

FSC Guidance Note No. 53

CPS 230 Criticality and Materiality
Guidance

17 September 2024

FSC Guidance Note No. 53

Date of this version:	17 September 2024. No prior versions.
Application of this Guidance Note:	This Guidance Note is designed for use by APRA-regulated superannuation funds in their compliance with the obligations under <i>APRA Prudential Standard CPS 230: Operational Risk Management</i> (CPS 230).
Main Purpose of this Guidance Note:	The purpose of this Guidance Note is to provide potential approaches for members in managing operational risk and material service providers under CPS 230.
Disclaimer:	<i>This document does not constitute any legal, accounting, tax or financial product advice, and does not take into account the objectives, financial situation or needs of any person or the terms of any commercial transaction. Users should obtain their own professional advice tailored to their own circumstances before using this document for their own commercial purposes. The Financial Services Council Ltd (FSC) does not give any warranty with respect to this document and has no responsibility for any loss, damage or liability whatsoever arising from the use of this document. The use of this document is subject to the terms and conditions prescribed by the FSC from time to time in relation to the access, use, transmission or dissemination of this document.</i>

FSC Guidance Note No. 53

TABLE OF CONTENTS	Paragraph	Page
Scope	1	3
Background	2	3
Definitions	3	4
Proportionality	4	4
Criticality	5	4
Material Service Providers	6	7
Example decision tree—Criticality	Appendix A	10
Example decision tree—Materiality of a Service Provider	Appendix B	11

FSC Guidance Note No. 53

1 Scope

The purpose of this guidance is to provide potential approaches for superannuation funds to the questions of criticality and materiality under CPS 230: Operational Risk Management (**CPS 230**). This guidance is not intended to be best practice or replace official APRA guidance and communications in relation to CPS 230.

As per CPG 230, CPS 230 sets baseline expectations for all APRA regulated entities, for the management of operational risks which can crystallise and adversely affect their customers. CPS 230 notes that proportionality is a key factor in determining compliance with CPS 230, with Significant Financial Institutions expected to have stronger practices, commensurate with the size and complexity of their operations.

Similarly, this guidance has been drafted to provide some common thinking on approaches to the concepts of criticality and materiality. Different superannuation funds will approach these concepts with reference to their individual circumstances.

Example decision trees are provided in the appendix.

IMPORTANT NOTE: The Standard, CPS 230, as published by APRA, is the only document against which compliance can be judged. In using this guidance, RSE Licensees must satisfy themselves that their approach to implementation is consistent with the Standard.

Conformity with this guidance does not indicate compliance with CPS 230, equally non-conformity does not indicate non-compliance with CPS 230.

2 Background

CPS 230 is a new cross-industry prudential standard that applies to all APRA regulated entities. First consulted on in 2022, CPS 230 sets out minimum standards for managing operational risk, including requirements for business continuity and material service provider management.

The key principles of CPS 230 require an APRA regulated entity to:

- effectively manage its operational risks and set and maintain appropriate standards for conduct and compliance.
- maintain its critical operations within tolerance levels through severe disruptions.
- manage the risks associated with the use of service providers.
- identify, assess, and manage operational risks that may result from inadequate or failed internal processes or systems, the actions or inactions of people or external drivers and events.
- to the extent practicable, prevent disruption to critical operations, adapt processes and systems to continue to operate within tolerance levels in the event of a disruption and return to normal operations promptly once a disruption is over.
- not rely on a service provider unless it can ensure that in doing so it can continue to meet its prudential obligations in full and effectively manage the associated risks.

CPS 230 comes into effect from 1 July 2025 however, APRA have indicated some “soft” deadlines for when it thinks entities should have met substantial requirements by. Additionally, any material service provider arrangements entered into between the publishing of the Standard and 1 July 2025, must meet the requirements of CPS 230 with a transitional deadline for contracts not up for renewal in the short term. Specifically, by 1 July 2026, all material service provider arrangements must incorporate the requirements of the Standard.

The finalised standard was released in July 2023 with associated guidance also provided. The full Prudential Standard CPS 230, can be found [here](#) and the associated guidance can be found [here](#).

FSC Guidance Note No. 53

3 Definitions

APRA means the Australian Prudential Regulation Authority.

