Operational resilience: defining your business services

Insurance

The regulatory context

The regulatory direction on operational resilience in the UK grew more certain with the publication of the consultation papers (CPs) in December 2019[1]. We can have confidence that the core concepts within the proposals will remain the same through the experience of this coronavirus (COVID-19). There may be some tweaks to the application of the policy, but we would expect these to be minor[2]. Furthermore we do not expect there to be much change in light of the recent paper by the Basel Committee on Banking Supervision (BCBS) which included some proposed principles of operational resilience. The UK supervisory authorities will likely view their approach as in line with the overarching standards proposed by BCBS and are looking to apply a consistent regime across the financial services sectors[3].

Alongside the commercial decisions to improve operational resilience, there remains a lot for firms to do to meet the incoming policy regime. While the impact of COVID-19 has hit every industry across the globe, we should remember that a pandemic represents just one scenario that a firm may need to respond to. It would be unwise to extrapolate the ability to respond to pandemics to ransomware attacks and data corruption issues, for example.

Insurance sector context

Our experience working with Insurance firms suggests that as a sector, they are somewhat behind their peers in the banking sector in mobilising their resilience work (with some exceptions). This may, in part, be because so far they have not suffered the same operational incidents or been subject to the same supervisory scrutiny. A speech by Charlotte Gerkin (Executive Director of Insurance Supervision, Bank of England) over the summer reported that insurance firms appear to have managed through COVID-19 extremely well, but experience in the early days suggested more needed to be done to sharpen the response. Understanding the resilience of third parties in particular will remain key for the insurance sector, given the use of brokers and other third parties as a key channel to sell and service products.

> The UK supervisory authorities[4] define a business service as **'a service that a firm provides to an external end user or participant.'**

Determining which are your important[5] business services is the critical first step in applying the draft policy requirements. It sets the scope for the rest of the work as it is these services which need to be mapped, need to have impact tolerances set for, and will be subject to scenario testing.

Develop self assessment document

1	2	3	4	5
Identify and map services (pre-requisite)	**Gather baseline data**	**Set impact tolerances**	**Scenario test**	**Ongoing governance**
Determine which business service are 'important' and map the resources to support delivery.	Gather data to show the day-to-day functioning of the business service.	Assess **how** the business service is impacted by a disruption and propose impact tolerances.	Test the firm's ability to manage service delivery within impact tolerances in different scenarios.	Develop a testing programme and monitoring regime for ongoing assurance. Sign off self-assessments.

Practical tips to define business services

As the definition above suggests, firms must define their business services primarily through the lens of their end users and not, for example, through the lens of how the business is structured. Determining the important business services then requires consideration of how disruption would impact customers, the financial markets and the firms themselves. The supervisory authorities are not proposing to create a single taxonomy at this point, taking the view that defining business services, and identifying the important ones, will be a matter of judgement for firms. In our experience, however, firms are often blurring the lines between **business services, internal services and transversal processes**[6]. We illustrate the differences in the diagram below.

[1] https://www.pwc.co.uk/industries/financial-services/regulation/understanding-regulatory-developments/uk-supervisory-authorities-reveal-more-on-how-firms-should-build-their-operational-resilience.html

[2] https://pwc.blogs.com/fsrr/2020/07/how-covid-19-could-change-operational-resilience-policy.html

[3] https://pwc.blogs.com/fsrr/2020/08/hollywood-blockbuster-or-rotten-tomato-does-the-basel-committee-paper-on-operational-resilience-deliver.html

