Operational resilience and operational risk: industry study reveals move towards integration

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Operational resilience of financial services firms has been put to a severe test during the past 18 months as a result of the pandemic. As articulated by the Bank for International Settlements, pre-pandemic resilience conversation was centred on technology and "increasingly hostile cyber environment (1)". COVID-19 has refocused the efforts to include a widespread long-lasting disruption which impacts firms' most important asset – their people.

Basel Committee principles for operational resilience (2) published earlier this year urge the firms to up their continuity and recovery capabilities. For risk practitioners, the guidance has a special significance, as it introduces operational resilience as an "outcome" of operational risk management.

As organisations enhance their frameworks and approaches, this is the perfect time to seize the opportunity and work towards maximum integration of the two disciplines, avoiding silos and reducing fragmentation. Important areas for collaboration include:

- Developing meaningful reporting capabilities, agreeing governance, roles and responsibilities for effective monitoring and management of threats;
- Putting operational risk and control assessments to use, to identify vulnerabilities and pressure points for business services end-to-end; and
- Comparing and aligning scenarios used to test firm's resilience with the existing set of operational risk scenarios.

A survey conducted by the Best Practice Operational Risk Forum, comprised of risk professionals from more than 50 international financial services firms, noted a steady progress in integration of operational risk and resilience domains. An increasing number of organisations (50% of respondents, as seen in figure 1) opt for the winning formula of partnering and jointly leading the efforts.

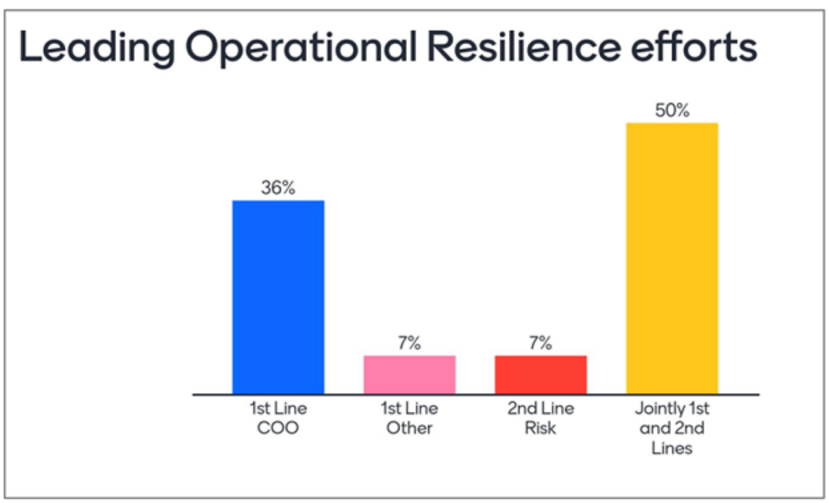

Figure 1: Source: Best Practice Operational Risk Forum

There is, however, a siloed approach adopted by others, whereby day-to-day resilience is managed by the first line of defence chief operating officer function, whereas the risk department is left to its own devices to deal with risk-related matters.

When it comes to framework development, the firms acknowledge that operational resilience is a steep step up from its predecessor, business continuity. A widely used definition introduced by UK regulatory authorities refers to resilience as a firm's ability to "prevent, adapt, respond to, recover and learn from operational disruptions" (3). The prevent aspect, in particular, is based on prudent and proactive risk management: identifying, understanding and mitigating threats and vulnerabilities. Assuming that disruptions are inevitable and will occur, post event detective and corrective controls help firms to respond, recover and learn from incidents.

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The framework, therefore, has to reflect operational resilience as a continuous process, integrating risk management, in particular focusing on information security and cyber, outsourcing and third-party and people risk components.

This complexity is reflected in figure 2, where a significant number of firms (58%) have not yet finalised their operational resilience frameworks. On a positive side, there is a desire for synergies, with 12% of respondents succeeding in their alignment efforts instead of choosing to create stand-alone policies.

