



**Response: CP23/30: Operational resilience: Critical third parties
to the UK financial sector**

Background

Established in 1961, the World Federation of Exchanges (WFE) is the global industry association for exchanges and clearing houses (CCPs). Headquartered in London, it represents over 250 market infrastructure providers, including standalone CCPs that are not part of exchange groups. Of our members, 34% are in Asia-Pacific, 45% in EMEA, and 21% in the Americas.

The WFE's 90 member CCPs and clearing services collectively ensure that risk takers post some \$1.3 trillion (equivalent) of resources to back their positions, in the form of initial margin (IM) and default fund requirements. WFE exchanges, together with other exchanges feeding into our database, are home to over 50,000 listed companies, and the market capitalisation of these entities is over \$100 trillion; around \$140 trillion (EOB) in trading annually passes through WFE members (at end 2022).

The WFE is the definitive source for exchange-traded statistics and publishes over 350 market data indicators. Its free statistics database stretches back more than 40 years and provides information and insight into developments on global exchanges. The WFE works with standard-setters, policy makers, regulators, and government organisations around the world to support and promote the development of fair, transparent, stable, and efficient markets. The WFE shares regulatory authorities' goals of ensuring the safety and soundness of the global financial system.

With extensive experience of developing and enforcing high standards of conduct, the WFE and its members support an orderly, secure, fair, and transparent environment for investors; for companies that raise capital; and for all who deal with financial risk. We seek outcomes that maximise the common good, consumer confidence, and economic growth, and we engage with policy makers and regulators in an open, collaborative way, reflecting the central, public role that exchanges and CCPs play in a globally integrated financial system.

If you have any further questions, or wish to follow-up on our contribution, the WFE remains at your disposal. Please contact:

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Response:

The WFE welcomes the opportunity to comment on the UK Regulators Consultation Paper [CP23/30: Operational resilience: Critical third parties to the UK financial sector \(CP\)](#), which empowers the UK regulators and HM Treasury to identify and designate potential Critical Third Parties (CTPs) and sets out proposed requirements for CTPs (including, fundamental rules and operational resilience requirements).

The CP is based on the [Discussion Paper \(DP\) 3/22](#) that sought views on managing systemic risks posed by certain third parties and gave powers to HMT to identify and designate certain third parties as critical to UK financial sector. The WFE responded to the discussion paper¹, emphasising that the obligations already placed on regulated entities and Financial Markets Infrastructures (FMIs) should be recognised and that any new regulatory requirements should not impose additional burden on the FMIs, as they already have comprehensive Third-Party Risk Management (TPRM) programs in place.

The consultation is primarily relevant to CTPs and focusses on their services to UK firms and FMIs. The WFE appreciates that the proposal acknowledges WFE's concern regarding new requirements on FMIs and does not seek to impose additional requirements on firms and FMIs. Nevertheless, the proposal may indeed impose additional requirements on firms and FMIs if the requirements on CTPs are not carefully targeted. Specifically, when regulators pose questions to a CTP, it is highly probable that the CTP will subsequently seek responses from the relevant firms and FMIs under its purview. Given that these firms and FMIs will already be regulated, it is likely that these firms and FMIs have already provided comprehensive answers to similar inquiries posed by the regulators. Consequently, there exists a potential for redundancy in the information sought through duplicative questionnaires. This is far from a theoretical risk; we understand from our members that these duplicative questionnaires are already something that they experience in other areas.

Generally, in the interest of optimising resources and streamlining the regulatory communication process regulators could coordinate internally and align their inquiries to minimise the repetition of questions posed to entities within the financial sector. This approach would not only enhance operational efficiency but also allow for a more focused and strategic allocation of regulatory efforts.

The WFE acknowledges the proposals' alignment with the regulator's primary goal of bolstering the safety and soundness of supervised UK firms, contributing to the long-term system-wide resilience of the financial sector. We agree with the assertion that UK firms and FMIs may increasingly rely on specific third-party services for crucial business functions.

