Policy Statement | PS6/21

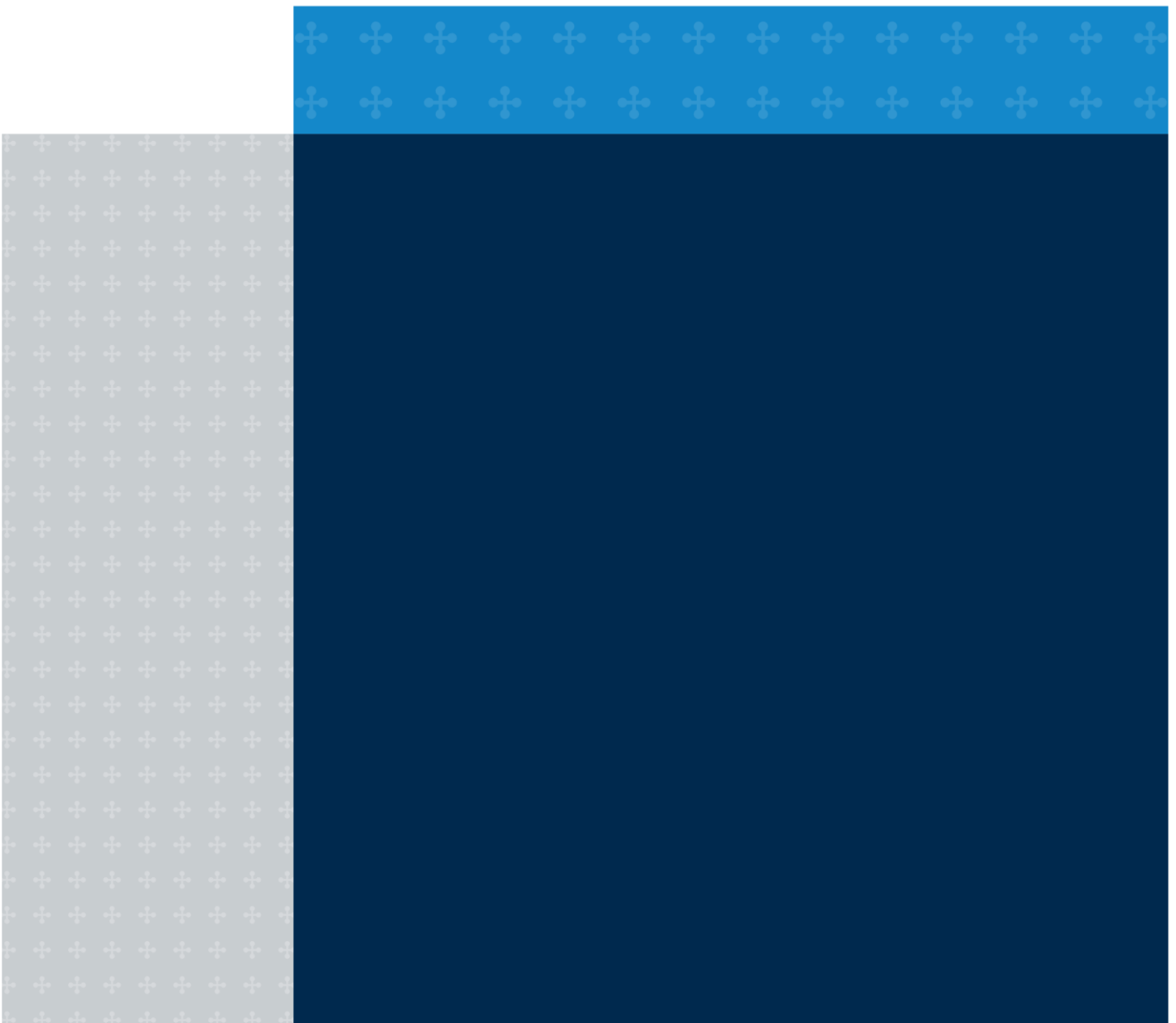# Operational resilience: Impact tolerances for important business services

March 2021

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Contents

1   Overview

1.1 This Prudential Regulation Authority (PRA) Policy Statement (PS) provides feedback to responses to Consultation Paper (CP) 29/19 Operational resilience: Impact tolerances for important business services.[1] It also contains the PRA's final policy, as follows:

- new Operational Resilience Parts of the PRA Rulebook (Appendix 1);

- amendments to the Group Supervision Part of the PRA Rulebook (Appendix 1);

- a new Supervisory Statement (SS) 1/21 'Operational resilience: Impact tolerances for important business services' (Appendix 2); and

- a new Statement of Policy (SoP) 'Operational resilience' (Appendix 3).

1.2 This PS is relevant to:

- UK banks, building societies, and PRA-designated investment firms (banks); and

- UK Solvency II firms, the Society of Lloyd's and its managing agents (insurers).

1.3 Banks and insurers are collectively referred to as 'firms' in this PS.

Background

1.4 In CP29/19 the PRA set out its proposals for operational resilience policy, building on the principles in the 2018 Discussion Paper (DP) 'Building the UK financial sector's operational resilience'.[2] The proposals are designed to improve the operational resilience of firms and protect the wider financial sector and UK economy from the impact of operational disruptions. The CP proposed to set requirements and expectations for firms to:

- identify their important business services by considering how disruption to the business services they provide can have an impact on PRA objectives;

- set an impact tolerance for disruption for each important business service; and

- ensure they can continue to deliver their important business services and are able to remain within their impact tolerances during severe but plausible scenarios.

Summary of responses

1.5 The PRA received 48 responses to the CP. There was general support for the main components of the policy, consistent with feedback to the 2018 DP. Broadly, the responses focused on implementation, proportionality, alignment with the Financial Conduct Authority (FCA), alignment with international principles and requests for further detail on PRA expectations. More detail covering all CP responses is set out under the relevant policy sections in Chapter 2.

1.6 Fifteen respondents highlighted that the final policy should retain a proportionate approach. One respondent commented that smaller firms would benefit from a detailed explanation of how

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[1]   December 2019: https://www.bankofengland.co.uk/prudential-regulation/publication/2018/building-the-uk-financial-sectors-operational-resilience-discussion-paper.

[2]   July 2018: https://www.bankofengland.co.uk/prudential-regulation/publication/2018/building-the-uk-financial-sectors-operational-resilience-discussion-paper.

proportionality will apply to them, and one respondent requested that the policy should be more prescriptive. The PRA has considered options for proportionality in all aspects of the policy and has decided that for many areas the most proportionate approach is flexibility. Where possible, the PRA has provided further clarity in the policy changes.

Changes to draft policy

1.7 Where the final rules differ from the draft in the CP in a way which is, in the opinion of the PRA, significant, the Financial Services and Markets Act 2000 (FSMA)[3] requires the PRA to publish:

(a) details of the difference together with a cost benefit analysis; and

(b) a statement setting out, in the PRA's opinion, whether or not the impact of the final rule on mutuals is significantly different to: the impact that the draft rule would have had on mutuals; or the impact that the final rule will have on other PRA-authorised firms.

1.8 After considering responses to CP29/19, the PRA has amended the following aspects of its draft policy:

• Operational Resilience Parts have been amended to further align definitions and requirements with FCA definitions and requirements;[4]

• Operational Resilience Parts have been amended to specify the firms that are required to consider the stability of the UK financial system when setting their impact tolerances.[5] The SS has been amended to reflect the amendments to the rules;

• Operational Resilience Parts have been amended to specify that firms must specify the length of or point in time, in addition to any other relevant metrics, for which a disruption to an important business service or important group business service can be tolerated;[6]

• paragraph 2.8 of the SS, to include examples of internal services and the circumstances that would necessitate them to be included in a firm's mapping of an important business service;

• paragraph 2.10 of the SS, to introduce an expectation for firms to review their important business services annually at minimum;

• paragraph 3.3 of the SS, to introduce an expectation for firms to consider the impact of the failure of other related important business services when setting impact tolerances for individual important business services;

• paragraphs 3.6, 3.11 and 3.12 of the SS, to clarify the use of time-based metrics for impact tolerances and how time-based metrics may be used in conjunction with other metrics;

• paragraphs 4.8 to 4.11 of the SS, to provide guidance and examples on how PRA-FCA dual-regulated firms can act to remain within their two impact tolerances;

• paragraphs 4.12 to 4.16 of the SS, to clarify the timeframes for firms to implement the full policy;

• paragraphs 5.6, 5.7 and 6.13 of the SS, to clarify the expectations for firms to undertake assurance work on third parties;

- paragraph 8.3 of the SS, to introduce an expectation for firms to identify any lessons learned when undertaking scenario testing in documenting their self-assessments;

- paragraph 9.2 of the SS, to clarify and introduce an example of important group business services; and

- other minor amendments throughout the SS to improve readability, increase the overall clarity of the PRA expectations, and bring them into line with the current format for these documents.

1.9 The PRA considers that these changes will not have a significant impact on firms, and will not have a significantly different impact on mutuals than for other firms. As a result, the cost benefit analysis has not been updated in respect of these changes.

Implementation

1.10 The Operational Resilience Parts will be effective from Thursday 31 March 2022. To comply with the rules, firms should contact their supervisors to agree their plans for meeting the policy requirements.

