Australian Custodial Services Association

ACSA CPS 230 OPERATIONAL RISK GUIDANCE NOTE

Critical Operations

June 2024

Australian Custodial Services Association

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Introduction

Australian Prudential Regulation Authority ("APRA") released the final CPS 230 ("CPS 230") Operational Risk Management Prudential Standard ("Prudential Standard") in July 2023 and the accompanying Prudential Practice Guide ("PPG") in June 2024.

The Prudential Standard is effective from 1 July 2025 and introduces substantial changes to the way APRA-regulated entities are to oversee and manage arrangements with services providers, including custodians. Entities that are classified as "non-Significant Financial Institutions" have an additional 12 months to comply with certain requirements in CPS 230 relating to business continuity and scenario analysis. For pre-existing contracts with service providers, CPS 230 will apply from the earlier of the next contract renewal date or 1 July 2026.

APRA have indicated its expectations that APRA-regulated entities identify their critical operations and material service providers by mid-2024 and set their tolerance levels by end of 2024. APRA also included a "Day 1" checklist for entities to assist in their implementation of CPS 230. Refer to Figure 3. The checklist clarifies what information entities are not required to provide to APRA for Day 1 compliance (but which may be requested by APRA). For example, entities are not required to submit their list of critical operations or tolerance levels to APRA on Day 1 nor risk profiles or operational and senior accountabilities.

ACSA Guidance Note

The impact of CPS 230 on the members of the Australian Custodial Services Association ("ACSA"), as material service providers to many APRA-regulated clients ("ACSA member clients"), will be significant, increasing client expectations with respect to reporting, escalation, access, and data. Whilst not all ACSA members are regulated by APRA, custodians are captured under CPS 230 as a Material Service Provider.

ACSA established a CPS 230 Working Group to collaboratively review the implications of this Prudential Standard and develop a Critical Operations guidance note for ACSA's members and its clients to leverage. This guidance note also considered high level outcomes from engagements with other industry bodies as it relates to critical operations and material service providers, however ACSA expects members and member clients to determine their own response.

This guidance note is general in nature and does not consider all nuances that may exist. It is the responsibility of each individual APRA regulated entity to perform their own independent assessment and, if necessary, secure their own independent advice on the regulations to ensure compliance with the regulations. As per the final APRA Prudential Standard, APRA-regulated entities approach to operational risk must be appropriate to its size, business mix and complexity.

Material Service Providers

Material Service Providers (MSPs) are those on which an APRA-regulated entity relies to undertake critical operations or that expose them to material operational risk.

In the final guide APRA has modified its expectations with regards to an APRA-regulated entity outlining its approach to managing the risks associated with any fourth parties that MSPs rely on to deliver a critical operation. APRA has clarified that an entity is expected to take reasonable steps to know who the fourth parties are that the MSP relies on in delivering a service linked to a critical operation, which gives entities more discretion to decide how downstream service providers are identified and managed.

APRA's expectations is that APRA-regulated entities submit a register of material service providers annually to APRA with the first register to be submitted by 1 October 2025, although through the course of its supervision APRA may request the register earlier.

To assist with compliance with the APRA obligations, ACSA member clients should:

- Classify a provider of custodial services and fund administration as a material service provider, unless it can justify otherwise
- Identify and maintain a register of MSPs for annual submission to APRA; take reasonable steps to know who the fourth parties are that a MSP relies on, in delivering a service necessary to support a critical operation, e.g. sub-custodians
- Undertake appropriate due diligence and risk assessment when entering into a new MSP arrangement or modifying an existing one, including fourth parties the MSP relies upon
- Maintain a comprehensive service provider management policy including the methodology to assess the materiality of MSPs[1]
- Manage the key risks associated with MSPs and any fourth parties that MSPs rely on to deliver critical operations including financial and non-financial risks
- Seek confirmation from MSPs that they maintain a robust business continuity plan (“BCP”) testing and consider joint testing arrangements
- Have a testing program tailored to the material risks of the APRA-regulated entity and include a range of severe but plausible scenarios, including disruptions to services provided by material service providers and scenarios where contingency arrangements are required
- Monitor and provide Senior Management with appropriate reporting on material arrangements including performance and control effectiveness of custodians and fund administrators
- Maintain a formal legally binding agreement for any material arrangements and ensure the agreement includes the minimum APRA requirements and provisions
- Notify APRA as per the PPG of new or changes to material arrangements, e.g., change in custodian
- Any proposed material arrangements involving outsourcing of a critical function must be reviewed by Internal Audit

