ECSDA
European Central Securities Depositories Association

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ECSDA comments on the FSB guidance on continued access to financial market infrastructures for firms in resolution

This paper constitutes ECSDA's response to the Consultative Document issued by the Financial Stability Board (FSB) on 16 December 2016 in view of finalising international guidance on continuity of access to financial market infrastructures (FMIs) for a firm in resolution. It focuses on cases where financial firms are direct participants in central securities depositories (CSDs) and therefore addresses primarily Section 1 of the Consultative Document.

Executive Summary

When a CSD participant enters into resolution, the challenge for the CSD and for financial regulators is to strike the right balance between, on the one hand, the need to preserve the safety and soundness of the CSD and to avoid any contagion to other participants in the CSD, and, on the other hand, the need to maintain access by the firm in resolution to critical CSD services to facilitate the resolution process. The draft FSB guidance issued on 16 December constitutes a good basis to address this issue. In particular:

- CSDs should not automatically terminate access when a participant enters into resolution. However, access to critical CSD services should remain subject to the fulfilment of all contractual obligations towards the CSD and towards participants in the CSD system.

- Procedures applying to participants should be transparently disclosed in CSD rules. However, CSDs should not be obliged to include specific procedures for participants in resolution in their rulebooks or contractual arrangements. It should be possible to handle resolution scenarios within the general framework in place and CSDs should retain enough flexibility to be able to adapt to the resolution strategies adopted by resolution authorities. These may differ from one firm to another and cannot be known in advance.

- Some of the definitions put forward in the FSB Consultative Document can be further improved. For instance, the guidance should make it clear that “critical services” will be determined by the resolution authority and may differ from one firm to another. Clarifying definitions is especially important to avoid as much as possible inconsistencies between the recovery plans of CSDs and those of their participants.

- CSDs should seek to facilitate the continued access to their critical services by a successor entity to a firm in resolution. However, continued access will only be possible if strict conditions are met and a fast-track application process, if it exists, will not avoid the successor entity from meeting those participation requirements, checks, controls and other obligations which fall onto all other participants.

- Domestic and foreign participants in CSDs should be treated equally for resolution purposes, and national rules and regulations imposing a differentiated treatment should be avoided.

- Because the FSB guidance will apply to different types of financial market infrastructures, it would be helpful if it distinguishes more explicitly between those provisions which apply to all infrastructures, and those which are particularly relevant for a certain type of infrastructures. The participation rules and legal arrangements of CCPs, in particular, are quite different from those of CSDs due to the lower risk profile of CSDs

- Finally, it is essential that resolution authorities communicate in a timely way with all relevant authorities and market actors in cross-border scenarios. Without timely information, there is a risk that the situation of a CSD participant could be mistakenly taken for a default, thereby triggering a different treatment by the CSD and/or the CSD’s supervisory authority.

1. Introduction and definitions

ECSDA believes that the structure of the Consultative Document is helpful and we support a clear distinction between the impact of "continuity of access arrangements" on the different actors involved, i.e. FMIs themselves and firms providing access to critical FMI services to third parties (section 1), financial firms relying on FMI services (section 2) and regulators (section 3).

Q1. 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?

The Consultative Document is generally balanced and appropriately stresses the importance of preserving the safety and soundness of providers of FMI services while facilitating an orderly resolution of users of critical FMI services. ECSDA thinks that the FSB guidance is especially helpful in cases where a CSD participant in resolution does not pose significant risks to the CSD and the other participants in the system.

The final guidance could nonetheless more explicitly stress the fact that continuity of access by a CSD participant in resolution should not hamper the CSD's ability to apply its own rules and risk management measures which are designed to protect the CSD and its participants from potential contagion. Although a participant's resolution should not *per se* automatically trigger termination of access to CSD services, there will be cases where the CSD will have no choice but to terminate such access, e.g. if the firm in resolution no longer meets its obligations towards the CSD or towards other CSD participants. In such cases, standard procedures applying to participants in default may apply. For the same reasons, it is important to ensure continuity in the application of risk management measures set out in CSDs' rules, including risk-based participation requirements and the ongoing monitoring of participants.

As regards the level of discretion retained by CSDs and other FMIs, we believe that some flexibility is indispensable given that FMIs will typically have no *ex ante* visibility on the resolution strategy defined by (the) resolution authority(ies). CSDs must be able to adapt to the very unique conditions surrounding the resolution of a participant firm.

Q2. 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.

ECSDA agrees with the overall scope of the guidance and has the following comments on the proposed definitions on pages 10 and 11 of the Consultative Document:

- Under the definition of "**critical FMI services**", we welcome the recognition that some ancillary services provided by CSDs, such as triparty collateral management services, may in certain cases

be critical for the ongoing functioning of essential post trade services. We also remark that the notary service, which is not explicitly mentioned in the FSB Consultative Document, is usually considered a core and critical service provided by CSDs to market participants.