1.11 SS1/21 will be effective from Thursday 31 March 2022.

1.12 The final policy set out in this PS has been designed in the context of the UK having left the European Union and the transition period having come to an end. Unless otherwise stated, any references to EU or EU derived legislation refer to the version of that legislation which forms part of retained EU law.[7] The PRA will keep the policy under review to assess whether any changes would be required due to changes in the UK regulatory framework.

2   Introduction to feedback to responses

2.1 Before making any proposed rules, the PRA is required by FSMA to have regard to any representations made to it, and to publish an account, in general terms, of those representations and its feedback to them.[8]

2.2 The PRA has considered the responses received to the CP. The chapters below set out the PRA's feedback to those responses, and its final decisions.

2.3 The chapters below have been structured broadly along the same lines as the chapters of the CP, with some areas rearranged to better respond to related issues. The responses have been grouped as follows:

- important business services;

- impact tolerances;

- implementation timelines and remaining within impact tolerances;

- mapping;

- scenario testing;

- governance;

- self-assessment;

- groups;

- international alignment;

- alignment with other policy areas; and

- other responses.

3   Important business services

Internal services

3.1 The PRA proposed that firms would be required to identify and prioritise the services that, if disrupted, would impact the PRA objectives and thereby the public interest. These were termed important business services. This represented a shift away from thinking about the resilience of individual systems and operational resources to considering the continuity of the services that firms provide to their end-users.

3.2   Ten respondents asked for clarity as to whether internal services were included within the definition of an important business service. Four respondents asked whether services that are not customer facing such as settlement, treasury services and financial reporting, should be in scope of the definition of an important business services. Respondents suggested that internal services such as human resources or payroll might have a significant impact on the delivery of services if they are disrupted.

3.1 The PRA notes that the outcome of the policy is focused on the delivery of services to external end users. The PRA is therefore requiring firms to prioritise the work to build the operational resilience of those services. While internal services may support the delivery of an important business service, they are not included within the definition of important business services on a standalone basis. If internal services alone were defined as important business services, this would expand the coverage of the policy, and could reduce focus on the most important external services.

3.2 The PRA expects that important business services should be resilient, and this requires the supporting chain of activities to be resilient. To elaborate on paragraph 2.7 of the SS, the PRA expects that the failure to perform internal services need only be considered to the extent that they affect the delivery of external facing business services which have direct consequences for the PRA's objectives. As such, any internal service that is necessary for the delivery of an important business service should be included in the firm's mapping, scenario testing, and any remediation to ensure the firm could remain within impact tolerances in severe but plausible disruptions. To provide further clarity, paragraph 2.8 of the SS has been updated to set out an example of internal services and the circumstances that would determine them as necessary for the delivery of the important business service.

Definitions

3.3 Five respondents commented on the differences between the PRA and FCA definitions of important business services. The responses expressed a preference for alignment of the definitions between the supervisory authorities.

3.4 The PRA and FCA consider that the respective policies and definitions are aligned. The PRA expects that work done to meet the requirements of one regulator should be leveraged to meet those of the other. The design and goals of our respective policies are the same, while respecting our different objectives and legal frameworks. The PRA would encourage firms to avoid duplicative work.

3.5 Following comments from respondents, the PRA and FCA have reviewed the definitions to improve consistency and clarity for firms. Accordingly, the PRA definition has been adjusted to set out that an important business service could be delivered wholly or in part by another person.

3.6 Differences in the definitions which remain are driven by a number of reasons, including different objectives, legislation, and regulatory frameworks. For example, the PRA has chosen to use the word 'person' in order to align with the language used in the PRA Rulebook, however, the FCA is not subject to this constraint.

3.7 The updated definitions of important business services are detailed in the table below. This will be of particular interest to dual-regulated firms.

Table 1: PRA and FCA definitions of 'important business service'

Term	PRA[9]	FCA
Important Business Service	A service provided by a firm, <u>or by another person on behalf of the firm,</u> to another person which, if disrupted, could pose a risk to: (1) (where the firm is an O-SII/where the firm is a relevant Solvency II firm) the stability of the UK financial system; or (2) the firm's safety and soundness; or (3) (for Solvency II firms) an appropriate degree of protection for those who are or may become the firm's policyholders.	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 <u>intolerable levels</u> of harm to any 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 the financial markets.

3.8   Nine respondents stated that the definition of important business services is too broad and requested greater specificity to remove ambiguity without becoming overly prescriptive or introducing a taxonomy.

3.9 Five respondents welcomed the PRA's proposal not to set any taxonomies for important business services. The respondents stated that this approach would allow firms to identify important business services differently.

3.10 The PRA requires firms to identify their own important business services having considered whether disruption to those business services could pose a risk to the firm's safety and soundness, financial stability or the appropriate degree of policyholder protection (where applicable). When determining the level of granularity at which to define an important business service, firms should consider whether their definition will allow:

[9] This table summarises the important business services definitions for CRR and Solvency II firms set out in the Operational Resilience Parts. Please refer to the text of the rule.

- an impact tolerance to be applied to the important business service which can be tested; and

- boards and senior management to make prioritisation and investment decisions.

3.11 Having considered the responses, the PRA has decided to publish the approach as consulted upon. The PRA considers that the most proportionate approach is for firms to have flexibility in identifying their important business services. The PRA encourages firms to use this flexibility to integrate their identification of important business services with existing approaches to operational resilience or related PRA policy such as operational continuity in resolution (OCIR) and Outsourcing and third party risk management.

3.12 Two respondents stated that proposed definitions and descriptions run counter to research and practice in quality management and systems reliability, as the proposals do not embrace the nature of and variation in system composition and tend to focus on parts (in practice, the easily measured ones) rather than the whole system. The PRA considers that the concept of important business services is a shift away from focusing on the operational resilience of individual parts.

3.13 One respondent suggested that firms should be given the flexibility to add extra criteria to shape their prioritisation of business services. The Operational Resilience Parts set out that a business service is an important business service where it could pose a risk to the firm's safety and soundness or financial stability, or in the case of insurers, the appropriate degree of policyholder protection. Paragraph 2.5 of the SS sets out the factors that firms are expected to consider when identifying important business services. The PRA considers that firms should not be using additional criteria to those set out in the SS if these could reduce the list of important business services identified. However firms could include additional criteria to identify additional important business services if they consider this relevant in meeting the Operational Resilience Parts.

Determining impact on financial stability

3.14 Five respondents said that firms will struggle with practical issues in identifying their impact on financial stability, such as identifying the necessary metrics. One respondent requested an explanation of the requirement for PRA firms to take into account public interest and how the PRA intends to assess and supervise this. One respondent requested that the reference to the financial sector as a whole should be removed from the definition of operational resilience to provide greater clarity. One respondent commented that it would be unlikely for an insurer to impact financial stability through an operational disruption, suggesting that the PRA should focus on safety and soundness unless the firm meets a high criteria, such as large market share.

3.15 Following these responses, the PRA considers that it would be proportionate for small and medium firms to be excluded from the requirement to assess their potential impact on financial stability when identifying important business services and setting impact tolerances. The PRA does expect that larger and systemic firms should have the capabilities and resources to make these decisions. Such firms consider these issues as part of their recovery and resolution planning where appropriate. The PRA has therefore amended the requirement for firms to consider financial stability when identifying important business services and setting impact tolerances. This requirement will be limited to firms identified by the PRA as other systemically important institutions (O-SIIs) and insurers with gross written premiums exceeding £15 billion or technical provisions exceeding £75 billion, both on a three-year rolling average. As firms and supervisors gain more experience of the regime, the PRA may review these thresholds to understand if they are capturing an appropriate universe of firms.

Substitutability

3.16 There were a number of responses in relation to the internal substitutability of firm's activities. One respondent commented that the PRA's approach to setting impact tolerances has shifted from alternative processing, ie substitution, in the DP to a more recovery based approach in the CP. One respondent stated that it could be challenging to identify important business services based on external end users, as the firm could have many different channels, ie access to savings. One respondent commented that it was unclear whether the substitutability of a firm's activities can be considered in identifying important business services and setting impact tolerances.

3.17 The intention of the policy is that firms will be able to resume their important business services within set impact tolerances if it is appropriate to do so. Within a firm, substitutability of operational resources and methods of delivery is likely often to be a key enabler of this. Equally, it may be easier to recover an operational resource than to substitute it. As such, the PRA has no preference between recovery and substitutability.

3.18 Within a firm, substitutability could be one factor that helps firms in deciding the correct granularity for their important business services. For example, if a firm has identified ATMs as an important business service, but finds that cash provision could be achieved through a different channel, then it may be more appropriate to consider 'access to cash' to be the important business service, not ATM provision.

3.19 The concept of substitutability is also relevant to market provision by other firms, as opposed to the substitutability of a firm's own activities. Generally, firms should not assume that other providers will step in to provide an important business service when identifying important business services and setting impact tolerances. The PRA expects firms to consider the impacts of disruption before they are mitigated.

