UK Finance response to the Financial Stability Board's (FSB's) Consultative document on "Enhancing Third-Party Risk Management and Oversight: A toolkit for financial institutions and financial authorities.

UK Finance response

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Preface

UK Finance is the collective voice for the banking and finance industry. Representing around 300 firms, we act to enhance competitiveness, support customers, and facilitate innovation.

We welcome the opportunity to respond to the Financial Stability Board (FSB)'s consultation on Enhancing Third-Party Risk Management and Oversight.

Executive Summary

In the modern landscape of financial services, businesses often partner with external service providers to fulfill a variety of needs, including essential operational functions. This trend has been magnified with the ongoing digital transformation within the sector. Embracing such collaborations offers financial institutions several advantages, such as adaptability, creative breakthroughs, and heightened operational durability.

Nonetheless, it is crucial to exercise adept oversight. Any disruption to pivotal services or their providers, if not meticulously handled, could potentially expose financial institutions to risks and, in certain scenarios, even impact the stability of the financial services sector as a whole.

UK Finance represents firms with global operational footprints, and the misalignment of Financial Authority / Regulator approaches to these activities across a multitude of jurisdictions can be problematic. An effective toolkit to help firms and financial authorities to navigate TPRM and its oversight is a welcome addition to the FSB's work in this area.

Chapter 1

1. Are the definitions in the consultative document sufficiently clear and easily understood? Are there any important terms and definitions that should be included or amended?

In general UK Finance is content with the clarity and understandability of the wording and terminology used within this consultation. UK Finance encourages simplicity and clarity that can be achieved through common global taxonomy on a variety of technical subjects.

We are supportive of the terms that have already been defined by international standard setters and therefore the FSB should avoid redefining these terms, but instead use existing definition formulated by the international standard setters. We encourage the FSB to make clear that the terms referenced in this toolkit are specific to third party services, firms' interactions and relationships with these services, and for any oversight of services by financial authorities. There is one term that raised particular concern and that should be refined further.

Given the use of similar terms in adjacent areas of regulation, the term "critical service" in the toolkit risks potential confusion on what it intends to define and capture. Furthermore, we encourage the FSB to avoid diluting this category with criteria which goes beyond potential impacts to financial stability – the definition should apply an appropriate scope and criteria to identify third-party services which could significantly impair an FI's safety and soundness and create risks to financial stability.
We therefore recommend that the FSB update this term to be a "**critical third-party service**", defined as **"[a] service whose failure or disruption could significantly impair a financial institution's safety and soundness or critical operations and create risks for financial stability."**

Other words or phrases that require some form of deconfliction:

We agree with the definition of third-party service relationships and that these do not include services related to:

- Correspondent banking
- Lending
- Deposit-taking
- Provision of insurance
- Clearing and settlement
- Custody services

Those relationships are already subject to more targeted risk management frameworks which capture the nuances of these services.

Chapter 2

2. Are the scope and general approaches of the toolkit appropriate?

UK Finance supports the general approach adopted by toolkit. It was noted that the document may provide little in the way of “new” information to TPRM specialists within the UK’s financial sector.

Additionally, building on a point raised in Chapter 1, UK Finance accepts that the primary focus of the FSB toolkit is indeed on critical services.

3. Is the toolkit’s focus on regulatory interoperability appropriate? Are there existing or potential issues of regulatory fragmentation that should be particularly addressed?

Given that many financial institutions, as well as service providers, operate across multiple jurisdictions, UK Finance agrees that the toolkit’s focus on regulatory interoperability is appropriate. .

Additionally, it is likely that some service providers will provide services to other sectors of the economy and therefore we would suggest the toolkit’s focus on regulatory and supervisory interoperability is extended to include consideration for non-financial authorities.

Furthermore, we would welcome practical examples what the FSB expects from interoperable regulatory and supervisory approaches to third-party risk management across different areas of the financial sector and between jurisdictions to be implemented such as process, governance, contractual expectations etc.

4. Is the discussion on proportionality clear?

UK Finance believe that the discussion on proportionality is clear but could go further. For some members, it is felt the document could be stronger in its views on how proportionality can be used as a principle to implement practical action. We welcome the benefits of proportionality, as management of third-party risks varies due to many different factors including a firm’s risk appetite.

In addition, financial authorities should apply the principles of proportionality to the management of third party related systemic risks.

Chapter 3

5. Is the focus on critical services and critical service providers appropriate and useful? Does the toolkit provide sufficient tools for financial institutions to identify critical services? Do these tools rightly balance consistency and flexibility?

Yes, UK Finance believes that this document's focus on critical services and critical service provider is appropriate and useful.

