

Discussion Paper

Financial Stability Department



SOUTH AFRICAN RESERVE BANK



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Discussion document

Proposed arrangements to support operational continuity in resolution

Note: This discussion paper sets out proposed principles and requirements that will be adapted into a regulatory instrument upon conclusion of the consultative process and after promulgation of the Financial Sector Laws Amendment Bill.

Contents

1. Definitions	3
2. Introduction	5
3. Scope	6
4. Objective	6
5. Proposed arrangements to support OCIR	6
5.1 Design of arrangements to support OCIR	6
5.2 Identification and assessment of risks to OCIR.....	7
5.3 Mapping of essential services	7
5.4 Management information systems.....	8
5.5 Arrangements to mitigate risk to OCIR	8
5.5.1 <i>Contracts and service level agreements</i>	8
5.5.2 <i>Pricing</i>	10
5.5.3 <i>Operational resilience</i>	10
5.5.4 <i>Rights of use and access to essential operational assets</i>	11
6. Governance and management oversight	12
References	13

1. Definitions

‘Core business lines’ means business lines and associated services which represent material sources of revenue or profit and are essential for the overall sustainability of the designated institution.

‘Core shared services’ means activities performed by a designated institution or outsourced to a third party where failure would impair a designated institution’s ability to continue its core business lines.

‘Critical function’ means, as defined in the Financial Sector Laws Amendment Bill, 2018 (FSLAB), in relation to a designated institution, a function that is –

- a. essential to, or that contributes substantially to financial stability and is performed by the designated institution; or
- b. provided to, and is essential to the continued operation of, the designated institution.

‘Critical shared services’ means activities performed by or within the designated institution or outsourced to third parties where failure would lead to the designated institution’s inability to perform critical functions.

‘Closed resolution strategy’ means a resolution strategy, typically adopted in relation to a designated institution that has not been designated as a systemically important financial institution (SIFI), where such designated institution is wound up in terms of clause 166H of the FSLAB.

‘Designated institution’ means, as defined in clause 42 of the FSLAB,

- a. a bank;
- b. a SIFI;
- c. the payment system operator and participants of a systemically important payment system;
- d. a company that is a holding company of a bank, a SIFI or a payment system operator of a systemically important payment system; and

- e. subject to any determination in terms of subsection (2), if a bank or a SIFI is a member of a financial conglomerate in terms of section 160 of the Financial Sector Regulation Act 9 of 2017 (FSR Act), each of the other members of the financial conglomerate.

‘Designated institution in resolution’ means, as defined in the FSLAB, a designated institution in respect of which a determination in terms of clause 166J (2) is in force.

‘Essential services’ means the core shared services and critical shared services that enable the maintenance of core business lines and the provision of critical functions by a designated institution.

‘FSLAB’ means the Financial Sector Laws Amendment Bill [B152020].

‘Open resolution strategy’ means a resolution strategy in terms of which an institution that is designated as a SIFI in terms of clause 42 of the FSLAB is stabilised and continues to function in its existing form under its own licence.

‘Operational continuity in resolution’ means the capability of a designated institution in resolution to support the continuity of its essential services and maintain core business lines to enable its continued provision of critical functions to facilitate orderly resolution.

‘Orderly resolution of a designated institution’ means, as defined in the FSLAB, the management of the affairs of the designated institution as provided for in Chapter 12A in a way that:

- a. maintains financial stability; and
- b. in the case of a bank, protects the interests of depositors,

including by ensuring that the critical functions performed by the designated institution continue to be performed.

‘Resolution’ means, as defined in the FSLAB – of a designated institution – the management of the affairs of the designated institution as provided for in Chapter 12A.

‘Resolution action’ means, as defined in the FSLAB, action in terms of clause 166S.

2. Introduction

- 2.1. This discussion paper expands on the operational continuity in resolution (OCIR) proposals contained in the South African Reserve Bank's (SARB) 2019 paper titled 'Ending too big to fail: South Africa's intended approach to bank resolution' and should be considered in the context of the SARB's overall approach and arrangements to facilitate the orderly resolution of designated institutions (DIs) in line with the provisions of the FSLAB.
- 2.2. In the context of resolution, operational continuity refers to the means of ensuring or supporting the continuity of core business lines and essential services that are necessary to maintain the provision of, or to facilitate the orderly wind down of, a DI's critical functions in resolution.
- 2.3. The Financial Stability Board (FSB) has identified lack of adequate arrangements to support OCIR as one of the main obstacles to the orderly resolution of financial institutions.
- 2.4. OCIR is defined in the context of core business lines and essential services because, without the continuity of core business lines and essential services, it is unlikely that the continued provision of critical functions in resolution will be achieved.
- 2.5. OCIR is one of the elements in resolution planning and thus a component in the process of improving the resolvability of DIs with inherent interdependencies with other core elements of a resolution framework.¹
- 2.6. It is acknowledged that operational continuity is also addressed as part of DIs' business continuity planning and recovery planning processes. This means that there is likely to be substantial correlation between the critical functions, core business lines and essential services identified by the SARB as part of the resolution planning process and by DIs as part of their recovery planning processes.