3.20 However, identifying a lack of substitutability from other market providers is an important consideration for insurance providers operating in specialist markets. Paragraph 2.5 in the SS sets out that in the case of insurers, firms should consider if the availability of substitute products would offer a policyholder a similar level of protection. This is to ensure the delivery of important business services in specialist markets to ensure an appropriate degree of policyholder protection.

3.21 Similarly, identifying a lack of substitutability from other market providers will be an important consideration for those firms required to consider financial stability, when identifying important business services and setting impact tolerances.

Important business services, critical functions, and critical services

3.22 Fourteen respondents queried how operational resilience, and in particular important business services, link with existing policies such as OCIR and Outsourcing and third party risk management. Some respondents queried if their approaches to meet such relevant policies could also be used to meet operational resilience requirements.

3.23 The PRA acknowledges that both Operational Resilience and OCIR policies concern firms' operational services and there is a potential for overlap. However, the PRA considers that important business services and critical services, a term used in OCIR policy, have distinct and useful purposes. A firm's important business services will be a relatively short list of external-facing services for which the firm has chosen to build high levels of operational resilience (redundancy and back-up plans) in anticipation of operational disruption. As such, firms will require a granular, functional understanding of the linkages between the resources that support these services. The list should be manageable for boards and senior management to make prioritisation and investment decisions.

3.24 A firm's critical services for OCIR are likely to be a more comprehensive set of internal and external provided services that must continue during the process of resolution from stress to post-resolution restructuring. Because OCIR requires a broader organisational view, mapping for OCIR purposes should cover a broader range of activities, including, potentially, services supporting a firm's Core Business Lines as proposed in CP20/20 'Operational continuity in resolution: Updates to the policy'. OCIR policy requires services to be identified so that contracts will be honoured, staff employed, legal entities maintained, and for critical parts of the business to maintain access to operational assets.

3.25 Using critical services, or the proposed definition of essential services, for operational resilience would be likely to require firms to build the operational resilience of a much wider set of services than necessary to meet the policy's objectives. Setting the scope of OCIR to important business services would be too narrow for OCIR purposes because operational continuity of the firm during resolution would not be ensured.

3.26 Further details regarding the interaction between OCIR and Outsourcing and third party risk management terminology may be found in PS7/21.

3.27 CP20/20 proposed that work done to map and understand the interconnectivity of functions, business lines, and services should be leveraged to meet the requirements of both OCIR and operational resilience policies once finalised. Given the specific focus of the operational resilience policy on important business services, the PRA considers that finalisation of operational resilience policy need not be contingent on a finalised OCIR policy.

3.28 If the policy currently being consulted upon in CP20/20 is finalised without changes, the firms in scope of the relevant policies would be required to identify critical services, essential services, and important business services.[10] The PRA will respond to consultation responses received regarding OCIR terminology as part of the OCIR CP process.

Example of the interaction of critical functions, critical services and important business services

3.29 The example below sets out one way the concepts of critical functions, critical services, and important business services might apply within a firm. OCIR policy does not provide a list of critical services, nor does it prescribe at what level they need to be identified, so in some cases, a firm might identify its critical services at a different level of granularity.

3.30 In this example, 'retail current accounts' is deemed to be a function the firm performs that is critical to the UK economy or UK financial stability, and so is identified as a critical function. This firm has chosen to identify critical services at the level of 'Client onboarding', 'Transactions', 'Settlement', and 'Reconciliation'.

3.31 All services for which failure would lead to the collapse of, or present a serious impediment to, the performance of the critical function are in scope of OCIR.

3.32 In many cases, a firm's important business services will also support a firm's critical functions (where it has them). In contrast to OCIR, these services will always be delivered to external end users and are identified according to which would have the greatest impact on financial stability, safety and soundness, or policyholder protection in the event of an operational disruption. The services the firm has identified as important business services are set out in Figure 1 below.

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10   October 2020: https://www.bankofengland.co.uk/prudential-regulation/publication/2020/operational-continuity-in-resolution.

Figure 1: Critical Functions, critical services, and important business services

Retail current accounts - critical function

Client onboarding
- Application processing
- On boarding
- Card issuance
- Credit checks

Transactions
- Cash withdrawal
- Customer enquiries
- Overdraft facilities
- Payment processing (cash/cheque)
- Customer enquiries

Settlements
- Deposit funding/ drawdown
- BACs advice
- Account closures
- Fund counter-parties
- FPS advice

Reconciliation
- Balance checking

Internal services
For example: HR, payroll, legal, IT, finance

□ Critical services   ⬡ Business services   ⬡ Important business services

Examples of important business services

3.33 Nine respondents requested that the PRA provide more examples of important business services. Four respondents wanted more guidance on which business services would be considered common to a majority of firms and what differentiates business services for different types of firms. One respondent asked for more guidance on the types and number of important business services firms should consider, depending on their size and complexity.

3.34 Figure 1 above sets out examples of important business services in the context of a firm that also has critical services and critical functions. Not all firms in scope of this policy will have critical services and critical functions, however Figure 1 is designed to be informative to all firms in demonstrating an approach for how a firm might identify important business services. Other examples have been included in the SS, for example in the context of impact tolerances for dual-regulated firms and the inclusion of internal services as part of an important business service.

3.35 The PRA considers it important that firms are able to take an outcomes-based approach when identifying their important business services. An important business service for one firm may not be appropriate for another. Firms may arrive at different conclusions due to the nature and scale of their client bases. The PRA considers that encouraging boards and senior management to make judgements in the selection of their important business services will facilitate better decision-making as firms build their operational resilience.

Other

3.36 One respondent questioned whether the policy should require that every firm has at least one important business service. The policy aim in focusing on **important** business services is to ensure that firms prioritise their operational resilience work, and focus on the services that matter. The PRA does not consider that this aim would be achieved if firms did not have any important business services. Therefore, having considered the responses, the PRA will maintain the approach as

consulted upon, and require that all firms will have at least one important business service that may impact the firm's safety and soundness.

3.37 The draft Operational Resilience Parts proposed to require that a firm's board must approve and regularly review the firm's important business services, impact tolerances and written self-assessment, but did not specify how frequently the firm should review these. Further, the draft SS proposed that firms should update their mapping annually at a minimum or following significant change if sooner. Additionally, the FCA policy proposed that firms should identify their important business services at least once a year. Five respondents suggested that important business services be reviewed less frequently than the proposed annual expectation, while one firm stated they would prefer to review their important business services more frequently. To align the policy with that of the FCA, the PRA has set out in paragraph 2.10 of the SS that firms should review their important business services annually at a minimum, or sooner if a significant change occurs. The PRA expects firms to undertake an annual check of their existing important business services and whether any new important business services need to be identified.

3.38 One respondent commented that operational disruptions to insurers would not result in a change to their viability and requested that general insurers should be able to consider events with probabilities closer to 1 in 200 years as part of their scenario testing activities for operational resilience.

3.39 To clarify, the PRA's operational resilience policy assumes that failures will occur and focuses on a firm's ability to respond to and recover from disruptions. The policy is designed to encourage firms to identify the severe but plausible events that would threaten PRA objectives, including firm viability. General insurers are not immune to cyber-attack, for example, and the PRA expects firms to know which important business services would need to be resumed as a matter of priority and the timescales for doing so. Having considered this response, the PRA is publishing its final policy as consulted upon.

3.40 Paragraph 3.9 of the draft SS set out that impact tolerances should apply at peak times as well as in normal circumstances. One respondent commented that there would be decision-making challenges in identifying how the important business services could change during the different times of the year, and change depending on the 'point in time' of client deals. To understand the point at which disruption becomes intolerable and to build the appropriate level of operational resilience, impact tolerances should be formulated with peak times in mind. Firms may wish to consider different times of the day, different points in the year, or broader factors when identifying their important business services and setting impact tolerances. Having considered this response, the PRA is publishing its final policy as consulted upon.

3.41 Two respondents commented that the definition of an important business service refers to individuals who 'may become insurance policyholders', but suggests firms should be prioritising the protection of existing policyholders. The PRA has a primary insurance objective of contributing to the securing of an appropriate degree of protection for those who are or may become insurance policyholders. Accordingly, the PRA considers it needs to retain the broader expectation and is publishing its final policy as consulted upon. Firms should continue to assess if they may have important business services that, if disrupted, could impact individuals who may become policyholders.

3.42 One respondent commented that there would be less time-critical business services for non-life insurers and suggested that the policy proposals are therefore disproportionate to general insurance business. The PRA considers that where firms and their business services vary, there may

be differences in the approach to operational resilience policy based on the concept of proportionality.

3.43 One respondent requested more information on the Financial Policy Committee (FPC) approach to operational resilience. This is not in scope of the PRA policy.

3.44 One respondent suggested that firms use 'external end-user profiles' to frame their supervisory dialogues. The PRA considers that the policy approach gives firms the flexibility to use external end-user profiles if they wish to.

4   Impact tolerances

Dual-regulated firms

4.1 The PRA requires firms to consider PRA objectives when setting impact tolerances. Dual-regulated firms must also identify a separate impact tolerance for their important business service, where the important business service is also relevant to the FCA's objectives. The PRA and FCA set out in the joint covering document accompanying their CPs that the two impact tolerances may be the same or they may differ.