In order to effectively recognise critical services however, financial institutions must take a consistent approach to in the identification process. There is an acceptance that "critical services" provided to one financial institution may not be critical to another. Therefore, we would seek clarification as to what the FSB means in terms of identifying the criticality of services "at inception". UK Finance seeks clarity for our membership on this matter as this wording could suggest that the identification of critical service would start from the commencement of the third-party service relationship rather than during the onboarding of that third-party.

A such, UK Finance believes that the identification of critical service should commence when the financial institution still has the ability to refine and agree contractual terms with the service provider.

Furthermore, we believe it would be helpful if the toolkit was developed to reflect the significance of intra-group services, as the services provided via an intra-group relationship can be as equally 'critical' as the services provided via an external service provider.

6. Are there any tools that financial institutions could use in their onboarding and ongoing monitoring of service providers that have not been considered? Are there specific examples of useful practices that should be included in the toolkit?

UK Finance would welcome guidance or a checklist to determine what good/acceptable levels of alternative assurance could look like.

While firms can use any appropriate vendor risk management tool that is available in the market, firms should consider using an accreditation tool that provides a standard for gathering and managing service providers compliance assurance information across the financial service sector.

While UK Finance has developed the Supplier Assurance Framework, firms may also consider formulating their own bespoke questionnaires for service providers and their supply chain that supports the service being provided to the financial institution.

Furthermore, consideration could be given on a proportionate and risk based approach, as part of onboarding and ongoing monitoring of service providers, whether adverse media checks should be conducted. This is as well as monitoring of the share price of any listed service provider to indicate (if the share price goes down) as to whether the service provider is experiencing potential issues.

UK Finance would welcome a recommendation that the FSB creates a post-toolkit workstream, akin to the work being undertaken with incident reporting via FIRE, to develop a standardised template with standardised data fields and formats for common information required from FIs on their third-party arrangements.

7. What are the potential merits, challenges and practical feasibility of greater harmonisation of the data in financial institutions' registers of third-party service relationships?

Greater harmonisation seems possible and greatly valuable/efficient. A key challenge will be the consistent identification of the correct entities given the lack of or inconsistency of unique identifiers (e.g. not all companies having an LEI). Given that firms may be updating their core data systems to match the newly required data fields it should be limited wherever possible that these change on a regular basis given the re-work this will create. It would create greater visibility of concentration risk for firms if the consolidated information were shared back with firms.

Furthermore, there are challenges for financial institutions who manage and receive services via an intra-group service provider. The requirement to build a register of third-party service relationships which asks for external information may not in practice be applicable given the financial institution is part of a wider group.

8. Are the tools appropriate and proportionate to manage supply chain risks? Are there any other actionable, effective and proportionate tools based on best practices that financial institutions could leverage? Are there any other challenges not identified in the toolkit?

UK Finance welcomes a balanced, risk-based approach to supply chain risk management. We support the focus on "key nth parties" we would recommend the adoption of the term "material subcontractor" in its place with the associated definition:

> *"service provider of a third party providing a material part of the contracted service supporting a critical service*

UK Finance aims to avoid more specificity on what additional information is needed from subcontractors, especially given scope of nth parties is open to interpretation as drafted in the toolkit.

Furthermore, a stand-alone risk rating for supply chains as suggested in the toolkit would not provide value to risk management and may introduce unhelpful complexity to TPRM programs.

Supply chain risk is already addressed as part of the holistic assessment and oversight of a third-party arrangement and subsequent control assessments – a standalone risk rating for the supply chain, on the other hand, would merely be a time-consuming exercise with no real-world risk management benefit. Aside from a focus on material subcontractors, supply chain risk is more effectively addressed by requirements in contracts that a third-party maintains a robust TPRM program of their own and then the FI assesses that program as part of its due diligence.

9. What do effective business continuity plans for critical services look like? Are there any best practices in the development and testing of these plans that could be included as tools? Are there any additional challenges or barriers not covered in the toolkit?

UK Finance urges the FSB to ensure that the concepts of continuity, exit, and resilience planning are not conflated within the toolkit as seems to have been done in certain places. These plans are designed for different stages and events in the lifecycle of a third-party relationship and as a result have different considerations that make them effective. We also believe that the FSB and FAs can draw significant value from work that has already been done with respect to FI resolution and recovery planning obligations. These plans already require FIs to identify those services and service providers that, if disrupted, would pose a serious challenge to the FI's operations and viability. A similar approach can be incorporated into an FI's business continuity planning.

10. How can financial institutions effectively identify and manage concentration and related risks at the individual institution level? Are there any additional tools or effective practices that the toolkit could consider?

Financial institutions can effectively identify and manage concentration and related risks at the individual institution level by regularly monitoring its service providers and, on a proportionate basis, key Nth parties or "material subcontractors" to understand where concentration risk could be a concern.