ACSA members should:

- Notify its clients of other material service providers that it materially relies upon through sub-contracting or other arrangements

1 A service provider may be connected to a critical operation but that does not mean they are material to its delivery. A service provider could support a critical operation without being essential to the provision of that operation

Critical Operations

CPS 230 mandates that APRA-regulated entities must identify and manage critical operations to mitigate operational risks effectively. **Critical Operations** are processes undertaken by an APRA-regulated entity or its service provider(s) which, if disrupted beyond tolerance levels, would have a material adverse impact on depositors, policyholders, beneficiaries or other customers, or its role in the financial system. This includes the provision of custodial services.

The final guide clarifies that APRA-regulated entities may wish to review the overlap of 'critical functions' in relation to resolution planning under CPS 900 with 'critical operations' under CPS 230.

To assist with compliance with this obligation, ACSA member clients should:

- Classify custodial services and fund administration as a Critical Operation, unless it can justify otherwise
- Define, identify and maintain a register of critical operations as part of the BCP
- Conduct a thorough assessment to identify Critical Operations within their organisation, considering both direct and indirect factors such impact on policyholders, beneficiaries or customers, profitability, financial soundness, reputation or the ability to comply with regulatory requirements as well as the broader financial system or economy [2]
- Identify and document the processes and resources needed to deliver Critical Operations, including people, technology, information, facilities and service providers, the interdependencies across them, and the associated risks, obligations, key data and controls
- Ensure Senior Management have sufficient details about the processes and resources needed to deliver critical operations, including service providers, during business as usual and a disruption
- Establish tolerance levels as described in the Prudential Standard (refer to the Glossary of Terms) and reassess levels from learn lessons from actual disruptions, testing, scenario analysis and evolution in industry practices
- Maintain effective internal controls to minimise the likelihood and impact of disruptions associated with critical operations
- Maintain a credible BCP that sets out how it would maintain its Critical Operations within tolerance levels through disruptions, including disaster recovery planning for critical information assets
- Notify APRA as per the PPG, if an APRA-regulated entity has suffered a disruption to a critical operation outside tolerance

<u>ACSA members should:</u>

- Discuss the **custodial services** that form part of its clients Critical Operations

[2] Paragraph 36 of the final CPS 230 rules

ACSA’s Critical Operations

The ACSA Working Group reviewed the critical operations provided to APRA Regulated Entities and categorised the key services underpinning these Critical Operations into the following categories:

