

20 October 2023

Mr Gideon Holland
General Manager Policy
Australian Prudential Regulation Authority

Via email: PolicyDevelopment@apra.gov.au

Dear Mr Holland

CPG 230 Operational Risk Management

COBA welcomes the opportunity to respond to APRA's draft Prudential Practice Guide CPG 230 Operational Risk Management (guidance).

COBA is the industry association for Australia's customer owned banks (mutual banks, credit unions and building societies). Collectively, our sector has over \$160 billion in assets and is the fifth largest holder of household deposits. Customer owned banks account for around two thirds of the total number of domestic Authorised Deposit-taking Institutions (ADIs) and deliver competition and market leading levels of customer satisfaction in the retail banking market.

COBA supports the development of the prudential guidance and its format which links guidance to specific sections of the prudential standard that make it significantly easier for users to understand APRA's guidance. This change is a welcome development from APRA's modernising the prudential architecture project.

Key points

APRA must ensure that any supervisory expectations around CPS 230 compliance are proportionate to an entity's "size, business mix and complexity".

APRA should be aware of and monitor the risks that third and fourth party expectations may pose to the supply of services to smaller regulated entities.

COBA appreciates the consultation periods which APRA has offered for changes to CPS 230 and CPG 230, but we request that APRA remain open to receiving and acting on feedback throughout the implementation period, as issues arise.

Proportionality

COBA recognises that the guidance includes this statement on proportionality: "APRA expects an entity's approach to operational risk to be proportionate to its size, business mix and complexity". However, the concept of proportionality is not explicitly referenced throughout the rest of the guidance.

We believe that the guidance should detail the specific instances in which APRA expects to apply a proportionate approach to the requirements of CPS 230. This will provide clarity and certainty to

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smaller ADIs on how APRA will apply proportionality to the standard, especially given what is expected to be a significant compliance task for smaller entities.

Guidance for smaller, less complex entities

Although the guidance states that APRA expects smaller entities to take a simpler approach to implementing and complying with CPS 230, we are concerned that the guidance does not sufficiently capture the breadth of business models when providing best practice guidance under each section. Best practice approaches are provided throughout the guidance, however, it appears that such approaches are targeted towards larger, more complex businesses and do not specifically take into account the limitations of smaller ADIs, such as COBA members, which may not need or be able to undertake the practices outlined in the best practice guidance. We suggest that the best practice guidance provided throughout the lead up to 2025 be expanded and tailored towards different business sizes and level of operations, where appropriate.

Service Provider Arrangements

COBA is concerned that the obligations outlined in the prudential standard and guidance relating to the management of third and fourth parties is onerous, particularly regarding fourth parties. The ability to monitor fourth party downstream service providers and the risks they pose will be very challenging for small entities, especially if this relies on the cooperation of third parties to facilitate the necessary information and assurance.

This concern also extends to small third party service providers, which may find these APRA requirements onerous and challenging to meet. This could result in small, local third party providers, which some entities may have a long term relationship with, exiting the market. This will reduce competition and potentially increase concentration risk in the provision of particular services. More broadly on third parties, we have concerns that some lenders may choose not to supply smaller entities if any APRA-related expectations are too onerous relative to the commercial benefit.

COBA believes that proportionality in, and further guidance on, expectations for small, regulated entities, and a consideration of the capability of small service providers to meet the requirements, should also be incorporated into the guidance.

COBA would also like to raise draft CPG 230 paragraph 96 which states that: "A prudent entity would manage the operational risk associated with cohorts of service providers, where the aggregate impact of those service providers is material, but each individual provider is not." This paragraph provides that individual providers within a cohort should be treated as material, if the entire cohort impact is material. There is a risk that such an approach will create a significant additional burden on regulated entities and service providers to meet materiality requirements, particularly if such providers are small. The guidance should clarify that these risks can be managed in an appropriate way without imposing material service provider obligations on each individual provider in the cohort.

Critical Business Operations

The draft CPG 230 paragraph 58c of the guidance asks entities to consider business operations that, if disrupted, could impact the broader financial system or economy, including through flow-on effects or contagion in determining whether such operations are critical. COBA believes that individual entities are not best placed to determine impacts to the broader financial system from critical business operations and that the requirement to do so should not fall on entities which do not have a broad view of the financial system. This consideration should extend to tolerance level considerations as outlined in draft CPG 230 paragraph 64c.

Timelines for consultation

COBA appreciates the consultation periods which APRA has offered for changes to CPS 230 and CPG 230. However, we would like to note that the implementation deadline for CPS 230 compliance remains almost two years away and it is likely that our members will discover additional issues and will raise concerns over various aspects of the prudential standard and guidance throughout the implementation period. We request that APRA remain open to receiving and acting on feedback throughout the implementation period, as issues arise.

Thank you for taking the time to consider our submission. We look forward to continuing our engagement with APRA on this important prudential reform. If you wish to discuss any aspect of this submission, please contact Alexander Woloszyn, Senior Policy Adviser, (awoloszyn@coba.asn.au).

Yours sincerely

A handwritten signature in black ink, consisting of the letters 'M' and 'N' in a stylized, cursive font, with a horizontal line underneath.

MARK NGUYEN
Chief of Policy