

ALLEN & OVERY

*Ahead of the Curve:
Regulating critical
service providers*

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Introducing



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But first, the news...



But first, the news...

Today's topics

- UK SRF
- UK regulators
- AI and Fintech
- Financial crime
- Updates on advice and guidance, financial promotions, markets regulation and payments

But first, the news...

UK Smarter Regulatory Framework (SRF)

UK

List of SRF instruments published

FCA

FCA speech by Clare Cole on UK Listing Regime

FCA

FCA interview with Clare Cole and Mark Austin on Primary Markets Effectiveness

FCA

House of Commons letter on Commodity Derivatives Framework consultation

UK

Meeting of the US-UK Financial Regulation Working Group

But first, the news...

UK Regulators – priorities and oversight

1 FCA responses to statutory panel 2022-3 annual reports

2 FCA and practitioner panels survey for 2024

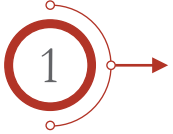
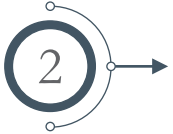



3 House of Commons: evidence on the work of the PSR

4 FCA and PSR publications on cost benefit analysis

5 House of Lords: Who watches the watchdogs?

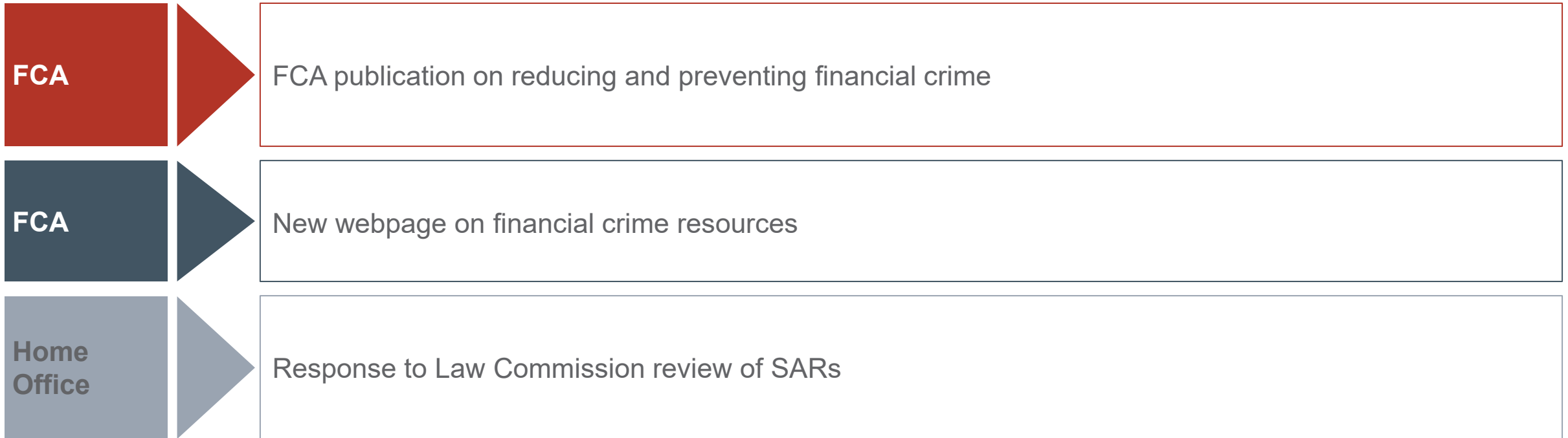
But first, the news...

AI and Fintech

-  Bank of England staff working paper on consumer data access and fintech entry
-  Consultation outcome – A pro-innovation approach to AI regulation: government response
-  FCA Emerging Technology Hub
-  House of Lords committee report on large language models and AI
-  FCA Practitioner Panel – Call for input: Potential competition impacts from the data asymmetry between Big Tech and firms in financial services

