



Operational Resilience Important Business Services – Impact Tolerances Guide

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Introduction

Impact Tolerances are hard. That's a consistent message from firms. But they are important.

Many firms have found, in practice, that it is difficult to understand what Impact Tolerances to set, how they should be measured and the difference between risk management and impact tolerance.

This Good Practice Guide sets out how firms should approach the setting of Impact Tolerances.

A firm only needs to set both a PRA and FCA impact tolerance if the Important Business Service is relevant to both PRA and FCA objectives.

A firm may set its PRA impact tolerance for a given Important Business Service at the same point as its FCA impact tolerance.

Impact Tolerance is set at the point where any further disruption to the Important Business Service could cause intolerable harm to clients or pose a risk to the soundness, stability or resilience of the UK financial system or the orderly operation of financial markets.

Intolerable Harm to clients is material detriment that the end user or client cannot easily recover from.

The Guide sets out:

1. common definitions,
2. how firms should look for the Three Harms,
3. other considerations for determining intolerable harm (with examples),
4. an approach to defining Customers,
5. proportionality,
6. the interplay with Risk Management,
7. methodology,
8. metrics for measuring impact tolerances, with practical examples, and
9. recommendations for firms.

This Guide recognises the practical difficulties firms face and how to tackle them in a straightforward way. We commend it to the industry!

Taxonomy of Related Terms

To support alignment with common related definitions a taxonomy has been created.

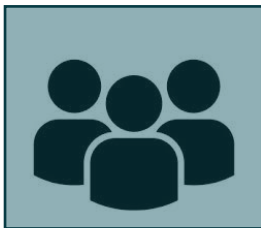
Term	Source	Definition
Intolerable Harm	FCA PS 21/3	Intolerable harm constitutes harm from which consumers cannot easily recover. As such, it is considerably more severe than inconvenience or harm, as in these cases it is assumed that firms can remediate any disruption without significant ill effects. What constitutes intolerable harm will vary from firm to firm, taking account of various factors relating to customers and market position.
Impact tolerance	PRA PS 6/21 FCA PS 21/3 SYSC/15A	An impact tolerance is the maximum tolerable level of disruption for each Important Business Service. It is a requirement for each Important Business Service to have an individual impact tolerance set (per regulator). This is to enable firms to understand the maximum level of disruption acceptable to an Important Business Service, measured in terms of duration and any other relevant metrics. This helps firms to take action to ensure that they remain within the tolerance.
Business Service	PRA CP29/19 FCA CP 19/32	A 'business service' is a service that a firm provides to an external end user. Business services deliver a specific outcome or service to an identifiable user and should be distinguished from business lines, such as mortgages, which are a collection of services and activities. They will vary from firm to firm.
Important Business Service	PRA CP29/19 FCA CP 19/32	An Important Business Service means a service provided by a firm, or by another person on behalf of the firm, to one or more clients of the firm which, if disrupted, could: <ol style="list-style-type: none"> 1. cause intolerable levels of harm to one or more of the firm's clients; or 2. pose a risk to the soundness, stability or resilience of the UK financial system or the orderly operation of financial markets

Intolerable Harm

Intolerable harm is defined as:

'material detriment the end user or client cannot easily recover from'

- When looking to establish Impact Tolerances for a firm's Important Business Services firms should look at them on a 'Three Harms' basis as outlined below.
- Whichever harm has the shortest time period to reach intolerable harm or pose a risk to the soundness, stability or resilience of the UK financial system or the orderly operation of financial markets is where an impact tolerance should be set.



Client Harm	Market Harm	Firm Harm
<p>Consideration of the potential harm to clients affected by the disruption of the service (e.g. CASS, etc)</p>	<p>Consideration of the impact on the UK financial system e.g. trading counterparties, LSE etc. (unauthorised activities) Pose a risk to the soundness, stability or resilience of the UK financial system</p>	<p>Consideration of the impact on the firm itself - where it could cause consumer harm or market integrity to soundness and stability of the firm (e.g. a liquidity event affecting the firm) as well as potentially affecting capital/revenue</p>

Intolerable Harm

Other considerations for intolerable harm:

