

September 30, 2020

Prudential Regulation Authority  
Financial Conduct Authority  
Bank of England



Japanese Bankers Association

## **JBA comments on the UK Consultation Papers on strengthening the Operational Resilience**

Dear Sir / Madam

The Japanese Bankers Association (JBA) appreciates the opportunity to provide comments on the UK Consultation Papers on CP 29/19 “*Operational resilience: Impact for important business services*” and related CP30/19 “*Outsourcing and third party risk management*” issued by the Prudential Regulation Authority (PRA), CP 19/32 “*Building operational resilience: impact tolerances for important business services*” issued by the Financial Conduct Authority (FCA) and consultation papers on *Operational Resilience: Central Counterparties/Central Securities Depositories and Recognized Payment System Operators and Specified Service Providers* issued by Bank of England (BoE)<sup>1</sup> (collectively, the Proposals, and we hereby refer to PRA, FCA and BoE collectively as the UK supervisory authorities).

The JBA is the leading trade association for banks, bank holding companies and bankers associations in Japan<sup>2</sup>. Major banking groups of our member banks have subsidiary banks and/or branches in the United Kingdom (the UK operations), primarily engaged in the wholesale banking business. While the Proposals aim to improve the operational resilience of the UK financial sector, the JBA recognizes that the Proposals will not only be applied to those UK operations, but could also potentially impact on the global operations of our member banks outside of the UK as discussed below. The JBA therefore would like to share our views on the Proposals as well as suggestions for amendments to the Proposals<sup>3</sup>.

### **I. General Comments**

#### **Principles- and risk-based approach**

As a general comment, the JBA supports the principles- and risk-based approach that the Proposals have taken, rather than a prescriptive or standardized approach, considering the fact that the expected operational resilience of a bank could vary by its type of businesses and their importance in the UK financial system. The JBA recognizes that banks are inherently responsible for ensuring their important services be operationally resilient in view of the public nature of the banks’ business and for maintaining the banks’ credibility<sup>4</sup>. COVID-19 pandemic also highlighted the importance of operational resilience. The scale and impact of the pandemic, across different geographies and sectors, demonstrated that firms everywhere need to be prepared for disruption events. Given that operational resilience is not merely a compliance issue, but rather all efforts made to achieve the above objectives, the frameworks for operational resilience should give banks flexibility to their practice and approach as far as they can achieve the same outcome. The JBA expects that the principles- and risk-based approach be kept in mind in the actual supervisory practices.

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<sup>1</sup> PRA: <https://www.bankofengland.co.uk/prudential-regulation/publication/2018/building-the-uk-financial-sectors-operational-resilience-discussion-paper>  
<https://www.bankofengland.co.uk/prudential-regulation/publication/2019/outsourcing-and-third-party-risk-management>

FCA: <https://www.fca.org.uk/publications/consultation-papers/cp-19-32-building-operational-resilience-impact-tolerances-important-business-services>

BOE: <https://www.bankofengland.co.uk/paper/2019/operational-resilience-of-fmis>

<sup>2</sup> As of September 30, 2020, the JBA has 117 Full Members (banks), 3 Bank Holding Company Members (bank holding companies), 72 Associate Members (banks & bank holding company), 58 Special Members (regionally-based bankers associations) and one Sub-Associate Member for a total of 251 members.

<sup>3</sup> More detailed comments on the Proposals can be found in the IIF/GFMA’s joint letter, which includes the comments by our member banks.

<sup>4</sup> For instance, Japanese banks have been improving the level of their operational resiliency through conducting regular exercises of the business continuity plan and assessing its effectiveness. In such practice, Japanese banks (i) assume a wide range of crisis events (natural disasters, terrorist attacks, pandemics, computer viruses, etc.), (ii) identify high-priority operations for each crisis event, and (iii) develop a business continuity plan with a target recovery period, commensurate with the level of importance of the services.

## Implementation date and consistency with the BCBS Principle

The UK requirements of operational resilience should be fully consistent with the BCBS's principles (the BCBS Principle)<sup>5</sup> and be implemented in line with the timeline of the BCBS Principles. For internationally active banks, the UK operations are a part of the banking group and are subject to its global operational resilience policy if the banking group has it. In such case, the JBA believes that the operational resilience of the UK operations can be more effective and comprehensive as ensured by the group governance (group-wide approach) rather than where the operations solely comply with the UK requirements. If the UK operations are required to comply with the UK requirements segregated from the group policy due to the fragmentary requirements, it, in turn, could weaken the operational resilience of UK operations and pose unreasonable regulatory burdens for the UK operations. We would like the UK supervisory authorities to clarify that foreign bank branches are not subject to the Proposals.

