



A response by UK Finance to the

**Bank of England's consultation paper on:**

**Fundamental Rules for financial market infrastructures**

(published on 19<sup>th</sup> November 2024)

# Response to the Fundamental Rules for FMIs Consultation Paper

## 1. Introduction

UK Finance is the collective voice for the banking and finance industry.

Representing more than 300 firms across the industry, we act to enhance competitiveness, support customers and facilitate innovation.

UK Finance, on behalf of our members, welcomes the proposed Fundamental Rules as a positive change to form the foundation of a broader Bank of England (“Bank”) rulebook for Financial Market Infrastructures (“FMI”).

The basis of the Fundamental Rules (“FR”) 1 to 8 is consistent with the existing and established Fundamental Rules for firms regulated under the Prudential Regulatory Authority (“PRA”) Rulebook and the relevant Financial Conduct Authority (“FCA”) Principles for Businesses. FMIs are critical to the financial services ecosystem and so it is right that the use of rules applying to them should be consistent with the level of rigour reflected in the rules that are applied to the banks.

FR 9 and 10 are focused on operational resilience and risks to the stability of the financial system. Our members believe that the existing Bank of England policy on Operational Resilience of FMIs and its implementation since 2021 has already provided a firm basis for regulation of this area of the financial services sector.

The FRs and their formalisation will help to reinforce confidence for FMI service users (participants) in the robustness of the FMI regulatory framework and FMI resilience.

## 2. Response to proposed Fundamental Rules for FMIs

The Fundamental Rules are expected to support consistency across all regulated firms in the UK, recognising that FMIs are critical to the operation of the UK financial services ecosystem and maintaining financial stability in the markets.

In response to the Consultation Paper, UK Finance members have provided constructive feedback that is outlined in the sections below.

### 2.1 Fundamental Rules 1 to 8

UK Finance members are supportive of FRs 1 to 8, recognising that these are aligned with the existing and established Fundamental Rules for firms regulated under the PRA Rulebook and the relevant FCA Principles for Businesses.

#### 2.1.1 FR4: An FMI must maintain sufficient financial resources

Section 2.15 outlines the intent of this rule. A UK Finance member concern specific to Central Counterparties (CCPs) is that the international standards<sup>1</sup> relating to Non-Default Losses (NDL) create liability for clearing members. Resilience related incidents such as cyber-attack, the cause of which may be due to weaknesses in cyber controls and resilience at the FMI, could result in losses that would need to be borne by clearing members.

For members' own risk management purposes and to mitigate against unreasonable losses, there is a need for information disclosure to relevant firms relating to the rationale for NDL amounts. Further, there needs to be an understanding and assurance of effective scenario analysis and valuation performed by CCPs, regarding sufficient capital provision to withstand the financial impacts of a cyber-attack.

Our members recommend that the Bank ensures transparency and consistency of the information required from CCPs to ensure sufficient financial resources are available.

The Bank are asked to also consider strengthening the 'Guidance for the FRs' in Appendix 1, specifically for FR4 statement 20. This is to ensure that reference to 'underlying regulatory frameworks' is clear on whether the FMI type is dependent on the supervisory tier an FMI falls into, and what the categories are for such FMIs.

<sup>1</sup> – Principles for Financial Market Infrastructures (CPSS / IOSCO April 2012)

### **2.1.2 FR6: An FMI must organise and control its affairs responsibly and effectively**

UK Finance member feedback proposes that the draft Supervisory Statement in Appendix 1 should be extended to reflect the responsibility to FMI customers (participants) and support for participant understanding of how the FMI services relate to the regulatory compliance and operational requirements of the participants.

The rationale for extending this would be complementary to the expectation of FR7, which requires timely co-operation and candour with regulators.