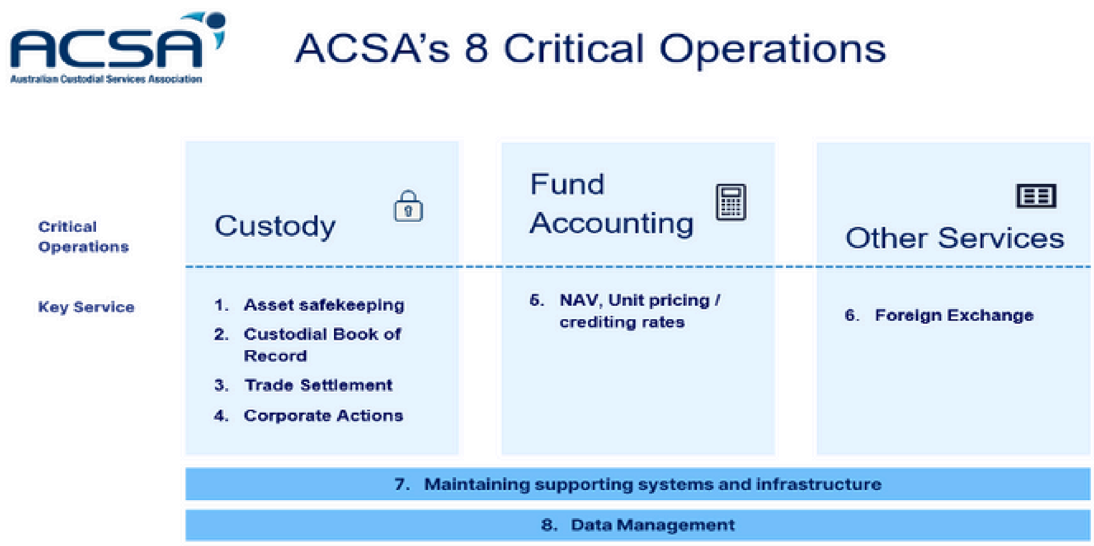
1. **Likely Critical Operations:** Services that ACSA members believe are likely to be identified as Critical Operations by APRA Regulated Entities
2. **Potential Critical Operations:** Services that ACSA members believe may be identified as Critical Operations by APRA Regulated Entities, based on client harm, market harm and firm harm factors
3. **Unlikely Critical Operations:** Services that ACSA members believe are unlikely to be identified by APRA Regulated Entities as Critical Operations

ACSA’s Critical Operations and Services Framework

ACSA Critical Operations and Services Framework uses several factors and metrics to determine which key services provided by Custodians are critical operations including the impact and level of importance of the service to its clients, financial impact in the event of disruption, substitutability and transferability of the service, reputational damage, and regulatory exposure.

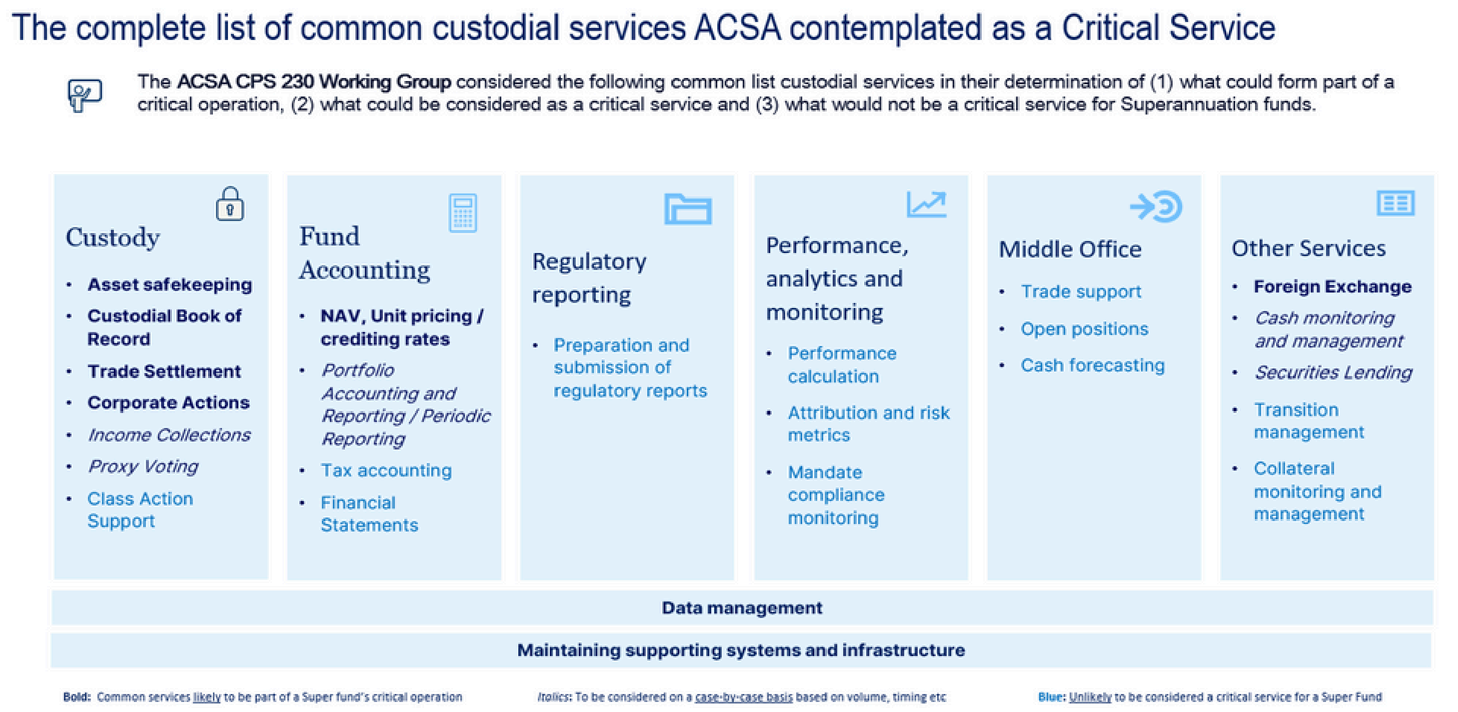
Eight services met the criteria for a Critical Operation. The below list is to be used as a guide to assist custodians plan and anticipate their clients' needs with respect to information on Critical Operations. Ultimately, **the services considered part of a critical operation need to be determined by the APRA regulated entity/client.**

