

# EARLY REPORT INTO BUILDING OPERATIONAL SUSTAINABILITY AND RESILIENCE INTO THE FINANCIAL SYSTEM



as well as the business model changes, and the strategic and financial objectives companies hope to accomplish when implementing their resilience programs.

## Setting boardroom expectations for operational resilience

Operational resilience is commanding increased time and attention by boards of directors, with over two-thirds of US companies stating that they have a board-approved roadmap to address it, compared to 49% of European financial services firms.

While it is clear that board members are recognizing the importance of operational resilience and affording it more time in the boardroom, the level of board engagement is still evolving across sectors of the industry. A quarter of wholesale banking participants have engaged the board for approval of their operational resilience program, compared to nearly two-thirds of asset management participants, indicating that, overall, the asset management sector has progressed further in its operational resilience efforts.

Appointed ownership between C-suite roles varies by location. In the US, two-thirds of Chief Risk Officers are responsible for operational resilience; however, in Europe, over half of participants said that Chief Operating Officers were charged with the responsibility.

## How is operational resilience becoming a central theme across the financial services industry?

In the US, just over half of participants report that an operational resilience policy has been issued, compared to

around a quarter of European participants. This could indicate that European companies are watching proposed regulatory policies before advancing their own programs. Furthermore, a quarter of retail banks said they do not plan to issue an operational resilience policy at all.

When it comes to operational resilience program spend, 4% of European companies plan to spend more than \$5 million, compared to nearly half of US companies. This could be an effect of the US's global focus, as shown in the survey results – 33% of US companies focus their operational resilience efforts on their global operations, but for Europe this is only 8%. It could also indicate that European companies are still assessing the cost implications of operational resilience or relying on US parent companies to direct their approach.

## How has the financial industry's view on operational resilience changed during the COVID-19 pandemic?

The survey points to the positive steps being taken to build operational resilience in the face of COVID-19, with three-quarters of retail banks accelerating their efforts, followed by 40% in asset management, 22% in insurance, and 12% in wholesale banking. This suggests that the pandemic has provided boards and senior management with a practical example of the importance of building operational resilience into the sustainability of business operations.

## Conclusion

While the results presented herein are early indications from the survey, they suggest that operational resilience is gaining recognition as a core pillar that can protect financial services companies from high-impact operational events that lead to significant financial repercussions. You can read more about the global research on Building Operational Sustainability and Resilience into the Financial System when the full report is issued by CeFPro in late Autumn. ●

## OPERATIONAL RESILIENCE: THE NEW PILLAR ON WHICH TO BUILD

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Imagine you are starting your family vacation: as you walk past the welcoming flight attendant and step onto the airplane for an international flight, you consider how you are putting your family's life in the hands of the airline and manufacturer. You have instinctively trusted that they took all precautionary steps to represent your best interests and considered all that could go wrong during the journey in order to keep you safe. To deliver such consumer confidence and ensure operational resilience, the aviation industry has embedded and stress tested a variety of controls designed to prevent harm to you, your family, and millions of annual customers.

Operational resilience, therefore, is not a new concept. For years, it has been a critical discipline embedded in the functioning of business services across many industries including aviation, automotive, and power & utilities. As global financial markets become increasingly interconnected, with advanced systems and on-demand digital solutions providing consumers and businesses with the ability to manage their financial affairs when and how they want, operational resilience is evolving as the minimum standard.

### WHAT IS OPERATIONAL RESILIENCE?

As a new approach to the design of financial products and services, operational resilience promotes the transformation and development of new and existing capabilities, with broad views across the industry of their operational value, including:

- business process management;
- supplier/supply chain risk management;
- technology risk management;
- business continuity management & disaster recovery;
- crisis & incident management.