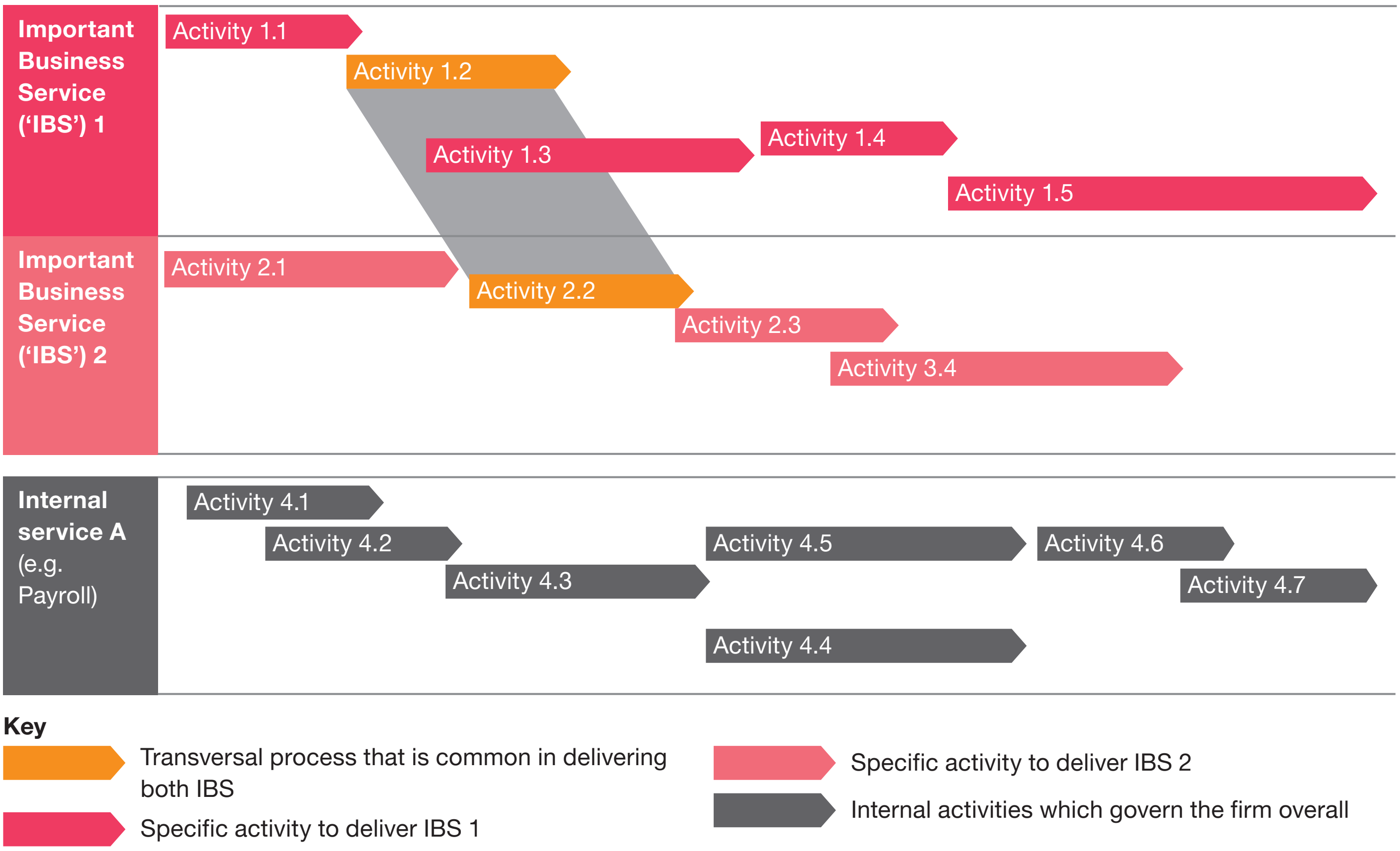
[4] The Bank of England, Prudential Regulation Authority and Financial Conduct Authority

[5] The draft policy statements include a set of minimum criteria to use when determining whether your business services should be considered important'

[6] Note, firms will need to consider the relationship between important business services and critical operations', as per the BCBS paper, and critical services' as per with recovery and resolution planning. The BCBS consultation paper defines operational resilience as the ability of a bank to deliver critical operations through disruption'. This definition links closely to recovery and resolution planning which uses critical functions, and is expanded to include activities, processes, services and their relevant supporting assets, where disruption would be material to the continued operation of the bank or its role in the financial system'. This is interpreted to go beyond the UK focus on services provided to an end user or participant and to include what we refer to here are transversal processes and internal services.