4.2 Twenty-five respondents challenged the necessity for two impact tolerances for dual-regulated firms, suggesting this would be impractical for firms and burdensome. One respondent queried whether two tolerances would be sufficient. One other respondent suggested the PRA and FCA take an approach that lets dual-regulated firms define a 'zone of disruption' whereby firms identify the upper and lower impact tolerance parameters, suggesting that the PRA impact tolerance would always be the upper impact tolerance. Respondents commented that the action taken to remain within the impact tolerances should be the same, but the level at which the firm breaches the impact tolerances would differ. Respondents requested more detail on the expected action firms should take to ensure they can remain within both tolerances.

4.3 The PRA emphasises that, if appropriate, a firm may set its PRA impact tolerance for a given important business service at the same point as its FCA impact tolerance. The PRA expects that work done to meet the requirements of one regulator should be leveraged to meet those of the other, and would encourage firms to avoid duplicative work. The PRA and FCA view the design and goals of their respective policies as the same.

4.4 However, the PRA does need to construct its policy in such a way as to advance its own statutory objectives. For this reason, the policy approach has not changed. Dual-regulated firms will need to have identified two separate impact tolerances for their important business services, where the delivery of the important business service is also relevant to the FCA's objectives.

4.5 The PRA expects dual-regulated firms to understand whether the scenarios that may cause firms to exceed their respective PRA and FCA impact tolerances would differ (whether or not those impact tolerances are aligned), and to take action to ensure they can remain within their PRA impact tolerance.

4.6 The PRA understands that in practice firms may concentrate their efforts in ensuring they can remain within the more stringent tolerance. Taking action to ensure firms can remain within the more stringent tolerance will be acceptable if a firm can demonstrate:

• how they have considered the PRA's objectives when setting their impact tolerances;

• how their recovery and response arrangements are also appropriate for the longer impact tolerance (recovery and response arrangements must be viable for both shorter and longer time periods); and

• that scenario testing has been performed with the longer impact tolerance in mind as a shorter impact tolerance might constrain the universe of severe but plausible events that a firm might consider.

4.7 The PRA has clarified how dual-regulated firms should interpret impact tolerances in paragraphs 4.8 to 4.10 of the SS. Alongside this clarification, the PRA has added an example in paragraph 4.11 of

the SS to illustrate where the impact tolerances between the PRA and FCA would differ, and how firms can demonstrate they have the recovery and response arrangements that would allow them to remain within both their shorter and longer impact tolerances in practice. The example is purely illustrative to provide clarity around these specific expectations, and firms will need to consider how the elements apply to their individual circumstances.

4.8 The PRA clarifies that it does not mandate that dual-regulated firms must set two impact tolerances for all important business services. For example, if an important business service is identified to pose a risk only to the FCA consumer harm objectives, that important business service would not be in scope of PRA policy and would not require an impact tolerance considering PRA objectives.

4.9 Where a firm's important business service does have an impact tolerance for each authority, the PRA does not suggest that a disruption will always have an impact on the consumer harm objective of the FCA before the safety and soundness objective of the PRA.

Disruption to multiple important business services

4.10 The CP proposed that firms should set impact tolerances for each important business service. Seven respondents suggested that the PRA objectives are more likely to be impacted by a disruption to multiple business services rather than by significant disruptions to single important business services. Respondents suggested that this should be reflected in the PRA's definition of impact tolerances.

4.11 The PRA recognises that multiple disruptions could significantly compound the impacts of disruptions, and has therefore introduced a new expectation in paragraph 3.3 of the SS for firms to take into account the impact of the failure of other related important business services when setting impact tolerances for individual important business services. These may be related because, for example, they share common resources which support the delivery of the important business services or where simultaneous disruption could have compounding impacts on similar external end users. The PRA expects firms to take a proportionate approach in making this assessment, and only to consider extra layers of complexity where there are significant benefits in terms of building operational resilience.

Measuring and remaining within impact tolerances

4.12 The draft Operational Resilience Parts proposed to require firms to, at minimum, specify the length of time for which a disruption to that important business service can be accepted (i.e. use a 'time-based' metric for all impact tolerances). The CP also proposed that firms should ensure they could remain within impact tolerances during severe but plausible scenarios.

4.13 Eleven respondents agreed that the use of time-based metrics should be mandatory but encouraged the PRA to allow for different approaches in how firms meet this requirement. Two respondents also commented that a time-based metric for all impact tolerances could transform setting impact tolerances into a compliance exercise for firms, in which a time-based metric does not best measure disruption to the important business service. Two respondents additionally commented that a focus on time-based metrics may lead to undue focus on technical decisions rather than encouraging flexibility for different situations.

4.14 The PRA considers that the use of time-based metrics is necessary to ensure that firms plan around the continuity of important business services, and ensure that there are contingency plans in place to limit the extent of disruption. This common approach to all impact tolerances would also enable a minimum level of consistency - an idea that was supported by the respondent's comments.

However, the PRA also understands the importance of considering other metrics depending on the type of important business service in question.

4.15 The PRA clarifies that a time-based metric can be defined in different ways and, where appropriate, should be used in conjunction with other metrics. For this reason, the PRA considers the use of a time-based metric would not transform setting impact tolerances into a compliance exercise for firms. The impact tolerance must specify that a particular important business service should not be disrupted beyond a certain period or point in time. As an example, this could be a number of hours/days or a point in time, such as the end of the day, in conjunction with, for example, a certain volume of interrupted transactions. This clarification has been reflected in paragraph 3.11 to 3.12 of the SS.

4.16 Seven respondents commented that the PRA was not being clear or proportionate in its requirements and expectations for firms to be able to remain within impact tolerances during events beyond firms' control. Respondents interpreted that the PRA would take regulatory action against firms for failing to remain within their impact tolerances during uncontrollable events such as sophisticated cyber-attacks.

4.17 The PRA clarifies that the aim of the policy is to ensure firms prepare their recovery and response arrangements in advance to ensure they are operationally resilient and hence able to meet their impact tolerances in severe but plausible scenarios. However, during disruption, the PRA expects firms to consider the current circumstances to make informed recovery and response actions, in which they may decide to not resume the provision of their important business services within the specified impact tolerance. As set out in paragraph 3.16 of the SS, the PRA Fundamental Rules will remain relevant to decision making in operational disruptions. When setting impact tolerances, the PRA expects firms to consider the circumstances in which they may decide to not resume the provision of their important business service.

Requests for worked examples and more detail
4.18 Three respondents requested that the PRA provide examples for setting and testing a firm's ability to remain within impact tolerances. One respondent requested guidance on how impact tolerances should be used in relation to other stages in the lifecycle of a service.

4.19 CP29/19 set out examples on setting impact tolerances, which the PRA considers are still relevant to explain the final policy. The SS provides an additional example in the context of setting an impact tolerance for a dual-regulated firm. However, the operational resilience policy is a framework covering many different firms and it is not possible to provide examples across the wide variety of firms that the PRA regulates. The PRA considers that there are benefits in maintaining an outcomes-based approach. An important business service for one firm may not be appropriate for another. Firms may arrive at different impact tolerances for similar business services due to differences in the nature and scale of their client bases. The authorities consider that encouraging boards and senior management to make judgements in the setting of impact tolerances will facilitate better decision-making as firms build their operational resilience. However, firms may consult with their supervisors to discuss their own specific situations if appropriate.

Definitions
4.20 The CP proposed defining an impact tolerance as the 'maximum acceptable level of disruption for an important business service'.

4.21 Seven respondents commented on differences between the definitions of impact tolerance between the PRA and the FCA. The respondents requested greater alignment of the definitions between the supervisory authorities.

4.22 The PRA has designed these concepts in collaboration with the FCA and considers that the respective policies and definitions are aligned. Following comments from respondents, the PRA and FCA have reviewed the definitions to improve consistency and clarity for firms.

4.23 Differences in the definitions which remain are driven by a number of reasons, including different objectives, legislation, and regulatory frameworks.

4.24 The updated definitions for impact tolerance are outlined in Table 2 below and are reflected in the final rules. This will be of particular interest to dual-regulated firms.

Table 2: PRA and FCA definitions of 'impact tolerance'

Term	PRA	FCA
Impact Tolerance	The maximum ~~acceptable~~ tolerable level of disruption ~~for~~ to an important business service or an important group business service as measured by a length of time in addition to any other relevant metrics.	The maximum tolerable level of disruption to an important business service, as measured by a length of time and any other relevant metrics, reflecting the point at which any further disruption to the important business service could pose intolerable harm to any one or more of the firm's clients or risk to the soundness, stability or resilience of the UK financial system or the orderly operation of the financial markets.

Process

4.25 One respondent commented that firms have already built systems which can fix issues relating to impact tolerances. Another respondent suggested that firms should be given the flexibility to integrate impact tolerances into existing approaches. Having considered this response, the PRA clarifies that it encourages firms to integrate impact tolerances into their existing approaches where they are suitable for meeting the requirements and expectations of the policy.

4.26 One respondent suggested that a Business Impact Analysis (BIA) may be a useful tool in determining impact tolerances. Having considered this response, the PRA considers that the approach as proposed provides firms with the flexibility to identify and set their own impact tolerances. Therefore, firms may look to processes such as a BIA in order to do so.