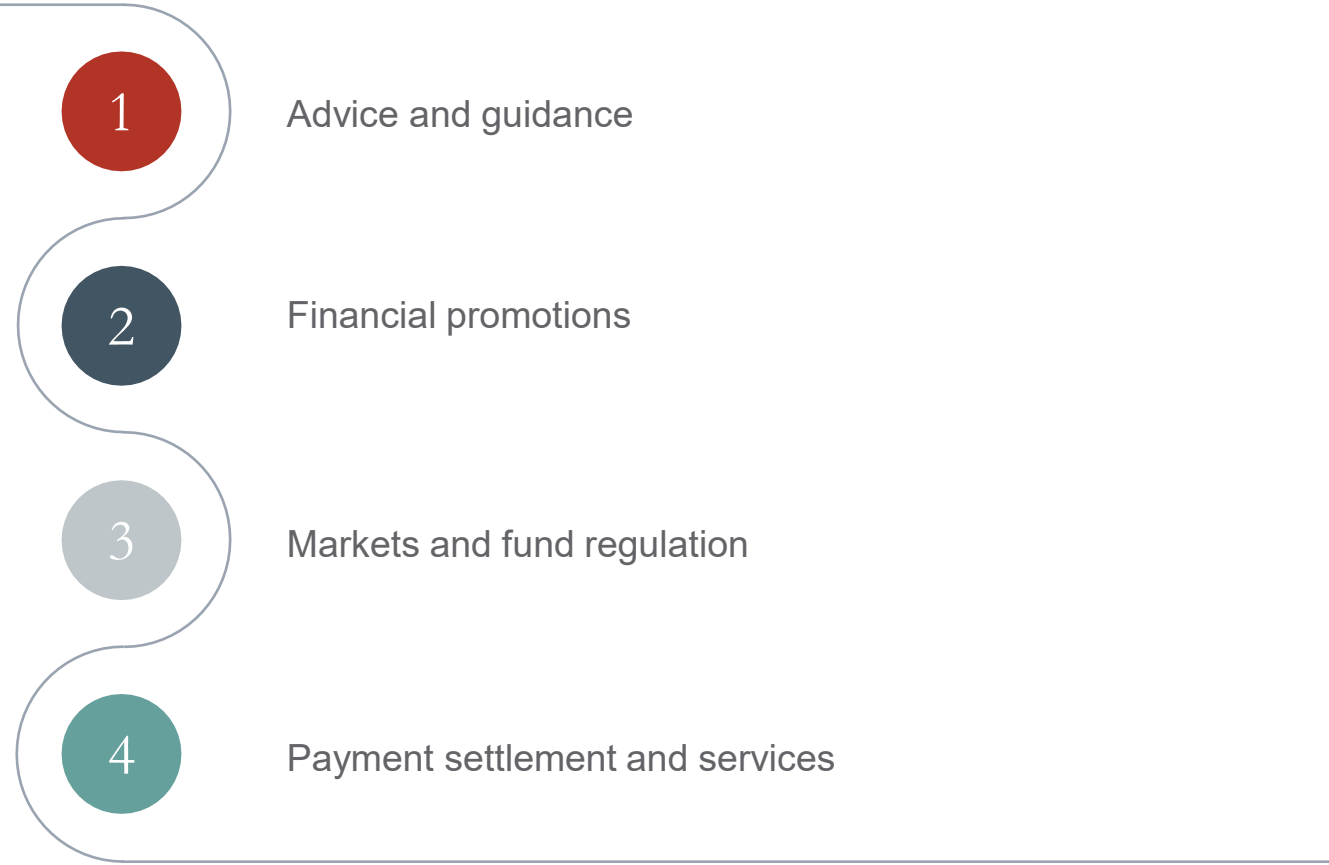
But first the news...

Financial crime and market abuse



But first, the news...