Firms should make a distinction between:

- Those specific services they provide to **external end users or participants.**
- **The more granular set of activities, or processes, which are transversal in nature,** in that they run on a consistent basis across the firm to facilitate the delivery of more than one important business service (i.e. anti-money laundering screening and monitoring). These activities may occur at different points throughout each process.'
- **Internal services in** place that are not visible to the external customer but are critical in controlling and monitoring the organisation (i.e. payroll and internal risk assessments).



Business service

- A service that a firm provides to an external end user or participant
- Clearly identifiable as a separate service and not a collection of services (e.g. as with traditional business lines)
- Client and reputational impacts are the focus
- End user must be clearly identifiable so the impacts of a disruption are clear
- Must be capable of having an impact tolerance set against it

Transversal processes

- Appears in business service maps
- Facilitates delivery of a business service rather than being the primary purpose
- In general not a client facing service
- Is performed consistently across multiple business services
- Critical part of a business service

Internal services

- A service that controls and monitors the activities of the firm
- End users are staff members or the firm itself
- Supports the internal operations and meeting legal and regulatory requirements
- Can still be considered 'critical' to how a firm operates but does not meet the regulatory definition of a business service

As a result, **business services** and **transversal processes** are the key elements for attention to meet the regulatory requirements. Firms may choose to invest resources to assess and enhance the resilience of their internal services, and they may deem them to be critical to their operations, but these are not the core focus of the incoming policy as disruption to these services is much less likely to **directly** impact the end users of the service day-to-day.

Example services

Below we give some examples of business services, transversal processes and internal services within the insurance sector. One particular area that we have seen insurance firms find challenging is defining their responsibility to end users (the customers) within the broker model. Firms are increasingly recognising that for the purpose of defining a business service, the end user is ultimately the purchaser of the product rather than the firms' brokers. This is brought to life in considering the expectations of customers with regard to servicing an insurance product in the event that their broker was unable to perform this activity on their behalf. Insurers therefore need to have a view of what business services they provide through the entire value chain, and ensure the critical parts are made resilient, even when delivered by third parties

Insurance firms must also consider how to identify vulnerable customers within a business service to facilitate a response appropriate to the needs of such customers when an operational incident happens. This could be done through, for example, the type of customer, but also potentially the type of claim (e.g. home emergency claim).

Example business services

- Take out a new [life insurance] policy
- Make a [home insurance] claim
- Payment of an annuity

Example transversal processes

- Payments processing
- Anti-money laundering/ Know Your Customer checks
- Claims handling

Example internal services

- Regulatory reporting
- Payroll
- Treasury

Next steps

When firms are clear how to define their business services they need to agree a methodology for determining which business services are 'important' according to the proposed definition and minimum criteria set out in the draft policy documents. This is an important step as it defines the breadth of work firms will have to complete ahead of the regulatory deadlines.

The implementation timeline for the policy looks challenging to address. Even with the six month delay we can expect the policy to be finalised in the first half of 2021 and in force 12 months later. That means firms have less than two years (from now) to determine their important business services, map them out end-to-end including the resource dependencies to deliver them, set impact tolerances, use scenarios to test the ability to remain within them, and prepare a self-assessment document to capture all of this which is signed off by the Board. It is at that point that firms will have up to three years (though the policy is clear that it is 'as soon as reasonably practical') to make the necessary investments to remain within impact tolerances.

To read more about how to meet the regulatory requirements refer to our white paper, **'Operational resilience: how to set and test impact tolerances'.**

To discuss how PwC can help you on this journey please contact

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