CoData Solutions

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Consultation on Discussion Paper and draft CPS 230 - Operational Risk Management

Thank you for the opportunity to provide a submission on the proposals set out in this Discussion Paper and draft CPS 230.

The CoData team draws on decades of executive management operational experience and market knowledge. Based on our executive consultation across financial institutions and their service providers we comment on the consultation questions posed by APRA, and also provide observations on several key practical issues particularly relevant to superannuation.

Yours sincerely

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About CoData

CoData Pty Ltd brings business insight, operating model design, automation and implementation support to add efficiency, resilience and service uplift in support of investment operations professionals in funds, wealth, insurance and superannuation organisations.

Consultation questions

Overall design

1. Is a single cross-industry standard for operational risk management supported?

   Comment: In principal, yes. There is merit in drawing on the lessons of operational risk management across industry verticals in both framing policy and to maximise the potential for regulated entities to share experience and know-how within a common prudential framework.

   The level of commercial interaction and people movement across verticals also supports a cross-industry approach, and could also serve to increase familiarity within both senior executives of regulated entities and supporting professionals (for example, legal, compliance, audit and risk).

2. Are there specific topics or areas on which guidance would be particularly useful to assist in implementation?

   Comment: Yes. See comments below (Specific requirement Q1) regarding the definitions of critical operations, tolerance levels and material service providers.

3. How could proportionality be enhanced in the standard, and is there any merit in different requirements for SFIs and non-SFIs?

   Comment: Balance is required to accommodate the span in size and complexity (and therefore operational risk) inherent in APRA regulated entities both across and within industry sectors.

   On the other hand, the fact that an entity is APRA regulated at all means (by definition) they are within the prudential framework, and therefore merit a consistent approach (that is, equivalent policy requirement for SFIs and non-SFIs).

   Proportionality is then achieved within a consistent prudential regulatory policy setting, but right-sized by the Boards of each entity appropriate to their footprint. It would be helpful if APRA provide further guidance in terms of how proportionality will be interpreted in practice.

4. What are the estimated compliance costs and impacts to meet the new and enhanced requirements?

   Comment: Costs will be generated at each point in the regulatory change lifecycle – including interpretation, mapping to internal policies and compliance regimes, and review of all key functions and supplier agreements.

   We plan to provide a separate submission to APRA in terms of quantification.

Specific requirements	**1. How could APRA improve the definitions of critical operations, tolerance levels and material service providers?** *Comment: A challenge of any "principles based" approach is the potential for regulated entities to apply different interpretations. This is to a degree unavoidable, and arguably required if proportionality is a feature of the standard.* *Guidance by APRA on the definitions of critical operations, thresholds for tolerance levels, and material service providers would assist industry in convergent interpretation.* *Critical operations are defined (at 34) as those that would have a material adverse impact if disrupted beyond tolerance levels, and that these tolerances are Board approved (at 37) in three categories:* *(a) the maximum period of time the entity would tolerate a disruption to the operation;* *(b) the maximum extent of data loss the entity would accept as a result of a disruption; and* *(c) minimum service levels the entity would maintain while operating under alternative arrangements during a disruption.* *Implicit in setting tolerances for critical operations is the necessary level of resilience to be put in place that would reasonably assure that operations perform accordingly (and therefore appropriate investment in oversight, back-up, contingency plans, redundant capacity, etc).* *Additional guidance to regulated entities on the need to demonstrate the link between tolerance levels and resilience could be considered.* *At 36, APRA may require an APRA-regulated entity, or a class of APRA-regulated entities, to classify a business operation as a critical operation. If APRA so required, relevant tolerance also need to be set by APRA to allow application of the policy. Additional guidance on how this would work in practice would be valuable.* **2. What additions or amendments should be made to the lists of specified critical operations and material service providers?** *Comment: Specifically for superannuation critical operations, consider replacing "fund administration" with two distinct functions:* • *Fund accounting and valuation* • *Member administration* *This should carry over to the list (at 49) of material service providers that provide services to an APRA-regulated entity to include "fund accounting and valuation" and "member administration".*

The suggested change better reflects the distinct asset servicing and member servicing functions of superannuation funds. Each function has its own distinct processes, technologies and specific risks associated with critical operations.

3. **Are the notification requirements and the time periods reasonable?**

   Comment: The requirement to notify APRA prior to entering into any offshoring agreement with a material service provider, or when there is a significant change proposed to the agreement, including in circumstances where data or personnel relevant to the service being provided will be located offshore could prove problematic in the case of global counterparties and supply chains. For example:

   - *active investment management by an RSE, necessitating trading, clearing, settlement and ongoing asset servicing (including sub-custody) in new offshore markets;*
   - *utilisation of the scale and know-how of a global service provider with multiple offshore service centres. The geographic location of service provision can change at short notice as a result of the provider initiating BCP due to a site interruption (for example, natural disaster, pandemic lock-down or war).*

4. **What form of transition arrangements and timeframe would be needed to renegotiate contracts with existing service providers (if required)?**

   Comment: Flexibility in terms of timeframe is generally an advantage to the regulated entity.

   A "forced" renegotiation imposed solely by an unduly strict timeframe will generally result in excessive legal costs and/or possibly trigger an overall deterioration in the overall terms and conditions of a supplier agreement.

Observations

While CPS 230 makes it explicit that an APRA-regulated entity must manage its full range of operational risks, there is an imbalance in the level of prescription for outsourced providers compared to functions performed in-house.

Specifically, CPS 230 at 46 sets out requirements for the management of service provider arrangements, yet the same level of detail is absent for critical operations performed by the entity directly (in-house).

Better alignment to policy intent, including a greater appreciation by regulated entities of operational risk, would be achieved in if the level of prescription was equally applied to in and out source functions.

For example, one of the key stated aims of the standard is:

> *"enhance third-party risk management by extending requirements to cover all material service providers that APRA-regulated entities rely upon for critical operations or that expose them to material operational risk, rather than just those that have been outsourced" (emphasis added).*

Accordingly, the key obligations created under CPS 230 should apply equally to functions performed in-house in support of critical operations as those out-sourced, and wording of the substantive clauses could be changed to reflect this equivalence.

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