17 February 2017

EBF_025642C

EBF Response to FSB consultation on Guidance on Continuity of Access to Financial Market Infrastructures

The European Banking Federation welcomes the Guidance on Continuity of Access to Financial Market Infrastructures ("FMIs") to ensure that banks in resolution are able to maintain critical clearing, payments and settlements functions.

For your consideration, we have provided the following key messages and answers to some of the consultation questions below.

General Comments

- For the avoidance of doubt, we understand that the guidance shall be applicable to such firms for which the FMI renders critical services, i.e. where an FMI is not critical to the firm the guidance shall not apply.
- The paper uses the term "custodian"; it does not define it, but appears to treat a custodian as falling into the category of FMIs. This is incorrect. A "custodian" falls into the category of an "FMI intermediary". We advise to drop the term "custodian".
- It is important to be very clear that the services provided by an FMI are different from the services provided by an FMI intermediary. FMI intermediaries provide access to infrastructure; FMIs provide infrastructure services. For example, if you look at the European CSD Regulation, you will see that three core CSD services are defined, and that CSDs provide these services, but that intermediaries do not and cannot provide these services.
- FMI intermediaries need to have discretion and flexibility about whether to continue to provide services. FMI intermediaries cannot be locked into an obligation to provide services no matter what the situation is; there needs to be some flexibility so that based on its own risk assessment the FMI intermediary has the ability to suspend services. The point is that collateral may help to manage risk, but some risks are uncertain and difficult to manage. (In this context, it should be noted that a single FMI intermediary may provide access to multiple FMIs located in many different countries; the risk profile for continuing to provide access may be very different).
- The coordination between authorities is the key to successful continuity of access to FMIs and authorities should take a proactive role in the dialogue between themselves. Firms are under specific obligations for ensuring continuity, and the authorities are in charge of their supervision and enforcement. Contractual arrangements cannot and

European Banking Federation aisbl

Brussels / Avenue des Arts 56, 1000 Brussels, Belgium / +32 2 508 3711 / info@ebf.eu
Frankfurt / Weißfrauenstraße 12-16, 60311 Frankfurt, Germany
EU Transparency Register / ID number: 4722660838-23

should not substitute supervisory practice/statute, and in any case they would be overridden by the authorities if necessary.

- Competent authorities shall align their information requirements where a requirements serves the same purpose and check the information already available and establish an information exchange.

Answers to consultation Questions

1. Does the consultative document appropriately address the tensions that may arise between the various financial stability objectives, with regard to the safety and soundness of providers of critical FMI services on the one hand and to the orderly resolution of the recipients of such services on the other?

Yes, the tensions are identified appropriately. Most importantly, the role of the authorities of the various involved stakeholders is most crucial. Discussions in 2016 with FMIs and providers of critical FMI services (intermediary agent banks) to the "material" group entities showed that they would, in the event of an impending insolvency of an FMI participant or client, always expect the relevant regulators to immediately engage in a dialogue about appropriate regulatory action and coordination. Most FMIs said that, when deciding on the exclusion of a participant in financial distress, they would act as directed by their regulator and not necessarily as foreseen in their published rule books.

2. Do you agree with the overall scope of the guidance and the proposed definitions, in particular the services and functions captured in the definition of 'critical FMI services'? Should any of the definitions be amended? If so, please explain.

The distinction between critical services and ancillary services is not clear. If access to critical services should require that ancillary service can continue to be provided, then the distinction between critical and ancillary services should not be made.

We agree with the scope of the guidance, but we consider the scope of "indicative information requirements" listed in the document annex to be excessive and in some parts without value. No globally active FMI participant will be able to meet these requirements without very substantial effort and cost.

We do not see the reason why the guidance singles out custodian banks alongside FMIs. FMIs are marketplace utilities, while custodians are pure commercial service providers and should not be confused with FMIs, not subjected to requirements appropriate to the former. Therefore, and for the purposes of this FSB guidance, a custodian should be included within the scope of this paper only if included within the definition of "FMI intermediary" and all separate references to custodians should be deleted.

3. What are your views on the proposal in sub-section 1.1 of the consultative document that providers of critical FMI services clearly set out in their rulebooks

or contractual arrangements the rights, obligations and applicable procedures in the event of an FMI participant entering into resolution?