Iterative establishing of impact tolerances

4.27 One respondent commented that setting impact tolerances would be challenging initially due to data scarcity. Having considered this response, the PRA clarifies that firms could use qualitative and quantitative factors to set their impact tolerances. The PRA understands that the requirement proposed in the CP to set impact tolerances with reference to financial stability could pose more challenges in obtaining necessary data as opposed to safety and soundness or policyholder protection. This supports the decision set out above in paragraphs 3.14 to 3.15 of this PS, to limit the scope of firms which are required to make this consideration when identifying important business services and setting impact tolerances.

4.28 One respondent said that the policy was too focused on 'big impact and big responses' and suggested a more nuanced approach to setting impact tolerances. The PRA clarifies that the policy is intended for firms to set, and take actions to meet, standards of operational resilience during severe but plausible scenarios, however this does not alleviate the need for firms to build resilience under

normal operating conditions. Having considered the response, the PRA has decided to publish the final policy as consulted on.

Alignment with risk tolerance/appetite

4.29 One respondent commented that the policy should focus more on preventing disruption. One respondent stated that identifying impact tolerances should encourage firms to direct investment to both proactive (risk reduction) and adaptive (response and recovery) measures, and that the wording of the policy should be adapted to reflect this. Three respondents commented that the policy should take a more risk-based approach overall.

4.30 The PRA considers preventing disruption to be a component of operational resilience. Existing approaches to operational resilience have often focused on prevention, and this should continue to be a priority. The identification of important business services and other aspects of the policy such as mapping should allow firms to focus their prevention work. However, the introduction of impact tolerances for important business services is also designed to improve operational resilience in the financial sector by putting more focus on the assumption that disruptions will occur.

4.31 Having considered these responses, the PRA clarifies that the adoption of the policy is not designed to be at the expense of prevention work. The policy has been designed to ensure the continuity of important business services and introduces a framework to ensure firms set clear standards and ensure they can meet them. The PRA notes that there are many aspects, such as risk management, that support overall operational resilience, and the PRA encourages action in these areas.

4.32 Two respondents requested that the PRA clarify the interdependencies between risk taking and managing disruptions within impact tolerances. Section 3 of the SoP sets out the relationship between operational resilience and operational risk policy.

System wide tolerances

4.33 Three respondents requested clarity regarding impact tolerances which may need a cross-industry approach. One of these respondents commented that it would be insufficient for firms to set impact tolerances based on internal metrics alone and suggested that the PRA instead take a cross-industry approach.

4.34 Having considered these responses, the PRA has decided to publish its final policy as proposed. The PRA strongly supports industry collaboration when identifying impact tolerances, and acknowledges that standards may emerge over time, but this is not a feature of the current policy requirements and expectations. To the extent that there are cross-industry issues that undermine individual firms' ability to meet their own tolerances, the PRA will be interested in those, and may consider whether further policy action is warranted. However, the PRA expects firms to take responsibility for their own business.

Other impact tolerances responses

4.35 One respondent commented that firms may focus on setting impact tolerances to account for worst case scenarios rather than more likely scenarios, where the likelihood of harm is higher due to the event being more likely to happen. Having considered this response, the PRA would like to clarify that the focus of firms should not be on worst case scenarios but on 'severe, but plausible' scenarios as proposed. This is a shift away from the operational risk approach which focuses on likelihood and towards an outcomes-based approach that focuses on firms building their operational resilience.

4.36 One respondent asked if the PRA is only consulting with firms identified as important contributors to vital services. The PRA clarifies that consultations are open to responses from any party and that the Operational Resilience Parts will apply to CRR and Solvency II firms.

4.37 Two respondents requested further clarity on whether impact tolerances would adjust between the crisis management and recovery phases, how this may change given the duration of an event, and how firms delineate between urgency and severity.

4.38 Having considered the responses, the PRA clarifies that firms could take a tailored approach in defining their impact tolerances and planning how their recovery and response arrangements allow them to remain within their impact tolerances. Paragraph 3.9 of the SS sets out that impact tolerances should be the maximum tolerable amount of disruption and should apply at peak times as well as in normal circumstances. Firms may wish to consider different times of the day, different points in the year, or broader factors. The PRA considers that the point at which disruption is intolerable would not change based on the phase of response to a disruption. If a firm considers that partial remediation would be sufficient to avoid exceeding an impact tolerance, it should use impact tolerance metrics that clearly set out what would or would not be acceptable.

5   Implementation timelines and remaining within impact tolerances

5.1 The CP proposed a one year implementation period before the Operational Resilience Parts of the PRA Rulebook enter into force. At the time of consultation, the proposed implementation date for the proposals was the second half of 2021. The consultation period was subsequently extended by six months in response to the Covid-19 pandemic. The CP proposed that firms must ensure they can remain within their impact tolerance for each important business service in the event of a severe but plausible disruption within reasonable time, but no later than three years after the Operational Resilience Parts enter into force. In the final policy, three years from the Operational Resilience Parts coming into force (2025) would be over six years after the publication of the Discussion Paper, and five years after the supervisory authorities' response to the HM Treasury Committee's Second Report: 'IT failures in the Financial Services Sector'.[11]

5.2 Twenty-eight respondents expressed concern that performing the analysis to understand their operational resilience and then undertaking the subsequent remediation activities will be challenging in the timeline set out in consultation. Some respondents cautioned that the timelines may rush firms into completing a fragmented operational resilience framework due to the threat of regulatory sanction.

5.3 The policy is designed to balance the risk of further delays to implementation against a proportionate approach that allows firms sufficient time to implement a new regime.

Mapping and scenario testing implementation

5.4 The CP proposed that firms would have one year to implement the Operational Resilience Parts of the PRA Rulebook. The PRA acknowledges firms' concerns with this implementation timeline, but considers that these must be balanced against the importance of operational resilience. In response to the CP feedback, the PRA has added a new Policy implementation section in the SS (paragraphs 4.12 to 4.16) which sets out how firms should approach meeting the policy outcomes within this timeline.

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11   https://publications.parliament.uk/pa/cm5801/cmselect/cmtreasy/114/11402.htm.

5.5 The new Policy implementation section in the SS sets out that firms must have identified their important business services and set impact tolerances by Thursday 31 March 2022. In order to achieve this, and to identify any vulnerabilities in their operational resilience, firms should have mapped their important business services and commenced a programme of scenario testing. Firms are not expected to have performed mapping and scenario testing to the full extent of sophistication by Thursday 31 March 2022. Both mapping and scenario testing are ongoing processes, and firms are expected to perform them at varying levels of sophistication over time. The PRA expects that firms' approach to both mapping and scenario testing should evolve over time.

5.6 The Policy implementation section in the SS introduces an expectation for firms to have a prioritised plan which sets out how they will comply with the Operational Resilience requirements. In order for the plan to be effective, the plan should be put into effect before Thursday 31 March 2022, and senior management are expected to take responsibility for delivering the policy outcomes. As part of the planning described in paragraph 4.14 of the SS, firms should prioritise their efforts on mapping and scenario testing so that firms will be able to identify vulnerabilities in sufficient time so that measures can be taken to remediate them. Firms, particularly larger more complex ones, will need to make choices and prioritise with the ultimate goal of delivering the outcomes of the policy.

Ensuring firms can remain within impact tolerances within three years

5.7 The PRA considers that it is critical that progress is made on operational resilience. The draft Operational Resilience Parts proposed to require firms to first identify their important business services, set impact tolerances, and then invest to achieve a level of operational resilience sufficient for the PRA objectives. The CP proposed that firms would have reasonable time to ensure they can remain within impact tolerances. This would be agreed with supervisors, would be commensurate with the potential impact that a disruption would cause, and would be no later than three years after entry into force of the Operational Resilience Parts.

5.8 Having carefully considered the responses regarding the proposed implementation timeline, the PRA has decided to retain the consultation proposal – firms must ensure they can remain within impact tolerances within a reasonable time and by no later than three years of the policy coming into force. The relevant date is therefore Thursday 31 March 2025. The PRA considers that there is urgency for firms to build and prioritise their operational resilience as soon as reasonably possible. The PRA further considers that it is being proportionate and flexible in its requirement for firms to agree with their supervisors what a 'reasonable time' is for them to comply with the requirement to ensure they can remain within impact tolerances.

5.9 The Policy implementation section in the SS clarifies the PRA expectation that, after Monday 31 March 2025, maintaining operational resilience will be a dynamic activity. Firms should have sound, effective and comprehensive strategies, processes and systems that enable them to address risks to their ability to remain within their impact tolerance for each important business service in the event of a severe but plausible disruption.

5.10 In light of the cross-authority decision to postpone the consultation close date to Thursday 1 October 2020, the PRA is amending the year set out in Rule 2.6 to 2025. Based on the final publication date for this Policy Statement, the final Rule instrument sets out that this deadline is Monday 31 March 2025.

6   Mapping

6.1 The CP proposed that a firm would be required to identify and document the necessary people, processes, technology and information required to deliver each of its important business services. In particular, mapping should enable firms to:

- identify vulnerabilities in the delivery of important business services within an impact tolerance; and

- test their ability to remain within impact tolerances.

