How to make operational resilience a "win-win"

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As the dust settles on UK supervisors' recent publications on operational resilience, internal management committees across financial services will be considering their next steps, given that the timelines for action, resource mobilisation and establishing governance will be imminent and the relevant accountable individual — SMF24 or equivalent — will be seeking advice on how to formulate a response.

Despite extensive consultation with the industry, there had been an expectation that further regulatory guidance would be forthcoming to provide a clear framework and a "to-do" list for firms to follow. With a clear mandate for more outcomes-based regulation, however, supervisors will not be providing a "safe-harbour" to provide shelter.

"One of the benefits of not being prescriptive and following an outcomes-based approach is that firms do not waste time. This way of thinking applies to other policies such as outsourcing and the use of third parties — we want firms to show us that they understand their risks and spend their energy and resources addressing them," said Lyndon Nelson, deputy chief executive and executive director-regulatory operations and supervisory risk specialists at the Prudential Regulation Authority, during the UK Finance Operational Resilience Webinar held on May 5.

What this means in practice is that the sophistication and dynamism required to deliver operational resilience objectives will require careful thought. Organisations looking to delegate this responsibility to existing business continuity plans or operational risk functions will be underestimating the scope of what is required. In terms of Nelson's recent comments, the emphasis on "sophistication" means that affected firms must be able to monitor, measure and address their vulnerabilities. This will require a much deeper dive in terms of systems and processes than most organisations will ever have done before, and is something that should not be treated lightly.

A cloud with a silver lining?

The timeline for action — mapping work must have delivered a compelling gap analysis by March 2022 — may seem daunting given the typical complexity associated with even relatively small firms. Many organisations, however, will have seen at first hand in the last 12 months the stresses on their process, even if they will not admit this publicly. Manual pinch points across much of the middle and back office will have been evident, whether this was availability of staff to cope with higher volumes or the reality that systems were unable to cope with the extended periods of market volatility. By engaging with the right levels of management through their post-trade domain, leadership will find experience to support initial identification of these vulnerabilities. Typically, these domains are people-heavy where a decade of cost cutting, lack of IT investment and aggressive offshoring agendas have left most organisations with an obvious challenge — that their total cost of ownership (TCO) across these functions is overwhelmingly driven by people. Around 60-70% is typical in the author's experience, with some functions being even higher than this. With the traditional view of these functions being "costs to be managed", the focus has been unsurprisingly on cost reduction at the expense of automation (and ultimately resilience)

By embracing this as an opportunity to position post-trade transformation within the "mandatory compliance" agenda for investment committees, however, forward-thinking leaders can find a silver lining to this cloud. The SMF24 should be leveraging their own personal accountability to drive support for the right level of investment to deliver the appropriate response, which should be directed at the framework that underpins daily operations. The richness and maturity of the fintech environment provides solutions that can be deployed to improve automation levels, the growth of financial market infrastructure (FMI's) can provide solution options for a range of asset classes and the emergence of large, managed service providers can give size and scale to support a broad spectrum of post-trade processes. All of these are levers that should be explored to deliver greater resilience.

Success will require recognition that the systems and processes within most organisations are unique — a reflection on the "legacy" of their business evolution — and so there will not necessarily be a "plug and play" solution to the challenge. It will require focus, leadership and generally investment to satisfy the resilience requirements for important business services.

Five actions leaders can take now

The scope and complexity of compliance may seem significant, but there are some practical steps firms can take to shape their response. Here are five things to consider:

- *Mobilise the organisation*. Much of the knowledge and experience in terms of understanding process vulnerabilities will sit with process owners. Lack of automation for the most part means that there is actually good visibility on the manual steps in the process, and people performing these roles are well-placed to explain how or if a process can scale. Creating a framework that attacks this "bottom-up" will very quickly provide good intelligence about where vulnerabilities sit, for example, through interviews and working sessions, rather than trying to control everything centrally and "top-down".

- *Avoid functional responses*. Most organisations are driven by functional silos, making them a complex matrix of product and process owners (with their own budgets and agendas). Remediating resilience vulnerabilities, however, will require a different response, given the cross-functional nature of processes end to end. Taking the analogy that "every chain is only as strong as its weakest link", successful compliance will have to be driven from front through to back office. Organisations should be wary of the launch of ad hoc "settlements resilience" or "regulatory reporting resilience" agendas.
- *"Automation-first" principle*. There is always good reason to resist automation — risk of change, cost, historic failure to deliver — but the best resilience is ultimately a well-automated technology solution. This will scale and respond to stresses much better than anything else. Leadership must be strong to capitalise on the opportunity that compliance will bring. Compromising this principle will compromise resilience; it is that simple. The maturity of the fintech landscape in the last five years has been significant, making adoption and integration much easier than many "nay-sayers" might try to claim.
- *Solve for data*. The challenges of solving for post-trade data are not insignificant and generally draw a sharp intake of breath akin to a tradesman quoting on house maintenance. The hidden cost of this challenge — in terms of people's time to compensate for it — is significant (the author has witnessed first-hand this cost being more than 20% of the post-trade cost base for some organisations). The "sophistication" to which Nelson alluded will require scenario and stress testing of vulnerabilities, which will demand clean, accurate data to be credible. This level of hygiene in terms of things such as failed trades or disputed margin calls does not exist for the majority of organisations. Taking the opportunity to address this will improve resilience and also reduce cost overtime. While complex, it is not unsolvable if organisations focus on letting the use-cases drive solutioning, as opposed to the other way round.
- *Time to be agile*. Most compliance programmes are governance-heavy, but to enable the right level of transformation and embed resilience by 2025, organisational agility will need to improve. Forcing every innovation decision or budget request through a monthly steering committee will likely end in failure, and will ultimately lead to the types of short-term decision-making that created the vulnerabilities in the first place. Delegation does not mean negligence and it is time for organisations that claim to be agile actually to make it happen.

By embracing the opportunity, leaders may just find that efficiency and cost reduction are surprising by-products of their compliance journey through to 2025.

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