In addition, if there are discrepancies between the UK requirements and the home country's regulatory and supervisory framework based on the BCBS Principles, the supervisory framework of the home country authorities should supersede others. The UK operations should be allowed to comply with the UK requirements by adopting the global policy based on the BCBS Principles as a part of the group and then addressing the gaps between the global policy and the UK requirements. Given that the BCBS published the consultative document on principles for operational resilience, it should be avoided to fragmentarily impose the UK requirements to the UK operations. The JBA recommends that the UK requirements of operational resilience be fully consistent with the BCBS Principles, at least with respect to the objectives, definition and fundamental frameworks of operational resilience. While the proposed rule is to be applied after the end of 2021, the final UK rules and guidance should allow for the necessary flexibility in timelines, in line with the BCBS Principles so that the firms can implement the appropriate controls and responses, taking into account the prolonged impact of the COVID -19.

Notwithstanding our general support for the overall objectives of the Proposals, the JBA believes that the UK supervisory authorities should give further consideration to the following points, and suggests several amendments to the Proposals to ensure that operational resilience is effective without posing undue regulatory burdens.

## II. Specific comments

### The principle of proportionality

The substitutability of the bank's activities should be included in the factors to determine the proportionality. The draft operational resilience requirements are set to be proportionate to the nature, scale and complexity of the banks' activities as per 3.2 and 5.3 of the draft PRA rulebook. The JBA believes that the provisions are reasonable to avoid undue burdens to the banks, particularly to banks with a limited presence in the UK financial system. It is, however, not clear whether the substitutability of the bank's activities can be taken into account in determining the importance of the bank's business services and impact tolerances. Even if an operational disruption occurs, it does not necessarily pose risks to the UK financial stability where the business services the bank provides are likely to be substituted by other banks within a reasonable time. The JBA therefore suggests explicitly including substitutability into the proportionality factors, if it is warranted by, for instance, the observations of the past operational incidents across the UK financial sector.

The firm's safety and soundness should be separated from the factors to determine the importance of the bank's business services. The draft operational resilience requirements suggest (1) the stability of the UK financial system; or (2) the firm's safety and soundness for the factors to determine the importance of the business services, as per paragraph 2.3 of the draft PRA rulebook. However, the firm's safety and soundness affected by operational incidents have been already captured under the capital requirements for operational risk<sup>6</sup> where banks are required to maintain adequate capital against potential operational losses. Further, the revised capital requirements for operational risk (Basel III) will be implemented in 2023, which the Japanese banks will be required to meet at the consolidated level, including their UK operations. It seems to overlap if firm's safety and soundness are factored in determining the importance of the business services. Even if these factors are to be included, it should be clarified as to what kind of

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<sup>5</sup> The consultative document was published on August 6<sup>th</sup>, 2020, by the Basel Committee on Banking Supervision (BCBS) on principles for operational resilience.

<sup>6</sup> Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.

risks that are not captured under the capital requirements is intended to be captured and why.

## **Strategies, Processes and systems**

Strategies, Processes and systems should be flexible as long as the same outcomes can be achieved. As per paragraph 3.1 of the draft PRA rulebook, banks are required to put in place sound, effective and comprehensive strategies, processes and systems; namely (1) identify its important business services, (2) set an impact tolerance for each important business service and (3) identify and address any risks to remain within their impact tolerances by carrying their scenario testing. While the JBA agrees that they are key attributes to ensure the operational resilience and one of the ideal practices, the JBA believes that the process to ensure effective operational resilience is not limited to the way proposed. A number of practices already exist to ensure the operational resilience of banks, including voluntary frameworks in view of the public nature of the business of banks and for the purposes of maintaining the banks' credibility. In some cases, the same outcomes of operational resilience may be achievable by the different processes, such as (1') set stress scenarios as a starting point; (2') identify business services potentially disrupted under such scenarios, and then (3') mitigate potential operational disruptions. The process should therefore be flexible (should not be mandatory) for banks, and a "fill-in-gap" approach between the existing practices and the requirements should also be allowed, as long as they can assure the same degree of operational resilience. In terms of this process, we also expect the adequate communication and coordination with authorities.