CPS 230 means prudential standard CPS 230: Operational Resilience

CPG 230 mean prudential practice guide CPG 230: Operational Resilience

RSE means a registrable superannuation entity as defined in the Superannuation Industry (Supervision) Act 1993 (SIS Act).

RSE licensees has the meaning given in the SIS Act.

Significant Financial Institution means any institution designated by APRA to be a Significant Financial Institution. A full list can be found here.

4 Proportionality

- 4.1.1 In determining the aspects of criticality and materiality for the purposes of CPS 230, RSE Licensees should have consideration for their individual size and structures, making decisions as to compliance and implementation that best suit the individual needs of the organisation.
- 4.1.2 It is important that decisions about critical operations, sub-processes, material service providers, and other events are right-sized and proportionate.
- 4.1.3 In complying and ensuring ongoing implementation, RSE Licensees should ensure that they continue to update its methodology to ensure that as the business changes, so too does its approach to CPS 230, to ensure that it remains right sized for the organisation in the contemporary context.
- 4.1.4 RSE Licensees should consider how on-going testing, pilots, scenario planning, and other exercises can assist in the ongoing development of the Licensee's compliance with CPS 230, including how it implements lessons learned and ensures that its approach continues to grow as per 4.1.3.

5 Criticality

CPS 230 Requirements Extract

The following has been extracted directly from CPS 230: Operational Resilience

- 24 An APRA-regulated entity must manage its full range of operational risks, including but not limited to legal risk, regulatory risk, compliance risk, conduct risk, technology risk, data risk and change management risk. Senior management are responsible for operational risk management across the end-to-end process for all business operations.

Critical Operations

- 35 Critical operations are processes undertaken by an APRA-regulated entity or its service provider which, if disrupted beyond tolerance levels, would have a material adverse impact on its depositors, policyholders, beneficiaries or other customers, or its role in the financial system.
36. An APRA-regulated entity must, at a minimum, classify the following business operations as critical operations, unless it can justify otherwise:
- c) for an RSE licensee: investment management and fund administration; and (d) for all APRA-regulated entities: customer enquiries and the systems and infrastructure needed to support critical operations.
 - d) for all APRA-regulated entities: customer enquiries and the systems and infrastructure needed to support critical operations.
38. For each critical operation, an APRA-regulated entity must establish tolerance levels for:
- a) the maximum period of time the entity would tolerate a disruption to the operation.
 - b) the maximum extent of data loss the entity would accept as a result of a disruption; and
 - c) minimum service levels the entity would maintain while operating under alternative arrangements during a disruption.

FSC Guidance Note No. 53

5.1 Overarching Principles

- 5.1.1 At the centre of decision making about whether an operation is critical, superannuation funds must consider whether the disruption to an operation, preventing the completion of that operation, would have a 'material adverse impact' to customers.
- 5.1.2 Superannuation funds must decide for themselves, relevant to their size and operations, how to define material adverse impact, relevant to developed tolerance levels, however, this guidance outlines one approach.
- 5.1.3 Superannuation funds may consider the following aspects in determining if a critical operation would have a material adverse impact:
- a) *a direct material impact on customers*
An event that would severely, adversely impact a customer or customers, if the function was disrupted for a given amount of time. For example, a customer might be materially impacted if they were unable to receive their pension payments.
 - b) *an indirect impact on customers or the organisation*
An event that, although indirect, would severely affect a customer or customers because it affects the superannuation fund's ability to operate or compete. This might have reference to legal, reputational, or regulatory risks.
 - c) *an impact on the broader financial system or economy*
An event that affects the broader superannuation industry, financial system, or wider economy due to contagion or other on flowing affects. This might have reference to legal, reputational, or regulatory risks.
- 5.1.4 In determining if the above impacts are affected by operations that should be considered critical, funds could use a combination of examining the funds existing risk management framework, along with additional relevant considerations. This approach is outlined below.

5.2 Critical Operations and Sub-Processes

- 5.2.1 In mapping its critical operations, superannuation funds have the ability to classify a group of processes as critical operations, underpinned by individual sub-processes, or alternatively, a fund can choose to consider each individual process a critical operation.
- 5.2.2 Funds should carefully consider their individual circumstances in determining how to define critical operations and sub-processes noting that the full map of the Licensee's critical operations, including any sub-processes should work together to underscore its approach to criticality.