Refer to Figure 1, for the full list of common custodial services considered by ACSA and the Service Definitions for Critical Operations on page 12.



Note:Identified Critical Operations do not necessarily need to exactly match between the ACSA member and ACSA member client, as these will vary depending on the size, business mix and complexity of the APRA Regulated Entity

Figure 1: Likely, Potential and Unlikely Critical Operations and Key Services



Refer to the Service Definitions for Critical Operations on page 12

Figure 2: Operational Resiliency Global Lifecycle Process Flow

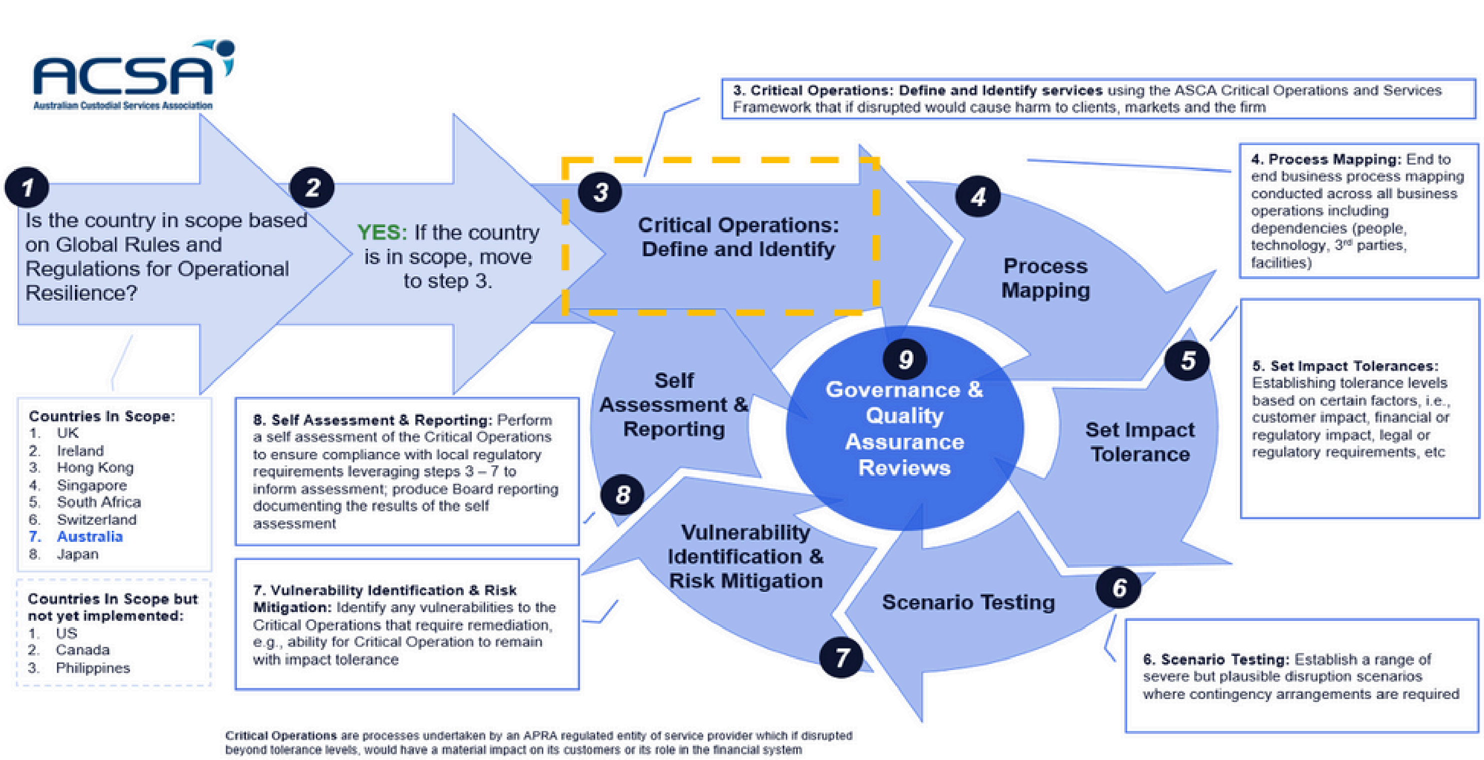


Figure 3: CPS 230 Compliance Checklist [A]

#	Requirement	Submission to APRA	Updated or New Requirement
1	Critical Operations (COs) are identified.	Entities are not required to submit their list of critical operations. However, an APRA supervisor could request it.	NEW as concept of Critical Operations is introduced by CPS 230.
2	Tolerances are defined and approved by the Board for COs (time, data loss, and service level).	Entities are not required to submit tolerance lists. However, an APRA supervisor could request it, to understand how critical operations are monitored and to confirm Board approval as required by the Standard.	UPDATE as tolerances exist under CPS 232 for time and SLAs. CPS 230 applies a Critical Operations lens.
3	Material Service Providers (MSPs) are identified.	Entities are required to submit a register of MSPs to APRA on an annual basis. APRA requests the first submission by 1 Oct 2025. This is the key data requirement of CPS 230 along with incident notifications and supplier/offshore notifications.	NEW but building on the requirements that have been in place under CPS 231, in monitoring and oversight of suppliers.
4	Notifications are operational for material events, tolerance breaches and MSP changes.	Entities are required to have notifications to APRA in place per paragraphs 33 (material events), 49 (tolerance breach) and 59 (MSP arrangement/offshoring changes).	UPDATE as notification requirements do exist under CPS 231 and CPS 232 in the current architecture.