- **It should be considered before assessing any mitigating actions** that may be taken to avoid impacts. For example, payments disruption to BACS services could be managed by, instead, processing payments through CHAPS. This action may reduce the number of clients impacted and therefore avoid breaching a firm's impact tolerance simply by changing the payment method at cost to the firm. However, mitigating actions should not inform the identification of intolerable harm or setting of the related impact tolerance. Please note this is different from recovery actions which deal with correcting impacted clients who have been 'harmed' which is covered in the next point.
- **How easily a client can recover from the impact.** For example, if trading or dealing is disrupted, firms may decide for all trades to make the clients financially whole. If there is no other form of harm and the client is fully compensated, they would have recovered quickly. This can be an influencing factor used as an overlay when ratifying the impact tolerance. It then becomes a firm harm assessment where a firm defines at which point they can cover the cost for making clients right.
- **It should be set at the lowest common denominator** or at a plausible stress point. For example, tax year end may result in more or additional types of intolerable harm than other points in the year. This demonstrates why data analysis is key to setting impact tolerances. It is important to look at the typical and peak values in conjunction with any other time factors like daily cut off times.

Intolerable Harm

- Cannot be '*made good*' easily i.e. large scale financial compensation
- Systemic widespread problems i.e. resulting in a large number of complaints

Intolerable Harm

Below are some examples of the type of harms or situations firms should consider when trying to assess the full impact of disruption to an important business service and where intolerable harm might occur. However this will be dependant on the nature and scale of a firm's identified important business services.

Financial

Losses close to or beyond the firms ability to compensate or cover

Example:

- Financial Impact of market movement on assets i.e. price movements on trades
- Compensation for distress

Events / Timing

Principally secondary financial impacts due to the failure of the Important Business Service

Examples:

- Tax year end missed i.e. tax allowances not recoverable
- Missed payments result in customers not being able pay rent and has adversely impacted their credit score
- Missed payments result in clients not being able to complete on house move.

Other types of harm

- Reputational harm and loss of business and opportunity
- Record keeping – i.e. security of title
- Data breaches, loss or corruption of customer data
- Disruption to the wider market impacting clients or firms that the firm in question do not have a direct relationship with

Defining the 'Customer'



- The diagram to the left shows examples of the considerations when defining the customer or the end user of an Important Business Service.

- It is important to note that not all direct 'customers' or end users will be retail customers. However, it is possible that retail customers will be impacted at the end of the chain.

- As per the guidance on the types of harm, this will be dependent on the nature and scale of a firm's identified Important Business Services.

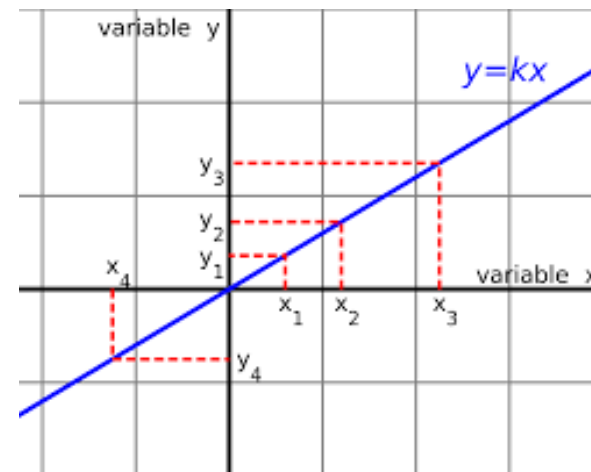
- When defining the customer, the process should be evidence driven, and don't forget to document the process and methodology.

Proportionality

A key principle to operational resilience management is proportionality. This principle is applicable to all aspects of this guidance. Firms should be flexible in their approach which should be appropriate to the size and complexity of their firm.

- Building operational resilience is a detailed activity and firms have finite resources. As such, firms should seek to focus on, and invest in, services which pose the highest risk to consumers, the firm and the market in the event of a disruption.
- This principle also applies to the level of granularity that a firm goes to in the identification of important business services, dependency mapping, assessment, and approach to scenario testing.
- Similarly, the degree of governance and documentation should be proportionate. For example, a firm may choose to invest heavily in building operational resilience into important business services which have low impact tolerances and take a proportionately lighter approach for important business services as the impact tolerance duration extends.