5.3 Risk Appetite Approach

- 5.3.1 When approaching the question of criticality, superannuation funds may consider their risk appetite with reference to their existing risk matrix.
- 5.3.2 Risk matrices typically have two axes, one to determine likelihood and one to determine impact, as per the below example.

FSC Guidance Note No. 53

		Impact				
		Insignificant 1	Minor 2	Significant 3	Major 4	Severe 5
Likelihood	Almost Certain 5	Medium	High	Very high	Extreme	Extreme
	Likely 4	Medium	Medium	High	Very high	Extreme
	Moderate 3	Low	Medium	Medium	High	Very high
	Unlikely 2	Very low	Low	Medium	Medium	High
	Rare 1	Very low	Very low	Low	Medium	Medium

5.3.3 The likelihood of the event occurring speaks to the probability of the event occurring on a scale where one end is that the event is almost certainly going to occur, and on the other, the event is almost certainly going to occur. The impact of the event speaks to how severe of a consequence the incident would have it occurred.

5.3.4 When considering the risk matrix, the superannuation fund should consider various types of disruptions to a critical operation to assess the risk that the disruption of that critical operation poses. This should be done in conjunction with the superannuation fund's individual assessment of its operations as a whole, combined with its risk appetite.

5.3.5 Applying the overarching principles noted above, superannuation funds may consider that, as a starting point, those operations whose disruption may result in direct or indirect impacts on customers and/or the wider ecosystem are '**extreme**' (as per the above example), would be considered critical.

5.3.6 For the purposes of CPS 230, therefore, a fund may approach the criticality of operations by considering what are the impacts on a customer or the wider financial system that may be major or severe, either directly or indirectly. Examples include, but are not limited to:

- Customers not being able to access their pension payments; and/or
- Customers not being able to make changes to their accounts for significant periods of time; and/or
- The fund being unable to adequately determine unit pricing at the end of the day, impacting transactions on an account; and/or
- Significant impacts to the reputation of the entity; and/or
- Significant regulatory enforcement; and/or
- Failure of an entity, resulting in its exit from the superannuation industry.

Funds should then consider how likely these events are. Those which are, in the superannuation funds' opinion, more than likely to occur should be carefully considered for their criticality.

5.4 Additional Relevant Considerations

5.4.1 In addition to direct and indirect impacts on customers and the financial system, when considering whether an operation is critical, a superannuation fund may also have regard to factors outside of those listed above including:

- a) the financial and operational impact and impact on reputation of a failure of the service provider to perform over a given period of time; and/or

FSC Guidance Note No. 53

- b) the disruption of the operation may lead to legal or regulatory action; and/or
- c) whether a disruption to a critical operation might impact data security, resulting in the loss of material customer or business data; and/or
- d) whether a disruption to an operation may not be easy to restore in a timely manner due to, for example, sophistication of systems, outsourcing arrangements, or lack of suitable back up providers; and/or
- e) whether a disruption of the operation might lead to failure of other operations, whether critical or not, the sum of which presents a material operation risk.

5.5 Cohorts of Customers

- 5.5.1 When considering whether the disruption to a critical operation has a material adverse impact, either directly or indirectly, on customers, funds should consider the various cohorts of customers.
- 5.5.2 Some events or loss of critical operations may not have an impact on all customers but may have an impact on a specific subset of customers. The characteristics of these customers may be relevant to the consideration as to whether the loss of the operation beyond tolerance levels is critical.
- 5.5.3 Cohorts that might be differently impacted by the disruption of a critical operation to the general customer base include:
 - Customers with disabilities; and/or
 - Customers who are from cultural or linguistically diverse backgrounds; and/or
 - Elderly customers; and/or
 - Customers of First Nations or Torres Strait Islander backgrounds; and/or
 - Customers from remote parts of Australia; and/or
 - Customer experiencing significant financial hardship; and/or
 - Customers who are experiencing bereavement.

6. Material Service Providers

CPS 230 Requirements Extract

The following has been extracted directly from CPS 230: Operational Resilience

- 49. An APRA-regulated entity must identify and maintain a register of its material service providers and manage the material risks associated with using these providers. 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.
- 50. 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:
 - c) for an RSE licensee: fund administration, custodial services, investment management and arrangements with promoters and financial planners
 - d) risk management, core technology services and internal audit.

