of these regulations. As stated, in many cases this is not problematic due to their existing attention on the topic. However, the arbitrary selection of the SM&CR status of firms being used as the threshold for applicability is slightly disadvantageous to them. We do not consider that a firm's SM&CR status is an appropriate proxy for their potential detrimental impact upon consumers or counterparties. Care should be afforded by the regulator to ensure that this does not put these firms at a disadvantage and that this status is not regularly used as a convenient threshold for future regulatory interventions on other subjects.

We note the FCA's intention to utilise their formal Guidance and Section 55J and 55L[13] abilities under the FSMA in the event that a firm is deemed to have not complied and the responsibilities therefore on the senior management and board. We appreciate that the inclusion of these powers represents the importance with which the FCA takes this subject given that it is only elsewhere included in the internal capital adequacy standards of firms[14].

10. Do you have any comments on our proposed requirement for a self-assessment document?

We agree that such a document will help boards locate, in one place, the resiliency assessment of the business on an ongoing basis and initiate discussion and decision-making.

We appreciate that the document's contents are necessarily prescriptive but welcome the flexibility afforded by the proportionality considerations; it may be that some firm's documents will therefore be relatively short. The proposals set out in 7.16 provide a helpful framework and a basis by which firms can create their self-assessment documents. It would be beneficial to gain more insight on the expectations for dual-regulated firms who are required to maintain a self-assessment document by both the PRA and FCA. However, given the similarities in the requirements for the PRA[15] and FCA, we assume that only one self-assessment document would be needed to satisfy both regulators and avoid duplication of time, effort and resource.

The draft regulations[16] do not state precisely how often the document should be updated in the absence of a triggering event, but we have assumed that as an annual review is required elsewhere (for example in reviewing services and tolerances) at a minimum, then firms would be expected to conduct this exercise annually. On a related point, clarification would be appreciated on the deadline for the date of the publication of the first document; our reading takes this to be one year following the rules coming into effect.

We note that the FCA do not wish to receive the documents as a matter of course. Firms do not intend on sharing these documents with clients or otherwise publishing them and consider them to be confidential documents to be distributed outside of the firm only when requested to do so by the regulator, for their eyes only. Equally, firms may choose to publish a pared back version of the document.

We expect that firms who are out of scope of these proposed regulations will not be required to maintain such a self-assessment document, whether it is named as such or simply provides the same prescribed information. Firms who are out of scope may well

[13] Draft regulation SYSC 15A.9
[14] FCA Handbook: BIPRU 2.2.12C – 13A & IFPRU 2.3.14 - 16
[15] PRA CP29/19 section 4.29
[16] Draft regulation SYSC 15A.6.1 R

choose to produce a similar assessment analysis, but they should not be brought within the requirement via 'scope creep' over time.

11. Do you have any comments on the cost benefit analysis?

We welcome the apparently extensive cost benefit analysis (CBA) undertaken by the FCA. However, we feel that whilst most considerations have been addressed, the CBA is not entirely representative. With regard to the assessment of costs incurred with management time, number of people required and resources needed to plug resilience gaps, we believe some of these costs may have been underestimated.

Moreover, we would argue that the assumption that there would be little or no new work required by firms and that the majority of costs would be one-off rather than ongoing is misplaced.

This is a significant multi-faceted topic with extensive areas of reliance and interconnectedness with suppliers and other industry parties. There are potential costs which have not been addressed in the CBA in relation to service providers; if service providers maintain impact tolerances set at a higher threshold than their clients, then this could result in additional costs in work needed to bring them in line. Additionally, a firm may have to change their service provider if they found that requirements in this area could not be met and contractual negotiations fail. In both cases, there is a risk that the costs might be passed on to investors.

We note the importance that the joint regulators have put on the subject, via signposting of this consultation, the emphasis of its importance in supervisory visits and statements, and reference to the 55J and 55L powers. All of this means that firms will take the topic extremely seriously and invest a significant amount of time and cost in achieving compliance.

We foresee escalating costs across the topic, but most significantly in analysing and potentially replacing IT systems and implementing testing plans. The CBA does not necessarily reflect the appropriate levels of costs in these areas. There are also costs for those firms who, as we noted earlier, have chosen to opt-up to enhanced SM&CR status and therefore there are an additional number of firms who are in scope of the regulations and who may not be included in the CBA.

12. Do you have any comments on the examples of existing legislation?

We understand the implied point that existing regulations will continue to apply and that firms should consider the draft regulations as complimentary to activity already undertaken.

We look forward to seeing the two separate interventions you highlight. Firstly, the clarification on the links between the EBA guidelines and the draft regulations[17] and secondly the separate potential consultation on the application of the 'register of outsourcing' to a wider domestic audience[18].

[17] CP19/32 1.12
[18] CP19/32 8.25 - 8.27