Concerning the identification and designation of CTPs, Regulators must adhere strictly to the set criteria of materiality, concentration, and substitutability outlined in the statutory test otherwise it risks resulting in an influx of CTPs and might not identify appropriately those third parties who are truly critical. Advocating for a more focused approach, we believe a narrower set of criteria than what is contemplated in the proposal would allow regulators to concentrate on truly critical third parties and help avoid subjective interpretations. Broadly, we support the proposal's focus on material services of the CTP only, as this will allow regulators to channelise their resources to achieve their objective of ensuring long-term system-wide resilience of important business services. WFE would also urge Regulators to abide

¹ WFE Response: PRA DP3/22 – Operational resilience: critical third parties to the UK financial sector, 23rd December 2022, available at <chrome-extension://hbgjioklmpbdmemlmbkfckopchbgjpl/https://www.world-exchanges.org/storage/app/media/regulatory-affairs/wfe-response-to-pra-consultation-on-ctp-201222-for-final-submission.pdf>

by the defined approach and to ensure that firms and FMIs that are already subject to regulation and supervision/oversight that delivers equivalent outcomes would not be recommended for designations as CTPs.

We also advocate for careful consideration of certain explicit requirements outlined in the oversight function of this proposal, specifically the collection of information from CTPs about FMIs. This aspect warrants careful attention to avoid potential challenges related to confidentiality and information security in the sharing of data.

The WFE seeks clarification on terms such as "nth party". While Chapter 2 of the draft supervisory statement defines nth party, its scope is unclear regarding inclusion of the fourth party.

WFE members have expressed diverse views about the use of designation status, observed among both FMIs and the designated CTPs. Therefore, we strongly recommend the implementation of measures aimed at elucidating the implications of designation status. For instance, the regulator could establish a register and ensure that pertinent caveats are prominently highlighted.

Finally, we wish to highlight the concern that several of the proposed requirements for CTPs, such as information gathering and cost-benefit analysis, may ultimately be transferred to UK FMIs. This potential transfer of obligations could contradict the intention of avoiding additional burdens on UK firms and FMIs. Consequently, we strongly urge regulators to take necessary measures to address this potential issue.

We have answered some of the specific questions as below:

Questions:

Q1. Do you have any comments on the regulators' definitions of key terms and concepts outlined in Chapter 2 of the [draft supervisory statement](#)? Are there key terms or definitions the regulators could clarify or additional definitions to be included?

Answer:

The WFE seeks clarification on terms such as "key nth party service provider" and more specifically that the definition clearly provide that it is with respect to a CTP's fourth parties alone. In particular, while Chapter 2 of the draft supervisory statement defines nth party, its scope is unclear regarding inclusion of the fourth party. However, defining the fourth party should not introduce additional requirements for UK firms and FMIs, as they have no direct relationship with such fourth parties. In practice, UK firms and FMIs do not necessarily receive information about a given fourth party from their third-party service provider and instead, generally focus on their third-party service providers' TPRM programs.

We also recommend adding the definition of "operational resilience" in the draft supervisory statement which describes the ability of systems to resist, absorb, and recover from or adapt to an adverse occurrence during operation that may cause harm, destruction, or loss of ability to perform mission-related functions. Or also can describe it as the ability of an institution to deliver critical operations through disruption. This ability enables an institution to identify and protect itself from threats and potential failures, respond and adapt to, as well as recover and learn from disruptive events in order to minimize their impact on the delivery of critical operations through disruption.

Additionally, within the key concepts outlined in Chapter 2, one of the oversight functions involves regulators gathering information from a CTP and Persons Connected to a CTP, potentially containing sensitive information about FMIs. The WFE emphasises the need for regulators to establish adequate safeguards to maintain confidentiality in this

context. The key concepts appear to give wide reaching powers to regulators to instruct a CTP to "do anything" or refrain from "doing anything" and gather information. In this regard, it is not very clear under the key concept chapter whether regulator's powers are proportionately measured or not, e.g. whether these are relating to a specific service or group of users "material service".

Q3. Do you have any comments on the regulators' proposed Fundamental Rules? Should the regulators add, clarify, or remove any of these Rules, or any of the terms used in them, eg 'prudent', 'responsibly'?

