6 November 2020

Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland

By upload

Dear Sir/Madam

Re: BCBS Principles for Operational Resilience

The Australian Financial Markets Association (AFMA) welcomes the opportunity to provide comment to the Basel Committee on Banking Supervision (BCBS) on the proposed Principles for Operational Resilience. AFMA's membership, at around 110 members, includes a wide range of global and domestic financial market participants that employ sophisticated operational processes and securities systems.

During the substantial period of market volatility effected by COVID-19, the Australian financial services industry experienced significant strain but was ultimately successful in ensuring continued market functionality, that facilitated economic recovery.

AFMA appreciates the principles-based approach to the proposed guidance on operational resilience the BCBS has adopted. A principles-based approach is more likely to allow efficient levels of adaptation to different business models and less likely to restrain business evolution and adaptation to the evolving technological landscape and threat environment.

Market forces create incentives, including commercial reputational risks, for firms to ensure their operational resilience is appropriately calibrated. BCBS should consider encouraging regulators to recognise and allow for these forces to support operational resilience goals.

Please find AFMA's comments on the proposed principles below. Please contact Nikita Dhanraj either on +61 2 9776 7994 or by email ndhanraj@afma.com.au if further clarification or elaboration is desired.

Yours sincerely

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Senior Director of Policy

Definition of Operational Resilience

The proposed definition of Operational Resilience is stated as:

> *"… the ability of a bank to deliver critical operations through disruption. This ability enables a bank to identify and protect itself from threats and potential failures, respond and adapt to, as well as recover and learn from disruptive events in order to minimise their impact on the delivery of critical operations through disruption. In considering its operational resilience, a bank should take into account its overall risk appetite, risk capacity and risk profile."*

AFMA prefers the recent Bank of England definition:

> *"Operational resilience: the ability of firms and FMIs and the financial sector as a whole to prevent, adapt, respond to, recover and learn from operational disruptions."*[1]

AFMA notes caution around designing principles or guidance around outcomes, in this case where BCBS includes in the definition of Operational Resilience that it "enables a bank to identify and protect itself from threats and potential failure". A failure to identify a threat or protect against it might risk being seen as a failure of operational resilience. Given the asymmetry of state-actor based attacks this may not be warranted. Advance states themselves are not always able to prevent attacks by sophisticated attacks by other state actors.

The Bank of England's definition of operational resilience appears to be clearer that abilities in prevention, adaption, response, recovery and learning are all parts of operational resilience but that failure to prevent may not indicate failings in operational resilience.

The role of technology in operational resilience

AFMA holds that while technological advances can create operational risks it can also increase operational resilience. The widespread shift of operations and business activities from offices to homes, necessitated by the COVID-19 pandemic, was supported by technological capabilities. Virtual meetings, remote trading activities, cloud storage, remote security patches, electronic KYC and signatures, etc. were made possible due to rapid technological developments. This also drove market actors to switch to more efficient ways of conducting activities, including regulators. When sufficiently accounted for in business continuity plans (BCPs) and assessments, technology can increase operational resilience.

For example, the Commodity Futures Trading Commission (CFTC) has considered Artificial Intelligence[2], and sees it as a useful way to "use data to develop market models and identify risk factors, conduct ongoing market and risk surveillance, and help identify market manipulation, abusive trading, and fraud." They note the predictive nature of AI

[1] Bank of England, Financial Conduct Authority, Prudential Regulation Authority; (July 2018); *Building the UK financial sector's operational resilience*; BoE DP01/18; FCA DP18/04; PRA DP01/18; retrieved from: Building operational resilience: Impact tolerances for important business services.
[2] Commodity Futures Trading Commission, *LabCFTC Fintech Primers*, A Primer of Artificial Intelligence in Financial Markets.

as particularly beneficial. Several other research reports investigate the varying levels of adoption of AI in risk management in financial services and highlight how AI can be a fundamental element of core business processes in risk management.

Regulatory Approach to Operational Resilience

Taking account of the essential benefits of technological advances, AFMA supports that in addition to the industry taking all the requisite steps to ensure operational resilience, it is incumbent upon financial regulators to support the industry with a compliance environment that assists technological and process innovation, market competitiveness and does not create onerous, costly and inefficient regulatory obligations.

Regulators should work with the entities to enable them to reach a standard benchmark for operational resilience which can shift with the evolving nature and types of risks facing the industry. The specification of any 'aspirational' target would not be appropriate for mandating. AFMA thus supports the need for a standard of operational resilience that incentivises firms to prepare for disruptions and to invest resources where needed.