There should also be consideration given to geographical concentration. By focusing on the service provided by a service provider and being agnostic about the location of the service provider itself, there is the potential that the risk posed by a disruption at a local level is missed e.g. local outages at data centres used in the supply chain of a financial institution, or material events impacting specific geographies only.

An effective assessment of concentration should also capture both a) direct dependencies arising from contractual arrangements between financial institutions and the service providers; and b) indirect dependencies, through supply chains and other forms of interconnectedness.

11. Are there practical issues with financial institutions' third-party risk management that have not been fully considered?

Our membership would welcome clarification as to whether the FSB expect critical service providers to reinstate service (in the event the critical service has been unavailable) based on a prioritisation order to financial institution and, if so, what would this look like in practice.

Separately, UK Finance notes that data requirements for registers are clear, the expectations around notifications are less clear and open to interpretation. Given there will have been many provided by now could more be fed back on how to standardise these?

Chapter 4

12. Is the concept of "systemic third-party dependencies" readily understood? Is the scope of this term appropriate or should it be amended?

The concept of 'systemic third-party dependencies' is readily understood by UK Finance.

13. How can proportionality be achieved with financial authorities' identification of systemic third-party dependencies?

14. Are there any thoughts on financial authorities' identification/designation of service providers as critical from a financial stability perspective?

UK Finance membership believes that financial authorities' identification/designation of service providers as critical from a financial stability perspective should take into considerations the substitutability and recoverability (or lack of) of the service provider. Whether financial institutions are able to replace the service provider of a critical service in a cost-effective timely manner

Consideration should be given to the possibility of occurrences where a third party is described as critical by a financial authority, but the service is not critical for some individual firms.

15. Should direct reporting of incidents by third-party service providers within systemic third-part dependencies to financial authorities be considered? If so, what potential forms could this reporting take?

16. What are the challenges and barriers to effective cross-border cooperation and information sharing among financial authorities? How do these challenges impact financial institutions or service providers?

There are number of challenges and barriers to effective cross-border cooperation and information sharing among financial authorities. Most notably there does not exist an agreed uniformed legal framework to facilitate cross-border cooperation and information sharing amongst financial authorities.

The complexity of different legal and regulatory requirements at times prevents, or restricts, cooperation and information sharing. Furthermore, there does not exist common lexicons and taxonomy that would enable effective cross border cooperations and information sharing. Some third-party service providers operate in multiple jurisdictions and the potential systemic risks posed by their failure or severe disruption would not be confined to a single jurisdiction and therefore it would be beneficial for financial institutions if there was global framework that facilitates effective cross-border cooperation and information sharing - especially for third-party service providers within systemic third-party dependencies

17. Are there any views on (i) cross border information sharing among financial authorities on the areas covered in this toolkit (ii) including [certain third-party service providers] in cross-border resilience testing and exercises, including participation in pooled audits?

UK Finance agrees that pooled audit and testing hold the potential be an effective way for financial authorities, firms and FMIs to strengthen datasets to analyse the effectiveness of the 'critical service' provided by the 'critical service providers', but will also provide information on what enhancement can be made to close any gaps.

Using this approach, financial authorities will be able to obtain a view of the resiliency of the markets against certain scenarios while financial institutions can potentially obtain data for their own 'critical service providers' under the same scenario. We believe that greater cross-sectoral cooperation would be a benefit for both financial authorities and financial institutions as it will create efficiencies in relation to sharing information. However, any efficiencies in relation to information sharing can only be realised if there is a common agreed cross sectoral approach to supervising.

Of note, members have cited coverage of this aspect under the EBA "Colleges of Supervisors" regime.

18. Are there specific forms of cross-border cooperation that financial authorities should consider in order to address the challenges faced by financial institutions or service providers?

UK Finance members have highlighted that this aspect is broadly covered under the EBA's "Colleges of Supervisors" regime.

In general, UK Finance membership sees the relative benefits of contract/model clauses differently. With some organisations expressing concerns over the potential that they can limit or constrain some freedoms they may have in contractual negotiations. However, membership have expressed in this response that contract/model clauses (around audit (including pooled audits), sub-contracting, scenario testing, OCIR/resolution etc) for the provision of 'critical services' by 'critical service providers' to financial institutions could make cross-border cooperation easier and more efficient.

It is likely that some 'critical service providers' will be providing services to other sectors of the economy and therefore we support financial authorities taking into account resilience tests, sector wide exercises and other oversight activities undertaken by or on behalf of non-financial authorities on 'critical service providers' – provided that a standardised schema and format is used to ensure compatibility and comparability to the testing.