

What is CPS 230?

CPS 230 is a compulsory prudential standard issued by the Australian Prudential Regulatory Authority (APRA) which will **come into effect on 1 July 2025**.

CPS 230 is directed at addressing the increased operational risks faced, relevantly, by general insurers in using external providers to deliver key products and services to customers.

CPS 230 seeks to achieve this by imposing extensive obligations on general insurers to identify, assess and manage operational risks posed by the use of external providers.

CPS 230 will apply to an insurer's "*critical operations*" in so far as they are undertaken, or exposed to operational risk, by "*material service providers*" (**MSPs**).

Critical operations

Critical operations are any process undertaken by an insurer or its service provider which, if disrupted beyond tolerance levels, would have a material adverse impact on policyholders, beneficiaries or other customers. APRA has specifically stated that claims processing, customer enquiries and the systems and infrastructure needed to support critical operations are critical operations, but this is not an exclusive list and an insurer may identify more critical operations than those particular categories.

MSPs

MSPs are external providers upon which a general insurer relies to undertake critical operations or that expose the general insurer to material operational risk in respect of critical operations. APRA has expressly nominated:

- underwriting
- claims management
- risk management
- core technology, and
- internal audit services

as services which, if provided by an external service provider, will qualify that external service provider as an MSP.

Underwriting agencies (and the third parties they rely upon) who provide a service which supports a critical operation of an insurer will fall within the CPS230 framework.

At a minimum, this will extend to claims processing, customer enquiries and supporting systems and infrastructure in relation to underwriting, claims management, core technology and internal audit services.

Why has CPS 230 been implemented?

In July 2022, APRA issued a discussion paper in which it identified the following **three key trends** in respect of general insurers' management of operational risks.

- 1 **Control failures** in the form of ineffective controls to deal with major disruptions such as natural disasters.
- 2 **Lower tolerance for disruptions** due to policyholders' everyday reliance on insurance and reasonable expectation that services will always be available.
- 3 **Increasing reliance on service providers** by general insurers on external providers to deliver products and services to customers which, in turn, created longer and more complex supply chains and introduced greater risks of disruption to those services.

Against this background, CPS 230 was designed to enhance the operational risk management of general insurers by compelling them to identify, assess and manage operational risks posed by MSPs by fully integrating those risks into the general insurer's own operational risk framework.

What impact will CPS 230 have on underwriting agencies?

Underwriting agencies who operate under a binding authority with an APRA regulated general insurer are highly likely to be identified by that insurer as an MSP.

This means that the general insurer must ensure that the operational risk management framework within which the critical operations undertaken by the underwriting agency are provided comply with CPS 230.

This will require the general insurer, among other things, to be satisfied that it has:

- identified the relevant critical operations in respect of which the underwriting agency provides services;
- assessed the operational risk posed by the underwriting agency;
- identified all third party providers relied upon by the underwriting agency to deliver services in respect of critical operations (being fourth parties to the insurer);
- established risk tolerances in respect of relevant critical operations and incorporated those tolerances into the operational risk framework;
- established governance oversight and monitoring accountability and risk profile and reporting procedures in respect of the relevant critical operations;
- updated relevant contractual arrangements (including the binding authority) to be CPS 230 compliant;
- established business continuity management in respect of the relevant critical operations (which requires an assessment of the underwriting agency's business continuity plan); and
- established and implemented scenario testing.

General insurers will be reliant on underwriting agencies for information relevant to a number of those matters outlined above. This is particularly so in relation to identifying and assessing fourth party risks (that is, the third parties which the underwriting agency relies upon to deliver critical operations) and assessing the adequacy of existing business continuity plans.

It is in the interests of underwriting agencies to provide that information and work with their insurers to achieve CPS 230 compliance. If an insurer is not satisfied that the operational risks posed by an underwriting agency in respect of critical operations have been identified, assessed and capable of being managed in a compliant way, the insurer will be in breach of APRA's prudential requirements. This will have adverse legal and commercial consequences for both the insurer and the underwriting agency.

What should underwriting agencies be doing about CPS 230?

Regular, clear and constructive engagement between an underwriting agency and insurer about the insurer's process and priorities for achieving CPS 230 compliance and what role the underwriting agency needs to play in meeting that objective is critical.

At a minimum, underwriting agencies need to engage with their insurers about:

- what services provided by the underwriting agency have been identified as relevant to critical operations and its characterisation as an MSP;
- what information the insurer requires from the underwriting agency and when that information must be provided;
- what amendments need to be made to contractual documentation for CPS 230 compliance;
- what new processes will need to be implemented in order to meet CPS 230 requirements;
- when the insurer proposes to inform the underwriting agency that CPS 230 compliance has been achieved; and
- what the insurer will require on an ongoing basis from an audit and risk management perspective

Given CPS 230 is effective from 1 July 2025, it is imperative that underwriting agencies understand what is expected of them, and when, in order to ensure that they have the resources and capacity to adequately respond to requests for information from the insurer and take necessary steps to support the insurer in achieving CPS 230 compliance.

MORE INFORMATION

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