Answer: CTP Fundamental Rule 6 mandates a CTP to engage with the Regulators in an open and co-operative way and disclose to the Regulator appropriately anything relating to the CTP of which they would reasonably expect notice. This Fundamental Rule 6 may involve sharing sensitive information about UK FMIs. Generally, the sharing of information on FMIs warrants careful attention to avoid potential challenges related to confidentiality and information security in the sharing of data. The WFE would therefore recommend ensuring the proposal does not lead to confidentiality issues and to implement appropriate safeguards where necessary.

Q5. Do you have any comments on the regulators' proposed Operational Risk and Resilience Requirements? In particular, should the regulators add or remove any of these Requirements?

Answer: The operational resilience requirements seem to be quite comprehensive and has explicit and individual requirements for the most important areas like supply chain risk management, technology and cyber resilience, and change management.

However, in the absence of a clear guidance regarding the information to be obtained from fourth-party entities, the WFE recommends that regulators consider advocating for a focused questionnaire that is less time consuming and avoids unnecessary questions. This will ensure proper utilisation of resources.

As explained above, the FMIs might not to have access to the information from fourth party and generally focus on their third-party service providers' TPRM programs. Therefore, it is recommended that reliance on third-party risk assessment by the CTPs should be allowed. Members have informed that mapping of fourth party risk assessment may not be practically possible for the FMIs. The WFE believes that where a regulator has completed a TPRM assessment of a third-party, CTPs should be permitted to depend on the regulator's evaluation. This measure will help prevent unnecessary duplication of assessments.

Q 7. Do you have any comments on the regulators' proposal for the Operational Risk and Resilience Requirements to apply to a CTP's material services only?

Answer:

The decision to apply Operational Risk and Resilience Requirements selectively to CTP's material services demonstrates a targeted strategy, focusing on areas with significant potential impact on the financial sector, which will allow regulators to channelise their resources to achieve their objective of ensuring long-term system-wide resilience of important business services. Prioritising material services adopts a risk-based strategy, directing attention and resources where they are most needed. This enables a more focused and efficient regulatory oversight. Customising requirements to material services adheres to the principle of proportionality, recognising that not all services provided by a CTP carry equal significance in terms of their potential impact on the financial system. Narrowing the scope to material services can alleviate the regulatory burden on CTPs, particularly those offering a wide array of services. This streamlining may facilitate a more manageable compliance process.

Q 11: Do you have any comments on the regulators' proposals regarding what information should be included at each stage (initial, intermediate, or final) of notification?

Answer: Yes, we support a phased approach of initial, intermediate, or final notification, with information needs accumulating with each subsequent phase, however, appropriate flexibility needs to be maintained in the approaches due to the fluidity and variation of different scenarios. All the information required may not be available at the immediate or intermediate stage of an incident.

Q 12: What are your views on having a standardised incident notification template?

Answer: The Consultation does not allude to any standardised template, and hence it is not clear if the question is in the context of CTPs or more generally.

A standardised incident notification template would be welcomed but might be difficult to achieve considering different regulatory requirements across the world. FSB's initiative to develop Format for Incident Reporting (FIRE) might prove to be helpful in this regard.

Q 13: Do you have any comments on the regulators' proposed rules and expectations in relation to information gathering and testing?

Answer: WFE welcomes the Regulators' proposed rules and expectations in relation to information gathering and testing, specially, self-assessment certification covering Risk Management, Supply Chain management, Cyber and technology, scenario testing, etc.

Q 15: Do you have any comments on the regulators' proposals to require CTPs to share certain information with firms and FMIs?

Answer: We welcome CTP's sharing of assurance and testing information with UK firms and FMIs. This step will support FMIs ability to adequately manage risks related to their use of the CTP's services and TPRM programs of UK FMIs and firms will be bolstered by CTPs' sharing of assurance and testing information with firms and FMIs.

Q 16: Would the information the regulators propose to require CTPs to share benefit firms' and FMIs' own operational resilience and third-party risk management?

Answer: Yes, same as above.