

## Consultation Response

### *Joint European Supervisory Discussion paper on DORA (Criticality Criteria for CTPPs)*

June 2023

#### Executive Summary

**AFME** welcomes the opportunity to respond to the Joint European Supervisory Authority Discussion paper on DORA<sup>1</sup>. AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.

Our response to this consultation is from the perspective of our bank members, focusing on those issues which are most relevant to wholesale capital markets. We are responding to each of the specific questions set out in the discussion paper, but mindful of the tight timelines, wanted to raise as well a number of overarching points:

- **A targeted and limited scope at the outset is the most prudent approach for establishing an effective regime for Critical Third Party Providers (CTPPs), expanding later as required.** The discussion paper notes that the incoming regime is subject to tight timeframes and will need to be reviewed and revised in future years. It will also naturally evolve and grow, for example in light of indicator 1.4 which will in due course monitor the number of designated CTPPs using the same sub-contractors. AFME therefore urges the ESAs to develop a framework that focuses on capturing those Third Party Providers (TPPs) which truly pose a potential systemic risk in the initial phases of the regime (especially in terms of supporting a critical or important function). A targeted and risk-based approach allows for a more focused and efficient allocation of regulatory and supervisory resources, and will ensure financial entities are not unnecessarily managing a third party as a CTPP as the framework develops. While recognising that the four criteria are set by the Level 1 text, there are a number of ways in which the ESAs could secure a more targeted scope, including by:
  - **Minimum thresholds:** raising the minimum relevance thresholds which are currently so low as to have questionable value as a preliminary sift.
  - **Enhanced risk focus:** placing greater emphasis on certain criterion in the final Step 3 (holistic/collective assessment), particularly Criterion 1 and 3, which are seen to focus most on concentration risk and criticality. This will help ensure that the most significant risks are properly identified and addressed, leading to a more focused risk-based approach.
  - **Comprehensive assessment:** ensuring that TPPs will only be captured and subject to the further holistic/collective assessment if they meet each of the indicators in both Step 1 and Step 2.

<sup>1</sup> [https://www.esma.europa.eu/sites/default/files/2023-05/ESAs\\_Discussion\\_Paper\\_CfA\\_DORA\\_criticality\\_criteria\\_and\\_OVS\\_fees.pdf](https://www.esma.europa.eu/sites/default/files/2023-05/ESAs_Discussion_Paper_CfA_DORA_criticality_criteria_and_OVS_fees.pdf)

We also call on the authorities to consult with industry on the proposed methodology on which the holistic/collective assessment will be based, to ensure that all involved industry participants have full transparency on the end-to-end designation process and the development of an informed and robust assessment framework.

- **Availability, collection and evaluation of data is a higher challenge than acknowledged within the discussion paper.** We have a number of concerns in terms of identifying the relevant databases and how to extract this data for collation and reporting:
  - **Fourth parties:** obtaining the data requested from providers who are further down the supply chain (so called Fourth Party Providers, etc.) creates significant practical challenges for financial entities. Direct engagement with the third parties by the authorities is most likely to be necessary.
  - **Leveraging existing databases:** extracting all of the stipulated information from existing databases such as the Outsourcing Registers does not appear feasible, especially in relation to those more subjective indicators (1.3, 3.2 and 4.2), raising further concern over the incoming resourcing implications. Seeking however to create new DORA-specific data attributes risks divergence with the existing operational resilience frameworks and would take time to put in place.
  - **National divergence:** the inclusion of definitions set by national competent authorities raises potential lack of uniformity over what amounts to systemic for the purposes of indicator 2.2. It also runs counter to DORA's overarching objective of harmonisation in the field of Operational Risk Management.
  - **Taxonomies:** subjective metrics will inevitably carry greater interpretation risk, and may require greater clarity and communication from supervisors, but we would be against the creation of new taxonomies (as indicated under 3.2) at least in the initial phase, given the complexity in standardising the varying criticality of a service across different firms. Where taxonomies are in future to be applied, the ESAs should directly leverage and rely upon those which are already in existence, for example those developed by the ECB and SRB (Single Resolution Board).

