

21 October 2022

**Confidential Communication**

**General Manager**

Policy

Australian Prudential Regulation Authority

Email: [REDACTED]

**Australian Custodial Services Association response on APRA Prudential Standard CPS 230  
Operational Risk Management**

Dear Sir/Madam

The Australian Custodial Services Association (ACSA) is the peak industry body representing members of Australia's custodial and investment administration sector. Our mission is to promote efficiency and international best practice for members, our clients, and the market. Members of ACSA include NAB Asset Servicing, J.P. Morgan, HSBC, State Street, BNP Paribas Securities Services, BNY Mellon, Citi, Clearstream and The Northern Trust Company.

Collectively, the members of ACSA hold securities and investments in excess of AUD \$4.0 trillion in value in custody and under administration for Australian clients comprising institutional investors such as the trustees of major industry, retail and corporate superannuation fund, life insurance companies and responsible entities and trustees of wholesale and retail investment funds.

Those institutional investors are responsible for a sizable proportion of the money invested and held for Australian retail investors. ACSA member services are therefore integral to supporting the investment and retirement savings of a large part of the Australian population.

This submission is intended to provide the Australian Prudential Regulation Authority (**APRA**) with the collective views of ACSA members on the issues raised by APRA Prudential Standard CPS 230 (**CPS 230**) and its proposed implementation on the Australian custodial and investment administration sector.

While members of ACSA are not opposed to the introduction of CPS 230, many ACSA members request further clarification from APRA in relation to the intent and implementation of the prudential standard.

## EXECUTIVE SUMMARY

Our detailed response to CPS 230 and the associated discussion paper, 'Strengthening operational risk management', can be found in Annexure A.

Key points from our review of the proposed prudential standard include the following:

- additional guidance would be useful to assist in the implementation of CPS 230, relating to:
  - the material risks associated with the use of third party service providers, and any ancillary services they may provide to APRA-regulated entities;
  - whether a materiality threshold could be applied to fourth parties, such that the focus of CPS 230 remains only those fourth party services that are ultimately relied upon by the APRA-regulated entity to undertake a 'critical operation' or that expose the regulated entity to a material operational risk; and
  - the definition of 'systemically important to Australia' and the entities that APRA considers would fall within the definition;
  - the content in the material service provider register and whether APRA will provide a standardised template to be used by APRA-regulated entities;
  - notification of 'near misses' and 'material' changes to agreements to APRA;
- transitional arrangements to comply with CPS 230, including in particular whether the new requirements relating to third party contracts should apply only to contracts with material service providers that are entered into or renewed more than 12 months after the commencement of finalised CPS 230 and the associated guidance; and
- the tender and selection process when renewing or materially modifying formal service agreements with material service providers who are related bodies corporate or provide services which are assessed as low risk prior to renewal.

## CONTACT INFORMATION

If you have any questions in relation to this submission, please direct those questions to the ACSA Regulatory Working Group Deputy Chair, Daniel Di Stefano, Vice President, APAC Product Management, State Street, [REDACTED].

Regards



David Travers  
Chief Executive Officer

## Annexure A – ACSA Responses

APRA Question	ACSA Response
<b>Overall design</b>	
1. Is a single cross-industry standard for operational risk management supported?	Yes.
2. Are there specific topics or areas on which guidance would be particularly useful to assist in implementation?	<p><b>(a) Guidance relating to material risks associated with the use of third party service providers</b></p> <p>ACSA notes that in determining whether a third party is a material service provider for the purposes of draft CPS 230, it appears from the current draft CPS 230 that it will be relevant to consider all services provided by the third party, including those that may currently be considered to be ancillary to core services. For example, liquidity and foreign exchange services may be ancillary to the provision of custody services. However, they may not be relied upon by the APRA-regulated entity to undertake a critical operation and may not expose the APRA-regulated entity to a material operational risk.</p> <p>ACSA seeks clarification that the focus of CPS 230 is on the <i>material</i> risks associated with the use of third party service providers including, if any, material risks associated with ancillary services provided to APRA-regulated entities.</p> <p>Certain requirements in draft CPS 230 indicate that a risk-based approach to managing any ancillary outsourced services is likely to be required. For example, paragraphs 46 and 48 of draft CPS 230 state that an APRA-regulated entity must 'manage the material risks' associated with using material service providers. Similarly, paragraph 29 of CPS 230 refers to the regular monitoring, review and testing of operational risk controls 'for design and operating effectiveness, the frequency of which must be commensurate with the materiality of the risks being controlled'. However, other paragraphs in draft CPS 230 (such as paragraph 55(a)) simply refer to a requirement to identify and manage any risks to the APRA regulated entity that could result from a third party arrangement, and should be amended to retain the focus on material risks.</p>

