

The PRA's expectations on Operational Continuity in Resolution (OCIR)

The PRA has published updates to its policy and a revised supervisory statement on ensuring operational continuity in resolution (PS 9/21 and SS4/21) following its consultation paper in October 2020 (CP 20/20). This bulletin highlights what this means for firms; who is impacted, what they need to do and by when.

Application

The scope of firms to which the requirements apply is unchanged.

The policy continues to apply to UK banks (including subsidiaries), building societies, and PRA-authorized designated investment firms (**firms**) that receive "critical services" supporting "critical functions" if on 1 January of any year:

- (1) the average of the firm's total assets it was required to report for the previous 36 months in accordance with Chapters 7 and 9 of the Regulatory Reporting Part of the PRA Rulebook exceeds £10bn; or
- (2) the average of the firm's safe custody assets it was required to report for the previous 36 months in accordance with SUP 16.14 of the FCA Handbook exceeds £10bn; or
- (3) the average total amount of received sight deposits it was required to report for the previous 36 months in accordance with the ITS on supervisory reporting, or that it would have had to report if the ITS on supervisory reporting had been in force, exceeds £350m.

The scope is intended to capture all firms that the PRA considers pose risks to financial stability, particularly those for which the Bank of England (Bank) has set bail-in or partial transfer as their preferred resolution strategies.

It is, of course, open to the PRA to use its power under section 55M of the Financial Services and Markets Act 2000 (FSMA) to require other firms to comply with the Operational Continuity Part and the expectations in SS 4/21.

For example, if a firm has been authorised for less than 36 months but exceeds one of the three quantitative thresholds with less than 36 months of data, the PRA will assess on a case-by-case basis whether the firm is in scope and therefore should comply with the Operational Continuity Part and the Supervisory Statement. The PRA will consult with affected firms before reaching such a decision.

The policy does not apply to UK branches of third-country firms (including EEA firms). For these firms, the PRA's approach will follow that prescribed in SS1/18 'International banks: the Prudential Regulation Authority's approach to branch authorisation and supervision'. In this context, the PRA will consider the operational continuity regime of the home authority when determining the risk appetite around the critical functions that the UK branch of the third-country firm intends to perform or is performing in the UK.

The Operational Continuity Part of the PRA's Rulebook and Supervisory Statement apply equally to all in scope firms, regardless of whether the Bank of England is a firm's home ('home firms') or host ('hosted firm') resolution authority. However, firms can meet the requirements and expectations in varying ways; for example, a hosted firm may be able to meet some of the detailed expectations in the Supervisory Statement by relying on its group-wide capabilities. The PRA encourages firms to take an approach to meeting the expectations that takes account of, and where appropriate is integrated with, capabilities elsewhere in a group.

Scope – extension of requirements to services supporting core business lines

The rules and revised Supervisory Statement extend the OCIR policy to provide for the continuity of ‘core business lines’ as well as critical functions during recovery, resolution and related restructuring. To do this, the PRA has amended the definition of ‘critical services’ in the Operational Continuity Part.

Critical services are now defined as those services the failure of which would lead to the collapse of, or present a serious impediment to, the performance of a firm’s critical functions or core business lines.

What do firms have to do?

Firms in scope of the current OCIR policy will have systems, processes and documentation in place to meet the existing expectations. Additionally, in a number of cases, the expectations cross-refer to other recent policy publications on operational resilience and recovery and resolution. The PRA considers that firms should be able to leverage their planning and activity under those other Statements of Policy to meet a number of the expectations in the OCIR Supervisory Statement. However, notwithstanding the possibility of leveraging existing capabilities, the PRA’s updated expectations will still require a significant additional compliance lift for all firms in scope particularly with respect to systems build and contractual remediation requirements.

1. Be able to demonstrate effective operational arrangements to facilitate recovery and resolution

There is a large emphasis in the revised Supervisory Statement on a firm’s ability to demonstrate how it will maintain operational resilience at the point of stress, resolution or a related restructuring of the firm, another group entity or the critical service provider itself. SS4/21 requires firms to have “appropriate policies, processes, and procedures to be able to demonstrate how operational arrangements supporting critical services meet all other relevant expectations in this SS and the requirements in the Operational Continuity Part”.