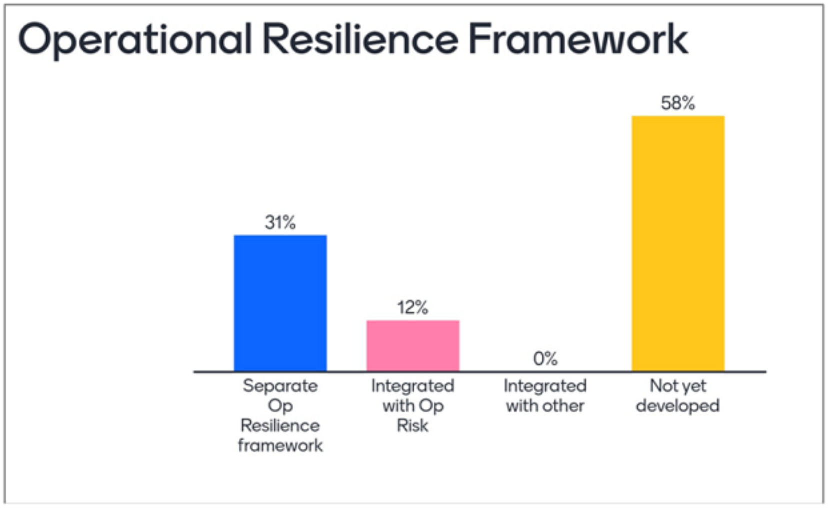

Figure 2: Source: Best Practice Operational Risk Forum

Reflecting on the broader progress of operational resilience implementation, apart from the framework, the component attracting the most attention is the business services framework (figure 3). Defining business services end-to-end has been a priority and a task for many organisations over the past year. The view enables to assess resilience as well as risk profile of the service.

The link with operational risk is particularly apparent here. Historically, some organisations applied process-based (rather than departmental) risk and control self-assessments (RCSAs), driven in part by Sarbanes-Oxley regulation. In process-based RCSAs, the service is commonly viewed end-to-end and risks are identified and assessed by a cross-functional group of stakeholders from front office to operations and technology. Firms that have historically applied this methodology are now more prepared when it comes to satisfying operational resilience demands.

COVID-19 has also expedited the study of important business services at firms. In practice, organisations had to take decisions to suspend some services while continuing to offer others. This prioritization process has underlined the concept that some services are more important than others, and that during disruptions, firms should be concentrating on the resilience of those prioritized activities.

There is also a softer side, related to achieving a shift in organisational mindset by developing a business service mentality among employees. Firms should aim to not only understand the interconnectedness of different processes but also harness an end-to-end business service mentality; one in which employees look out beyond their own narrow silos at the impact on the end client.

Other aspects of the framework, such as resilience scenarios, impact tolerances and metrics, are still at the early stages of development (fig 3).

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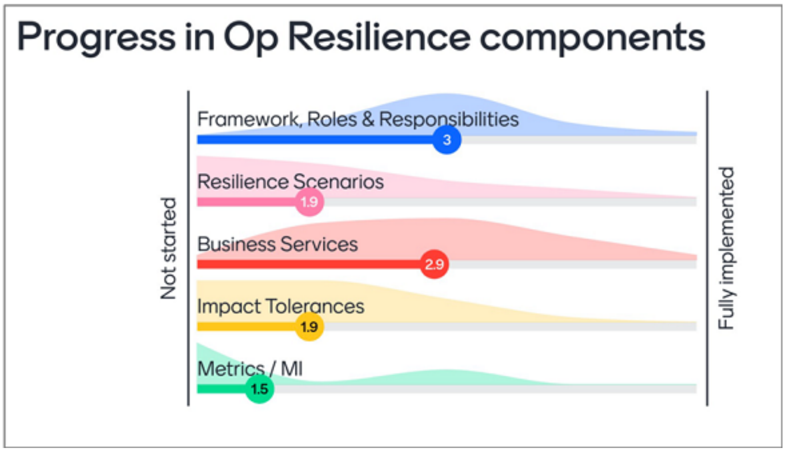

Figure 3: Source: Best Practice Operational Risk Forum

Best Practice Forum noted that UK-regulated firms are somewhat ahead on their operational resilience journeys, largely due to the clear path and implementation timeline set by the regulators. Firms must define business services and their impact tolerances by March 2022 and ensure ability to operate within set tolerances in 2025.

Great momentum has been achieved during the COVID-19 pandemic, with all functions including risk and resilience working in close collaboration. Carrying this momentum and energy forward will be beneficial for organizations in future years.

(1) Bank for International Settlements (BIS) 2020, FSI Briefs: Covid-19 and operational resilience: addressing financial institutions' operational challenges in a pandemic.

(2) Basel Committee on Banking Supervision (2021), Principles for Operational Resilience.

(3) Bank of England, Prudential Regulation Authority, Financial Conduct Authority, Building the UK financial sector's operational resilience.

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