6.2 Thirteen respondents requested greater clarity and granularity on the mapping expectations. Some respondents queried whether all resources should be mapped and some suggested that the PRA prescribes minimum expectations. Respondents expressed concern that unclear expectations would create inconsistency in the industry and result in some firms going beyond what is required, which could lead to spending resources inefficiently. One respondent commented that mapping requires significant resource and time to be done to a sufficient degree.

6.3 The PRA considers that the approach to mapping will vary between important business services and between firms. This will depend on the different requirements necessary for a firm to meet the outcomes set out in paragraph 5.2 of the SS. The PRA emphasises that the resources that should be mapped are those considered necessary for delivering the important business service. The PRA recognises that building operational resilience is a detailed activity, and for this reason expects firms to focus on a proportionate number of important business services.

6.4 The PRA considers that the proportionate approach should be for firms to take responsibility and ownership of this judgement as opposed to prescribing detailed standards. The PRA also considers that prescribing minimum standards for mapping would require some commonality across how firms could approach mapping and so could limit its usefulness.

6.5 Three respondents commented that it would be difficult to update mapping frequently. One other respondent suggested that mapping should be completed every three years, and one respondent queried what might determine a material change that warrants an update to mapping. To meet the outcomes set out in paragraph 5.2 of the SS, mapping should be usable and thereby up-to-date. A material change would be a change that would negatively affect the firm's ability to use its mapping in order to meet these outcomes. The PRA recognises that the resources which deliver important business services change frequently and so mapping for these must also update frequently to be usable. The PRA considers it is proportionate to give firms flexibility in determining material changes but expects mapping to be updated at least once a year to ensure a reasonable minimum level of relevance.

6.6 One respondent supported mapping requirements but added that determining the necessary resources should be with reference to the risk profiles of the resources. The approach to operational resilience set out in the CP is that firms should assume failure and ensure they can remain within impact tolerances in the event of severe but plausible disruptions. The PRA will require firms to map the resources necessary to deliver the important business service and the extent of this mapping should enable the firms to meet the outcomes set out in paragraph 5.2 of the SS. This may draw firms' attention to resources that, if disrupted, would impact the delivery of the important business service, but the PRA does not introduce the concept of likelihood, and thereby risk profiles.

6.7 One respondent commented that mapping is useful to identify resources but more detailed mapping would provide limited benefits in identifying vulnerabilities compared with scenario testing. The PRA considers that the two are inter-related and paragraph 5.2 of the SS directly creates a link between the detail required for mapping and the outcome of facilitating scenario testing.

6.8 One respondent queried how a firm should treat mapping where a service is provided by another group entity outside of the UK perimeter. The respondent suggested that an equivalent depth of mapping would not be consistent with keeping an arm's-length arrangement with the entity. For outsourcing and third party arrangements, firms are required to gain assurance that such arrangements would not create a vulnerability in meeting the firm's impact tolerances.

6.9 One respondent commented that boards should not be required to satisfy themselves that the firm is meeting the requirements for mapping. The respondent suggested that this level of detail could undermine a more focused oversight of operational resilience. Having considered this response, the PRA has decided to maintain this requirement as proposed. Paragraph 8.3 of the SS sets out that a self-assessment should detail the firm's approach to mapping. This should include a description of how the firm has used mapping to identify vulnerabilities and to support testing activity. When a board assesses this part of the self-assessment, they may challenge if the firm's approach to mapping is sufficient for a firm of the size, scale, and complexity, and should be provided with the management information necessary to make this decision.

6.10 Five respondents requested clarity on including sub-outsourcing dependencies through mapping. The PRA is not prescribing this level of mapping, however, the PRA recognises that this could be an appropriate approach to gaining assurance and performing risk assessments. Paragraph 9.5-9.6 of SS2/21 sets out that firms should assess whether sub-outsourcing is material and ensure that the service provider has the ability and capacity on an ongoing basis to appropriately oversee any material sub-outsourcing in line with the firm's relevant policy or policies.

6.11 Two respondents asked if the PRA would help to identify common third parties across the industry and any corresponding concentration risk. One other respondent queried whether the documentation of mapping should be made available to supervisors upon request and one respondent sought assurances that the PRA would hold sensitive mapping information securely. The PRA clarifies that mapping is not a data collection exercise for the PRA, but a method for firms to understand the resources that comprise their important business services and identify vulnerabilities within them. The PRA will not use this work to identify common third parties and other concentration risks, but supervisors will need to be able to assess whether firms are meeting the mapping requirements.

6.12 One respondent suggested that the requirement for end-to-end mapping should be limited to important business services. To clarify, the PRA requires firms to map resources necessary to deliver the important business service. Firms are not required to map their whole organisation.

7   Scenario testing

'Severe but plausible' scenarios
7.1 The CP proposed that firms should articulate specific maximum levels of disruption, including time limits within which they will be able to resume the delivery of important business services following severe but plausible disruptions. It also proposed that firms would be required to take action to ensure they remain within impact tolerances in severe but plausible scenarios.

7.2 Seventeen respondents sought further clarity on what a 'severe but plausible' scenario entailed. Respondents suggested that a definition or examples for 'severe but plausible' scenarios would create consistency in implementation. Six respondents also suggested that the PRA should set out industry-wide scenarios that could allow the PRA to understand the systemic impact a 'severe but plausible' industry-wide scenario has on the market. Two respondent suggested that scenarios that are too narrow would risk providing a false assurance to the firm. One respondent suggested approaches to testing should mature over time. One respondent requested clarity as to whether '1 in 100 year' events, such as the Covid-19 pandemic, would count as a severe but plausible event. Another respondent stated that events such as the Covid-19 pandemic would have been considered alongside events such as war and large-scale terrorist attacks in terms of plausibility prior to 2020.

7.3 The CP proposed that firms would be required to test their ability to remain within impact tolerances in severe but plausible disruption scenarios. Paragraph 6.2 in the SS sets out that when setting scenarios, firms could consider previous incidents or near misses within the organisation, across the financial sector and in other sectors and jurisdictions. A testing plan should include realistic assumptions and evolve as firms learn from previous testing.

7.4 The PRA considers this an area where the interest of both firms and the PRA should be aligned. If a firm tests itself to scenarios that are insufficiently severe, then boards and senior management would be taking inappropriate risks with the management of their businesses. The nature and severity of scenarios appropriate for firms to use will vary according to size, complexity, and a firms' importance to the financial system. Providing a prescriptive definition or lists may limit the range of scenarios firms test themselves against.

7.5 Having considered the responses, the PRA has decided not to provide a detailed definition or lists of severe but plausible scenarios. The PRA expects that this will be a common area for supervisory discussion. Supervisors will ask how firms have selected their scenarios and why. As the industry and supervisory authorities learn more through these conversations, the PRA anticipates that good practice will emerge over time.

Outsourcing and third parties

7.6 The CP proposed that firms should assure themselves that third party providers would not limit a firm's ability to remain within impact tolerances. Scenario testing is one approach to this. One respondent commented that this proposal is duplicative for individual firms. The respondent suggested an independent certification process for suppliers to confirm they are operationally resilient with reference to pre-agreed impact tolerances. Three respondents suggested that the PRA and FCA should liaise with large third party providers to ensure a coordinated approach, and another respondent encouraged the PRA to consider how regulators might themselves take action to remediate vulnerabilities occurring in third parties.

7.7 The PRA maintains the policy requirement that individual firms should assure themselves about the operational resilience of third parties but would encourage an industry solution if synergies across the assurance work from firms on third parties such as certifications or other 'off the shelf' assurances that third parties could provide to firms. Paragraphs 8.6 to 8.8 of SS2/21 set out that firms should exercise their access, audit and information rights in respect of material outsourcing arrangements to assess whether the service provider is providing the relevant service effectively and in compliance with firms' operational resilience obligations. Firms may use a range of audit and other information gathering methods, including offsite audits, such as certificates and other independent reports supplied by service providers and onsite audits, either individually or in conjunction with other firms (pooled audits). Chapter 12 of PS7/21 sets out the PRA position on respondents suggesting direct engagement with third party providers.

7.8 Five respondents commented that third party suppliers may be reluctant or slow to take the necessary actions for firms to comply with the policy, particularly where firms have low negotiating power in relation to large suppliers. The CP did not propose that third party suppliers must disclose all (and sometimes sensitive) information to all firms, but firms will need to cooperate with their third party suppliers to assure themselves that they can remain within impact tolerances. In supervising these expectations, the PRA will take a proportionate approach. For testing, evidence that a firm has satisfied itself that a third party has undertaken testing may be sufficient. Linking business continuity and exit planning (as set out in SS2/21) to impact tolerances will enable firms to assure themselves and supervisors that third party arrangements will not create a vulnerability in their operational resilience. Moreover, the PRA considers that this clarification of firms' expectations from suppliers will help suppliers understand the constraints they are operating under when agreeing contract terms, and thus improve the negotiations for firms.