ACSRA Response	APRA Question
<p><b>(b) Guidance relating to fourth party assessment</b></p> <p>ACSRA submits that the focus of draft CPS 230 should be on <i>material</i> fourth parties and that the onus of identifying and managing other sub-contractors down the supply chain should remain with the material service provider. It is noted that paragraph 53(d) of draft CPS 230 refers to other 'material service providers' but there is no reference to a materiality threshold in the requirement to manage fourth parties in paragraph 47.</p> <p>Similarly to the definition of a 'material service provider' provided in paragraph 48 of draft CPS 230 and the Discussion Paper to CPS 230 (page 25), a 'material fourth party' could be defined as one on which a regulated entity ultimately relies to undertake a critical operation or that could expose it to material operational risk.</p> <p><b>(c) Guidance relating to the identification, assessment and management of operational risks</b></p> <p>ACSRA requests additional guidance on the identification, assessment and management of operational risks associated with outsourced services such as would encourage consistency in approach across the industry.</p> <p><b>(d) Guidance relating to "systematically important to Australia"</b></p> <p>ACSRA requests further guidance from APRA on how to ascertain whether a material service provider is "systemically important to Australia". ACSA expects that such service providers must be essential to the preservation of stability in the Australian financial system.</p>	<p>3. How could proportionality be enhanced in the standard, and is there any merit in different requirements for SFIs and non-SFIs?</p>
<p><b>Proportionality</b></p> <p>ACSRA notes that the expansion of regulated entities' management of material service providers with respect to fourth party risks is a significant enhancement. As such, ACSA submits that draft CPS 230 be amended to allow for/confirm a proportionate application to fourth party service providers and others down the supply chain, having regard to the practical difficulties of the industry going down this route and APRA being able to regulate same.</p>	

APRA Question	ACSA Response
4. What are the estimated compliance costs and impacts to meet the new and enhanced requirements?	ACSA is open to providing input to APRA of estimated compliance costs through the lens of a material service provider. Though to do so in a meaningful manner would require further guidance as outlined in our comments in relation to Questions 2 and 8.
<b>Specific requirements</b>	
5. How could APRA improve the definitions of critical operations, tolerance levels and material service providers?	<b>"Material service provider" definition:</b> Please see our comments in relation to Question 2, including in relation to fourth parties. ASCA is comfortable with a principals based definition that has regard to the nature, scale and complexity of the specific APRA-regulated entity's business.
6. What additions or amendments should be made to the lists of specified critical operations and material service providers?	<p><b>(a) Content and format</b></p> <p>ACSA seeks:</p> <ul style="list-style-type: none"> <li>• further information on the format of, and information to be contained in the register of third party material service providers; and</li> <li>• a description of what APRA proposes to do with the information.</li> </ul> <p>ACSA queries whether APRA will release a standard template format of the register of material service providers.</p> <p>ACSA submits that paragraphs 46 to 51 should be amended to clarify that the information in the register of material service providers shall relate to third party providers.</p>
7. Are the notification requirements and time periods reasonable?	<p>ACSA seeks clarification on APRA's reference to 'near misses' in paragraph 31 of draft CPS 230 and guidance on APRA's expectations of notifications of near misses versus actual operational risk incidents.</p> <p>ACSA requests guidance on what could amount to a 'material' change to an agreement for the provision of a service on which an entity relies to undertake a critical operation (referred to in paragraph 58(a) of draft CPS 238) such as would trigger a requirement to notify APRA of the change.</p>

APRA Question	ACSA Response
<p>8. What form of transition arrangements and timeframe would be needed to renegotiate contracts with existing service providers (if required)?</p>	<p>ACSA notes the potentially significant efforts that will be required to re-negotiate and re-write agreements to conform to the requirements noted in para 53 and 54 of draft CPS 230.</p> <p>ACSA submits that the new requirements for agreements with material service providers apply only to such agreements as are entered into or renewed at least 12 months after the commencement of the finalised CPS 230 and related guidance (i.e. proposed to be 1 January 2024).</p> <p>ACSA submits that APRA's proposed power to require an APRA-regulated entity to review and make changes to such agreements where it identifies "heightened prudential concerns" only be effective following the commencement of the finalised CPS 230. ASCA expects the threshold for the exercise of this power to be high but guidance on the scenarios / trigger points for when this power may apply would be helpful.</p> <p>Similarly, ASCA expects the threshold for APRA's exercise of its power to conduct on-site visits to service providers to be high but welcomes clarification of this.</p>
<b>Additional areas for APRA's consideration</b>	
<p>9. Formal service agreement contents</p>	<p>ACSA notes the requirement in paragraph 52 of draft CPS 230 to undertake an appropriate tender and selection process before entering into, renewing or materially modifying an arrangement with a material service provider.</p> <p>ACSA submits that this tender requirement is not appropriate for:</p> <ul style="list-style-type: none"> <li>(a) agreements with related bodies corporate; and</li> <li>(b) the renewal of services which are assessed as low risk prior to renewal.</li> </ul>