



The Recovery, Resolution and Resilience Team
PRA
20 Moorgate
London EC2R 6DA

By email

12 December 2022

Dear Sir/Madam,

DP22/3: Operational resilience: critical third parties to the UK financial sector

The Panel welcomes the ideas put forward in the DP of how the supervisory authorities could use their proposed powers in the FSM Bill to assess and strengthen the resilience of services provided by critical third parties (CTPs). We have focussed our comments on five areas: the need for additional measures; unintended consequences; proposed enforcement powers; the need for cross-sectoral and international coordination; and identification of CTPs.

Need for additional measures to manage CTP risk

We agree there are significant implications of firms' and FMIs' increasing reliance on third parties which pose wider risk to the supervisory authorities' objectives. The first obligation is on regulated firms to ensure the resilience of CTPs they enter contracts with, but we welcome the recognition that no single firm or FMI can adequately monitor and manage risks stemming from concentration in the provision of services to multiple firms and FMIs by the same third party.

Q1: Do you agree with the supervisory authorities' overview of the potential implications of firms' and FMIs' increasing reliance on third parties (in particular the potential systemic risks to the supervisory authorities' objectives)? Is there anything else that the supervisory authorities should consider in their analysis?

Given the FCA's [proposed] new competitiveness objective, we suggest the authorities also consider the reliance new FMI's have on ICT services providing their "critical services" on a fair and equal basis. Many ICT services will have a key role in the network that facilitates the trading, or operating cycle of a product or services. If a new entrant is unable to access this network as a result of a decision by a CTP ICT provider not to engage, competition and innovation suffers.

Q3: Do you agree that, when considering potential requirements for CTPs, it is appropriate for the supervisory authorities to focus on (a) minimum resilience standards, and (b) resilience testing, in respect of the material services that CTPs provide to firms and FMIs? Are there any alternative or additional areas that the supervisory authorities should consider?

Regular, demonstrable testing of core offerings provided to customers via a CTP is, in our view, essential. Cloud acceleration, for example, has been exponential so when building vast datacentres at speed and scale, mistakes may happen. This is why testing is key.

Authorities should also consider whether CTPs are providing fair and equal access and facilitating services on behalf of common stakeholders.

Unintended consequences

Q8: What are your views on how best to avoid or mitigate potential unintended consequences, including potential distortion, such as deterring third parties from entering the market or providing services to firms and FMIs, as a result of a third party being designated as a CTP?

We are concerned that there could be unintended consequences to the introduction of the proposed measures, such as to competition. Many CTPs may be global organisations and over-regulation could risk driving providers away, leading to poor outcomes for firms and FMIs. In our view a balance needs to be struck where CTPs are held responsible, while also recognising the regulatory framework needs to apply to CTPs in a different way to financial services firms.

Proposed enforcement powers

We support the proposed provisions to ensure appropriate enforcement powers if a CTP failed or refused to meet the potential minimum resilience standards but have some concerns regarding the resource capacity of the financial regulators to take enforcement action.

The primary method of engagement by the supervisory authorities should be the use of dialogue with CTPs to obtain relevant information. Where issues are identified it is sensible that guidance should be given and requests made of the CTP to bring about necessary enhancements to its due diligence, monitoring or business continuity. Where this fails, or requirements are breached there needs to be the provision for appropriate and proportionate action to be taken by the supervisory authorities. We note that the range of proposed powers, which include issuing a direction, appointing a skilled person, censure, imposing conditions for the provision of services to firms and FMIs could require additional resource which may not currently be factored into business planning, and would encourage further thought around this. Consideration of the proposal to prohibit firms and/or FMIs from receiving services from CTPs in certain circumstances also needs to be mindful there may be limited numbers of providers supplying niche services to businesses, so this action would need to consider overall risk.

Cross Sectoral and International coordination

We welcome the suggestion of potential ways to improve international and cross-sectoral coordination in this area. In our view the role of critical third parties is so significant, both to the financial services industry and to the broader economy, that it needs to be addressed at the highest, cross-industry levels, and on an international basis.

Identification of critical third parties as CTPs

Q5: What are your views on the factors that the supervisory authorities should consider when assessing which third parties to recommend for designation as CTPs? Are there any additional factors that the supervisory authorities should take into account?

A CTP's impact on the competitiveness of the UK should also be taken into account given the FCA's [proposed] new competitiveness objective.

We would be happy to discuss these points further if required.

Yours faithfully,

[signed]

Penny James
Chair, FCA Practitioner Panel