

## CP 24/3 Quarterly Consultation

### FCA Statement of Policy on disciplinary measures for Critical Third Parties (CTPs)

April 2024

AFME welcomes the opportunity to publicly comment on the FCA's proposed statement of policy addressing disciplinary measures for Critical Third Parties (CTPs). AFME does not object to the proposed approach, noting that the provisions are largely in line with the relevant provisions of the Financial Services and Markets Act (FSMA) 2023, but we make the following comments as operational good practices:

#### 1. Supervisory proportionality

We acknowledge that financial services authorities need a set of effective disciplinary tools at their disposal to address any future breach by CTPs of their regulatory obligations. We are however mindful that third-party providers facing designation are likely to be unfamiliar with the level of incoming supervision. The differences in culture between financial institutions and many of their tech providers is considerable and well understood. **It will inevitably take time for most CTPs to adjust to the expectations and practices of the new regime, and we would stress the importance of a bedding-in period, where authorities seek to educate rather than enforce.** Ultimately an approach which lacks proportionality could result in financial institutions herding around a smaller number of CTPs, thereby enhancing concentration risk across the sector's supply chain.

Of particular concern is the potential for CTPs and/or financial institutions to be instructed to suspend and/or terminate certain services. In certain cases, there may not be a viable market alternative or readily available in-house expertise to take over these responsibilities. **In deciding which, if any, disciplinary measure is appropriate, we would strongly urge that substitutability is explicitly considered by the authorities, to ensure that enforcement is proportionate, and there is no unintended disruption which could threaten the stability of and confidence in the UK financial system, as required under section 312R(4)(b) of FSMA 2023.**

#### 2. Safeguards for financial institutions

AFME notes that while it is the CTP which will have failed to meet supervisory expectations, it is financial institutions which may have to respond to and implement the disciplinary measures. Section 312R(2)(b), (c) & (e) of FSMA 2023 directly imposes the burden of compliance on authorised persons over the receipt of services. This approach reinforces the need for safeguards for financial institutions, including:

- Notification from the FCA that a CTP with which the financial institution has a contractual arrangement is subject to a disciplinary measure. **This notification should be in advance of any public disclosure, for example under section 312Q of FSMA (public censure).**

- **An 18-month window for implementing any prohibition on CTP services.** This length of time is necessary for ensuring that an alternative provider can be identified and fully onboarded without any operational disruption. Adequate windows for implementation do not diminish the deterrent effect of these disciplinary measures, given the financial institution is unlikely to rotate such critical providers with any degree of regularity.
- **Assurances as to what financial institutions should do in the event that a CTP exercises its right to refer a disciplinary measure to tribunal** under Section 312S of FSMA 2023.

### 3. Clarification on scope

AFME flags that it is our understanding that any suspension or termination of services relates only to those arrangements related to the breach of regulatory compliance by the provider in question. There is consequently no expectation that the decision to invoke such disciplinary measures would require a financial institution to completely cease all commercial arrangements with the provider as an entity. Should authorities intend to be more far-reaching we would welcome the opportunity to discuss further at the earliest opportunity.

AFME remains on hand to discuss in further detail our points above.

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