Moreover, where CSDs operate with a banking licence and provide credit to their participants for the purpose of supporting the settlement process, such credit should not fall under the FSB definition of "critical FMI services", and this should be stated clearly in the final FSB guidance. Indeed, in order to avoid exposing the CSD to counterparty credit risk, credit lines will in most cases be moved to zero before a participant enters into resolution. CSD participants are expected to plan in advance for alternative sources of liquidity to support their settlement activity when they are in resolution. That said, we acknowledge that access by CSD participants to their cash accounts (where the CSD offers cash accounts), as well as the ability to make money transfers, may be deemed critical.

More generally, the FSB guidance should more explicit state that "critical FMI services" are defined from the point of the view of the resolution authority(ies) of the user(s) of FMI services, not from the point of view of the providers of FMI services. In fact, some FMI services may be considered critical for certain users and not for others (who may not require the service as part of their core activities). CSDs' recovery plans assess which services are critical for the market as a whole, not which services are critical for each individual participant. The FSB should consequently also consider how to address potential inconsistencies between the recovery plans of CSDs (and other FMIs), which are drafted from the FMI's perspective, and recovery plans of CSD participants.

- The joint definition of "**FMI participant"** and **"firm"** is confusing and we recommend distinguishing both terms in the form of two separate definitions, which would be consistent with the CPMI-IOSCO Principles for financial market infrastructures (PFMI). The new definitions would read as follows:

  - An "**FMI participant**" is an entity with direct access to FMI services (e.g. a direct member). Consistent with the scope of the guidance, this definition covers those FMI participants for which recovery and resolution planning is required under the Key Attributes.

  - A **"firm"** is an entity with indirect access to a FMI through an FMI participant. Consistent with the scope of the guidance, this definition covers those firms for which recovery and resolution planning is required under the Key Attributes.

- ECSDA understands that the definition of "**provider of critical FMI services**" encompasses both FMIs and FMI intermediaries, as defined in the Consultative Document. Including "custodians" in the definition, in addition to the notion of "FMI intermediary", is however a confusing (especially since "custodian" is not defined). Since custody is defined as a critical FMI service, custodians providing critical custody services should qualify as FMI intermediaries, and only FMIs and FMI intermediaries should thus be considered as providers of critical FMI services.

Moreover, we believe that it would be helpful for the FSB guidance to explicitly confirm that settlement banks which process the cash leg of securities transactions where the securities leg settles in a CSD, for instance where the CSD or central bank cannot offer cash accounts (e.g. foreign currency settlement), should be considered as "providers of critical FMI services".

- Finally, we wonder whether it would not be preferable to amend the current definitions in order to more clearly distinguish the different roles of infrastructures and intermediaries, in line with the approach adopted in the PFMI. The amended definitions could read as follows:
  - "**Critical FMI services**" are clearing, payment, securities settlement and custody activities, functions or services, for which a lack of continuity would lead to the collapse of (or present a serious impediment to the performance of) a firm's critical functions. They include activities, functions or services that are ancillary to such clearing, payment, securities settlement or custody but whose on-going performance is necessary to enable the continuation of the clearing, payment, securities settlement or central custody. Critical FMI services may be ***accessed*** ~~***provided***~~ either directly ~~***by an FMI or custodian to a participant***~~ ("direct access"), or ~~***by***~~ ***through*** an FMI intermediary ~~***that itself has direct or indirect access to an FMI through one or more other entities or firms***~~ ("indirect access").
  - An "**FMI intermediary**" is a firm that provides ***access to*** clearing, payment, securities settlement and/or ***central*** custody services to other firms. FMI intermediaries are direct members of one or several FMIs and provide indirect access to the critical services offered by such FMIs (e.g., to other entities/affiliates within the firm, or to a non-affiliated firm or customer).

2. Continuity of access arrangements at the level of the provider of critical FMI services

Q3. 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?

ECSDA agrees that the rights and obligations of CSD participants, as well as the applicable procedures, should be clearly set in the participation agreement or in the general terms and conditions of the CSD. These typically include general provisions governing rights and obligations of participants (whether or not they have entered into resolution), the terms surrounding the provision of CSD services, the description of risk-based participation requirements and procedures for monitoring compliance with these requirements by participants on an ongoing basis. Importantly, CSDs' rulebooks and contractual arrangement should apply to participants in resolution in the same way as to other CSD participants. The final FSB guidance should therefore not oblige CSDs to include specific procedures for participants in resolution in their rulebooks or contractual arrangements.

We agree that entry into resolution should not in itself constitute an "event" (p. 14) under the rules of the CSD which would trigger termination of access. Termination of access to a CSD should only be enforced when participants no longer meet their obligations under the relevant contractual framework, irrespective of whether or not they have entered into resolution. This principle is generally key for financial market infrastructures which have a duty to ensure an equal treatment of all participants. Besides, it would not be possible for a CSD to determine *ex ante* measures to address the resolution of a participant since the specific circumstances and resolution measures are likely to differ from one firm to another. Situations may occur during the resolution process which require a case-by-case assessment, based on the approach adopted by the resolution authority(ies).