## **2.2 Fundamental Rules 9 and 10**

The positive intent of these two FRs to support the Bank's focus on operational resilience and financial stability are supported by UK Finance members. However, members are asking for greater clarity of the proposed regulation to ensure consistency of interpretation across the sector in areas relating to:

- a) Operational Resilience Requirements for FMI participants
- b) Risks to Financial Stability
- c) Risk Management and Resilience Information Sharing
- d) Risk Management and Business Workarounds
- e) Regulatory Objectives - Financial Stability and Innovation

### **a) Operational Resilience Requirements for FMI participants:**

1. UK Finance members understand the basis of FMI participation requirements and that these need to take account of the risks to be managed by the FMI, as outlined in FR10 Scenario 1.
2. In implementing FR10, an FMI might place additional responsibility on participants. For example, this could mean participants (direct and indirect) are expected to ensure alternative capabilities are in place for continuity of service, as opposed to an FMI-led development of operationally resilient capability in conjunction with participant involvement. This could be influenced by cost considerations, particularly where such capability may be complex or require significant resources to deliver. This may result in unintended consequences.
3. With reference to the draft Supervisory Statement in Appendix 1 for FR9, statement 38 "The Bank would expect FMIs to be meeting the more detailed expectations set out in the existing policy on operational resilience for CCPs and CSDs". However, there is a lack of standardisation of more detailed third party resilience, data and cyber disclosures to provide members with an

understanding of the resilience risks associated with a given CCP. The Public Qualitative Disclosures for CCPs follow the standard PFMI structure but is not at a consistent or sufficiently detailed level that a member would expect to receive from a comparative material outsourcing relationship.

**b) Risks to Financial Stability (FR10):**

4. The UK Finance membership is supportive of the Bank's aim to ensure that FMIs have a full appreciation for their interconnected nature within the financial system and therefore the focus on outcomes to identify, assess and manage risks to financial stability.
5. The requirement for FMIs to consider impacts to immediate participants and beyond to the broader market is agreed as an important priority for the sector, as the potential for FMIs to become channels of operational contagion or amplification during times of market stress may not be robustly understood currently. We have seen work to this end already being undertaken within the sector following various exercises.
6. However, members have raised concerns over the operability of FR10 and as such it requires further discussion with the financial services sector before it can be effectively implemented. As has been recognised by the UK regulatory authorities, and highlighted in the FR10 example scenarios, FMIs comprise complex service chains of critical entities, including ones managed by third parties. Fully understanding the cascading impacts of any disruption to a given operation by an individual participant firm is therefore likely to be a significant undertaking with firm specific idiosyncrasies to consider.
7. It is unclear how this Fundamental Rule requirement could be sufficiently actioned by FMIs, or other financial institutions, across their services considering the range of different circumstances that could apply. As a result, the members' view is that this concept is not yet sufficiently mature to be ready for supervision.
8. UK Finance members believe that this concept requires further review and continued work across the industry. A key area to consider is understanding how long any identification and assessment of risks and their mitigation would remain valid given the pace of change within the sector. This would need a method of regular / continuous update to ensure no new operational resilience vulnerabilities are introduced, whilst ensuring that this can be performed efficiently across all involved parties. It is therefore suggested that a pilot focused on a specific sub-sector / service may be helpful to understand the approach to implementation.

9. In addition, the sector's view is that this principle could not easily be applied to the wider financial industry. A more diverse range of clients and Important Business Services would significantly complicate the ability to achieve this principle in practice.
10. We also consider, that whilst understanding financial stability impacts may be a useful concept for planning, it is less useful as a tool for decision making in a crisis. For example, disconnection is cited in the Bank's paper on Operational Resilience in a Macroprudential Framework (August 2024). However, in that scenario, undertaking a full assessment of financial stability impacts of a decision to disconnect would likely not be possible with any confidence.
11. The Bank are requested to provide more clarity on what would be an impact to financial stability, with examples to provide better and common understanding for firms, especially for the FMIs themselves.
12. While firms should consider the business impact of a decision to disconnect, and financial stability may be an element of this, the authorities should be cautious about an explicit mandate to consider financial stability impacts. This may have the unintended consequence of significantly slowing the decision-making process, thereby exposing the firm and sector to amplified risk. If implemented as a supervisory requirement, it is possible that risk takers in a bank would be encumbered in proceeding because of an inability to evidence that there would be no financial stability impact from the decision.
13. In addition, member feedback has noted the practical aspects of disconnection and a recognition that this may in itself be a more complex operation requiring co-ordination, e.g. not simply 'pressing a button'.
14. A further example is incident reporting, where a similar concept has been included in the ongoing 'Operational Incident and Third Party' consultation (PRA CP17/24). Determining the knock-on impacts of an incident may not be practical in the timeframes dictated by an incident. As a result, the requirement is likely to serve primarily to inject a degree of regulatory uncertainty and papering of decision making into the incident management process.