We agree with the draft guidance that FMI rulebooks and other contractual provisions should make it easily understandable for all interested parties which procedures would be implemented and which rights and obligations should be exercised, if any, upon entry into resolution of a participant. However, we note that there are no existing standards at this point and that best practices have yet to be developed as to the exact issues that should be addressed and standard clauses that my apply. This specific type of arrangements is a nascent practice.

Above all, such provisions should stipulate beyond any ambiguity upon which basic conditions access to the critical services will be maintained or otherwise terminated. The relevant rulebook and/or contract provisions must therefore provide crystal clear answers to two questions:

1. what conditions must be fulfilled for the access to the critical service to continue, and
2. what will occur, if anything, upon entry into resolution of the service recipient.

Generally, the FMIs already have detailed rulebooks which describe the criteria that constitute reasons to trigger suspension, exclusion, and the procedures that would follow. At the same time, the FMI reserve the right to retain flexibility to act differently, if this is considered to be in the best interest of the market, or if so directed by the relevant regulators. There is probably not too much substance to be put into such rules, compared with the rules under business as usual conditions.

Intermediaries put in place commercial arrangements with their clients, but they are also bound by the FMI rules on the other side. No intermediary will be able to continue providing services if their continuity id not ensured by an FMI.

4. Sub-section 1.1 of the consultative document proposes that the exercise by the provider of critical FMI services of any right of termination or suspension of continued access to critical FMI services arising during resolution of an FMI participant be subject to appropriate procedures and adequate safeguards. What are your views on those procedures and safeguards? In your answer, distinguish where relevant depending on whether the firm that enters resolution continues or fails to meet its payment, delivery and collateral provision obligations to the FMI or FMI intermediary.

We support the principle in the draft guidance by which entry into a resolution should not result in an automatic suspension or termination of access to critical FMI services. This is already reflected in the EU and US regulations applicable to credit institutions. In line with our previous remarks, suspension or termination events should be clearly distinct from any other legal status, be it business as usual, recovery or resolution.

We also support the guidance proposal that regardless of the status of an entity, suspension and termination rights should be exercisable whenever the entity fails to meet

its payment and/or delivery obligations, or other obligations that could compromise the ability of the FMI to provide its services in a safe and orderly manner.

We find it essential that guidance confirm that ordinary contractual provisions for the termination of the commercial relationship should be exercisable at any time and at the discretion of any of the parties, according to the termination conditions agreed upon and stipulated by the parties in the contract.

From the perspective of a service provider, whether in business as usual or in resolution, the nature of the relation between the intermediary and the client is a commercial one and as such it is based on the willingness of the counterparts to be in that relation. Termination conditions agreed ex-ante should be respected and remain enforceable whether or not a default has taken place. It must be possible for any party to orderly exit the relation at any time, upon the agreed conditions.

We therefore find it appropriate, at least in the jurisdictions that do recognise the special status of an entity in resolution, to make clear how the mutual rights and obligations will be affected in such event. A right of a service provider to terminate a commercial relation should remain untouched, in accordance with the appropriate notice period and any other applicable safeguards.

The respect of contract is particularly relevant in the context of legal succession or a bridge institution taking over some or all obligations of the entity in resolution. Unless special provisions had been made for the event where a successor entity may not fulfil **all** contractual conditions of access, while still honouring the basic ones (meeting payment and delivery obligations), any amendment of the mutual rights, obligations, and of the applicable procedures should be mutually agreed.

5. Sub-section 1.2 of the consultative document proposes that the general rights, arrangements and applicable procedures of a provider of critical FMI services that would be triggered by entry into resolution of an FMI participant, its parent or affiliate, should be the same irrespective of whether the firm entering into resolution is a domestic or foreign FMI participant. What safeguards should be considered and what measures are needed to ensure a consistent approach is taken across providers of critical FMI services to these safeguards?

We agree that arrangements and procedures should be the same irrespective of the firm's domicile. We note, however, that the coordination between authorities would be indispensable for the arrangements and guarantees of continuity arrangements to pan out positively. Contractual arrangements cannot and should not substitute nor contradict the applicable statute and supervisory guidance. Therefore the authorities should be more proactive in determining the conditions upon which they would support and enforce the resolution plans and their continuity arrangements. It is essential to avoid supervisory arbitrage on a cross-border basis.