If the Bank (as resolution authority) has set a preferred resolution strategy of bail-in, operational arrangements should support operational continuity throughout resolution as described in the stylised timeline referred to in the Bank Recover Assessment Framework Statement of Policy.

A core business line is a business line and associated service(s) which represent material sources of revenue, profit or franchise value for a firm or for its group. “Critical functions” continues to have the meaning set out in section 3(1) and (2) of the Banking Act 2009.

The PRA has clarified that, when identifying its core business lines, a firm should consider the business lines of the wider group of which it is a part. Hosted firms that have already identified business lines that are core to the firm may use these for OCIR purposes.

2. Identify and document critical services

Given the expansion in scope to cover core business lines, this in an area in which existing OCIR capabilities will generally fall short. Firms should be able to leverage work done to map critical services, critical functions and important business services in the context of operational resilience and outsourcing requirements to meet the PRA’s expectations of firms to map operational assets and data and identify critical services for the purposes of OCIR, and need not reclassify services where they have already mapped the services supporting core business lines. However, the operational resilience and OCIR policies serve different purposes and, as such, the requirements and expectations for each policy are different. The PRA encourages firms to follow an “efficient approach” in meeting the needs of both policies. Mapping done to meet the requirements of one policy can be leveraged to meet those of the other but the purpose and specific expectations of each policy should be considered to ensure that all expectations are met. In the context of the OCIR requirements, firms should understand which legal entities, business lines, or divisions perform critical functions or are core business lines, and which services need to continue during resolution and post-resolution restructuring.

Critical service arrangements must be comprehensively documented and updated at least annually (or in a timely manner following any material change to a firm's service provision). The SS suggests that documentation could take the form of a service catalogue and should enable timely access to, at a minimum:

- identified critical services and the critical functions or core business lines they support;
- the service provision model used;
- information about each party, including jurisdiction;
- service level agreements;
- contractual arrangements;
- pricing;
- operational assets used, including ownership information;
- relevant policies, processes, and procedures; and
- interdependencies.

The PRA has not prescribed the format of a firm's identification and documentation system and, as a result, firms have the flexibility to develop their own format provided that it ensures the information remains useable and available at the point of need. Firms should be able to access, search, extract, and leverage the information in a timely manner in planning for and executing recovery actions, resolution, or both. This should also include providing information, where requested, to the PRA, Bank, a bail-in administrator appointed by the Bank, or (for hosted firms) the home resolution authority. The PRA does not expect a hosted firm to maintain an entirely separate service catalogue for the UK entity where this is incorporated in a group-wide service catalogue

3. Ensure continuity during changes to service provision – transitional service agreements

Firms should ensure continuity of critical services during possible changes to service provision resulting from restructuring related to recovery or resolution, irrespective of the scenarios that they may encounter during such a restructuring. Firms should take different scenarios into account in planning for continuity and consider how their capabilities would be effective in practice. The PRA suggests that this could be done by maintaining a playbook or documented and tested procedures. At a minimum, the PRA expects firms to be able to develop and implement transitional service agreements (TSAs), "in a timely and prudent manner", during recovery, resolution, and related restructuring. Although the concept of TSAs exists in the current supervisory statement, the updated policy is far more prescriptive.

There is no requirement or expectation that firms put in place TSAs in advance of resolution, since the exact design of a TSA cannot be determined in advance. However, firms should have appropriate operational arrangements, and relevant information available, to support them in designing and implementing the TSAs as they become necessary in resolution. In order to do so, the PRA expects that, at a minimum, firms should maintain:

- information about interdependencies among firms and service providers;
- objective service level agreements;
- predictable and transparent charging structures;
- management and governance arrangements; and
- any further arrangements that may be necessary to be able to design and implement TSAs.

The PRA considers that firms can leverage documentation maintained to meet other expectations in the Supervisory Statement to support the creation of TSAs. It is not intended that additional or more granular documentation is required. However, the PRA expects firms to consider whether any additional arrangements are needed in order to maintain their ability to design and implement TSAs.

