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Briefing Doc

PS24_16 Operational

Resilience CTP to UKFS



Detailed Briefing Document

Briefing Doc: Bank of England Policy Statement PS16/24 - Operational Resilience: Critical Third Parties to the UK Financial Sector

Date: 12 November 2024

Source: "PS16/24 – Operational resilience: Critical third parties to the UK financial sector | Bank of England"

Authors: Bank of England (Bank), Prudential Regulation Authority (PRA), and the Financial Conduct Authority (FCA)

Overall Objective: Manage risks to the stability of, or confidence in, the UK financial system arising from failures or disruptions in services provided by critical third parties (CTPs) to firms (authorised persons, relevant service providers, and financial market infrastructure entities).

Key Themes:

- **CTP Designation and Oversight:** The policy statement details the framework for identifying, designating, and overseeing CTPs. HM Treasury designates CTPs based on the potential systemic risk posed by the disruption or failure of their services. The regulators then have the power to impose rules, gather information, conduct investigations, and take enforcement actions against CTPs.
- **Systemic Third-Party Services:** The focus is on "systemic third-party services" (previously termed "material services") – those services whose disruption or failure could threaten the stability of, or confidence in, the UK financial system. This definition encompasses a wide range of services, including ICT services.
- **Focus on Systemic Risk:** The policy emphasizes a systemic perspective, recognising that the failure of a CTP could have a cascading impact on multiple firms and the broader financial system. It acknowledges the limitations of the "shared responsibility model" in managing systemic risk, as it doesn't consider the interconnectedness of firms and the asymmetric impact of CTP failures.

- **Key Requirements for CTPs:** CTPs will be subject to a range of rules and expectations, including:
- **Fundamental Rules:** These cover governance, risk management, and operational resilience. Notably, CTPs must "act in a prudent manner," disclose relevant information to regulators, and have a central point of contact with appropriate knowledge of financial regulation.
- **Operational Risk and Resilience Requirements:** These include requirements for mapping resources and dependencies, setting appropriate maximum tolerable levels of disruption for systemic third-party services, developing incident management playbooks, and ensuring technology and cyber resilience.
- **Testing and Assurance:** CTPs must conduct self-assessments, scenario testing, incident management playbook exercises, and share relevant information with firms and regulators.
- **Incident Reporting:** A clear definition of a "CTP operational incident" is provided, and CTPs must report such incidents to both the regulators and affected firms.
- **Proportionality and Implementation:** The regulators have attempted to balance the need for robust oversight with the principle of proportionality. The scope of most rules is limited to systemic third-party services, and there are transitional arrangements for implementation.
- **Enforcement:** The Bank of England and FCA have outlined their respective approaches to enforcing the CTP regime, emphasizing coordination and clarity.

Important Facts and Quotes:

- **Definition of Systemic Third-Party Service:** "A service, or group of connected services, provided by a CTP to one or more firms, a failure in, or disruption to, which could threaten the stability of, or confidence in, the UK financial system." (Section 2.14)
- **Shared Responsibility Model Limitations:** "While the shared responsibility model can be relevant to the demarcation of a CTP's duties under the CTP oversight regime, the model is not designed with systemic risk in mind." (Section 2.46)

- **Maximum Tolerable Level of Disruption:** "A CTP should use appropriate metrics and targets when setting an appropriate maximum tolerable level of disruption for its systemic third-party services." (Section 2.118)
- **Incident Management Playbook Exercises:** "The main aim of these exercises is to assess the effectiveness of a CTP's incident management playbook and promote its continuous improvement by deploying it in a simulated, scenario-based CTP operational incident." (Section 2.159)
- **Halo Effect Mitigation:** "What a CTP must not do, however, is imply that it has the approval or endorsement of the regulators by virtue of its designation by HMT, or that its designation confers any potential advantage to a firm or anyone else in using its services compared to a third party who is not designated as a CTP." (Section 2.226)

Implementation:

- The final rules will take effect from 1 January 2025. However, the obligations and requirements apply to a CTP only from the date specified by HM Treasury in the designation order.
- Certain requirements are subject to transitional periods, as detailed in the policy statement and SS6/24.

Overall, the policy statement outlines a comprehensive regime for overseeing CTPs. It emphasizes the importance of managing systemic risk and ensuring the resilience of vital services to the UK financial system. The implementation of this regime marks a significant development in financial regulation, acknowledging the crucial role of CTPs in the stability and confidence of the financial system.

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