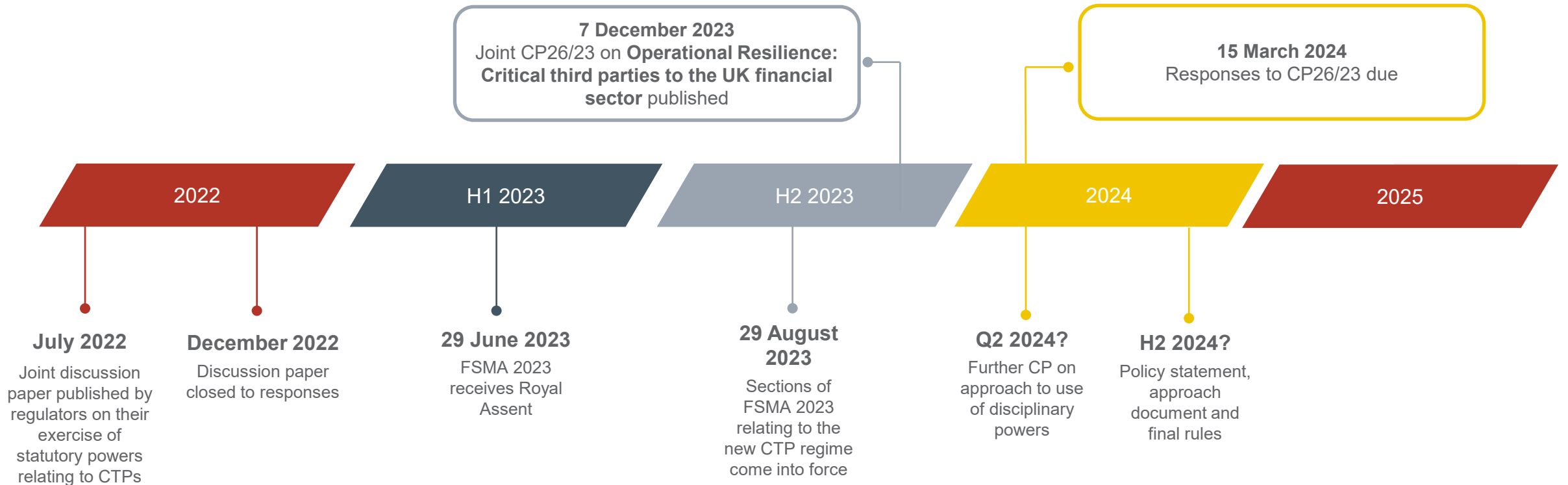
Further updates



Oversight of critical service providers



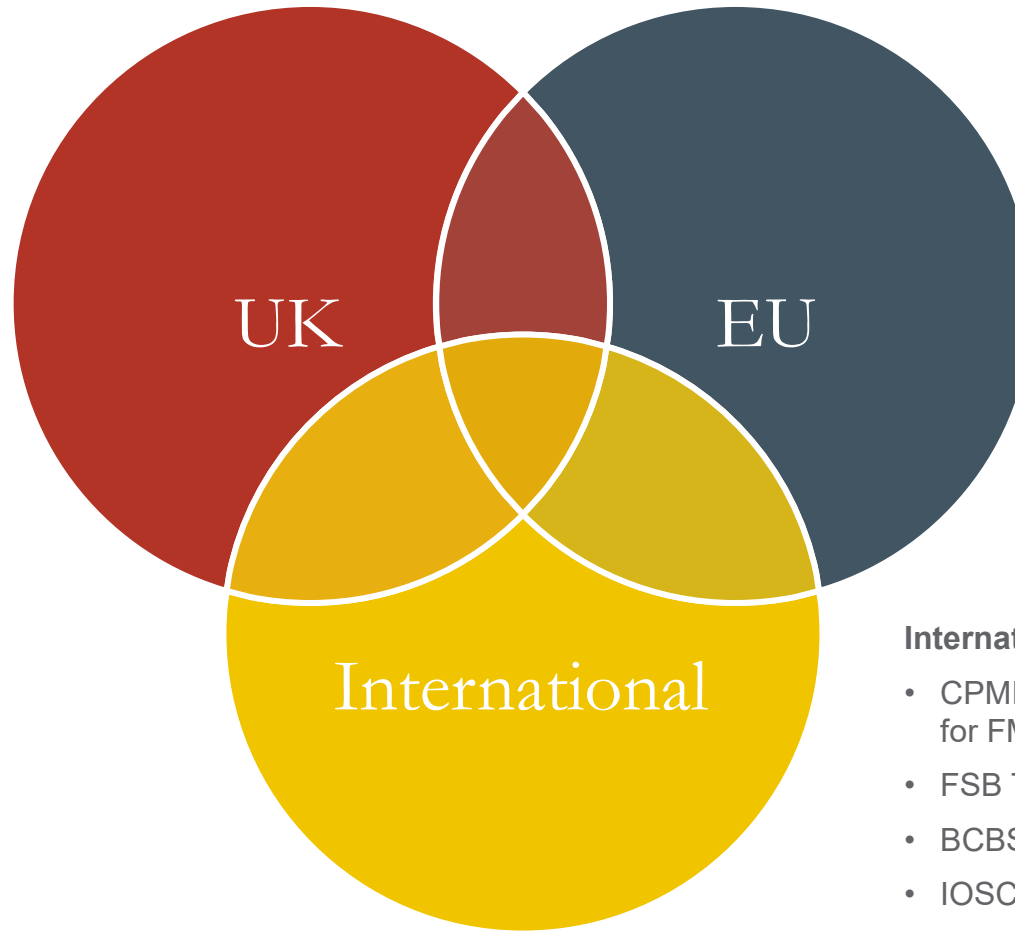
Current status and key dates



Operational resilience: backdrop

Regulators have been paying greater attention to operational resilience in recent years.