**c) Risk Management and Resilience Information Sharing:**

15. As a result of regulatory policy, FMIs have identified their Important Business Services (IBS) and Impact Tolerances to comply with Bank of England requirements. UK Finance members have noted increased positive engagements with FMIs and a greater willingness to partner on resilience related activity. Some FMIs have been more forward leaning in their bi-lateral

engagement with members and communication of operational resilience details.

16. However, dissemination of information to participants by FMIs is not considered to be consistent and with reference to the 'Case for action – all FMIs' (section 3.7), there should be a greater emphasis on providing reasonable assurance of FMI compliance to participants to support more comprehensive regulatory compliance across the sector.
17. It is imperative that information sharing is not only between FMIs and the Bank, which is the current drafting of the FRs, but also between FMIs and their major participants. FMIs could use information from major banks in setting Impact Tolerances for the services they provide to support more precise understanding and communication across the sector.
18. It is recommended that the scope of FR10 wording is amended to reflect support for risk management by members, 'An FMI must identify, assess and manage the risks that its operations could pose to the stability of the financial system **and to the safety and soundness of their participants and users**'. This would reflect the need for FMIs to have identified their most important participants and develop plans with those participants to be prepared in advance of an incident (disconnect, reconnect, testing) to minimise the effect of an FMI disconnecting a participant as part of maintaining their resilience.
19. The proposed change above for FMIs to take into account risks to the safety and soundness of its participants is reflective of the systemic nature of FMIs within financial services and the services provided to participants. It would not be feasible nor appropriate to similarly require banks to identify, assess, and manage the risks that its operations could pose to their clients, as these represent a much broader and more diverse segment of the market.
20. In conjunction with this change the 'Guidance for the Fundamental Rules' in Appendix 1 must be firmer in setting expectations of the FMI to engage direct and indirect participants to disclose the information needed by these participants to manage their own risk profiles and meet their own risk management regulatory responsibilities. In respect of managing cyber security risk, provision of information such as controls and operational plans in place is critical to supporting members' own due diligence.
21. The boundaries of financial stability (e.g. operations, provision of liquidity) will need to be clear to ensure that FMIs can in turn communicate effectively with participants. As part of adhering to these Fundamental Rules FMIs should consider establishing resilience groups with their members where information

regarding the FMI's resilience capabilities and plans can be discussed and areas for combined/collective action identified.

22. One further suggestion is to support the FMIs through the development of foundational standardised templates for information sharing to underpin FR9 and FR10. Such templates should be developed, and regularly reviewed, in close consultation with FMIs and their participants, and with consideration for existing regulatory frameworks.
23. This approach will help reduce the variability of different requests from participants who are assessing their own third party services resilience risks. Equally, clear communication to participants will enhance transparency, trust, and shared understanding of the operational resilience capabilities of FMIs. We do note here, that while standardisation is key, templates should be used as the foundation, and not the endpoint, of resiliency discussions between FMIs and their participants. There needs to be room for customisation, acknowledging that FMIs and their participants may have unique information requirements that exceed the information shared in the template.
24. We further note that the information that is appropriate to exchange between FMIs and their participants, who are typically larger firms with sophisticated resilience capabilities, is unlikely to be appropriate for exchange between banks and their clients. In this latter situation, such clients often represent a much broader segment of the financial services market and may not have the same level of sophistication in their resilience capabilities or in their ability to protect sensitive information.