Where possible, existing regulatory databases should be directly leveraged and relied upon by the ESAs, to both avoid the above challenges and reduce the incoming burden for financial entities, which will already be noticeably impacted in this area by the maintenance of the Register of Information. It will additionally help ensure that the indicators are in fact based upon the SMART characteristics set out within the discussion paper, especially **timely** and **available**.

## Consultation Questions

### Question 1 *Do you have any comments about the related issues listed above?*

- Firstly, we appreciate the acknowledgement within the discussion paper that the timeframes are tight and welcome that there will be opportunity for future adjustments to the proposed designation process, taking account of both parallel ESA exercises and the proposed 3 year reviews of the delegated act itself. We would strongly encourage the ESAs to keep in mind this evolution when determining the indicators to be used in the initial rounds of designation. Rather than seeking to bring too many entities into potential scope and subsequently refining, the ESAs should be targeted and controlled, and look to expand at a later stage if necessary.

This will also ensure the regime is manageable and most effective in the early years. We propose in further detail below how the ESAs could target their indicators around the systemic importance of a Third Party Provider (TPP), but two points to highlight are:

- The minimum relevance thresholds under Step 1 should be raised to become a more meaningful initial sift of potential criticality.
  - There should be a consideration of the significance of the criteria for the purposes of the Step 3 (holistic/collective assessment), with Criterion 1 and 3 carrying greater importance due to their outcome-based focus on the systemic impact from a TPP failure.
- Secondly, the suggestion that the list of essential or important entities under NIS2 may be taken into account, for a process which has its legal basis within DORA, has raised concern as to whether this in practice undermines or negates the stipulated *lex specialis*.

**Question 2**     ***Do you think there are additional issues that should be included? If yes, please elaborate on which additional issues you see and why you do so.***

- AFME does not recommend any additional issues, and stresses that the introduction of wider factors will hamper compatibility with the key characteristics outlined in the discussion paper, especially the need for designation criteria to be **relevant** and **timely**.

**Question 3**     ***What do you perceive as the key obstacles and practical challenges to implement the proposed set of indicators listed below?***

- Availability of data will be a significant challenge, especially in relation to subcontractors and other providers who are further down the supply chain (so called fourth parties). It is likely that direct engagement by the authorities with TPPs will be necessary. The extent to which financial entities' internal databases will assist is impossible to say at this stage, given various questions below over what information is actually being sought. Addressing such challenges will add to resourcing pressures, particularly in light of the suggestion that there will be other information gathering exercises run by the ESAs in parallel. Introducing new, DORA-specific data attributes will meanwhile likely create divergence from the existing operational resilience frameworks, and take time to put in place. We flag there is also some uncertainty within the market, from the discussion paper noting in certain sections that sub-contractors should be explicitly included within information on TPPs, while in other areas it appears sub-contractors are to be dealt with separately.
- Additionally we are concerned that the Step 1 and Step 2 processes, by failing to be sufficiently relevant, could result in an expansive list of potential CTPPs, with the holistic/collective assessment becoming the fundamental stage, despite the lack of guidance over this aspect. We again urge the ESAs to consult with industry on the methodology for the final step in due course.

**Question 4**     ***For an already designated CTPP, what could be the minimum turnover time (lifecycle duration) in the CTPP list in case the minimum relevance thresholds specified below are not met for a consecutive number of years?***

- AFME would recommend that the lifecycle duration be reduced to 2 years, as part of a fast-tracked and publicised delisting process, in order to avoid unnecessary resourcing drain for both TTPs and financial institutions.
- We want to stress the importance for a TPP to remain accountable for the remedial actions defined/planned during the oversight as CTPP even when it stops being designated as “critical”.

**Question 5**     *Do you consider the indicators identified are relevant and complete in the case of opt-in requests according to Art. 31(11) of the DORA? Please explain if you think they are not relevant and complete in such cases.*

- We would not support a different set of indicators for Opt-In requests.