- UK regulators rules and guidance**
- PRA Rulebook (operational resilience), Supervisory Statement SS 2/21, Statement of Policy on Operational Resilience
 - FCA Handbook (SYSC 15A), CP 22/12 & PS 23/4
 - BoE policy on outsourcing and third-party risk management for FMIs



EU

- EBA Guidelines on outsourcing arrangements
- ECB Cyber resilience oversight expectations for FMIs
- ESMA opinion on market outages
- ESMA guidelines on outsourcing to cloud service providers

International

- CPMI and IOSCO guidance on cyber resilience for FMIs
- FSB TPR toolkit and Cyber Lexicon
- BCBS Principles for Operational Resilience
- IOSCO Principles on Outsourcing

UK FSMA CTP Regime: Intention and Architecture

Manage **financial stability risks** arising from the failure or disruption of services provided to firms and FMIs

Statutory Framework

- Sections 312L – 312R FSMA 2000
- **HMT power to designate** an entity as a CTP
- PRA/FCA/BoE powers to make rules for, issue directions to, investigate and discipline CTPs
- MoU between the PRA, BoE and FCA on co-ordinated use of their powers (no public draft currently available)

Three Regulators

PRA BoE FCA

Regulatory Rules & Guidance

- **PRA Rulebook:** Critical Third Parties Part
- **BoE Rulebook:** Critical Third Parties Part and Critical Third Parties Emergency Provisions Parts
- **FCA Handbook:** Critical Third Parties Sourcebook (CTPS)
- PRA/BoE/FCA **CTP approach document** (no public draft currently available)
- **PRA, FCA and BoE rules are broadly identical – their intention is for each regulator to have an identical regime**
- PRA/BoE/FCA **Supervisory Statement – Operational resilience:** Critical third parties to the UK financial sector
- PRA/BoE/FCA **Supervisory Statement – Reports by skilled persons:** Critical third parties
- PRA/BoE/FCA **policy on outsourcing and third-party (OATP) data collection** (no public draft currently available)
- PRA/BoE **statement of policy regarding disciplinary powers over CTPs** (no public draft currently available)
- FCA **statement of policy regarding disciplinary powers over CTPs** (no public draft currently available)

Designation of critical third parties

- Only HMT has the power to designate a CTP but will look to the three Regulators to make recommendations
- HMT can designate a CPT only if “*in [its] opinion, a failure in, or disruption to, the provision of those services (either individually or, where more than one service is provided, taken together) could threaten the stability of, or confidence in, the UK financial system*”
- Regulators must consider ‘**materiality**’ and ‘**concentration**’ but will also consider other factors e.g. **substitutability** and **survivability**

Materiality

- The materiality of the services the third party provides to the delivery of “*essential activities, services or operations by firms (wherever carried out)*”
- Activities, services or operations are “*essential*” for this purpose if they are essential to the **economy of the UK**, or the stability of, or confidence in, the **UK financial system**
- The Regulators could take into account the **aggregate effect of a supplier’s various services**

Concentration

- Concentration refers to the **number and type** of firms, service providers and FMIs to which the relevant third party provides services
- Concentration is **not automatically problematic** and can reflect quality and resilience of the service
- Assessment will **account for systemic importance of service recipients**
- This assessment should capture both **direct dependencies** arising from contractual arrangements between firms and third parties, as well as **indirect dependencies** through supply chains

Application in Practice

- Application of the factors entails a degree of **subjectivity**
- Both materiality and concentration allow the regulators to consider the **aggregate effect in the UK market of the services provided**
- Uncertainty as to how the factors will be applied and operate together
- **The Regulators currently expect to recommend that HMT designates a “very small number and percentage” of providers as CTPs**

Overview of Regulators Rules

Scope of Rules

- Services to firms and FMI only
- Services provided to other clients not in scope

6 Fundamental Rules

- Integrity
- Skill, care & diligence
- Prudence
- Risk strategies & management
- Responsible & effect organisation and control
- Open & co-operative with Regulators

Apply to all services to firms & FMIs

8 operational risk & resilience requirements

- Governance
- Risk management
- Dependency and supply chain risk management
- Technology and cyber resilience
- Change management
- Mapping
- Incident management
- Termination of services

Apply to 'material' services only

Full range of supervisory powers

- **Information-gathering:** Annual written self-assessment, provide information upon request
- **Testing:** regular scenario testing, financial sector incident management playbooks
- **Skilled persons review:** Section 166 of FSMA 2000
- **Notifications:** Notify regulators and customers of certain incidents

Apply to 'material' services only

- **Record-keeping:** Orderly records for all services to firms & FMIs
- **Status:** Misleading use of designation status prohibited
- **Emergency relief:** When it would be impossible to comply

Territorial Scope

- Not limited to CTPs located in / operating from the UK
- Receipt of services by firms and FMIs globally – also not limited to the UK
- No requirement to set up a UK branch or subsidiary
- Need central point of contact for the Regulators and, for non-UK CTPs, a UK 'nominated person' in the UK to receive notices from the Regulators.