5	Board Governance & Oversight is in place and clear roles and responsibilities are set.	Entities are not required to submit updated senior management accountabilities or target operating model documentation. This could be requested and discussed as part of a prudential review.	UPDATE to align with the critical operations requirements in CPS 230 but builds on CPS 220 positioning.
6	Risk Profiles & Reporting is established and supporting oversight accountabilities.	Entities are not required to submit risk profiles or risk reporting as part of compliance with CPS 230. These could be requested and discussed as part of a prudential review.	UPDATE against critical operations and building on CPS 220, 231, 232 foundations.
7	Accountability for COs, MSPs, and monitoring is in place.	Entities are not required to submit updated operational accountabilities or examples of BAU monitoring, reporting or controls for compliance with CPS 230. These could be requested as part of a prudential review.	UPDATE to accountabilities, to refer to new concepts introduced under CPS 230 building on CPS 220, 231, 232 foundations.
8	Contract Updates have an extension of 12 months per paragraph 7 of the standard.	Entities have an additional 12 months to ensure that pre-existing service provider arrangements comply with contract requirements under CPS 230.	UPDATE to pre-existing contracts to comply with CPS 230.
9	Business Continuity Management (BCM) shifts from Critical Operations focus	Entities are not required to submit their updated BCM strategy, policy, or plans. These could be requested and discussed as part of a prudential review.	UPDATE of existing BCM policy, plans, testing under CPS 232 to the CPS 230 Critical Operations focus.
10	Scenarios align with BCM uplift and focus on severe yet plausible scenarios for Critical Operations and Material Service Providers.	Entities are not required to submit their new scenarios or testing results as part of CPS 230 compliance. This could be requested and discussed as part of a prudential review.	UPDATE of existing scenario approach under CPS 232 to apply a CPS 230 critical operations lens.

