

# HM Treasury confirms approach to critical third party service providers

## AT A GLANCE

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### Contacts

#### Rakesh Majithia

Partner

T: +44 (0) 7803 023856

E: rakesh.majithia@pwc.com

#### Charles Rodger

Director

T: +44 (0) 7725 633265

E: charles.m.rodger@pwc.com

#### Duncan Scott

Director

T: +44 (0) 7894 393607

E: duncan.j.scott@pwc.com

#### Conor MacManus

Director

T: +44 (0) 7718 979428

E: conor.macmanus@pwc.com

#### Gurmaj Dhillon

Manager

T: +44 (0) 7483 416408

E: gurmaj.s.dhillon@pwc.com



### What's new?

- HM Treasury (HMT) published a [policy statement](#) on 8 June 2022, confirming how it proposes to mitigate risks from critical third party providers of services to the finance sector (e.g. Cloud Service Providers).
- Under its new regime, HMT will be able to designate certain third party service providers as 'critical', after consultation with the relevant financial regulator and other bodies. The relevant financial regulator will then be able to take appropriate action, in situations where the services provided by designated 'critical' third parties are of particular relevance to the regulators' objectives.

### What does this mean?

- UK financial regulators currently have the powers to set requirements for firms in relation to their operational resilience. [This framework](#) covers regulated firms' contractual relationships with third party providers, in areas such as data security, business continuity and exit planning (refer to [PwC's Hot Topic briefing](#) for further details). However, HMT considers that this framework is insufficient to address systemic risks around disruption to third party service provision, particularly the concentration risk arising from the provision of critical services by a single third party to multiple firms.
- The FPC [expressed its concerns](#) in 2021 over the financial stability risks presented by the increasing reliance of financial institutions on a small number of cloud service providers and other critical third parties. For example, a 2020 [Bank of England publication](#) cited that over 65% of UK firms used the same four providers for cloud infrastructure services, while the National Cyber Security Centre's 2021 [Annual Review](#) highlighted the increasing risk of supply chain disruption through cyber incidents.
- As a result, HMT has developed a proposal in collaboration with the Bank of England, PRA and FCA, to mitigate risks from critical third parties to financial institutions. Through the proposed regime, HMT will be able to designate certain third party service providers as 'critical'. Financial regulators will then be able to set minimum resilience standards that critical third parties will be directly required to meet in relation to any material services provided to UK financial institutions.
- The relevant financial regulator will be granted a range of statutory and regulatory powers to oversee these resilience standards, including rule-making to oversee critical service provision, the ability to commission Skilled Person Reviews focusing on the third party, gather relevant information and take formal enforcement action where needed. This regime will allow the relevant financial regulator to directly oversee the services provided by critical third parties to regulated firms.

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- The EU has proposed a similar regime through its proposal for a [Regulation on Digital Operational Resilience \(DORA\)](#). Through this proposed regime, the European Supervisory Authorities (ESAs) would be able to designate certain third party service providers as 'critical' and therefore subject to direct oversight by the designated lead ESA.

HMT's proposal, as well as potential implications for their wider market strategy. Operational resilience has been a key focus for the regulators in the UK in recent years and there will be considerable lessons for critical third parties to learn from the experience of FS firms.

## What do firms need to do?

- Given the strengthening regulatory focus on the role of third party service providers, firms should consider their dependencies in these areas. In particular, they should review their existing contractual arrangements with third party providers and ensure that they are fully complying with regulatory requirements in relation to their operational resilience.
- For firms which provide third party services to financial institutions, HMT's proposals are likely to bring them into scope of the UK's financial regulatory framework. Therefore they will need to consider the operational impact of

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T: +44 (0) 7803 023856

E: [rakesh.majithia@pwc.com](mailto:rakesh.majithia@pwc.com)

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T: +44 (0) 7725 633265

E: [charles.m.rodger@pwc.com](mailto:charles.m.rodger@pwc.com)

### Duncan Scott

Director

T: +44 (0) 7894 393607

E: [duncan.j.scott@pwc.com](mailto:duncan.j.scott@pwc.com)

### Conor MacManus

Director

T: +44 (0) 7718 979428

E: [conor.macmanus@pwc.com](mailto:conor.macmanus@pwc.com)

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## Next steps

The Government intends to table the legislation for this regime in due course. The UK financial regulators will then publish a joint Discussion Paper, outlining how they propose to exercise the powers to be granted through primary legislation (as well as seeking industry feedback), to be followed by a Consultation Paper on their proposed rules.



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