**d) Risk Management and Business Workarounds:**

25. Closely related to resilience information sharing, UK Finance members have highlighted there is further work to be done within the sector on developing plans for more complex scenarios to mitigate for potential disruption. A key area that requires greater information sharing and discussion is the detailed consideration of disruption to an FMI IBS and the actions that would be expected of participants to support response and recovery.
26. Whilst some FMIs have begun to explore this, this is currently only for a limited set of scenarios or has been undertaken in a way that has not yet been adequately communicated to participants to ensure sufficient understanding of the range of plausible scenarios and impacts (e.g. service outage, data loss, service closure).
27. Technology recovery across the FMIs remains a key area to assure, in common with the view from UK authorities that recovery from a severe cybersecurity

incident within Impact Tolerances may not always be possible, or appropriate dependent on circumstances. Information on testing and evidence of capabilities should be shared with participants as part of demonstrating their wider resilience capability to support financial stability.

28. It is anticipated that this will require further investment from FMIs in their technology recovery capabilities to reduce the time between completion of non-deterministic elements of recovery, and execution of deterministic activity to either a return to normal operations or recovery to a state of minimum viable service to the market. In particular, investments in data immutability and capability to rebuild from a 'bare-metal' position should be prioritised.
29. More generally, assuring these areas requires more frequent industry-wide resilience exercises. These tests are crucial for testing collective response mechanisms, fostering collaboration, and enhancing the ability to manage large-scale incidents. Tests are a means to an end, and conducting high-quality well-designed industry simulations addressing participant concerns should be firmly prioritised over volume of tests (e.g. identifying actions required from participants during an FMI IBS disruption). Moreover, after a test, it is crucial for FMIs to transparently remediate the identified weaknesses.

**e) Regulatory Objectives - Financial Stability and Innovation:**

30. The UK Finance membership have noted the applicability of the Bank's Financial Stability Objective to all FMIs, and the Secondary Innovation Objective to Central Counterparties (CCP) and Central Securities Depositories (CSD) specifically. Whilst these are seen as compatible objectives relevant to this consultation, the view from UK Finance members is that emphasis should be placed on the primacy of resilience over innovation.
31. This is aligned to the point raised in the section above on Risks to Financial Stability (FR10), regarding pace of change and implications for the currency of understanding of risks.
32. UK Finance recognises the focus on growth and need for innovation to support this, and the link with the UK government's strategic priorities for the UK economy. Recognising also that an appropriate balance is needed to maintain and further develop the resilience of the UK financial system to meet the intended regulatory outcomes.

## 2.3 FMI Specific Considerations

The nature of FMI regulation is fundamentally based on mitigation of systemic risk within the financial services ecosystem. The 'Have regards' section in the consultation recognises the need for the proposed rules to be proportionate. However, there is not a clear, formalised mechanism to ensure that the outcome of achieving proportionate implementation is applied consistently and with transparency across the FMIs that are within the scope of policy.

This raises questions based on FMI size and risk profile across a number of the FRs. UK Finance therefore advocate further industry review and dialogue to ensure a reasonable balance is maintained between ensuring robustness of implementation, including resilience and financial stability, whilst also ensuring support for innovation and prospective new entrants to the financial services sector.

## 3. Summary

There is support from UK Finance members for the basis of the proposed Fundamental Rules to strengthen the resilience of FMIs. As part of this consultation and ahead of implementation there is a request for further sector engagement, with the following identified as priority matters:

- Sufficiency of financial resources to withstand the impacts of a major cyber-attack.
- FMI responsibilities to their participants, in particular information sharing to support effective risk management throughout the financial system.
- The likely complexity of implementation of FR10 and financial stability considerations that may affect timely decision-making and recovery.

In conclusion, the Bank is asked to consider the points outlined in this response and review areas where potential unintended consequences of implementation have been identified.

We hope you find the UK Finance response helpful and we would be happy to discuss any of the points raised in further detail.