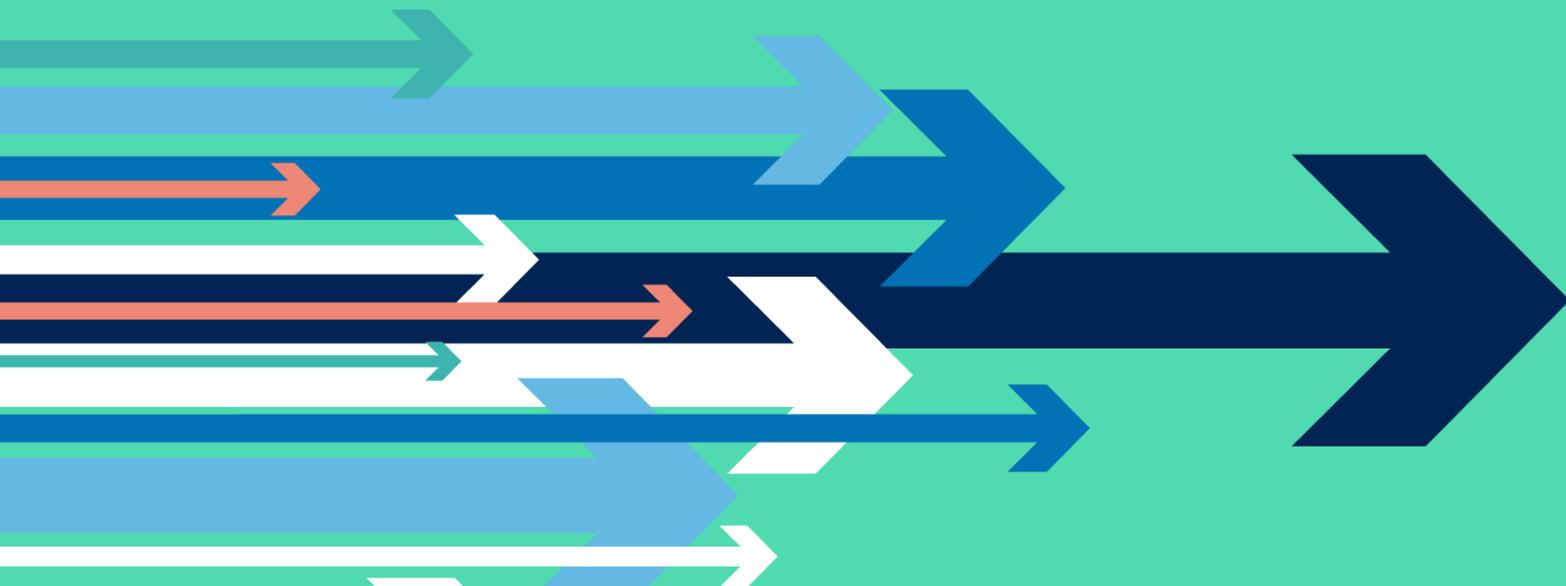


UK Operational Resilience Policy Statement

John Allan | April 2021



Contents

a) Introduction

- Pandemic feedback
- Policy context
- Scope & timelines
- Example investment firm

b) Discussion prompts

- Important business services
- Impact tolerances
- Mapping
- Scenario testing
- Communications & self-assessment document
- Governance
- International