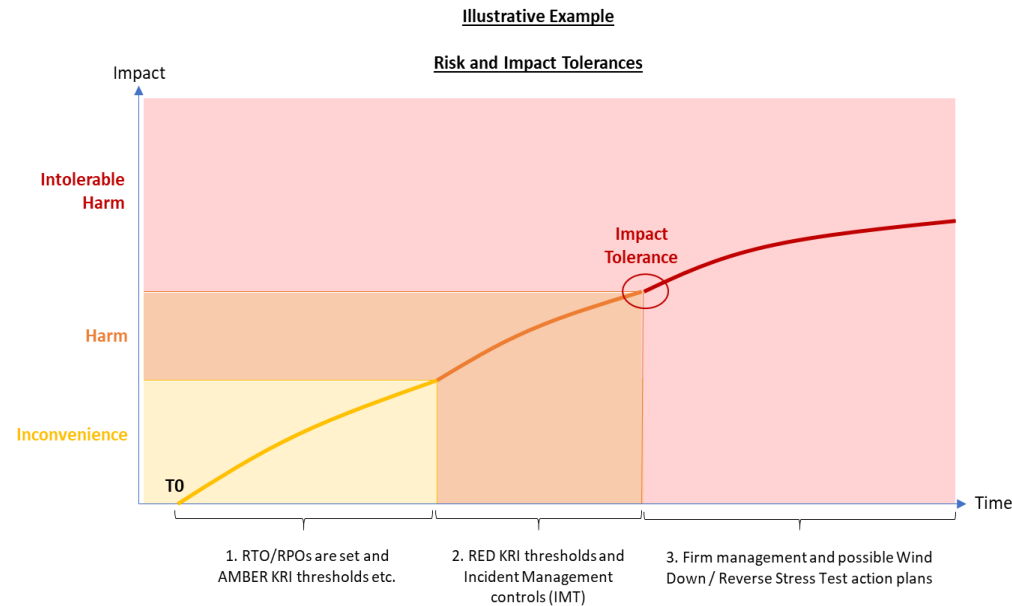
- Firms may apply a higher frequency to maintenance cycles and governance to important businesses services with low impact tolerances and proportionately less for those with higher impact tolerances. The Board (or equivalent management body), and the accountable manager (normally the SMF24) should determine the proportionate approach taken and set a regular review schedule. Note that firms must reconsider impact assessments at least annually. Best practice would be to test when there is a material business change, or following revisions to a test.



Risk Management

Risk appetite/Recovery time objectives (RTO) and Impact Tolerances are not the same. But they are connected and in effect, when dealing with real world scenarios they work on the sliding scale of impacts that arise from disruption or resilience events

- As a guide, it is likely that a firm's Recovery time or point objective (RTOs/RPOs) and Risk Appetite and Key Risk Indicators (KRIs) will be set well in advance of 'intolerable harm' points agreed as part of a firm's respective Operational Resilience Framework. e.g. System goes down - intolerable harm arises after 4 hours so recovery time is set as 30 minutes.
- When intolerable harm occurs, these situations are more likely to require key controls such as a firm's incident management framework and possibly further management actions, for example as captured by a firm's wind down plan or reverse stress tests.
- Note: A key difference between risk management and impact tolerance is probability. Impact tolerance assumes a risk has crystallised.



Risk Management

It is useful to link the defined impact thresholds for intolerable harm to a firm's Risk incident/breach matrix or severity scale as outlined below. These categorisations should be based on a firm's own assessment and documented. This is one way to ensure that operational resilience incidents or events are taken into account as part of a firm's risk management framework.

1.

Illustrative Example

Risk Matrix and Impact Tolerances

		Negligible (1)	Low (2)	Medium (3)	High (4)	Very High (5)	Severe (6)
Client Harm	NO. CLIENTS IMPACTED	Minor Inconvenience	Inconvenience	Harm	Intolerable Harm		
	CLIENT LOSS / DETRIMENT						
	UPHELD COMPLAINTS						
	ALTERNATIVE PROVIDERS						
Market Harm	MARKET IMPACT						
Firm Harm	FINANCIAL						
	REGULATORY						
	REPUTATIONAL						
	LEGAL						

2.