Again, the distinction between access directly to an FMI and access via an intermediary is also vital insofar the authorities of the different stakeholders concerned will act with

different primary objectives in mind. FMIs fulfil a utility and stability function towards the marketplace as a whole. Intermediaries are pure commercial service providers. The guidance should therefore recognise the need for a consistency between the different objectives of the authorities, at the level of the entity in resolution, the FMI, and at the level of the intermediary.

In practice, service contracts, rule books etc between FMIs or FMI Intermediaries and Participants/Clients, are always subject to the law in the jurisdiction of the FMI or FMI Intermediary, never the law of the participant/client's domicile (where different) or even a third country law. No FMI or FMI Intermediary servicing an international participant or client base would accept a different set-up.

In our experience, FMIs or FMI Intermediaries would not take foreign law into consideration when deciding their own actions.

In the event of conflict of national laws, the relevant regulators should define a mutually acceptable solution.

We note that not all jurisdictions award a special status to resolution with the legal effect of making it distinct from insolvency or default. However, the clarity concerning procedures to be implemented in the case of entry into resolution of a firm can still be contractually achieved with or without distinguishing the entry into resolution as a special legal status (as opposed to business as usual or insolvency, or other type of default event.

6. What are your views on the proposal in sub-section 1.4 of the consultative document that providers of critical FMI services should engage with their participants regarding the range of risk management actions and requirements they would anticipate taking in response to the resolution of an FMI participant? Does this strike the right balance between the objectives of orderly resolution and the FMI or FMI intermediary's prudent risk management?

We are in agreement with the high-level principles of section 1.4. However, guidance should not take the one-size-fits-all approach to all types of critical FMI services.

Depending on the nature of the critical service, the nature of risks to which providers of those services would be exposed to upon the entry into resolution of a client or participant would differ. Should the FSB envisage to provide more granular guidance on more precise arrangements for the different types of critical services, such guidance should be informed by the nature of risk specific to each type of service.

Moreover, we question the ability of any FMI to reliably plan or quantify in advance the extent of technology and financial implications if the business of the defaulting participant is transferred to a bridge or successor firm, in particular if the successor is a third party. From a practical point of view we see one of two scenarios as likely:

1. The successor company continues to use the existing connectivity and IT infrastructure of the defaulted FMI participant. Changes would then be more of legal than a technology nature.

2. All business of the defaulted participant is migrated from the infrastructure of the insolvent party to the infrastructure of a third party successor company. That company is very likely to be a participant of the FMI already with full connectivity to the FMI.

In both scenarios, IT and technology transfer or integration issues will mostly impact the relationship between the two FMI participants, not the FMI itself.

7. Do you agree with the proposal in section 2 of the consultative document that firms should be required to develop contingency plans to facilitate continuity of access in both the lead-up to, and upon entry into, resolution? Does the consultative document address all aspects of the information and analysis that may be required for such contingency plans?

The requirement for firms to develop contingency plans will be problematic for European banks as their relevant resolution authority are responsible for drafting and maintaining bank resolution plans. Given that European banks have limited access to resolution plans, EU resolution authorities should lead the drafting of contingency plans for these banks to ensure that these realistically link with resolution plans for the bank and furthermore avoid any duplication between e.g. FMI participants' requirements under the recovery planning and the resolvability assessment.

For banks, liquidity contingency plans and recovery plans are already in place and provide a first level of contingency planning to facilitate continuity of access in both the lead-up to, and upon entry into, resolution. Detailed contingency plans per FMI's do not appear as the most efficient approach.

Indeed, we do not believe that all the suggested data gathering and analysis outlined in the Annex, is needed to prepare such contingency plans. Much of it is "nice to have" but comes at a very substantial implementation and maintenance effort.

In practice, FMI intermediaries generally do not disclose uncommitted and unsecured credit lines they may have extended to clients under "business as usual" conditions. Clients therefore cannot reliably anticipate their liquidity needs under a stress scenario, unless they assume the worst case, namely that the FMI intermediary sets all credit facilities to zero.

