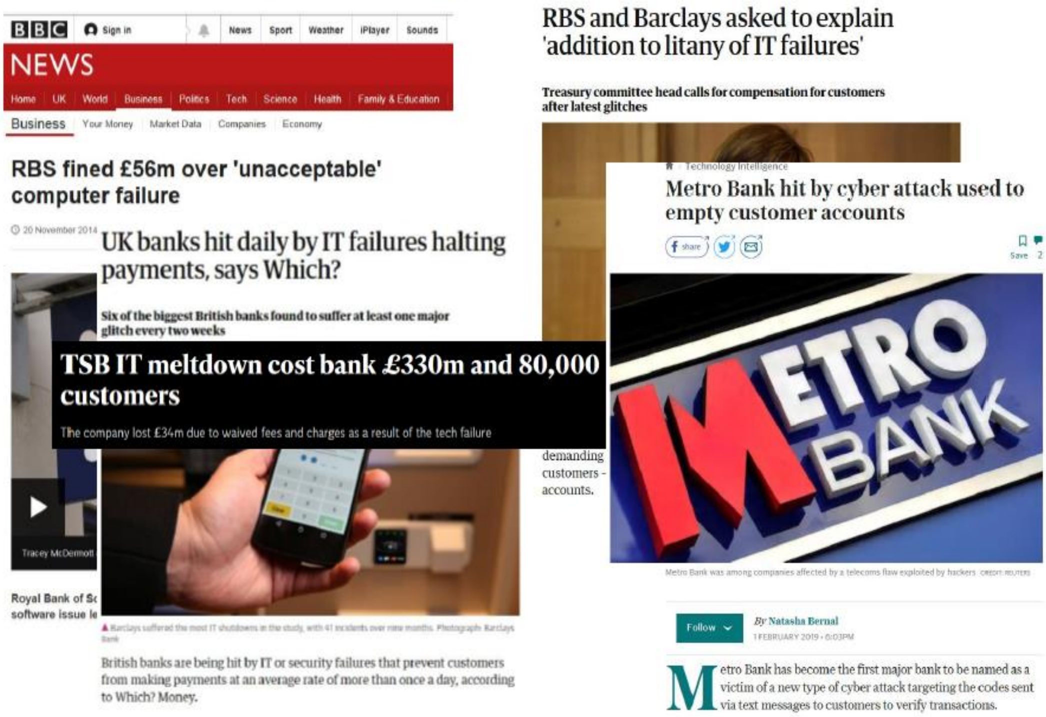
Operational Resilience

Well publicised outages in the financial services sector over recent years, such as those illustrated below, have led to an increased focus by UK financial services regulators on "operational resilience". The more recent focus by firms has been on risks arising from cyber-attacks or IT, but the volatility which has been caused by the spread of COVID-19 will have brought these plans into stark focus.

Operational resilience refers to the ability of authorised firms (including insurers) and the financial services sector as a whole to prevent, respond to, recover and learn from operational disruptions.



In their 2019/2020 business plans[1], the regulators responsible for supervising UK insurers have publicised their intention to build on the joint discussion paper of July 2018[2] and push forward the next stage of their work on operational resilience. Since then they, along with the Bank of England, have begun consulting on new rules[3] establishing a regulatory framework in this area. The consultation period is to run to 3 April 2020 with final rules expected to be published later in the year. The PRA also plans to consider regulatory reporting requirements for operational resilience, which it will do in the course of 2020.

The aim of the proposals is to bring about improvement to insurers' operational resilience in three key areas:

- prioritising activities which if disrupted would pose a risk to the stability of the UK financial sector, the safety and soundness of the insurer or the degree of policyholder protection;
- setting maximum acceptable periods of disruption;
- putting in place arrangements to resume disrupted services and to ensure important business services remain within their set impact tolerances.

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1 https://www.bankofengland.co.uk/prudential-regulation/publication/2019/pra-business-plan-2019-20; https://www.fca.org.uk/publications/corporate-documents/our-business-plan-2019-20

2 DP1/18 and DP18/04 "Building the UK Financial Sector's Operational Resilience"

3 PRA Consultation Paper 29/19 "Operational resilience: Impact tolerances for important business services"

FCA Consultation Paper 19/32 " Building operational resilience: impact tolerances for important business services and feedback to DP18/04

The proposals represent a change in emphasis from the systems and procedures which support an insurer's activities to the resilience of the business services themselves. Insurers should assume that individual systems and processes supporting a business service will be disrupted from time to time and should, therefore, concentrate on their back up plans and recovery options.

Under the new PRA rules, a "business service" is one that an insurer provides to an external end user and it will be an "important business service" if its disruption could pose a risk to the insurer's financial stability or the appropriate degree of policyholder protection. Whether or not a business service is an important business service will be a matter of judgment for boards and senior management. There can be no one size fits all definition because of differing business models, but the PRA does consider that payment of annuities by life insurers and the receipt of payment and provision of coverage by general insurers could be important business services.

Once identified, the important business services must be approved by the board and senior management of the insurer.

Insurers will also be required to quantify the maximum acceptable level of disruption to each of its important business services. This will be the "impact tolerance". It must be set by reference to a single disruption and expressed as a clear metric, to include the maximum tolerable duration of the disruption to each important business service. Like the identification of the important business services, the impact tolerances set for each important business service will need to be approved by the board and the senior management.

The draft rules require insurers to remain within the impact tolerances they have set but the PRA will allow a reasonable period of time from the time the proposals come into effect (up to a maximum of 3 years) for insurers to implement the proposals set out in the consultation paper and ensure that they are able to remain within their impact tolerances. The time allowed by the PRA will depend on a number of factors. To guard against changes in circumstances preventing an insurer from remaining in its impact tolerances, it will be expected to have agreed a rapid remediation plan with its supervisory contact.

In order to ensure that its important business services can remain within their respective impact tolerances, insurers will be obliged to undertake a series of actions:

- identifying and documenting the resources needed to deliver each of its important business services and those resources which are critical to delivery of those services. Any vulnerabilities identified in this "mapping process" will be expected to be addressed and mapping information should be made available to the insurer's supervisors on request;
- testing, in a range of severe but plausible scenarios, its ability to remain within its impact tolerances. There is no intention at present on the part of the PRA to set specific scenarios;
- documenting its own assessment of its compliance with the new rules. This self-assessment documentation will need to be approved by the board and senior management, who will be accountable for it.

The PRA's cost benefit analysis suggests that insurers not already operating on the basis of the proposed framework and/or those which have a larger than average number of important business services, may need to incur significant one off and ongoing costs in implementing the PRA's proposals.

For further information relating to COVID-19 please visit Eversheds Sutherland's Coronavirus hub at https://www.eversheds-sutherland.com/global/en/what/publications/coronavirus.page

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