A. APRA Response to submissions – CPG230 Operational Risk https://www.apra.gov.au/response-to-submissions-cpg-230-operational-risk-management?utm_source=Master+subscriber+list&utm_campaign=174a5c1287-CPG+230&utm_medium=email&utm_term=0_-174a5c1287-%5BLIST_EMAIL_ID%5D#day-one-checklist-for-entities-2025

Glossary of Terms

Critical Operations[3] - Critical Operations are processes undertaken by an APRA-regulated entity or its service provider(s) which, if disrupted beyond tolerance levels, would have a material adverse impact on depositors, policyholders, beneficiaries or other customers, or its role in the financial system. It is the responsibility of an APRA-regulated entity to identify its Critical Operations. APRA does not expect entities to rely solely on the list of activities prescribed by APRA as Critical Operations.

Tolerance levels[4] - for each Critical Operation, an APRA-regulated entity must establish tolerance levels for:

- the maximum period of time the entity would tolerate a disruption to the operation
- the maximum extent of data loss the entity would accept because of a disruption; and
- minimum service levels the entity would maintain while operating under alternative arrangements during a disruption

Material service provider(s)/Material arrangements[5]- material service providers are those on which the entity relies to undertake a critical operation or that expose it to material operational risk. Material arrangements are those on which the entity relies to undertake a critical operation or that expose it to material operational risk. A material service provider may be a third party, related party or connected entity. A service provider may be identified as material as a result of an individual or multiple arrangements with an APRA-regulated entity. An APRA-regulated entity must, at a minimum, classify a provider of the following services as a material service provider, unless it can justify otherwise:

- for an ADI: credit assessment, funding and liquidity management and mortgage brokerage
- for an insurer: underwriting, claims management, insurance brokerage and reinsurance
- for an RSE licensee: fund administration, custodial services, investment management and arrangements with promoters and financial planners
- for all APRA-regulated entities: risk management, core technology services and internal audit

Material offshoring arrangement[6]- a material arrangement where the service provided is undertaken outside Australia. Offshoring includes arrangements where the service provider is incorporated in Australia, however, the physical location of the service being provided is undertaken outside Australia. Offshoring does not include arrangements where the physical location of a service is performed within Australia if the service provider is not incorporated in Australia.

Fourth Party[7]- service providers may, in turn, rely on other service providers (fourth parties). A fourth party is a party that a service provider relies on in delivering services to an ARE. APRA expects that an entity would be aware of, and manage, the risks associated with fourth party and other downstream service providers for critical operations, including the correlated risk that arises when several of its service providers are reliant on the same fourth party.