a. Intro: Pandemic feedback

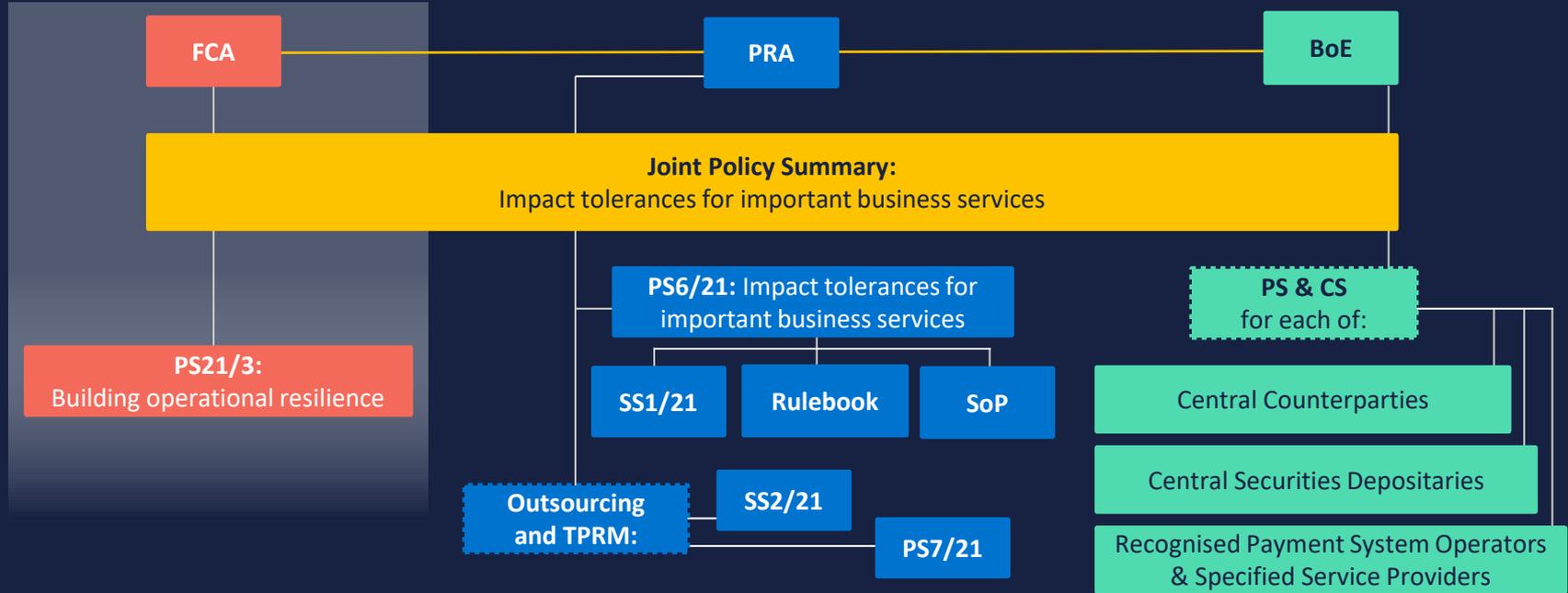
'We recognise that the coronavirus pandemic has had a significant impact on the firms we regulate.'

Firms that had mapped their important business services ahead of the pandemic found themselves in a much stronger position.

Overall, firms have been able to maintain continuity of service for consumers during the pandemic and we've seen a good degree of resilience.'