Illustrative Example

Risk Matrix and Impact Tolerances

		Low (1)	Medium (2)	High (3)	Major (4)
Client Harm	NO. CLIENTS IMPACTED	Minor Inconvenience	Inconvenience	Harm	Intolerable Harm
	CLIENT LOSS / DETRIMENT				
	UPHELD COMPLAINTS				
	ALTERNATIVE PROVIDERS				
Market Harm	MARKET IMPACT				
Firm Harm	FINANCIAL				
	REGULATORY				
	REPUTATIONAL				
	LEGAL				

Methodology

There is no single method to go about defining the impact tolerances; the requirement from the regulators is to be able to justify, with evidence, the approach taken by the organisation to get to the defined impact tolerances. Principally, this should be approached on both a data and judgement basis as outlined below.

Firms need to work out the most appropriate approach for them and ensure that sufficient rigour has gone into the decision-making process. They should document their process, the decisions arising from the process and how they relate to the FCA/PRA rules. It is important that the appropriate Senior Manager and the Board (Exec Committee) understand their firm's methodology and are able to provide their sign-off. The FCA have noted an important principle of defining the impact tolerance should be on the basis that the impact has already occurred, and not the risk of it occurring. Note that the FCA sets out the factors that a firm should consider in [FCA Operational Resilience Instrument 2021 15A.2.7](#)

The assumptions are;

- The Important Business Service is defined and approved

Approach A

One approach for deciding how to set impact tolerances may be a data-led approach, this is appropriate depending on the extent of data available. Where data is available, it can form a useful basis by which to determine the point in time in which intolerable harm manifests to consumers. Other measures could be used in addition to time, e.g. volume of transactions, value of assets under management, no of clients impacted etc. This may be established by using the relevant data points from mapping the important business services and understanding the metrics that describe the resources needed to deliver the service.

- Identify the potential types of harm and who could be impacted
- Identify how harm can be measured, typically for a specified period of time
- Understand current position, review metrics, incidents or disruptions to service over e.g. last year
- Determine impact threshold

Approach B

A judgement approach may be more appropriate, based on the experience of the teams involved and then validated against available evidence. While the FCA does not prescribe any specific approach to setting impact tolerances, as part of the self-assessment process, they do expect to see the firm's impact tolerances and the justification for the levels at which they have been set, as well as the methodology to determine them.

- Identify the potential types of harm and who could be impacted
- Identify how harm can be measured, typically for a specified period of time
- Determine the impact threshold based on judgement
- Use available data to sense check the tolerance threshold
- Adjust threshold across the other IBS (i.e., not viewed in isolation)

Measuring Impact Tolerances

This measuring the performance on an important business service against its impact tolerance firms should identify the metrics to show when intolerable harm has been or is near to being breached.

Some of these are likely to vary for different important business services however there may be some common metrics. The common metrics are outlined in the regulations as part of the standard considerations for assessing intolerable harm. i.e. as described under PR09. Many of these may already be captured as part of the firm's Risk Management Framework. Additional considerations should be given to a duration metric or threshold level, given that the regulatory requirement to set an impact tolerance as a period over time.

For example:

- Number of clients impacted
- Duration of outages/degradation
- Length of time to answer a customer's call
- Call abandonment rate
- Number of delayed payments
- Number of trades that fail to execute
- Number of upheld complaints

A combination of metrics is acceptable.



Challenges

A few of the common challenges that commonly occur when establishing and monitoring impact tolerances are outlined below.

- **Vulnerable customers** - Keeping the needs of vulnerable customers in mind and how this may impact the impact tolerance (although FCA have confirmed that separate impact tolerances for this particular customer base is not required as it should be considered in the process for setting the impact tolerance holistically). Note that for some client types there may be less substitutability so impact may be higher. The FCA have recently updated their terminology such that Vulnerable Customers are now referred to as 'customers with characteristics of vulnerability'.
- **Metrics and Measurement** - Identifying potential types of harm and the ability to measure. Not always obvious what metrics are involved to measure the threshold at which intolerable harm is reached and probably will vary depending on what IBS is being measured.
- **Document process** – In all cases document the basis for and reasons for the decisions made. This will require explicit Board approval. The document will provide a base line so that future re-assessments of Impact Tolerances can be easily benchmarked and any changes to the background information can be specifically addressed. Proper documentation will provide the basis for demonstrating that Senior Managers have acted reasonably in discharging their functions. This should include evidence of suitable second line challenges. If you prepare summary documents for Board/Exec level personnel, these should be supported by a more detailed underlying document.

