

**CONSULTATIVE REPORT PRINCIPLES FOR
FINANCIAL MARKET INFRASTRUCTURES:**

**ASSESSMENT METHODOLOGY FOR THE
OVERSIGHT EXPECTATIONS APPLICABLE TO
CRITICAL SERVICE PROVIDERS**

Clearstream's response to the consultative report

20 February 2014

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Clearstream Banking AG, Frankfurt and Clearstream Banking S.A., Luxembourg (jointly referred to as Clearstream) appreciate the opportunity to comment on the public consultation on the consultative report on the assessment methodology for the oversight expectations applicable to critical service providers, which relates to the overall assessment methodology applicable to the principles for financial market infrastructures issued by CPSS-IOSCO. As a wholly owned subsidiary of Deutsche Börse Group, Clearstream is one of the world's leading suppliers of post-trading services including settlement, safekeeping, and administration of securities, Clearstream welcomes the objective of the consultative report further harmonize at a global-level the existing international standards for the oversight expectations applicable to Critical Service Providers (CSPs) servicing central securities depositories (CSDs), and securities settlement systems (SSSs).

These comments dwell on our prior comments provided in 2011 in relation to the CPSS-IOSCO principles for financial market infrastructures (PFMIs), specifically on Principle 17 and Annex F.

Background

The settlement of market transactions and the custody of securities are Clearstream's most important fields of activity. In this environment Clearstream provides two fundamental services:

- International Central Securities Depository (ICSD): As an ICSD it has, over a period of over 40 years, developed a strong position in the international fixed income market. It handles the clearing, settlement and safekeeping of international securities and offers its customers the possibility to use Clearstream Banking as a single point of access for the settlement and custody of internationally traded bonds and equities across 53 markets.
- Central Securities Depository (CSD) for German domestic securities.

(I)CSDs have proven their resilience during the financial crisis, while playing a stabilizing role on the financial markets, in particular in facilitating the movement of collateral between counterparties at a time of severe liquidity stress and in ensuring the availability of global settlement liquidity to the financial centre. This has been a test for the (I)CSDs throughout the world that has proven the appropriate implementation of sound and safe risk management procedures and global best-practice standards. It needs to be ensured that newly introduced international rules and requirements do not affect the safety, efficiency and services innovation of the current post-trading arrangements.

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General comments

Compliance to the rules and regulations applicable to FMIs is of prime importance on the agenda of FMIs, who have for years been undertaking all necessary checks in accordance to their law of reference.

The 2012 PFMI have substantially strengthened the set of principles, risk management obligations and transparency/disclosure requirements to which CSDs are subject to, and we embrace this.

We are however concerned that the guidance included in the current assessment methodology is still too general and could impact more providers than only those that are truly critical to the operation of an FMI. Specifically, **more precise guidance on the definition of CSPs** would help ensure a consistent approach across different jurisdictions.

In particular, we note that the assessment methodology contains a very comprehensive set of questions **and requirements for CSPs that translate into a considerable burden in terms of administration and costs for such suppliers**. Given that a CSD's service providers are sometimes small companies with limited resources, it is important to make sure that the interpretation of the scope is not overly broad and that the **requirements should only apply to truly critical providers**.

The classification of FMIs being "systematically important" under the PFMI highlights their relevance in the eyes of national authorities. However the presumption that CSPs which provide services to (I)CSDs, SSSs, and CCPs are of critical importance to FMIs because of the role they play, is an assertion which would be true world-wide, and not only market by market or FMI by FMI. The applicability of the principles should be homogeneous at a functional level, otherwise leading to situations of regulatory arbitrage in certain jurisdictions, element that would negatively impact the level-playing field for the provision of services in a cross-border basis.

Should the national regulators classify differently the FMI's critical service providers in their home jurisdictions, this should be based on clear guiding rules to be defined in the principles themselves.

We wish to emphasize the paramount need for the treatment of critical service providers or firms to follow a balanced and comprehensive approach. We believe that the imposition of surcharges on categories of firms judged to be critical would not be the best way to address the risk, especially were such judgments to be based on simplistic measures such as type of institution alone (as opposed to the functions they undertake to the FMI). Such an approach would be ineffective and probably counterproductive in pre-defining a list of firms to be subject to these rules.

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Annex F - comments

The consultative report proposes under Annex F the following considerations:

- 1) *A regulator, supervisor or overseer of an FMI may want to establish expectations for an FMI's critical service providers in order to support an FMI's overall safety and efficiency.*

Whilst this would appear beneficial at first sight for FMIs, as it would resolve issues relating to the enforcement of standards on service providers, the question remains on which authority should enforce this requirement, as the FMI does not have the authority nor the means. Regulator should have a role to play in this regard, although in this case as well, the problem might be that the regulator of the FMI, might not be in a position to regulate the service provider (e.g.: an IT or telecom provider, which are not regulated by the financial market authorities).

The consultative report might want to bring solutions to these problems, prior to its implementation, or limiting this requirement to the financial markets only would already be an improvement.

Specific comments to the consultative document and questions

Page 1: *"where permitted under the applicable legal framework", "where they have the authority to do so":*

Please clarify the conditions under which authorities can assess directly an FMI's critical service provider.

Page 1: *"information technology and messaging providers"* are cited as the sole examples of FMI's critical service providers. The "key questions" seem to have been structured with this same focus in mind. However, an FMI (such as a CSD) may also have critical dependencies on other types of providers, such as:

- depository
- cash correspondent banks,
- central banks,
- payment systems (such as Target2), and
- in Europe settlement systems, as T2S the near future.

Is it intended by CPSS-IOSCO that such critical service providers be also in scope of Annex F of the PFMIs and its proposed Assessment Methodology? If not, what does the CPSS-IOSCO propose instead?

Is it intended as well to include Central Banks as service providers to the FMIs? Considering Central Banks are critical providers of central bank liquidity for CSDs, the special handling or carve-outs for such entities should be considered.

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Page 3 and page 10: "human resources risks":

Please clarify what are "human resources risks". It is not a Basel II risk category, nor is it listed or defined in the PFMI text.

Question 1.10: the sub-question "How frequently is the effectiveness of the internal audit function reviewed?" should be moved to the other questions related to internal audit, i.e. Q1.12 and Q1.13.

Pages 5-6 on Information Security and ***pages 7-8*** on Reliability and Resilience: there is an overlap respectively on the lack of clear distinction between the two subjects in particular with regard to the availability dimension.

For example: p. 5 and p. 7 talks about "ensuring ... availability of critical services". Whilst information security deficiencies may lead to unavailability of services, the scope of and difference between information security and reliability/resilience/business continuity, should be clarified.

Pages 7-8 on Reliability and Resilience: there is an overlap respectively on the lack of clear distinction between the questions regarding availability, reliability, resilience and business continuity.

For example, what is the difference between Q3.1 "operational availability, reliability and resilience objectives" and Q3.7 "business continuity and disaster recovery objectives"?

Pages 8: "cyber attacks": the questions regarding cyber attacks Q3.10 and Q3.12 should be moved to the Information Security section, as there are already questions on cyber risks and this is foremost an Information Security topic.

Question 3.9: this question should be moved to the section Risk Identification and Management.

For any further details or clarifications, please contact:

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