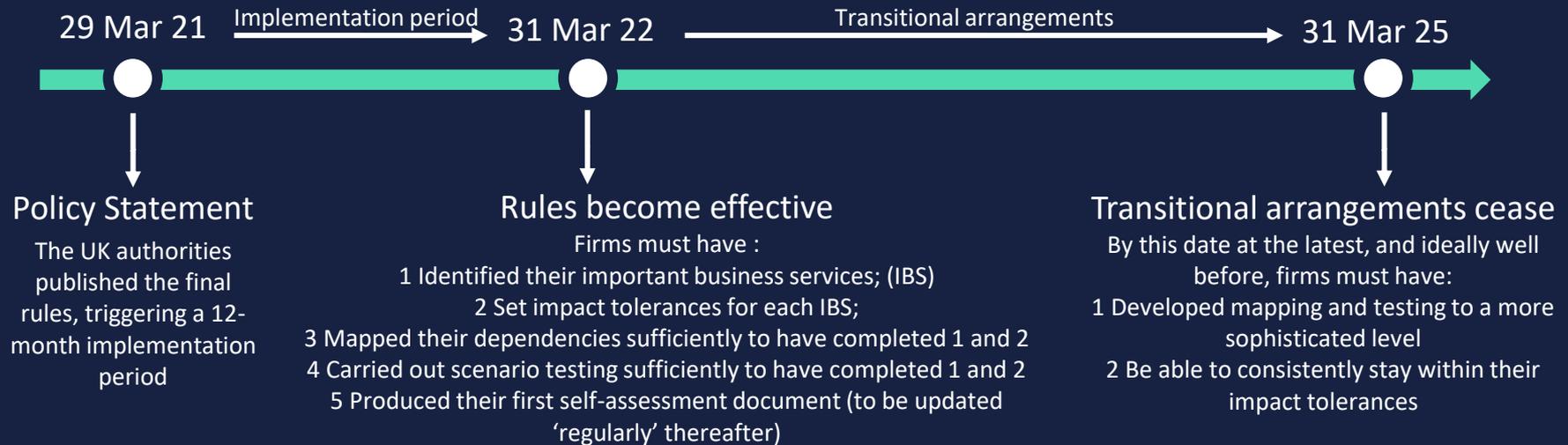


a. Intro: Policy context



a. Intro: Scope & timelines

FCA SM&CR Enhanced scope firms



a. Intro: Example investment firm

Firm C is an enhanced scope SM&CR firm that provides asset management services.

Firm C is at the centre of a complex ecosystem. On the customer side, the firm is connected with retail and institutional investors as well as the advisers; wealth managers; investment consultants; fund platforms; transfer agents; and messaging systems through which these customers transact with the firm. On the operational and markets side, the firm's dependencies include: data and risk modelling tool providers; order management and execution tools to create trade instructions; custodians which safeguard client assets; depositaries which oversee them; fund accountants which value the investment funds; brokers which execute instructions; clearing houses which clear transactions; banks; transaction reporting specialists to comply with its regulatory obligations; and markets.

Firm C is critically dependent on third parties for the delivery of its core services. Some of these third parties are regulated firms. Examples include the firms providing middle and back office processing; custody; fund accounting; and transfer agency. Many, though not all, of the technology tools and messaging systems relied on are from unregulated firms. Outsourcing oversight is one of Firm C's highest priorities.

b. Discussion points: Important business services (1of2)

- **All services:** Firms only need to identify their *important* business services
- **Granularity:** Firms are best placed to identify their services in the context of their business models
- **Internal processes:** Such as payroll do not constitute important business services
- **Number of affected clients:** Only a small number of customers may be affected by disruption but having considered all other factors the firm still considers the service to be important
- **Review:** Annually & when a material change occurs

means a service provided by a firm, or by another 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 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 financial markets.

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b. Discussion points: Important business services (2of2)

Firm C identifies generating orders to meet client subscription and redemption requests as an important business service. The firm uses an order management system (OMS) to provide the service. The OMS is central to the firm's portfolio management activity as it is essential for generating orders and to adjust the portfolio so that it delivers the objectives of the mandates and funds for which the firm is responsible. Disruption to the OMS could cause operational challenges within hours. These may affect both the firm's customers and, potentially, the markets in which the firm operates.

Customer harm could include investors being unable to buy or redeem units in funds or their investments suffering from lower performance because of fund transactions being delayed or incorrect. Outage has the potential to lead to market harm to the extent that some of a firm's market abuse controls are embedded in the system. Both the firm's reputation and customer confidence could also suffer.

b. Discussion points: Impact tolerances (1of2)