Embedded correctly, operational resilience will help financial services executives achieve predictable outcomes in the delivery of business services - before, during and after periods of disruption - while containing the customer, business, and wider market impacts of disruptions to within predefined tolerances. Operational resilience advances upon conventional practices of operational risk management, with an emphasis on identifying, measuring, and

modeling operational risks across business services. It leads to greater understanding of the potential effects of risk-taking against the ability to prevent or contain the levels of harm caused when, not if, severe but plausible risks materialize.

### THE COST OF RESILIENCE

The difference between a firm's appetite for risk and its tolerance for harm represents the 'cost of resilience'. Much like the stress testing of a new aircraft, financial products and services should be stress tested against a variety of severe but plausible scenarios of disruption to assess the preparedness and ability of substitution, contingency, and recovery arrangements to maintain the operational continuity, performance, and integrity of business services within the stated tolerances of harm. Additionally, the use of service stress testing allows firms to examine their understanding of harm, with an emphasis on the harm caused to customers, their continued viability, and the wider market stability when, not if, such operational disruptions occur.

Effective operational resilience reflects the strength of a firm's operational control environment, applying controls designed to prepare, anticipate, prevent, respond to, recover and learn from operational disruptions to critical business services.

By building and recurrently testing operational resilience against severe but plausible scenarios, financial services firms can remodel their operational risk capital to reflect the strengthened control environment and their tested ability to minimize the financial harm caused as a consequence of disruptions.

### THIRD-PARTY RISK

A challenge that has plagued the financial services industry in recent years is the ability to apply consistent risk management and resilience standards across applicable supplier arrangements. The rapid development of financial technology and cloud-based platforms for on-demand financial services has exacerbated this problem, posing a very real systemic risk to the functioning of the global financial system; particularly if a critical supplier should suffer at the fate of broad economic swings, such as the current stressed economic environment resulting from COVID-19 measures.

If we return to our airplane scenario: imagine you are settling in for the long journey overseas. You feel confident in the quality management system woven into the supply chain of the aircraft manufacturer. You know the system is built so that individual components that make up the aircraft have been designed, produced, checked, and tested against precise quality standards. These quality standards are designed around the sustainability and resilience of the aircraft and tested against extreme conditions before you even step onboard.

This analogy underscores the importance and benefits of process quality standards to delivering resilient business services across the components that make up each critical business services; e.g. critical technology, data, and suppliers. This requires firms to adopt business process management standards, providing a basis from which to build and model resilience around the delivery of critical business services.

### THE NEW NORMAL

Twenty years ago, planning for the worst may have seemed excessive. However, the world has seen an acceleration in the frequency of catastrophic operational risks, such as the 9/11 attacks, the Global Financial Crisis, the Fukushima accident, and now, the COVID-19 pandemic. During this period, we have also witnessed the escalating effects of climate change, with extreme weather events causing widespread operational impact to consumers and business across the globe.

As consumers and businesses become ever-more reliant on the operational resilience of the global financial system, the future success of financial services firms and their respective board and senior managers will be judged on the strength of their governance and strategic investment into building sustainability and resilience of the services they provide to their customers.

Put simply; given its current level of operational resilience, if your firm manufactured airplanes, would you step onboard? ●

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## Introduction

The global financial system depends on the successful operation of numerous sophisticated digital and physical systems. As digital banking, payments, currencies, and trading become the standard, consumers and companies rely on systems to provide access to financial services when and how they want it. The interconnectedness of the global financial system requires a measured approach to operational resilience to address the inherent vulnerabilities in the way financial products and services are delivered; one that puts operational resilience on the same level as financial resilience. But why now?

The answer lies partly in the cluster of innovation that is changing the industry foundations, including new and often risky financial products and channels for delivering services. Proliferating technology, major company model changes, new and more complex risks, and real-time interconnectedness expose companies to disruption that can cause irrevocable harm. Confronting these changes has compelled many companies to include operational resilience as an essential program within their company and product strategies.

Periculum Associates and the Center for Financial Professionals' (CeFPro) global research on Building Operational Sustainability and Resilience into the Financial System sought to understand the approach to operational resilience,



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