AFMA holds that guidance coming from multilateral organisations like BCBS should promote risk-based regulation, along with principles directed at industry. This will allow the regulators to continue to deliver more consistent, higher-quality supervision as the sector develops and risk profiles of firms change in reaction to competitive forces. Of particular concern is that the litigation-driven punitive approaches to regulatory enforcement should be avoided as they are less likely to deliver improvements for the markets and in turn may create avoidable negative externalities for the financial services sector that harm economic progress.

Responses to consultative questions

Q1. Has the Committee appropriately captured the necessary requirements of an effective operational resilience approach for banks? Are there any aspects that the Committee could consider further?

Apart from our comments surrounding the definition of operational resilience stated above, AFMA supports the requirements captured by BCBS for an effective operational resilience approach.

Q2. Do you have any comments on the individual principles and supporting commentary?

> Principle 1: Banks should utilise their existing governance structure to establish, oversee and implement an effective operational resilience approach that enables them to respond and adapt to, as well as recover and learn from, disruptive events in order to minimise their impact on delivering critical operations through disruption.

AFMA supports Principle 1.

> Principle 2: Banks should leverage their respective functions for the management of operational risk to identify external and internal threats and potential failures in people, processes and systems on an ongoing basis, promptly assess the vulnerabilities of critical operations and manage the resulting risks in accordance with their operational resilience expectations.

AFMA supports Principle 2 as consistent with existing market practice and the pressures of market forces.

> Principle 3: Banks should have business continuity plans in place and conduct business continuity exercises under a range of severe but plausible scenarios in order to test their ability to deliver critical operations through disruption.

AFMA supports Principle 3.

> Principle 4: Once a bank has identified its critical operations, the bank should map the relevant internal and external interconnections and interdependencies to set operational resilience expectations that are necessary for the delivery of critical operations.

AFMA supports a definition of critical operations that is based on international best practice and guidance but is tailored from specific domestic lens to account for jurisdictional specifications. Critical operations, once identified to an adequately granular level, should be applied and tested while considering their in-built impact tolerances to a range of potential disruptions.

> Principle 5: Banks should manage their dependencies on relationships, including those of, but not limited to, third parties or intra-group entities, for the delivery of critical operations.

It is AFMA's experience in the Australian context that financial institutions conduct holistic, detailed and regular due diligence exercises to assess and manage their dependencies on relationships, including those of, but not limited to, third parties or intra-group entities, for the delivery of critical operations.

> Principle 6: Banks should develop and implement response and recovery plans to manage incidents that could disrupt the delivery of critical operations in line with the bank's risk tolerance for disruption considering the bank's risk appetite, risk capacity and risk profile. Banks should continuously improve their incident response and recovery plans by incorporating the lessons learned from previous incidents.

In AFMA's experience, financial institutions ensure consideration of response and recovery plans to manage incidents, in their regularly tested and updated BCPs.

> Principle 7: Banks should ensure resilient ICT including cyber security that is subject to protection, detection, response and recovery programmes that are regularly tested, incorporate appropriate situational awareness and convey relevant information to users on a timely basis in order to fully support and facilitate the delivery of the bank's critical operations.

While AFMA supports Principle 7 and the BCBS commentary on the same, technological innovations that underpin ICT adoption and cyber security defences should be supported by a regulatory environment that recognises the efficiencies and benefits of these innovations and govern them by a regime that reduces administrative burdens, onerous costs, uncompetitive factors and punitive actions against the industry. Due attention and acceptance should be accorded to the industry's expertise and experience around ICT which should inform regulatory guidance.

Q3. Are there any specific lessons resulting from the Covid-19 pandemic, including relevant containment measures, that the proposed principles for operational resilience should reflect?

In keeping with AFMA's comments above, we recommend inclusion of the following in the proposed principles for operational resilience –

a. Guidance for financial regulation along with guidance to industry: Financial markets should be assisted by a supportive regulatory environment and regulatory reliefs that promote rapid economic recovery in the time of a crisis. Apart from crisis, financial regulation in general should uphold competitiveness and innovative enterprise, reduce duplicative, costly and restrictive obligations and follow an accommodative approach to administering the law.
b. Consistent industry-wide collaboration: Collaboration among financial market participants, infrastructure and service providers, regulators, governments and expert organisations, is useful to promote best practice, essential information sharing and high-level consistency in BCPs across the industry.
c. The crucial role of technological advances in ensuring and strengthening operational resilience.

Q4. Do you see merit in further consolidation of the Committee's relevant principles on operational risk and resilience?

AFMA suggests consolidation of principles 2, 4 and 5 which guide on internal and external functional dependencies, interdependencies and their management for critical business operations. Such consolidation would effectively direct rationalised and proper regulation by minimising duplicative guidance and obligations.

Q5. What kind of metrics does your organisation find useful for measuring operational resilience? What data are used to produce these metrics?

AFMA is a trade association.