- **Prescription:** Firms are best placed to set their impact tolerances at the appropriate level using the considerations and examples provided
- **Intolerable harm:** Undefined, but constitutes harm from which consumers cannot easily recover
- **Vulnerable customers:** Separate Guidance issued recently, and this category of clients added as a factor to consider when setting tolerances – but no separate one needed
- **Inter-firm tolerance differences:** Board to formally approve any differences between entity & group tolerances for same service
- **Multiple disruptions:** Focus on a single disruption
- **Aggregate harm:** Harm may be aggregated where multiple services are affected by a single disruption
- **Outsourcing:** Firms to 'work effectively' with suppliers to set & remain within tolerances
- **Metrics:** Duration is mandatory, others may be used too

means the maximum tolerable level of disruption to an important business service, as measured by a length of time in addition to any other relevant metrics, reflecting the point at which any further disruption to the important business service could cause intolerable harm to any one or more of the firm's clients or pose a risk to the soundness, stability or resilience of the UK financial system or the orderly operation of the financial markets.

b. Discussion points: Impact tolerances (2of2)

Firm C recognises that the order management system (OMS), which is fundamental to the provision of the firm's important business service of generating orders to meet client subscription and redemption requests, does not exist in isolation. Failures in other business services such as market data flows or visibility of subscription & redemption activity may mean the OMS is not fully reliable or usable for a period, in turn causing harm to consumers and risk to market integrity.

Firm C considers potential disruption to its important business service of generating orders to meet client subscription and redemption requests and cannot identify one overall tolerance. However, Firm C recognises the impact that disruption of the OMS could have on other processes/services, for which it already has tolerances in place. For example, failures in investment processes can lead to an incorrect or late order being sent to the Central Dealing Desk or failure in dealing processes leading to an incorrect or late trade being placed in the market leading to client detriment and financial loss to the firm. The firm has a defined tolerance threshold of £30m to pay-out on trade errors. This could be increased by taking into other factors such as market volatility or other plausible scenarios.

b. Discussion points: Mapping (1of2)

- **Granularity:** Different levels of granularity for each of the key dates
- **More guidance on resources:** people, processes, technology, facilities and information
- **Mapping templates:** FCA will not be providing these
- **Review:** Annually and with material changes
- **Authority:** Board to approve
- **Outsourcing:** Fourth parties+ still to be mapped

For 2022, to a level of sophistication necessary to identify important business services, set impact tolerances and identify any vulnerabilities in their operational resilience.

Firms will then have until 31 March 2025, at the latest, to continue performing mapping with a view to being able to remain within impact tolerances for each important business service

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b. Discussion points: Mapping (2of2)

Firm C's mapping exercise is complex due to the number of interconnecting systems and technologies it relies on and because many of them are outsourced to, or delivered by, third-party providers. Customisation of services and tools and the way that they are often integrated with consumers and counterparties increase this complexity further.

Technical services and components are mapped through developed process and governance function but Firm C does not have a complete view for all business and operational services including their underlying dependencies. However, Firm C considers that it has sufficiently undertaken the mapping exercise, liaising where necessary with its third-party providers, to identify vulnerabilities and next steps to remedy these.

b. Discussion points: Scenario testing (1of2)

- **Industry-wide tests:** FCA to 'consider if industry-wide tests could be developed over the longer term as part of our supervisory approach'
- **Testing methods:** will depend on the firm's size, scale, complexity, and its business (considering the sector, products, services)
- **Timescales:** By 2022, only 'some' business services need to be tested
- **Frequency:** No longer annually, instead 'regularly' including when material business changes or when improvements made
- **Third parties:** Firms to 'work effectively' with suppliers. If supplier conducting the testing, the firm is to satisfy themselves of its thoroughness

Testing in a range of severe but plausible scenarios is intended to help firms identify areas where further resilience needs to be built.

In carrying out testing and remediating any vulnerabilities, firms should in turn be better prepared for potential real-life disruption and reduce the number of such disruptions which could cause intolerable harm to consumers and/or risk to market integrity.