**Question 6**     *Do you agree with the list of step 1 indicators proposed to cover criterion 1 referred to in Article 31(2) of the DORA? If not, please elaborate and, if applicable, propose alternative indicators that could be considered taking into account the relevant background information about proposed indicators.*

- AFME has no objections to the specific Step 1 indicators. Instead our concern is that the 10% threshold is so low that it will not act as an effective gateway, even in terms of minimum coverage.

**Question 7**     *Do you have any comments on the proposed minimum relevance thresholds?*

- As noted there is concern that the 10% threshold will warrant this Step largely redundant as any form of *de facto* triage. It is stressed that one of the key characteristics for the indicators is that they ought to be *relevant*. Given the aim under Criterion 1 is to identify the potential *systemic impact*, the threshold is therefore too low, even as a minimum setting.
- Members have also recommended absolute value be used instead of percentage thresholds, given the latter is sensitive to interdependencies which can be difficult to measure.

**Question 8**     *With regard to indicators 1.2 and 1.3, please provide any equivalent metrics (in relation to the total value of their assets) you may consider appropriate to measure the pan-European footprint of the various financial entities subject to the DORA, that you would deem to be better adapted.*

- No proposed alternative metrics.

**Question 9**     *Do you agree with the list of step 2 indicators proposed to cover criterion 1 referred to in Article 31(2) of the DORA? If not, please elaborate and, if applicable, propose alternative indicators that could be considered taking into account the relevant background information about proposed indicators.*

- No objection to indicator 1.3, with the outcomes based approach welcomed.
- Indicator 1.4 appears duplicative, given that subcontractors are explicitly to be covered within the other indicators.

**Question 10** *Do you have any comments in relation to the information provided in the “Notes” section under each of the indicators?*

- No further comments.

**Question 11** *Which key data sources would you propose to use for the indicators under criterion 1? Please explain.*

- To ensure greater consistency across Operational Risk regulatory databases, we would strongly steer the ESAs to rely on the existing Outsourcing Registers (and/or other regulatory disclosures, for example on asset values) as much as possible, and certainly with regards to indicator 1.1 and 1.2.

**Question 12** *Do you agree with the list of step 1 indicators proposed to cover criterion 2 referred to in Article 31(2)(b) of the DORA? If not, please elaborate and, if applicable, propose alternative indicators that could be considered taking into account the relevant background information about proposed indicators.*

- No objection to indicator 2.1.
- We object to indicator 2.2: The inclusion of other entities deemed to be systemic by competent authorities risks introducing divergent definitions into the designation process. As such it runs counter to DORA’s overarching objective of harmonisation within the field of Operational Risk Management.

**Question 13** *Do you have any comments on the proposed minimum relevance thresholds?*

- For the reasons set out at Q7, we would support higher minimum thresholds to ensure that the Step 1 sift has meaningful effect.

**Question 14** *Do you agree with the list of step 2 indicators proposed to cover criterion 2 referred to in Article 31(2)(b) of the DORA? If not, please elaborate and, if applicable, propose alternative indicators that could be considered taking into account the relevant background information about proposed indicators.*

- Data for indicator 2.3 on the interdependences between G-SIIs, O-SIIs and other financial entities could be available from existing regulatory disclosures, depending on the interdependencies being sought. Before clarifying what is within scope, we recommend the ESAs conduct further analysis on the data which is already available.

- We also urge the ESAs to focus within Step 2 on identifying the number of G-SIIs, O-SIIs and other financial entities who are relying on the same ICT provider for critical/important functions, as the key interdependency.

**Question 15** *Do you have any comments in relation to information provided in the “Notes” section under each of the indicators?*

- As noted above, we would encourage the ESAs to assess the significance of those criteria which are indicators of systemic risk for the purposes of the Step 3 holistic/collective assessment. As the other indicators listed are more risk-based and outcomes focused, we would suggest Criteria 2 have a lesser weighting.

**Question 16** *Which key data sources would you propose to use for the indicators under criterion 2? Please explain.*

- This requires further clarity and analysis. As outlined, in determining which data is within scope, we urge the ESAs to conduct in advance analysis on the data which is already available. Given the tight timeframes for this discussion paper, AFME’s members have not been able to conduct this exercise in the allocated time.