7.9 The SS has been amended to include paragraph 6.13, setting out that assurance work on third parties should be proportionate. For some firms, this might mean it will not always be appropriate to carry out sophisticated testing on large third party providers. If this is the case, firms should seek alternative ways to gain assurance of their operational resilience such as desktop testing.

7.10 One respondent queried if, in the context of sub-outsourcing, the third party providers are required to test the service provider providing the sub-outsourcing. Chapter 9 in SS2/21 defines sub-outsourcing and sets out the PRA expectations on sub-outsourcing. Paragraph 9.6 of SS2/21 sets out that firms should ensure that the service provider has the ability and capacity on an ongoing basis to appropriately oversee any material sub-outsourcing in line with the firm's outsourcing policy. This includes establishing that the service provider has in place robust testing, monitoring and control over its sub-outsourcing.

7.11 One respondent queried if unregulated third party suppliers are required to ensure their own board and senior management approve important business services and impact tolerances. These firms are out of scope of the policy.

Approaches to testing

7.12 The CP proposed that firms should develop a testing plan proportionate to the potential impact that disruption might cause. Nine respondents asked for more guidance on scenario testing. Three of these respondents questioned when it might be appropriate to use live-systems testing, suggesting that this can increase the risk of disruption to important business services. The SS has been amended to set out in paragraph 6.7 that Fundamental Rules will remain relevant to decision making and firms should ensure that live-systems testing does not materially risk causing a disruption. Firms should be taking a tailored approach in developing testing plans. Paragraph 6.6 in the SS sets out the factors that firms should consider when developing testing plans and states that the approach to these should be proportionate to the potential impact that disruption could cause. Specific determinants on what is proportionate will differ between important business services and between firms.

7.13 Five respondents sought the PRA's view on how Operational Resilience scenario testing might link with existing approaches to testing. This includes reference to the Guidelines on ICT and Security Risk Management, business continuity management, operational risk testing, capital provisioning and stress testing for OCIR.

7.14 The PRA encourages that where possible firms should leverage existing testing arrangements irrespective of whether the testing is being required by other policy areas or driven by commercial interests.

7.15 One respondent asked whether the PRA would consult if at a future date it considered it necessary to set scenarios for firms to use when testing. The PRA's policy does not specify a role for it to set scenarios for firms to test. However, if the PRA were to contemplate setting scenarios for firms in future, it would consider its consultation obligations.

Frequency of scenario testing

7.16 The CP proposed that firms should regularly test their ability to remain within impact tolerances and should develop a testing plan detailing the nature and frequency of a firm's testing. Four firms questioned how they should interpret 'regular' scenario testing, asking if every impact tolerance should be tested annually and if each resource type (people, processes, technology, facilities and information) should be tested annually since each would be captured by different scenarios. The PRA clarifies that regular scenario testing, as proposed in the CP, does not prescribe annual testing. Paragraph 6.6 in the SS sets out that firms which implement changes to their operations more frequently should undertake more frequent scenario testing.

Cost of scenario testing

7.17 One respondent outlined that testing will incur significant investment and may potentially create an operational resilience incident itself. One firm suggested that it would be difficult for firms to analyse second and third order effects on end users. Another respondent asserted that regular testing can be too burdensome and requested a review of the requirement.

7.18 The PRA considers that regular scenario testing is a key way for firms to identify and address any risks to their operational resilience, and has therefore not changed the policy as proposed. The PRA clarifies that supervising this requirement will be proportionate and pragmatic.

Incident data

7.19 Six respondents suggested that the PRA should create an anonymised 'incident library' containing real occurrences of operational disruptions that firms could use to assess the plausibility of their own scenarios and obtain further guidance for their own testing.

7.20 The PRA is looking at incident reporting more generally and will take this into consideration for future work, but has made no changes to the policy as consulted upon.

8   Governance

8.1 The CP proposed to require boards and senior management to approve the important business services identified for their firm and the impact tolerances set. The approach to identifying important business services should enable the board to approve the impact tolerances set and make prioritisation and investment decisions. The draft Operational Resilience Parts proposed to require that a firm's board must approve and regularly review the firm's important business services, impact tolerances and written self-assessment. Boards are expected to ensure they have the appropriate management information, adequate knowledge, skills and experience to provide constructive challenge to senior management and inform decisions that have consequences for operational resilience.

8.2 The CP also proposed that firms should establish clear accountability for the management of operational resilience. The PRA proposed that firms structure their operational resilience oversight in the most effective way for their business, using existing committees and roles or establishing new ones if necessary.

8.3 Nine respondents raised comments on the appropriateness of the operational resilience oversight responsibilities of the Board and the Senior Management Function (SMF) 24. A number of firms indicated that the role of the board is to challenge rather than set the firm's operational resilience strategy. Some firms also suggested that management responsibilities should not be restricted to the SMF24, given the emphasis on collective responsibility, and to provide flexibility for firms to allocate the SMF appropriate for their individual structures.

8.4 The PRA has considered respondents' comments and has decided to maintain the policy as proposed on the responsibilities of a firm's board and SMF24. The PRA considers that the final sign-off on a firm's operational resilience strategy is a responsibility material enough to allocate to the board. The PRA additionally considers that assigning responsibility to the SMF24 is the proportionate method to create responsibility for operational resilience rather than introducing a new function or taking an alternative approach to ensure accountability. If the responsibility over operational resilience is spread out over different bodies and SMFs, accountability may become unclear within the firm.

8.5 One respondent asked whether the term 'management body' was inclusive of the board and senior management, and requested guidance for both boards and senior management. According to the definition in the Glossary Part of the PRA Rulebook, a management body means a firm's body or bodies, which are appointed in accordance with national law, which are empowered to set the firm's strategy, objectives and overall direction, and which oversee and monitor management decision-making, and include the persons who effectively direct the business of the firm. For firms with a board, this is their management body. Having considered this response, the PRA has decided to publish its final policy as consulted upon. Firms are encouraged to communicate with their supervisors should they need further guidance.

8.6 One respondent suggested the PRA take a more principles-based approach to governance, requesting more flexibility such as permitting board discretion over a firm's operational resilience framework. Having considered this response, the PRA is publishing its approach as consulted upon. It considers that the policy should give firms and boards the necessary flexibility to determine their own decision making process.

9 Self-assessment

9.1 The CP proposed an expectation for firms to: summarise the vulnerabilities they have identified to the delivery of their important business services; and outline the scenario testing performed and the findings from the tests. Firms would need to indicate what actions are planned to improve their ability to remain within impact tolerances and demonstrate that the timing for these is reasonable and in proportion to the systemic importance of the firm's important business service. The PRA defined this documentation as self-assessment.

9.2 The PRA received ten responses requesting that further guidance or a self-assessment template should be released to ensure cross-sector consistency and ease of comparability between firms. Four more respondents suggested that the self-assessment document for dual-regulated firms should be aligned with one another to prevent duplication.

9.3 The CP proposed to require firms to document a self-assessment of their compliance with the Operational Resilience Parts alongside the methodologies used to undertake these activities. Paragraph 8.3 of the draft SS outlined what the PRA would expect a firm's self-assessment document should cover.

9.4 Having considered the responses, the PRA considers firms should take a tailored approach in creating a self-assessment document, and setting exact minimum standards would not be proportionate given the differences in the structures of individual firms. Self-assessment documents should be bespoke, and firms should decide what they would specifically include in their self-assessment to retain flexibility. However, firms are encouraged to communicate with their supervisors should they need further guidance.

9.5 One respondent highlighted that the FCA's self-assessment document introduced an additional concept of addressing 'lessons learned' from scenario testing that was not specifically drawn out in the PRA proposals and would encourage consistent terminology to be used.

9.6 Having considered the responses, the PRA has added an expectation to include 'lessons learned' in their self-assessment documents in paragraph 8.3 of the SS to make it clear that this is aligned with the FCA.

9.7 The PRA considers that firms would not necessarily need to produce two self-assessment documents. As for the supervision of impact tolerances for dual-regulated firms, firms must ensure that their approach to operational resilience can meet the requirements of both supervisory authorities. If a firm can produce one document which meets the self-assessment requirements of the PRA and FCA in a way that makes clear which aspects apply to which supervisory authority, one self-assessment document would be acceptable.

9.8 One respondent commented that different timescales for self-assessments are impractical. This is not the case set out in the consultations. The PRA and FCA have both proposed that self-assessments should be reviewed by the board regularly. Having considered this response, the PRA has decided to publish its final policy as consulted upon.

Use and approach to the self-assessment

9.9 Two respondents suggested that there should be an iterative approach to the self-assessment documents, and one respondent suggested splitting the self-assessment document into two documents, covering the methodology and the results respectively, to avoid the document becoming too large. One other respondent suggested that the self-assessment should be used to evidence upcoming activities aimed at building resilience. A further respondent suggested that the self-assessment should prioritise qualitative over quantitative reporting.

9.10 Having considered these responses, the PRA has decided to publish its final policy as consulted upon. The self-assessment should be used as a tool for firms to ensure they understand the work they have done to demonstrate their operational resilience alongside their plans to remediate shortfalls. It is up to the individual firm to decide how the document should be structured and the approach to creating it.