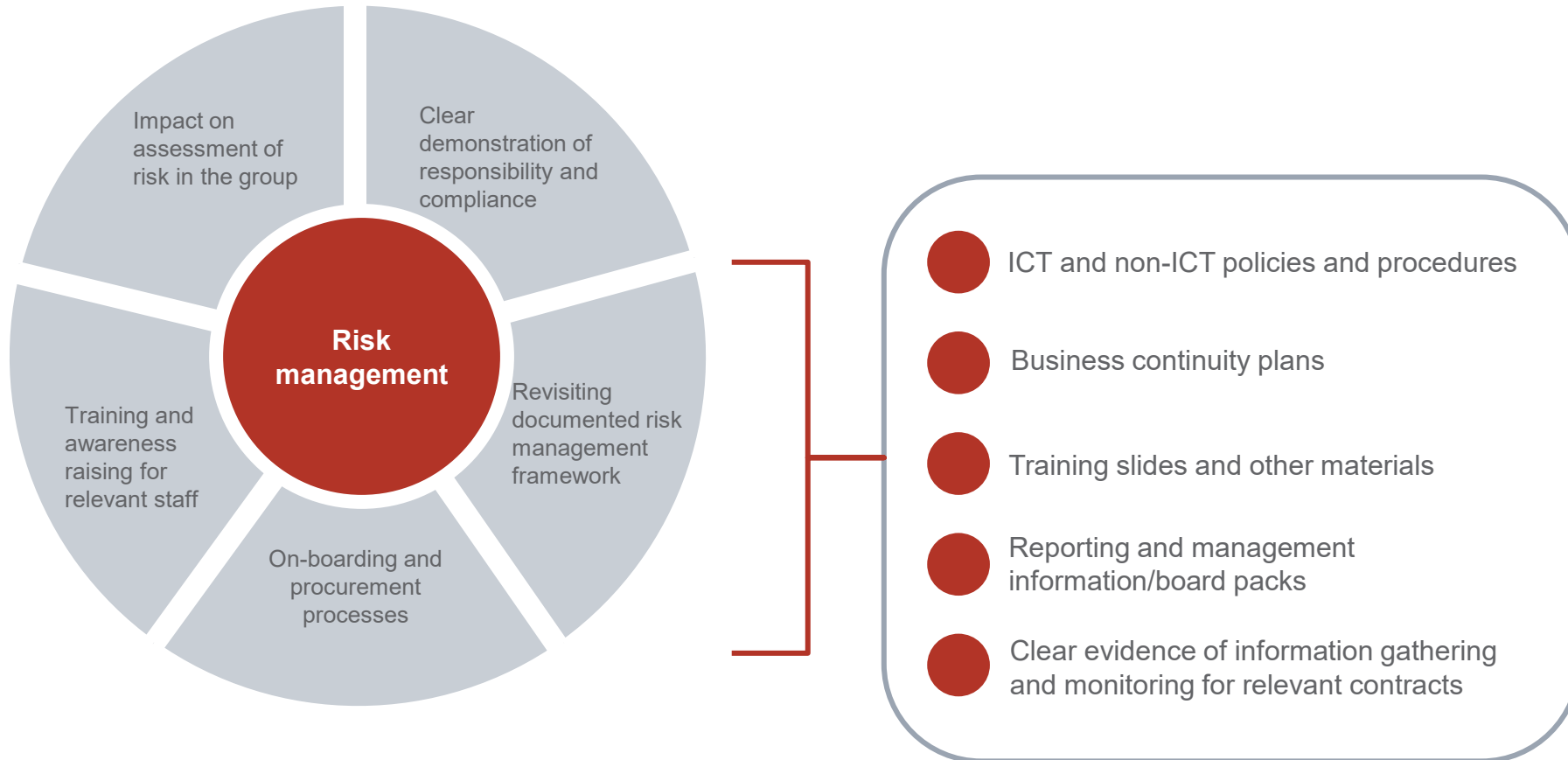
Practical considerations for CTPs



Practical impact for service-recipient firms

Review processes & procedures: update to comply with new requirements

Assess risk management framework: account for knock-on impacts



Practical implementation:

- Reviewing and updating existing contracts
- Reviewing and updating template contractual provisions
- Updating regulatory and compliance monitoring processes
- Completing register of information on contractual arrangements on the use of ICT services provided by third-parties at solo & consolidated levels
- Implement updated testing processes
- Integrate new reporting and notification processes

Questions?

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