FSC Guidance Note No. 53

6.1 Determining Materiality

- 6.1.1 When determining a list of material service providers, superannuation funds may have reference to its list of critical operations.
- 6.1.2 Material service providers involved in the delivery of critical operations may be material, however, superannuation funds may consider the role the provider plays in the delivery of the critical operation and how the provider may contribute to a potential disruption of the critical operation when considering its materiality.
- 6.1.3 Some providers whose services support the delivery of critical operations, however, may be more 'critical' than others, and funds could employ a tiering system to better determine which material service providers are core to the provision of their critical operations see Section 6.3.
- 6.1.4 CPG 230 also notes that material service providers are those that expose the organisation to material operational risk. Factors which may indicate the service provider exposes the organisation to a material operation risk include, but are not limited to:
 - a) whether a failure of the material service provider would result in the loss of customer or business data; and/or
 - b) the degree of difficulty, including the time taken, in finding an alternative service provider or bringing the business activity in-house; and/or
 - c) the ability of the superannuation fund to meet regulatory requirements if there are problems with the service provider; and/or
 - d) potential losses to the superannuation fund's customers and other affected parties in the event of a service provider failure.

Organisations may consider the above examples in conjunction with the risk matrix approach outlined in section 4.3 above noting that those material service providers whose disruption creates an '**extreme**' risk may, as a starting point, be considered material.

6.2 Scenario Testing

- 6.2.1 In determining if a service provider poses a material operational risk, superannuation funds may determine a threshold with reference to a hypothetical scenario.
- 6.2.2 When creating scenarios in which to test the materiality, superannuation funds may consider scenarios where the impact of the loss of the operation of that service provider would have a direct or indirect material impact on the fund's customers, or the wider ecosystem. Superannuation funds should also consider the likelihood of the scenario occurring, choosing scenarios that are both reasonable and plausible but with sufficiently severe consequences as to speak to material operational risk.
- 6.2.3 With the impact of the scenario in mind, the superannuation fund may again reference its risk matrix, focussing on service providers whose impacts would result in '**extreme**' consequences (see section 4.3 above).

6.3 Minimum Material Service Provider Classifications

- 6.3.1 Superannuation funds are required, at a minimum, to classify organisations which provide fund administration, custodial services, investment management services and arrangements with