9.11 One respondent sought clarity on the level of assurance the self-assessment needs to undergo before board sign-off.

9.12 The PRA is not prescribing a minimum standard on the assurance needed on the self-assessment ahead of board approval. However, firms should have a reasonable understanding of the work they have undertaken to demonstrate their operational resilience and this should be reflected appropriately in their self-assessment document.

9.13 One respondent requested clarification regarding when the document would be required by the PRA.

9.14 The PRA expects firms to be able to present the self-assessment to their supervisor on request once the rules come into effect (ie Thursday 31 March 2022). By this date, boards would have approved important business services and set impact tolerances which should be reflected in the self-assessment.

10 Groups

10.1 The CP proposed to require firms to identify important group business services and respective impact tolerances. This would include a service provided by an international entity of a UK group if it was (i) delivered to an external end user outside of the group; and (ii) if disrupted it could impact the safety and soundness of the UK (PRA-regulated) entity by causing failure of the whole group.

10.2 One respondent commented that aggregating impact tolerances across different entities would be a challenge. The PRA clarifies that the process of aggregating impact tolerances is not the policy requirement. The PRA requires firms to identify individual important group business services delivered by entities of the UK group and to set an appropriate impact tolerance for them.

10.3 Four respondents requested further explanation of important group business services. The PRA has included an example in paragraph 9.2 in the SS.

10.4 Two respondents questioned if Operational Resilience policy applies at holding company level. The PRA is monitoring the Financial Services Bill and the potential for applying PRA Operational Resilience rules to holding companies. The PRA will review the application of Operational Resilience policy in due course.

10.5 One respondent questioned if firms would be required to prioritise the recovery of important group business services or if regulators would intercede. The policy is designed to ensure firms plan for disruption. As such, firms should assume the disruption of an important group business service and understand whether they would be able to remain within the stated impact tolerance. Work done to remediate any vulnerabilities should be prioritised as part of a firm's overall programme to build operational resilience. There is no requirement to prioritise an important group business service over an important business service. A successful implementation of the policy would mean that if an important group business service is disrupted, it could be resumed without the need for regulatory intervention.

10.6 One respondent commented that the regulatory framework for operational resilience should allow enterprise-wide determination of important business services, and global risk-based prioritisation of resource allocation. The respondent further commented that any jurisdictional consideration of important business services should be a sub-set or section of these enterprise-wide determined important business services. One respondent commented that applying the UK regime to global enterprises would be challenging. The PRA acknowledges that enterprise-wide management of operational resilience could yield benefits. Nonetheless, the PRA's objectives relate to the safety and soundness of UK firms, UK policyholder protection and the financial stability of the UK. The policy therefore focuses on risks to the firms and groups that the PRA regulates.

10.7 One respondent requested clarity on the relationship between ring-fencing and operational resilience. The PRA has examined the relationship and considers the policies to be compatible. In the event that a firm believes there is a contradiction or has any concerns in relation to the two policies, they should discuss this with their supervisors.

11   International alignment

11.1 In August 2020 the Basel Committee on Banking Supervision (BCBS) published a consultation on principles for operational resilience.[12]

11.2 Nineteen respondents to CP29/19 commented on how the UK's proposals differ from international approaches. Seven respondents requested that the PRA clarify if important business services are considered equivalent to critical operations.

11.3 The PRA considers that the concept of critical operations set out in the BCBS consultation is not identical to important business services, as suggested by respondents, but the PRA considers that the terms are aligned. The BCBS definition (as consulted upon) of critical operations encompasses 'critical functions' as defined by the Financial Stability Board and is expanded to include activities, processes, services and their relevant supporting assets the disruption of which would be material to the continued operation of the bank or its role in the financial system'. This is consistent with the reference to both safety and soundness and financial stability in PRA policy.

11.4 The proposed BCBS principles also use the term 'risk tolerance' which is focused on a bank's 'risk appetite, risk capacity and risk profile'. The PRA also considers that impact tolerances are aligned with this term.

11.5 Comparing the PRA policy with the BCBS consultation, despite some differences in terminology, the PRA considers that there is alignment on the core principles:

- a distinction between operational risk and operational resilience;

- operational resilience as an outcome that firms continually need to work towards;

- the importance of operational resilience for both financial stability and the safety and soundness of firms;

- the concept of a risk or impact tolerance to define what might be acceptable that does not assume zero failure; and

- the use of scenario testing to assure resilience.

11.6 The PRA will continue to engage with international policy development processes. It is realistic to assume that there will be local differences in implementation, and it is reasonable that different jurisdictions will have different views on what they consider critical or important. As long as the principles are aligned, the PRA considers that firms and their supervisors should be able to work effectively across borders.

12   Other responses

Covid-19
12.1 The PRA recognises that the Covid-19 pandemic has had a significant impact on firms. The disruption caused by Covid-19 has shown why it is critically important for firms to understand the

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12   https://www.bis.org/bcbs/publ/d509.htm.

services they provide and invest in their resilience to protect themselves, their consumers and the market from disruption.

12.2 Thirteen respondents have indicated that operational resilience has been put in focus as a result of Covid-19, and asks the supervisory authorities to share any lessons learned from the pandemic. Seven respondents indicated that they were able to showcase their resilience in light of the pandemic and two respondents commented that the most adverse impacts were shown in smaller firms.

12.3 The PRA, FCA, and Bank of England have issued coordinated comments on Covid-19 in the covering document to this PS: 'Operational resilience: Impact tolerances for important business services''.

Industry collaboration

12.4 Seven respondents commented that industry should be encouraged to collaborate with other institutions and with the supervisory authorities in addressing issues such as the preparedness of industry for market-wide scenarios, approaches to setting and managing important business services, and overall resilience of the UK financial sector.

12.5 The PRA agrees that collaboration would be beneficial in establishing good practice for operational resilience and has emphasised this since the DP.

12.6 Seven respondents encouraged open dialogue between the supervisory authorities and industry over time. This could include checkpoints during the implementation and cross-sector benchmarking. The PRA supports open dialogue with industry as the new policy is implemented, and anticipates that this will be primarily be driven by supervision and industry engagement, rather than by additional policy changes.

Financial resilience

12.7 One respondent suggested that the supervisory authorities should recognise the firm's financial resilience efforts, such as recovery options and wind-down plans, when assessing operational resilience. The PRA considers that the focus on important business services puts emphasis on the areas of a firm that, among other things, would impact its safety and soundness if disrupted. Firms have the flexibility to align their important business services with existing frameworks, and so the PRA considers firms may look to areas identified in recovery planning.

12.8 One respondent noted that CP29/19 did not repeat the phrase set out in the DP that 'operational resilience is at least as important as financial resilience'. The PRA retains the view that operational resilience is at least as important as financial resilience.

Regulatory reporting

12.9 Five respondents have requested information on regulatory reporting requirements and how the PRA intends to assess a firm's progress. One firm asked if the PRA would be publishing further metrics that would be useful for operational resilience.

12.10 The PRA agrees that regulatory reporting for operational resilience is something to consider in the future, but this is out of scope of the current PS.

Communication plans

12.11 Three respondents suggested that communication enhancements should be made to existing arrangements rather than creating unique communication plans. A consistent method for

communicating externally should be made to include communicating with supervisors, third party providers and peers at an industry level.

12.12 Paragraph 4.8 of the draft SS set out that firms should develop communication strategies to prepare in advance how they can minimise the impact of disruptions. Having considered the responses, the PRA has decided to publish the SS expectations for communication plans as proposed, but would encourage firms to discuss their approach with their supervisors.

Operational risk capital requirements

12.13 Three respondents commented on operational risk. One suggested that if adequately implemented, firms may be able to justify a decrease in operational risk capital requirements. The PRA is maintaining the decision not to create a link between a firm's ability to remain within impact tolerances and its capital requirements. Chapter 3 of the SoP sets out the relationship between operational resilience and operational risk policy.

Cost benefit analysis

12.14 Thirteen respondents commented on the cost benefit analysis, and some suggested that the costs of operational resilience are underestimated. Two respondents highlighted that costs are unlikely to be known at the present time given the new concepts. Two respondents commented that the analysis was difficult to interpret and one respondent suggested that the policy could increase costs for consumers.

12.15 The cost benefit analysis was produced using survey data collected by the FCA, in which firms were provided context for the forthcoming proposals and asked to provide cost estimates for this. The PRA acknowledges that these estimates come with limitations but maintains that the analysis demonstrated a consideration of the costs. The PRA considers that the costs are proportionate to the benefits.

12.16 The PRA considers that the changes to the rules and SS following consultation are not significant and will not materially alter the cost benefit analysis presented in CP29/19.

Appendices

1   **PRA RULEBOOK: CRR FIRMS, SOLVENCY II FIRMS: OPERATIONAL RESILIENCE INSTRUMENT 2021, available at: https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2021/march/ps621app1.pdf**

2   **SS1/21 'Operational Resilience: Impact tolerances for important business services', available at: https://www.bankofengland.co.uk/prudential-regulation/publication/2021/march/operational-resilience-impact-tolerances-for-important business-services-ss.**

3   **Statement of Policy 'Operational Resilience', available at: https://www.bankofengland.co.uk/prudential-regulation/publication/2021/march/operational-resilience-sop.**