Impact Tolerance – Example 1

Service / Sector: Loss of Trading / Dealing / Inability to make payment

Nature of incident: Overall Service Unavailable

<p>Time The point at which intolerable harm occurs.</p>	<p>This should be measured on an individual and proportionate basis to each firm, using the considerations below. Firms should identify and analyse the first point at which intolerable harm occurs. Firms should consider i) time metric, in line with peak period of service, and ii) nature/time of incident e.g. tax year end / year end. This point is dependent on the expected levels of day to day performance and how a tolerance exceeds this.</p>
<p>Client Impact The number of clients that may be adversely impacted and the nature of the impact.</p>	<p>Firms must consider the number of clients that may be adversely impacted. For example, between 2-5% of a consumer base. These calculations will be wholly dependent on proportionality, Important Business Service and firm. Examples include clients who miss a valuation point and consequently face market exposure, or miss receiving funds within SLA. Firms should identify the ultimate impact to clients after all alternative methods and substitutes have been utilised.</p>
<p>Client Types The nature of the client base (including considering vulnerable customers).</p>	<p>An individual consumer could face irreversible impact based on life events that funds would be used for, e.g. house purchase, significant tax events, business funding, reinvestment in the case of market volatility. This includes institutional clients that serve many individual consumers. Considerations should also be made to any other material consumer of service i.e. fund manager, execution venue or third party recipient of service.</p>
<p>Financial Loss The potential financial loss to clients.</p>	<p>An institutional client represents significant market share with significant underlying retail client base. Such a client will be unable to meet obligations to onwards retail clients in the event of a service failure, which could result in reputational harm, loss of business and liability for costs. There may also be a potential impact on share price depending on the nature and time of incident. There may be further potential financial loss to the firm where there is a risk to the firms clients, the soundness, stability or resilience of the UK financial system or the orderly operation of the financial markets</p> <p>Where events impact i) a large number of clients, ii) the level firm can compensate to, and iii) the indirect impact to clients, firms should consider linkage to wind down plans proportionate to each firm. Associated metrics could be utilised to measure this. Where loss is incurred, it may or may not be due to compensation, it is wholly dependent on the scenario.</p>

Impact Tolerance – Example 2

<p>Reputational Damage The potential level of reputational damage to the firm and/or the potential impact on market or consumer confidence.</p>	<p>The impact to a firm if it has to correct market exposure following missed valuation point. If it is an Institutional Client impact, it could result in share price impacts or ramifications.</p>
<p>Market Harm The potential spread of risks to their other business services, other firms or the UK financial system.</p>	<p>If a trade service is unavailable, knock-on impacts are likely to be felt on the ability to trade, settle, take or make payments. It is important to think about market share considerations, and to consider large financial institutions with the different roles they hold in a trading capacity. Here, there is much potential for reputational risk across the industry.</p>
<p>Data Breach Any potential loss of confidentiality, integrity or availability of data.</p>	<p>For the purposes of our example, we can consider a breach is one that has exceeded RTO/RPO/ISO standard recovery expectation, at the point where disruption is assumed. Firms should consider the tolerance in line with service continuity but also data restoration and backlog refinement. When considering confidentiality, firms should bear in mind points 1-4 on the previous page and potential fraud implications.</p>
<p>Contagion Risks Disruptions of more than one Important Business Service.</p>	<p>This refers to the potential aggregate impact of disruptions to multiple IBS, in particular where such services rely on common operational resources. Firms should consider these risks from an internal standpoint using interdependency mapping or IBS correlation.</p> <p>For example, if a firm is unable to settle trades then as a consequence payments may also be effected, unless covered by the firm.</p>