4. Ensure resolution resilient contracts

Given the expansion in scope of the policy to include core business lines, even though the contractual requirements remain much the same as the existing OCIR policy, the new Supervisory Statement will trigger a requirement to remediate existing contracts that are brought newly in scope. Some contracts are excluded from this requirement; specifically,

1) contracts which are:

- governed by the laws of any part of the United Kingdom;
- between parties that are incorporated in, or formed under the law of any part of, the United Kingdom; and
- between parties that belong to the same resolution group; and

2) contracts entered into to receive critical services directly from certain financial market infrastructures (FMIs).

Clearly, however, these exclusions will be of limited assistance in the context of non-group service provider models.

5. Prevent preferential treatment of other entities over the firm

The PRA's expectations here remain largely unchanged and reiterate the requirement in rule 4.3 of the Operational Continuity Part of the PRA's rulebook that a deterioration in the financial circumstances of another group member should not interrupt the provision of critical services from an intra-group or intra-entity service provider. However, again, the revised policy applies to a broader universe of critical services.

The updated supervisory statement no longer includes the expectation that "firms should ensure that organisational structures and agreements do not require the group provider to prioritise its resources to support certain group entities over the firm".

6. Ensure objective service level agreements across all service models

The PRA continues to view the objective documentation of service provision as necessary for all models of service provision, including intra-entity service provision, in order to help identify operational interdependencies, as a basis for TSAs and to guide restructuring efforts. The PRA's expectations around what the service level agreements should contain remain the same, with a few minor clarifications, but the updated policy applies the requirements consistently to all service models. As such, firms may need to remediate intra-entity service level agreements.

Service level agreements should not be agreed and then filed and forgotten but rather must be kept up to date and accessible. Firms should be able to provide relevant information to the PRA within a reasonable timeframe, if requested.

7. Ensure predictable and transparent charging structures

All charging structures should be clear and easily understood, enabling firms to understand at a sufficiently granular level the charges for each critical service. Similarly, the charging structures for all types of service provision models must be predictable and transparent. By this, the PRA expects any future charges for critical services to be either known or calculable.

The updated policy does, however, vary the expectations according to firms' service provision models. For intra-group and non-group providers, charging structures for critical services must be set on arm's-length terms. SS 4/21 removes the requirement for charging structures related to intra-entity services to be set on arm's-length terms. The PRA does not expect payments for services to pass between business units of the same firm in the case of intra-entity critical service provision.

Again, the expansion of the policy to cover core business lines means that more services will fall within this requirement than before.

8. Ensure access to operational assets

Other than the expansion in scope of critical services that firms need to consider, there is little change to the PRA's expectations around access to operational assets. Firms will be required to demonstrate rather than simply articulate how access will be maintained and the PRA has clarified that the expectation also applies where another subsidiary negotiates the contractual arrangements on behalf of the group (not just when the parent does so). Technology has also been added to the list of examples of operational assets.

9. Ensure financial resilience

Aside from the expansion of scope of critical services, the financial arrangements section is the area subject to most change in the updated policy.

The PRA expects firms to have in place systems to monitor and maintain early warning indicators of risks to both their ability to meet payment obligations for critical services, including through recovery, resolution, and related restructuring and to the financial resilience of intra-group critical service providers. The risk assessment should be on a forward-looking basis and, wherever possible, firms should take remedial action to address any risks they have identified. Where firms can demonstrate that the intended outcome is met through existing capabilities, the PRA does not expect firms to duplicate work.

The requirement to ensure that intra-group critical service providers remain financially resilient requires firms to manage the risks associated with the assets of critical service providers, not just their liabilities, and the PRA gives much more guidance on how it expects firms to identify risks.

The OCIR liquidity resources requirement for intra-group service providers has also been modified; it is now tied more specifically to (one sixth of) the annual fixed overheads of the critical services provided to the firm rather than 50% of annual fixed overheads of critical services provided generally. The approach to the calculation of a critical service provider's annual fixed overheads is unchanged from the approach previously set out in SS9/16. The PRA continues to expect firms to consider whether this minimum requirement is sufficient to mitigate risks identified by firms and, if not, firms should ensure that intra-group service providers have access to additional resources to cover the risks. The expectation in SS9/16 that firms hold a minimum amount of OCIR liquidity resources for intra-entity service provision has been removed.