8. Are there any aspects of the proposed guidance that should apply differently according to whether access to a critical FMI service is provided directly by an FMI or custodian, or indirectly by an FMI intermediary? If so, please describe with reference to the particular section(s) of the proposed guidance, and include your views on how that section(s) should differ.

We find it essential that the guidance make appropriate distinction between access to critical services through a direct membership in an FMI and access via an intermediary. Access to FMIs may involve complex, multi-layers structures. The guidance should recognise that each entity in the chain is only capable of controlling its risks and commercial liabilities at an arm's length.

The distinction between access directly to an FMI and access via an intermediary is also vital insofar their behaviour towards an entity in resolution will be motivated by different objectives. FMIs fulfil a utility function towards the marketplace as a whole, whereas intermediaries are pure commercial service providers. This is already reflected in PFMI Principle 2, mentioned in the draft guidance. What's more, the FMIs are often natural monopolies (or flagship incumbents), while service provides are competing among many.

With this distinction in mind, FMIs and intermediaries will be differently able to negotiate commercial contracts with their contractual counterparts. FMIs are usually required to have transparent, non-discriminatory access conditions and would be less able to impose special, individually tailored conditions of access onto its direct participants. An intermediary would have a broader margin for negotiation of its commercial terms with the client on the one hand, but will be bound by rather strict conditions imposed by the FMI on the other. This said, no intermediary should be in a position where they would have to assume additional risk and continue to provide service to a client while being in breach or at risk of a breach of the rules by which it is bound towards the FMI.

The guidance should therefore recognise the need for a consistency between the provisions applicable at the level of the FMI and at the level of the intermediary. In practice, FMIs and intermediates will be motivated by different objectives, but the ultimate entity determining whether access to critical services may or may not continue is the FMI itself.

From the perspective of a service provider, whether in business as usual or in resolution, the nature of the relation between the intermediary and the client is a commercial one and as such it is based on the willingness of the counterparts to be in that relation. Termination conditions agreed ex-ante should be respected and remain enforceable whether or not a default has taken place. It must be possible for any party to orderly exit the relation at any time, upon the agreed conditions.

We therefore find it appropriate, at least in the jurisdictions that do recognise the special status of an entity in resolution, to make clear how the mutual rights and obligations will be affected in such event. A right of a service provider to terminate a commercial relation should remain untouched, in accordance with the appropriate notice period and any other applicable safeguards.

Respecting a contract is particularly relevant in the context of legal succession or a bridge institution taking over some or all obligations of the entity in resolution. Unless special provisions had been made for the event where a successor entity may not fulfil ALL contractual conditions of access, while still honouring the basic ones (meeting payment and delivery obligations), any amendment of the mutual rights, obligations, and of the applicable procedures should be mutually agreed.

9. Does the consultative document identify all relevant requirements and pre-conditions that a firm may need to meet to support continuity of access in both the lead-up to, and upon, resolution? What other conditions or requirements, if any, should be addressed?

As an absolute minimum, the continuity arrangements/agreements should stipulate beyond any ambiguity upon which basic conditions access to the critical services will be maintained or otherwise terminated. The relevant rulebook and/or contract provisions must therefore provide crystal clear answers to the following two questions:

1. what conditions must be fulfilled for the access to the critical service to continue, and
2. what will occur, if anything, upon entry into resolution of the service recipient.

10. Does the consultative document identify appropriate methods for providing the information and communication necessary for key decision making during the resolution of an FMI participant? Are there additional safeguards that could be put in place that would ensure adequate levels of transparency in the lead-up to, and upon resolution?

No comment.

About EBF

The European Banking Federation is the voice of the European banking sector, uniting 32 national banking associations in Europe that together represent some 4,500 banks - large and small, wholesale and retail, local and international - employing about 2.5 million people. EBF members represent banks that make available loans to the European economy in excess of €20 trillion and that securely handle more than 300 million payment transactions per day. Launched in 1960, the EBF is committed to creating a single market for financial services in the European Union and to supporting policies that foster economic growth.

www.ebf.eu @EBFeu

For more information contact:

Timothy Buenker
Senior Policy Advisor
Banking Supervision
t.buenker@ebf.eu
+32 2 508 37 22
+32 496 50 12 56