Testing is a preventative measure against real-life disruption.

b. Discussion points: Scenario testing (2of2)

Firm C scans the operating environment to understand changing risks and events that could affect parts of its business eg cyber security, political, environmental, social, technology and market changes. It engages with its business counterparties to enhance the validity of these tests. This includes carrying out end-to-end tests for individual processes involving all relevant parties (internal and external) and including an independent third party to verify the testing methodology.

Firm C carries out 'severe but plausible' scenario testing on investment execution including the order management systems to ensure procedures for execution and allocation of client orders are robust. The firm carried out a test whereby an inaccurate order was created during a period of high market volatility. Modelling the remediation required in simulated market conditions showed that a real-world occurrence of a similar event would have resulted in significant losses to the firm. It was identified that lack of resources to pick up the error and use of multiple platforms within the firm exacerbated the problem. Firm C has responded by both improving its trade monitoring and reducing the number of platforms used to order and execute trades.

b. Discussion points: Communication plans & self-assessment document

- **Communications with clients:** In line with existing requirements, and taking vulnerable customer's needs into account
- **Existing plans:** Can be repurposed where necessary
- **Major central systems & multi-firm incidents:** FCA will not co-ordinate, trade bodies to assist
- **Self-assessment document:** Can include additional information, such as audit reports, if desired
- **Format:** 'not important' – word, excel, ppt or mixture
- **Circulation:** FCA will request it when needed. No need to distribute to clients or put on website
- **Timescales:** By 2022. Reviewed 'regularly' thereafter

We consider that the self-assessment document will show a firm's resilience journey. When firms include in the document the required information... and the methodologies used to fulfil the activities... they will in turn show the steps they have taken over time to comply.

The document will not show the firm's resilience journey pre-introduction of the policy but it will show how the firm has endeavoured to meet its requirements.

b. Discussion points: Governance

- **Accountability:** SMF24
- **Review:** Firms must ensure that its governing body approves and regularly reviews the written records required (Self-assessment and lessons learned exercise documentation).

Senior management is accountable for their firm's operational resilience and should have improved oversight.

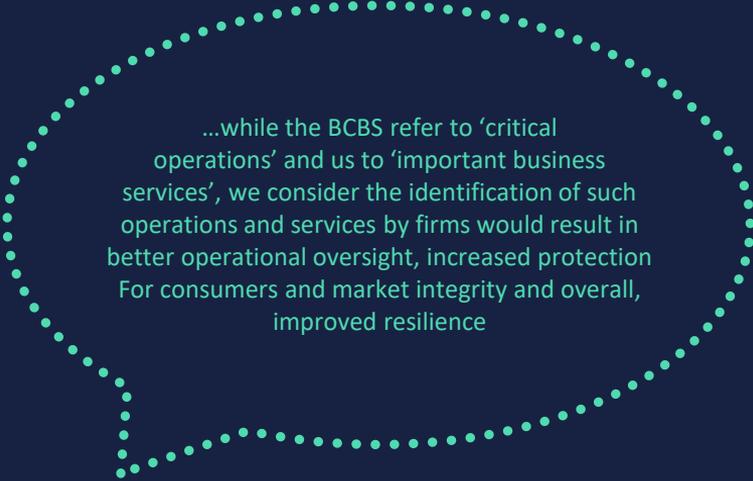
...should discuss the detail of the firm's operational resilience with other colleagues who have more technical expertise...

Firms in scope of the SM&CR should continue to refer to ...the CP where we set out our expectations for ...the SMF24.

If firms do not have an ...SMF24... they must determine the most appropriate individual within the firm who is accountable for OR.

b. Discussion points: International

- **BCBS:** (*Since published*) FCA considers framework & intended objectives as broadly aligned
- **EU DORA:** Draft & will monitor



...while the BCBS refer to 'critical operations' and us to 'important business services', we consider the identification of such operations and services by firms would result in better operational oversight, increased protection for consumers and market integrity and overall, improved resilience

Contact us

theia.org/campaigns/operational-resilience