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Preparing for critical disruption:
A perspective on operational resilience
SANJIV TALWAR

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DEAR READER,

Welcome to this landmark 20th anniversary edition of the Capco Institute Journal of Financial Transformation.

Launched in 2001, the Journal has followed and supported the transformative journey of the financial services industry over the first 20 years of this millennium – years that have seen significant and progressive shifts in the global economy, ecosystem, consumer behavior and society as a whole.

True to its mission of advancing the field of applied finance, the Journal has featured papers from over 25 Nobel Laureates and over 500 senior financial executives, regulators and distinguished academics, providing insight and thought leadership around a wealth of topics affecting financial services organizations.

I am hugely proud to celebrate this 20th anniversary with the 53rd edition of this Journal, focused on 'Operational Resilience'.

There has never been a more relevant time to focus on the theme of resilience which has become an organizational and regulatory priority. No organization has been left untouched by the events of the past couple of years including the global pandemic. We have seen that operational resilience needs to consider issues far beyond traditional business continuity planning and disaster recovery.

Also, the increasing pace of digitalization, the complexity and interconnectedness of the financial services industry, and the sophistication of cybercrime have made operational disruption more likely and the potential consequences more severe.

The papers in this edition highlight the importance of this topic and include lessons from the military, as well as technology perspectives. As ever, you can expect the highest caliber of research and practical guidance from our distinguished contributors. I hope that these contributions will catalyze your own thinking around how to build the resilience needed to operate in these challenging and disruptive times.

Thank you to all our contributors, in this edition and over the past 20 years, and thank you, our readership, for your continued support!

Lance Levy, **Capco CEO**

PREPARING FOR CRITICAL DISRUPTION: A PERSPECTIVE ON OPERATIONAL RESILIENCE

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ABSTRACT

In recent years, and particularly in the immediate response to COVID-19, the ability to spring back from operational disruption has become an organizational and regulatory priority. But building operational resilience can be a significant challenge. Financial institutions are increasingly faced with complex operations, evolving third party relationships and reliance on new technologies to conduct their business effectively. This article outlines the foundational elements of building an operationally resilient organization, highlighting the necessary leadership attributes, culture and risk management practices. It makes the case for organizations and regulators to embrace a broadened perspective of resilience. Practicing these elements will help ensure the continuity of critical operations and overall confidence in the system.

1. THE MEANING OF THE TERM "RESILIENCE"

The term "resilience" is generally defined as the ability to recover from difficulties. As an engineer by training, I also think about it as a measure of elasticity: the capacity to stretch out but return to a pre-stretched shape. Resilience is, therefore, a characteristic that can apply to a range of different things, such as materials, people, relationships, and organizations.

For people, resilience usually means the ability to spring back after a period of illness or discontentment. We can measure resilience in this context by the length of this period, with higher resilience often associated with shorter periods of malaise.

While this personal resilience is certainly at the forefront of our minds during the pandemic, the resilience of legal persons (i.e., corporations) is also important, particularly to regulators like the Office of the Superintendent of Financial Institutions (OSFI). In the context of an organization, I think of resilience as the ability to rapidly and seamlessly recover from difficulties encountered. This could mean having sufficient financial resources, such as cash reserves or shareholder capital, to withstand a financial shock. At OSFI, we refer to this as financial resilience.

Resilience can also refer to the continuity of an organization's operations in the face of significant disruption. In this context, financial resources are less relevant and the emphasis is on the speed of recovery. Ideally, customers and other stakeholders would not even know that the organization encountered operational difficulties. We can think of these organizations as having operational resilience.

Traditionally, regulators have focused on financial resilience, primarily due to the high externalities associated with organizational failure and financial crises. However, as organizations have become more complex and the pace of adoption of new technologies has increased, the ability to spring back from operational disruption has risen in prominence.

[1] The views and opinions expressed in this article are those of the author and do not necessarily reflect the official policy or position of OSFI.

Many organizations' business processes once resembled a factory floor. Under these conditions, it was relatively easy for companies to identify possible points of failure and problems were contained by the figurative four walls of the factory. Today, many organizations are operating in an environment that is more like a rainforest: a complex ecosystem in which small, often undetectable, changes to particular layers can become threats to the entire forest's survival.