As regards the possibility for a successor entity to a CSD participant being resolved to retain access to critical CSD services during the resolution process, we would like to stress that such continued access will only be possible if strict conditions are met. If the successor entity is not already an authorised CSD participant, and/or if it is incorporated in a different jurisdiction than the resolved participant, and/or if it has a new structure, business purpose and management team, necessary precautions will have to be taken by the CSD to ensure that the successor entity is not a source of risk for the CSD, and that it is able to meet all the participation criteria.

As regards information-sharing among resolution authorities (p. 14), we suggest that the FSB guidance could stress more explicitly the importance for relevant information to be shared in a timely way, including in cross-border scenarios where the CSD participant is established in a different jurisdiction from that of the CSD. Without timely information, there is a risk that the situation of a CSD participant could be mistakenly taken for a default, thereby triggering a different treatment by the CSD and/or the CSD supervisory authority.

Q4. 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.

ECSDA fully supports the general principle established by the FMI-Annex of the FSB Key Attributes according to which a CSD should not terminate the access of a participant when the latter enters into resolution. Access should be preserved as long as the participant or its receiver meets its payment and delivery obligations, as well as its general obligations under the CSD participation agreement.

Special consideration may also need to be given to those CSD participants which also act as service providers to the CSD, such as cash settlement agents, paying agents or agent banks.

Q5. 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?

ECSDA agrees that the procedures for firms in resolution should be identical for a given type of CSD participant, irrespective of the country in which the firm is established. We note however that there may be cases where national law makes it necessary for a CSD or another FMI to introduce a distinction between domestic and foreign participants. This is the case for instance in a few European markets where domestic participants in the CSD are required to maintain end investor accounts, whereas foreign intermediaries and/or CSDs are allowed to maintain omnibus accounts on behalf of their clients ("foreign nominee" concept). Another example pertains to the transposition of the EU Bank Recovery and Resolution Directive. In certain countries, national legal provisions implementing the Directive only cover the situation of domestic firms, leaving aside the question of whether the resolution of a firm in another jurisdiction would be equally recognised.

The FSB should thus encourage national regulators to ensure that they put in place an appropriate legal basis allowing for an equivalent treatment of domestic and foreign CSD participants. The issue extends beyond EU countries and we believe that more dialogue among authorities is key to achieve a mutual recognition of definitions and recovery and resolution measures.

Q6. 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?

Standard participation and risk management requirements should apply to CSD participants in resolution in the same way as to other CSD participants. Since resolution does not trigger *per se* termination of access, it should also not trigger any additional risk management measures apart from those already foreseen under the CSD rules, which are measured and tested under existing regulatory provisions. This avoids any "procyclical" effects against firms in resolution. Besides, such requirements are well known and agreed by all CSD participants.

As regards the "fast-track application process" described on page 17 of the Consultative Document, ECSDA notes that not all CSDs explicitly foresee such a process today. The FSB should be realistic about the time necessary to complete the onboarding process for the successor entity to a firm in resolution. The Consultative Document rightly mentions not only governance, but also operational arrangements to support continued access for FMI participants. Indeed, there should be sufficient time for a CSD to prepare actions with the relevant stakeholders, for instance if they are impacted by the establishment of connectivity between the successor entity and the CSD's IT system. Besides, the operational readiness of a successor firm is unlikely to be achieved over a single weekend.

As regards the “regular tests” mentioned in the last paragraph of section 1.4 of the Consultative Document, ECSDA assumes that most CSDs will integrate such tests in their existing testing framework, and that the frequency will vary depending on the systemic nature and level of interconnectedness of the CSD in question.

In the event of a resolution or a planned set of recovery measures for an existing participant, the resolution authority or entity should give guidance to the CSD on what level of information can be communicated by the CSD to other participants and the broader public. The FSB should be aware that CSDs may be under an obligation to disclose risks related to settlement or custody risk on their platforms.

3. Continuity of access expectations and requirements applicable to firms

Q7. 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?

ECSDA is not convinced that the contingency plans required under section 2.4 of the Consultative Document are necessary and we fear that such plans could duplicate with recovery plans already established by the relevant firms. Moreover, coming up with such plans is likely to be a rather theoretical exercise, given that firms typically have no visibility on the resolution strategy and tools that the resolution authority(ies) would choose to deploy. We therefore recommend that the contingency plan should rather form an integral part of the resolution plan to be defined by the relevant authority(ies) based on the individual circumstances of the resolution. Authorities should require all the information necessary to draft such a plan from the firms in question.

Q8. 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.

No comments.

Q9. 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?

No comments.

4. Co-operation among authorities regarding continuity of access to critical FMI services

Q10. 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 comments.

About ECSDA

The European Central Securities Depositories Association (ECSDA) represents 41 central securities depositories (CSDs) across 37 European countries. As regulated financial market infrastructures, CSDs play a vital role in supporting safe and efficient securities transactions, whether domestic or cross-border. If you have any questions on this paper, please contact Soraya Belghazi, Secretary General, at info@ecsda.eu or +32 2 230 99 01.