[4] Paragraph 35 of the final CPS 230 rules
[5] Paragraph 38 of the final CPS 230 rules
[6] Paragraph 49 and 50 of the final CPS 230 rules
[7] Paragraph 59b of the final CPS 230 rules
[8] Paragraph 48c of the final CPS 230 rules

Service Definitions

Critical Operation	Critical Service	Definition	ACSA Critical Operation
Custody	Asset safekeeping	Services related to the safekeeping of financial instruments	Yes
	Custodial book of record	Maintaining the book of records and data needed by Super Funds to manage their business from the investment perspective	Yes
	Trade Settlement	Clearing and settlement services on behalf of super funds executed through Financial Market Utilities (systems for transferring, clearing and settling cash payments and securities)	Yes
	Corporate Actions	Processing corporate action activities on behalf of Super Funds	Yes
	Income Collection	Management of the collection of interest and distributions from securities	No
	Proxy Voting	Processing proxy voting instructions on behalf of Super Funds	No
	Class Action Support	Processing class action settlements on behalf of Super Funds	No
Fund Accounting	Unit Pricing / Crediting Rates	Fund accounting services that support Super funds as it relates to the process of calculating Net Asset Value (NAV) and striking of NAV prices	Yes
	Portfolio Accounting and Reporting	Fund accounting services that support Super Funds as it relates to Portfolio Accounting and Reporting	No
	Tax Accounting	Fund accounting services that support Super Funds as it relates to Tax Accounting	No
	Financial Statements	Fund accounting services that support Super Funds as it relates to Financial Statements	No
Regulatory Reporting	Preparation and submission of regulatory reports	Preparation and submission of regulatory reports	No
Performance, analytics and monitoring	Performance calculation	Performance calculation services that support Super Funds	No
	Attribution and risk metrics	Attribution and risk metrics services that support Super Funds analyse performance	No
	Mandate compliance monitoring	Mandate monitoring services to ensure timely pre and/or post trade monitoring of all mandate, prospectus, regulatory and other investment guidelines owned by Super Funds	No
Middle Office	Trade support	Services that deliver investment book of record, including trade support functions	No
	Open positions	Services that deliver investment book of record, including open position functions	No
	Cash forecasting	Services that deliver investment book of record, including cash forecasting	No
Other Services	Cash monitoring and management	Cash monitoring and management services	No
	Foreign Exchange	Foreign exchange trading represents transactions with custody clients (Super Funds) or their investment managers	Yes
	Securities Lending	Entering into securities loan transactions with securities borrowers as agent for the participating Super Funds	No
	Transition management	Managing the efficient transition and reallocation of investment portfolios from one manager to another	No
	Collateral monitoring and management	Collateral monitoring and management related services for Super Funds	No
	Data Management	Data provisioning to enrich investment decision making, trading activity and / or member reporting for Super Funds as well as data storage and access	Yes
	Maintaining supporting systems and infrastructure	Access to core market infrastructure	Yes

About the Australian Custodial Services Association (ACSA)

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. ACSA works with peer associations, governments, regulators and other market participants on a pre-competitive basis to encourage standards, process consistency, market reform and operating efficiency. Established in 1994, ACSA members currently hold assets in excess of $4.5 trillion in custody and under administration for Australian institutions (at 31 December 2024).

The key sectors supported by ACSA members include large superannuation funds and investment managers, as well as other domestic and international institutions. Custodians provide a range of institutional services to clients including traditional custody and safekeeping, investment administration, foreign exchange, securities lending, transfer agency, tax and financial reporting, investment analytics (risk, compliance and performance reporting), investment operations middle office outsourcing and ancillary banking services.

www.acsa.com.au

Important Note

ACSA works with peer associations, regulators and other market participants on a pre-competitive basis to encourage standards, promote consistency, market reform and operating efficiency. The views expressed in this paper are prepared by ACSA and should not be regarded as the views of any particular member of ACSA.
The comments in this paper do not comprise financial, legal or taxation advice.

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