In this environment, operational disruption has become a question of when, not if. This creates a problem for regulators like OSFI, as a failure to spring back within an acceptable period could reduce confidence in a financial institution and potentially compromise system stability. Consumer expectations have also changed, meaning that institutions cannot afford large-scale outages from a competitive perspective.

2. HOW DO ORGANIZATIONS BECOME MORE OPERATIONALLY RESILIENT?

When thinking about operational resilience, the first question I have is: how self-aware is the organization? Without this self-awareness, it is impossible for an organization to anticipate and prepare for disruptive events. Organizations will otherwise assume that their business-as-usual operations can simply continue into the future. Organizations' risk management programs (e.g., business continuity management) are an obvious response to these questions, but it cannot end there.

Resilience begins with the people involved, particularly the leaders of an organization. There is a foundational question of whether leaders have the mental fortitude and the leadership capabilities to operate through disruption. This requires a proactive mindset, confidence in people management, logical thinking under pressure, and strong communication skills. Leaders must also build personal resilience in the people around them during peace time, giving staff the confidence to respond to significant disruption on their own initiative, within their span of accountability.

The focus of leaders must then turn to the systems and processes of the organization. Some important activities for leaders to engage with before disruption occurs include:

- Understanding the organization's core functions, from all stakeholders' points of view, including society at large.
- Understanding critical dependencies that support core functions (both inside and outside the organization). In financial services, examples include technology-related suppliers, payments systems, and clearing and settlement partners.
- Considering the time interval between failure and contingencies being operational, with severe but plausible scenarios in mind. This must be within risk tolerance, or else further investment will be required to reduce it.
- Establishing controls and contingencies to prevent a critical failure and to minimize the impact when a failure does indeed occur.
- Where one is not in a positon of strength in the operational ecosystem, efforts must be made to strengthen the organization's position within that ecosystem, or even potentially move to a new one.

When an organization has addressed these points, the focus then shifts to how, practically, organizations can maintain operational resilience over time. Similar to risk management, operational resilience is not a "once and done" exercise. It is an outcome requiring a cycle of evolution and learning, as events at home and abroad offer new insights.

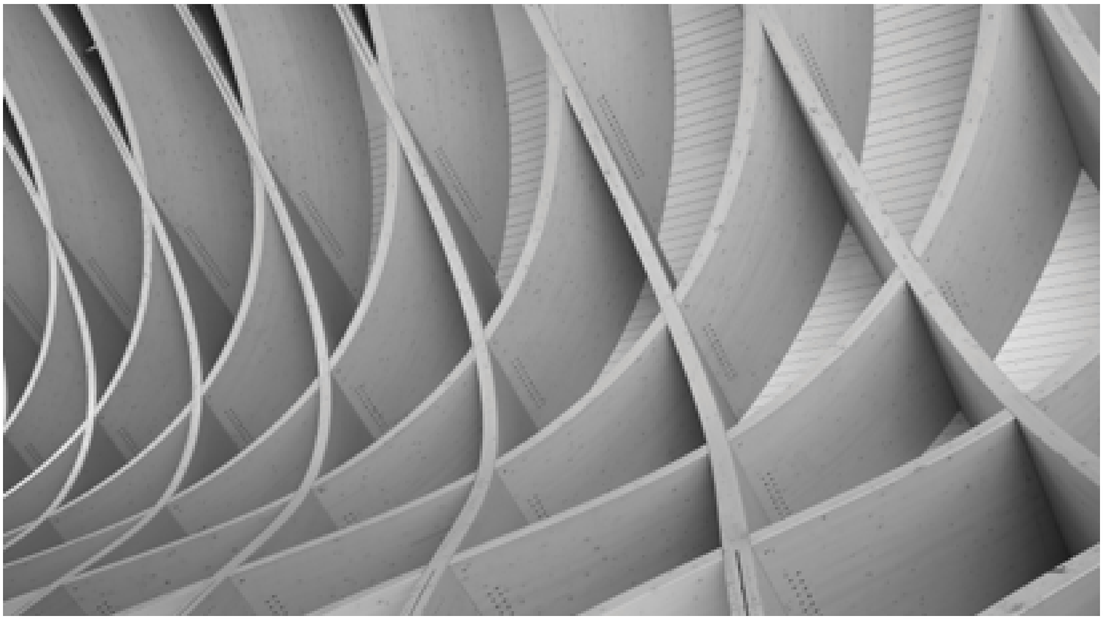
Some of the key questions that organizations should ask are:

