Survival of… the Most Adaptable

As the world continues to assess the current and future social and economic costs of the Covid-19 pandemic, Jonathan Graham looks at how Financial Services companies can enhance their Operational Resilience.

“It is not the strongest of the species that survives, nor the most intelligent that survives. It is the one that is most adaptable to change.”
Leon Megginson on Charles Darwin’s ‘On the Origin of Species’

On the Origins of Operational Resilience

Companies and regulators have been flirting with the concept of Operational Resilience for a number of years now. It was considered in earnest by a number of companies following the WTC terrorist event in 2001, after the Global Financial Crisis in 2008, and after the Fukushima Tsunami in 2011, though no regulation was introduced to address this challenge. Of course, this year’s Covid-19 pandemic has highlighted the importance of operational resilience on a global scale.

Before the Covid-19 pandemic began, the BoE, PRA and FCA issued a Joint Discussion Paper ‘Building the UK financial sector’s operational resilience’ in July 2018, and a Joint Consultation Paper, encompassing feedback from the Discussion Paper, was subsequently issued in December 2019. This new regulation will apply to Financial Services companies; however, the regulation is equally useful to non-Financial Services entities that want to become more operationally resilient. It is important to note that this is not the first guidance to be published on this topic, the British Standards Institute published BS 65000 Guidance for Organisational Resilience in November 2014, though this is only best practice guidance and not mandatory.

“The ability of firms and the financial sector as a whole to prevent, adapt, respond to, recover and learn from operational disruptions”

In the Consultation Paper, Operational Resilience is defined as “the ability of firms and the financial sector as a whole to prevent, adapt, respond to, recover and learn from operational disruptions”. The paper goes on to state that operational disruptions leading to the unavailability of important business services may “cause wide-reaching harm to consumers and market integrity, threaten the viability of firms and cause instability in the financial system”. This emphasises that a significant

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1 The deadline for feedback on the Joint Consultation Paper is 1st October 2020.
disruption has the potential to seriously impact the wider national economy or even the global economy, as was borne out by the global stock market crashes that followed the WTC and GFC events.

The Covid-19 pandemic is of course the event at the forefront of everyone’s minds and the extent of some impacts is greater than could have been imagined, such as the adverse impact on the mental health of some employees caused by the extended period of remote working. However, it’s crucial to acknowledge that significant disruptions come in a broad range of types and impacts – some disruptions are global, and others will be limited to a single entity. Additionally, there is value in distinguishing between disruptions that are due to making changes to internal systems e.g. TSB’s repeated IT failures affecting customers, and disruptions that are beyond their control such as natural disasters. This is because companies have greater ability to limit the impact of disruptions due to internal changes and they should use the learnings from previous failures to minimise future disruptions.

Why invest in Operational Resilience?

There are many excellent commercial reasons why a company should invest in Operational Resilience, besides the need to comply with the forthcoming regulation for Financial Services companies.

Companies that have embedded a robust Operational Resilience framework have a process in place to learn from trends that help them plug resilience gaps and subsequently minimise the associated financial impact. Also, operationally resilient companies will likely generate additional goodwill with their regulators, employees – current and prospective – and other stakeholder groups.

“An entity that is able to provide a continuity of service to its clients will enhance its reputation for reliability and client focus and achieve an advantage”

Strategically, a solid framework provides companies with an opportunity to generate a competitive advantage. An entity that is able to provide a continuity of service to its clients will enhance its reputation for reliability and client focus and achieve an advantage over the companies that are unable to continue to provide services to their clients.

For a company to maximise its advantage, it’s critical that the Operational Resilience framework is properly defined and implemented. In some quarters there is a misconception that Operational Resilience is simply a combination of the Business Continuity and Disaster Recovery plans. Though some of this content can be leveraged to create an Operational Resilience framework, this approach misses the point of what true Operational Resilience is. Moreover, it does not meet the proposed regulatory requirements.

Who is on Point for Implementation?

The Consultation Paper names the SMF 24 role holder as being responsible for Operational Resilience. This is generally the Chief Operating Officer and being the Executive Committee member with oversight for the company’s operational functions this is an entirely sensible allocation of responsibility. Though this is the recommendation in the Consultation Paper, for operational reasons, some companies have chosen to allocate this responsibility to the Chief Risk Officer, Chief
Compliance Officer, or General Counsel. Within the bounds of what is sensible, each company should allocate responsibility based on their own governance structure.

What does ‘good’ look like?