FSC Guidance Note No. 53

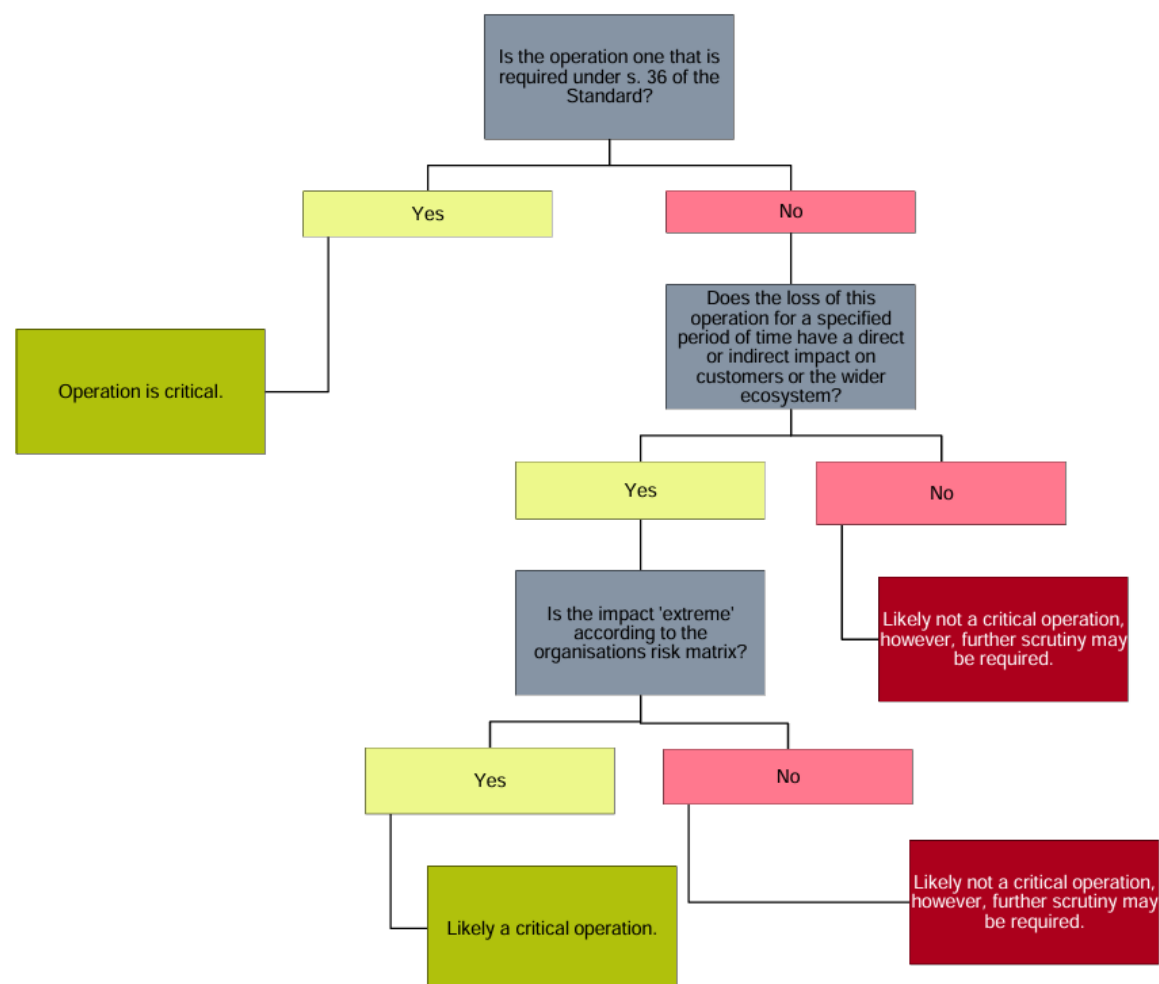
promoters and financial planners as well as risk management, core technology services and internal audit functions as material service providers.

- 6.3.2 A superannuation fund may elect not to consider one of these providers as a material service provider if it can be justified. Superannuation funds require a strong justification for not having a required service provider, as per section 50 of the Standard, as a material service provider and should carefully consider its justification, relevant to its individual circumstances.
- 6.3.3 When considering the justification for whether a required service provider is, in fact, material, the superannuation fund may consider again their risk matrix, and the overarching approach to determining criticality and materiality by considering whether a service has indirect or direct impacts on customers or the wider ecosystem.
- 6.3.4 In testing the materiality of a required service provider, superannuation funds should consider the scenario used to determine materiality and may use the approach outlined in 5.2 above.
- 6.3.5 A superannuation fund may have consideration to a tiering approach to material service providers, determining, based on their risk appetite, which level of tiering captures materiality of service providers. An example approach to tiering is outlined below:

Tier	Impacts based on hypothetical scenario	Risk Rating
Tier 1	• Directly or indirectly impacts a large number of customers; and/or • Has direct impacts on the wider superannuation sector, financial industry, or economy; and/or • Service provider is difficult to replace at short notice owing to niche service offering; and/or • Failure of the service provider could provide an existential threat to the superannuation fund; and/or • Failure of service provider results in the loss of sensitive customer or business data.	Extreme
Tier 2	• Directly impacts a small number of customers, especially if that cohort of customers is experiencing a type of vulnerability; and/or • Indirectly impacts a large number of customers; and/or • indirectly impacts the wider superannuation sector, financial industry, or economy.	Very high
Tier 3	• Directly impacts a small number of customers, but that cohort is not likely to be experiencing any type of vulnerability; and/or • indirectly impacts a small number of customers, where that cohort of customers is experiencing a type of vulnerability	High
Tier 4	• No directly or indirectly impacts on customers; and/or • No direct or indirect impacts on the wider superannuation sector, financial industry, or economy.	Less than high.

FSC Guidance Note No. 53

Appendix A: Example Decision Tre - Criticality



FSC Guidance Note No. 53

Appendix B: Example Decision Tree – Materiality of a Service Provider