¹ See South African Reserve Bank's 2019 paper titled 'Ending too big to fail: South Africa's intended approach to bank resolution'.

- 2.7. While the potential for material similarities between operational continuity for resolution planning and recovery planning is noted, it cannot be assumed that critical functions, core business lines and essential services identified for the two purposes will be identical. As such, a separate analysis for operational continuity should be carried out for resolution planning purposes.
- 2.8. The SARB will adopt a collaborative approach in the implementation of the proposals in this paper as well as other relevant resolution planning proposals. The implementation of these proposals will be an iterative process between the SARB and the DIs as part of the resolution planning process.

3. Scope

- 3.1. The proposals contained herein will apply to all DIs. However, the SARB intends to prioritise the implementation of OCIR requirements by DIs that have been designated as systemically important.

4. Objective

- 4.1. The proposals in this paper focus on arrangements to support the continuation of essential services in resolution.
- 4.2. To this end, the arrangements contained herein focus on operational activities, including information technology infrastructure and software, personnel and human resources, procurement and facilities management and transaction processing that support OCIR and are therefore essential for the implementation of an effective resolution.

5. Proposed arrangements to support OCIR

- 5.1. Design of arrangements to support OCIR
- 5.1.1. The SARB does not intend to prescribe any model for the delivery of essential services. It is therefore incumbent on DIs to determine a service delivery model or a combination of models that is appropriate for respective DI's continued maintenance of core business lines and provision of critical functions.

5.1.2. Financial institutions typically adopt one or a combination of the following models² for the delivery of essential services to maintain operational continuity:

- i. Intra-entity model – essential services are provided by a division within a DI.
- ii. Intra-group entity model – essential services are provided by a group entity that is not a service company.
- iii. Intra-group service entity model – essential services are provided by a specialised intra-group service company.
- iv. Third-party service provider model – essential services are provided by an external specialised service provider.

5.2. Identification and assessment of risks to OCIR

5.2.1. Regardless of the chosen service delivery model(s), DIs will be required to, as part of their normal risk management processes:

- i. identify the main risks, both internal and external, to OCIR;
- ii. assess and mitigate internal and external risks to operational resilience in resolution that may be posed by the technologies it employs and the service delivery model it adopts; and
- iii. demonstrate that the measures they have taken or are taking sufficiently addresses the risks identified.

5.3. Mapping of essential services

5.3.1. DIs will be required to, as part of their normal risk management processes, undertake, document and maintain a detailed mapping of essential services, including, but not limited to: (i) service delivery model; (ii) the relevant critical function; (iii) relevant core business line; (iv) relevant operational activity;

² Financial Stability Board, 'Guidance on arrangements to support operational continuity in resolution' (2016).

(v) relevant service provider; (vi) essential staff³; and (vii) related contractual arrangements.

5.4. Management information systems

5.4.1. A DI will be required to put measures in place to be able to:

- i. conduct a comprehensive mapping of all essential services it receives by, at a minimum, entity, core business line, critical function, product line and jurisdiction;
- ii. capture all direct and indirect dependencies between its provider of essential services and other relevant parties;
- iii. develop capabilities to produce management information on essential services in a flexible manner; and
- iv. develop a list of essential services with a robust governance and control framework in place to ensure data quality, including its accuracy, integrity, completeness and reliability.

5.5. Arrangements to mitigate risk to OCIR

Paragraphs 5.5.1 to 5.5.4 outline matters that DIs are required to consider as well as arrangements to put in place to mitigate risk to OCIR.

5.5.1. Contracts and service level agreements.

5.5.1.1. A DI will be required to have arrangements in place to ensure that contracts and service level agreements (SLAs) supporting the maintenance of core business lines and the provision of critical functions cannot be terminated, amended or suspended by the service providers solely as a result of DI's entry into resolution, and that the terms are clear, comprehensive and in writing.

³ Essential staff means staff members that are essential for the DI's execution of core business lines as well as the performance of critical functions to support OCIR.