- Are tests of all systems and contingencies performed with regularity?
- Are lessons taken from the tests and leveraged in contingency processes?
- How is the teamwork and collaboration required to sustain resilience achieved?
- Is this continually discussed, built-on, and tested as the team membership changes?

While this is by no means an exhaustive list, it does highlight the types of questions leaders need to ask themselves, and prepare for, when they are taking steps to make their organizations more resilient in the face of potential crises.

3. WHAT CHALLENGES AND OPPORTUNITIES LIE AHEAD?

One of the key benefits of resilience is that it results in reduced lasting stress from difficulties. For an organization, this means that many events, including extreme events, are handled as



due course activities, with reduced stress on staff members. We have seen this in the midst of a pandemic, with many truly resilient organizations delivering on their commitments to customers and the broader system, without excessive staff burnout.

For this reason alone, now is a good time for organizations to be investing in their operational resilience.

But even outside the lens of COVID-19, there is a need today for all organizations to think carefully about their ability to spring back. While many of the core services provided by financial institutions, such as deposit-taking or providing insurance coverage, have not changed, they are now underpinned by a large and increasing number of dependencies and rapidly changing technologies. Cyber risk has also become more prominent, raising the possibility that one or more organizations could suddenly become unable to provide critical services for an indefinite period.

These greater risks are magnified by the fact that organizations are still made of people, some of whom do not have the ability to cope well with the nature and scale of large-scale organizational transformations.

Some would argue that, for people, resilience is an innate characteristic. But for organizations that are made up of many individuals, I believe that resilience is something that can be worked on and maintained. Consequently, as organizations and regulators, we must continue to scale the twin peaks of operational and financial resilience. OSFI has historically emphasized the financial side of this equation. But we also see for ourselves a vital role in helping institutions maintain operational resilience.

While we cannot regulate resilience into existence, we will continue to encourage organizations to reflect on and improve their resilience. Institutions must have the right leadership, culture, and processes in place to deliver the critical services on which their customers and the entire financial system rely. As we have seen throughout 2020, this is a precondition to a sound and stable financial system.

4. CONCLUSION

Every major crisis is a wake up call for organizations to prepare their operations to be more resilient against future crises. However, few have been as profound as the one we are going through right now. The COVID-19 pandemic has shaken the world of business to its core, and yet we have seen examples of organizations that have not only survived the current crisis, but have even thrived. This was not merely a case of luck, many of these organizations had spent years preparing their infrastructures to be resilient through disruption.

My job, and that of OSFI, is to ensure the soundness and stability of Canadian financial institutions, and in doing so we work hard to prepare for crises. The current crisis was a once-in-a-century event, or at least we hope so, but I feel that Canadian financial institutions have, so far, withstood the stresses quite effectively. They have passed the test of continuing to provide services to clients during extraordinarily challenging conditions.

Of course, we cannot rest on our laurels, and there are certainly lessons to be learned from the pandemic. The next crisis is unlikely to mirror the current one. It could be faster moving or could compromise the technologies that have served the industry so well in the last year. This article aims to highlight some of those lessons, and potential responses, so that we can as an industry be even better prepared for the next crisis.

ABOUT CAPCO

Capco is a global technology and management consultancy dedicated to the financial services industry. Our professionals combine innovative thinking with unrivalled industry knowledge to offer our clients consulting expertise, complex technology and package integration, transformation delivery, and managed services, to move their organizations forward.

Through our collaborative and efficient approach, we help our clients successfully innovate, increase revenue, manage risk and regulatory change, reduce costs, and enhance controls. We specialize primarily in banking, capital markets, wealth and asset management and insurance. We also have an energy consulting practice in the US. We serve our clients from offices in leading financial centers across the Americas, Europe, and Asia Pacific.

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