## **Impact tolerance**

To remain flexibility, setting impact tolerances by recovery phase should be allowed as options. The JBA agrees that an impact tolerance is generally represented as the maximum time for which the bank can tolerate disruption to an important business service, given the expectation of stakeholders of banks for the recovery within a reasonable time. In our view, however, given that the recovery is practically achieved over time by substitute operations (including manual operations) and/or step-by-step remediation (e.g. by area or certain customer category), setting impact tolerances by recovery phase is more realistic and practical. For instance, when full disruption of a system occurs, impact tolerance is set as 80% recovery within 12 hours, 90% within 24 hours, and full (100%) recovery within 48 hours<sup>7</sup>. The JBA believes that this approach is in line with the objectives of the operational resilience frameworks.

## **Scenario testing**

It should be clarified that going beyond the impact tolerances may be allowed for extreme incidents. The JBA agrees with the view of the UK supervisory authorities that the scenario to use for the test should be "severe but plausible scenarios". It allows banks to focus their efforts on achieving the objectives of operational resilience without posing undue burdens under unrealistic extreme scenarios. The JBA also supports the view that "plausibility could be considered by modelling incidents or near misses that have occurred within a firm's organisation, across the financial sector, or in other sectors and jurisdictions". It is, however, not clear what the text "there will be extreme scenarios where firms find they could not deliver a particular important business service within their impact tolerance" means. The JBA believes that it is neither proportionate nor appropriate to require banks to stay within their impact tolerance in such extreme scenarios if it is solely attributable to external parties and uncontrollable for banks. The JBA therefore requests to explicitly clarify that it is possible for boards and senior management to go beyond the impact tolerances, even if banks need to consider in advance what the bank could do in such extreme circumstances.

## **Outsourcing agreements**

The example of "the contractual arrangements allowing the continuity of the access to the services for a transitional period following termination" should be deleted. In Chapter 10.13 of the draft supervisory statement (SS) of outsourcing and third party risk management<sup>8</sup>, banks are encouraged to "actively consider temporary measures that can help ensure the ongoing provision of important business services following a disruption and/or a stressed exit, even if these are not suitable long-term solutions, e.g. contractual arrangements allowing for continued use of a service or technology for a transitional period following termination". Given that the stressed exit is, by its definition, a circumstance where the service provider is no longer viable (failed or insolvent), the JBA believes that such contractual agreements would not work effectively as expected in most cases. The JBA suggests deleting the example

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<sup>7</sup> The hours of impact tolerances are solely illustrative.

<sup>8</sup> CP30/19 "Outsourcing and third party risk management" issued by PRA

of such contractual agreements in order to avoid confusion, or at the very least it should be clarified that such agreement is not mandatory to be included in the contractual agreements with third parties.

In Chapter 9 of the draft SS of outsourcing and third party risk management expects firms to oversight complex or material sub-outsourcing arrangements and Chapter 9.2 shows the examples of dependencies of service providers. The JBA believes that the scope of sub-contractors for oversight should be limited to the sub-contractors notified by service providers.

### **Intra-group outsourcing**

Substitute compliance and/or mutual equivalence recognition that are confirmed between regulators should be provided for intra-group outsourcing. For internationally active banks, there are a number of cases where the business services of the UK operations rely on group functions outside of the UK to some extent. The JBA is concerned that the Proposals contain several provisions that could potentially have extraterritorial effects to those entities outside of the UK. For instance, Chapter 3.6 of the draft SS of outsourcing and third party risk management requires banks to ensure that the outsourced service (intra-group outsourcing) is provided in compliance with the UK legal and regulatory requirements. Even if the entities outside of the UK are subject to the requirements of operational resilience in the jurisdictions where the entities are located, it cannot be assumed that the requirements are fully consistent with the UK requirements without any discrepancies on a line-by-line basis. While the JBA can understand the objectives of the provisions, it should be avoided that those provisions are applied in a way to lead to market fragmentation and operational localization in the UK. The JBA therefore recommends adding substitute compliance and/or mutual equivalence recognition as a backstop to mitigate potential extraterritorial effects. In particular, the insourcing intra-group entities that are subject to the BCBS Principles should be regarded as entities complying with the UK requirements.

(End)