When presented with new regulation, Boards commonly ask, ‘what does good look like?’

The answer to that question is most often rooted in the company’s cultural approach to implementing regulation – which is often based on their willingness to invest in the process.

“The benefit companies will get from their implementation will directly relate to their investment in the implementation”

At one end of the spectrum there are companies that pay ‘lip-service’ to the regulation and have a history of introducing a bare-bones tick box approach, and at the other end of the spectrum are companies that fully embed the spirit of the regulation into their operations to provide the board with comfort that they can continue to provide their important business services in the event of a significant disruption. In the case of Operational Resilience, the benefit companies will get from their implementation will directly relate to their investment in the implementation, and the benefit from their investment will come into sharp focus in the event of a significant disruption.

So, how should my company implement an Operational Resilience framework?

Implementing a robust Operational Resilience framework that will genuinely serve the company in its’ hour of need requires input from many operational functions within the company.

To maximise the likelihood of successfully implementing the framework, a formal programme should be set up for the initial implementation, with governance that clearly outline reporting lines through to the Board, programme objectives, terms of reference and the respective responsibilities of programme participants. As with all good programmes, there should be an executive sponsor, a business sponsor, a programme director, and be appropriately broken down into workstreams with project leads, project teams, timetables, and the involvement of relevant stakeholders for each workstream.

“It’s also imperative that the programme looks beyond the initial implementation”

It’s also imperative that the programme looks beyond the initial implementation of the framework and is structured so the full process can operate efficiently at least annually, or more frequently in the event of a significant internal or external change.

As illustrated in the diagram below, an Operational Resilience framework is best implemented as a process cycle. This section will cycle through each stage in the process, referencing examples of how the claims payment process in the insurance sector would be integrated into the overall framework.
The Operational Resilience Cycle

<table>
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<tr>
<th>Action</th>
<th>Description</th>
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<tbody>
<tr>
<td>Determine Governance Structure</td>
<td>Determine which Committee(s) will be responsible for Operational Resilience and ensure the Claims function is appropriately represented</td>
</tr>
<tr>
<td>Identify Important Business Services</td>
<td>Claim payment to an insured for a loss covered by the policy</td>
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| Conduct Resources Mapping Exercise | Document the underlying processes that must be completed to make the claim payment  
Identify the resources (people, processes, systems, facilities and information) that are required to complete the claim payment |
| Agree Impact Tolerances | Agree the duration which the claims payments process can be disrupted  
Agree the tolerable total volume and/or value of claims payments that can be disrupted |
| Draft Communications Plans | Prepare internal communications plans for relevant employees  
Prepare external communications plans for claimants, policyholders, regulators, media  
The communications should include the cause, extent and impact of the disruption |
| Perform Scenario Testing | Conduct a scenario test where the claims payments system has been compromised  
Determine if any claims payment impact tolerances have been breached  
Document resilience gaps and required actions |
| Complete Lessons Learned Review | Conduct a review and address deficiencies in the claims payment process |
| Report Self-Assessment Summary | Document the results for each stage in the cycle for the claims payment process  
The board reviews and approves the self-assessment  
The self-assessment is available to the regulator if requested |

Some Final Thoughts

There’s no time like the present to capture the operational impacts of the Covid-19 pandemic. Companies should be making a conscious effort to log these as they’re discovered, and when time permits, perform a post-mortem to close the resilience gaps they’ve identified in their framework.
“Operational Resilience should be very high on the Board’s agenda in 2020”

For Operational Resilience, the adage “What doesn’t get measured, doesn’t get managed” is fundamental. Companies should take a great deal of care when calibrating their impact tolerance metrics, including conducting back-testing against previous events. Impact tolerance breaches will reflect on the company’s preparedness for significant disruptions, and ergo the board can be held to account for its management of the company. A company’s ability to adapt in the face of adversity is a true measure of its leadership, and for this reason alone Operational Resilience should be very high on the Board’s agenda in 2020.

It may feel like, and be true that, there is still a great deal of work to be completed on Operational Resilience before it is embedded in the UK, though the UK should take some consolation in the knowledge that it’s ahead of the rest of the EU and the US in our development of the regulatory framework for Operational Resilience.

In a world that is becoming increasingly volatile, uncertain, complex and ambiguous, it will be the companies that can identify their important services, set appropriate tolerances, plan, test and prepare for disruptive events that will be best placed to survive, and dare it be said, thrive when significant disruption strikes.

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