OCIR liquidity resources no longer need to be segregated, but they must be maintained at all times, immediately available to the intra-group critical service provider and only used to support the operational continuity of intra-group critical services during resolution. Firms should maintain appropriate governance arrangements, policies, processes, and controls to meet this expectation.

While the PRA suggests holding structures for such liquidity to “ensure that they are in the most appropriate location to meet the expectations”, it remains for firms to determine and explain how and where such assets are held, as well as the arrangements for access in resolution. Resources maintained by an intra-group critical service provider that is part of a group containing a ring fenced bank (RFB), where such services are provided to an RFB, may either be held by the service provider itself, with an entity within the RFB sub-group, or on behalf of the service provider with a third party outside of the group. The PRA considers that OCIR liquidity resources held on behalf of the service provider, or deposits made by the service provider, with any other entity within the non-ring-fenced part of a group, even after resources are monetised, would be at unacceptable risk.

Firms should also consider how they would monetise OCIR liquidity resources. Firms may use the same types of assets that qualify as high-quality liquid assets (HQLA) for Liquidity Coverage Ratio purposes (but must avoid double counting such assets) or other types of assets as long as those assets would be immediately available to the intra-group critical service provider in resolution.

10. Management and governance arrangements

There is renewed emphasis on effective management and governance structures in the context of intra-entity and intra-group service provision. The PRA considers this important to ensure clarity of management responsibilities in resolution, sufficient seniority of service provision management and continued availability of staff critical to ensuring the continuity of service provision.

One area in which there is a slight softening of the PRA’s expectations is the requirement in relation to a service provider’s senior staff, where they have multiple roles within the group. The PRA no longer expects firms to ensure that the responsibilities for critical services are prioritised, but rather now simply that they are not deprioritised.

However, the PRA adds additional expectations around availability of staff and change capabilities. The PRA also discusses allocation of responsibility among senior managers with a suggestion that firms with Chief Operations Senior Management Function (SMF24) may consider allocating responsibility for operational continuity in resolution to that function. However, this is phrased as a suggestion only and the PRA states that as long as accountability for all relevant responsibilities is clear and explicit, firms may allocate them in whichever way best reflects the way they organise themselves in practice.

When?

The new SS and associated changes to the Operational Continuity Part of the PRA’s Rulebook will apply from 1 January 2023.

For firms that come or are likely to come into scope of SS 4/21 after 1 January 2023, the PRA may grant a temporary waiver or modification of the relevant requirement or requirements to allow for an appropriate implementation period.



Practical impact

- Some firms may have documented their existing OCIR service mapping using systems that cannot be easily scaled. Such firms will be required to build on existing systems and processes or indeed build new systems to be able to identify and document their critical services in a manner which permits the firm to access, search, extract, and leverage the required information in a timely manner.
 - Due to the expansion of services in scope of OCIR some firms may face a major repapering exercise. The policy statement acknowledges that it may not be possible for firms to remediate certain contracts before Sunday 1 January 2023. In such cases, firms should alert the PRA well in advance of that date to discuss mitigation and an appropriate plan for remediation.
 - Firms must have in place systems to monitor and maintain early warning indicators of risks to both their ability to meet payment obligations for critical services, and to the financial resilience of intra-group critical service providers. In the same way that existing systems used for mapping critical services might not be easily scaled, firms may face difficulties scaling existing systems to monitor and warn of risks to financial resilience and for calibrating appropriate OCIR liquidity resources required for intra-group service providers.
 - Firms must also consider whether any additional arrangements are needed in order to maintain their ability to design and implement TSAs.
 - Compliance will not be a box ticking exercise but rather firms must be able to demonstrate how they will maintain operational resilience at the point of stress, resolution or a related restructuring of the firm, another group entity or the critical service provider itself. Firms must have “appropriate policies, processes, and procedures to be able to demonstrate how operational arrangements supporting critical services meet all other relevant expectations in this SS and the requirements in the Operational Continuity Part”. This will require appropriate governance. Management responsibilities must be clearly and appropriately allocated and firms must ensure the continued availability of staff critical to the continuity of service provision.
- Although SS 4/21 updates an existing policy, its implementation is likely to be just as resource consuming as implementation of the original policy.

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