5.5.1.2. Contracts and SLAs governed by non-South African law and supporting the maintenance of core business lines and the provision of critical functions should include terms (resolution-proof terms) which,

- i. secure the continued provision of essential services in resolution with no adjustment to the terms and conditions on which the essential services are provided solely because of a DI's entry into resolution, provided there is no default in payment obligations under the contracts;
- ii. provide for the transfer, assignment or novation of the contract to enable essential services to be transferred by the essential service recipient to a different recipient or to be provided by a different service provider as needed;
- iii. secure the continued provision of essential services to a DI in a resolution on substantively the same terms as in business-as-usual for a reasonable period after the stabilisation phase, notwithstanding any disposal, transfer or any other restructuring actions taken in respect of the DI;
- iv. do not preclude the termination of a contract or SLA upon the maturity/termination date previously and mutually agreed by all signing parties of the contract or SLA;
- v. a DI should monitor contracts and SLAs that underpin essential services to ensure that they contain, and continue to contain throughout their term, effective and enforceable resolution-proof terms;
- vi. subject to the materiality of the relevant essential service, a DI may be requested to seek independent legal opinion on the effectiveness and enforceability of the resolution-proof terms, during the resolution planning stage; and
- vii. a DI is required to ensure that the continued provision of essential services is not hindered by any organisational structures and/or agreements and that, in the case of an intragroup service provider, the relevant contracts and SLAs prevent the service provider from prioritising its service to one

or more of the group companies over the DI in a stress or resolution scenario, unless otherwise instructed by the SARB.

5.5.1.3. Resolution-proof terms do not preclude the termination of a contract or SLA upon the maturity/termination date previously and mutually agreed by all signing parties of the contract or SLA.

5.5.2. Pricing

5.5.2.1. A DI will be required to have arrangements in place to ensure that

- i. the pricing structure for essential services is transparent and cannot be altered because of its entry into resolution;
- ii. where essential services are provided under the intragroup service company model, the pricing should be structured on an arm's length basis; and
- iii. it has the capability to evidence the robustness of the service pricing methodology adopted by reference to relevant external guidance and to monitor the robustness of such methodology on an on-going basis.

5.5.3. Operational resilience

5.5.3.1. A DI will be required to:

- i. consider whether its essential service providers have sufficient financial resilience to continue providing essential services to the DI in resolution;
- ii. regularly review the financial condition of its essential service providers in business as usual;
- iii. develop capabilities to monitor and estimate its liquidity needs for paying for essential services in resolution and ensure that it has sufficient and readily available financial resources to meet the cost of essential services in a resolution;
- iv. identify alternative service provider(s) during business as usual and estimate the time and financial resources that could potentially be required

for switching to such alternative provider(s) should such action become necessary;

- v. put in place adequate contingency arrangements to support OCIR, regardless of the chosen resolution strategy;
- vi. ensure that the contingency arrangements the DI has in place addresses any interdependencies among the essential service providers, including in a scenario where the essential service provider is an intragroup entity;
- vii. develop a strategy for retaining essential staff, develop a plan for on-boarding replacements for essential staff, should the need arise, and estimate the possible additional costs for the retention of essential staff and implementation of relevant alternative arrangements; and
- viii. develop and maintain an OCIR playbook⁴ that describes, at a detailed level, the actions and steps that it will take in order to facilitate OCIR. The playbook should be tested and updated regularly with lessons learned from the tests.

5.5.4. Rights of use and access to essential operational assets⁵

5.5.4.1. A DI will be required to:

- i. secure and maintain the rights of use of, as well as timely access to, essential operational assets, which assets include (but are not limited to) real estate, information technology (IT) infrastructure and systems, intellectual property, data, licences and leases in relation to the maintenance of core business lines and the provision of critical functions;
- ii. ensure that essential operational assets are identified and clearly documented, including information on their ownership, location, access rights as well as the terms and conditions for their use and access;

⁴ A 'playbook' means a set of rules, process workflows, actions and standard operating procedures that inform an entity's consistent response to certain situations.

⁵ Essential operational assets mean assets that are required for OCIR.

- iii. identify and address potential legal or practical obstacles to maintaining the use of, and access to, essential operational assets;
- iv. identify and address any uncertainties over the legal obligations of third-party service providers operating on a cross-border basis regarding access to, and use of, essential operational assets under contracts governed by foreign law; and
- v. have arrangements in place, including operational procedures and approval processes, to timeously grant the resolution authority and other relevant authorities the relevant rights in the run-up to, and during resolution.

6. Governance and management oversight

- 6.1. A DI will be required to have in place a governance framework that is underpinned by sufficient board and management oversight with clearly defined reporting lines to ensure the continued provision of essential services.
- 6.2. A DI will be required to ensure that its governance arrangements to support OCIR are integrated into its overall governance framework.
- 6.3. In implementing its OCIR arrangements, a DI should ensure compliance with applicable laws, regulations and supervisory requirements, including, but not limited to outsourcing standards and requirements, business continuity planning requirements as well as recovery planning requirements.

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