**Question 17** *Do you have any views about indicator 2.3 “Interdependence between G-SIIs or O-SIIs and other financial entities using ICT services provided by the same ICT TPP” (including situations where the G-SIIs or O-SIIs provide financial infrastructure services to other financial entities) and in particular about concrete data that could be used to inform this indicator? Please elaborate.*

- See responses to Q14 and Q16.

**Question 18** *Do you agree with the list of step 1 indicators proposed to cover criterion 3 referred to in Article 31(2)(c) of the DORA? If not, please elaborate and, if applicable, propose alternative indicators that could be considered taking into account the relevant background information about proposed indicators.*

- There appears to be considerable duplication with indicator 1.3.

**Question 19** *Do you have any comments on the proposed minimum relevance thresholds?*

- As with Q7 and Q13, the 10% minimum threshold is again considered to be too low to provide value.

**Question 20** *Do you agree with the list of step 2 indicators proposed to cover criterion 3 referred to in Article 31(2)(c) of the DORA? If not, please elaborate and, if applicable, propose alternative indicators that could be considered taking into account the relevant background information about proposed indicators.*

- In relation to indicator 3.2, we object to the ranking of criticality and would instead strongly encourage leveraging the ongoing work of the FSB on Third Party Risk Management, which is seeking to introduce greater international harmonisation as to what amounts as critical.

**Question 21** *Do you have any comments in relation to information provided in the “Notes” section under each of the indicators?*

- Subjective metrics will inevitably carry greater interpretation risk, and may require greater clarity and communication from supervisors, but we would be against the creation of taxonomies (as indicated under 3.2) at least in the initial phase, given the complexity in standardising the varying criticality of a service across different firms and the time it would take to put in place this set-up. Where taxonomies are in future to be applied, the ESAs should directly leverage and rely upon those which are already in existence, for example those developed by the ECB and SRB (Single Resolution Board).
- We flag there is a risk here of internal divergence within the EU’s operational resilience regulations. The EBA Guidelines on Outsourcing Arrangements already require that financial institutions develop a methodology to identify critical outsourcing contracts. Establishing a new stand-alone taxonomy of criticality for DORA, could result in inconsistencies, and potentially a contract being deemed as critical under the EBA Guidelines but not necessarily under the newly proposed DORA taxonomy.

**Question 22** *Which key data sources would you propose to use for the indicators under criterion 3? Please explain.*

- We anticipate that the ESAs will primarily make use of the existing Outsourcing Registers and the DORA-related data collection exercises which have been conducted since October 2022, and subsequently the Register of Information due under Article 28 of DORA.

**Question 23** *Do you agree with the list of step 1 indicators proposed to cover criterion 4 referred to in Article 31(2)(d) of the DORA? If not, please elaborate and, if applicable, propose alternative indicators that could be considered taking into account the relevant background information about proposed indicators.*

- We object to indicator 4.1 on the basis it does not focus only on those services which support critical/important functions, and therefore fails to be a relevant metric to the overall criticality of a TPP.
- Some of AFME’s members have called for greater clarity on what amounts to *highly complex/difficult to migrate or reintegrate*, for purposes of indicator 4.2.
- Our proposal would be that Step 1 indicators calculate the number of financial entities reporting they are unable to substitute an ICT service provider who provides or supports a critical/important function.



**Question 24** *Do you have any comments on the proposed minimum relevance thresholds?*

- Please see Q7, Q13 & Q19.

**Question 25** *Do you agree with the list of step 2 indicators proposed to cover criterion 4 referred to in Article 31(2)(d) of the DORA? If not, please elaborate and, if applicable, propose alternative indicators that could be considered taking into account the relevant background information about proposed indicators.*

- No objection to indicator 4.3.

**Question 26** *Do you have any comments in relation to information provided in the “Notes” section under each of the indicators?*

- We caution that, when assessing substitutability, authorities keep in mind that in many cases replacing the third party can in fact lead to greater resilience risk.

**Question 27** *Which key data sources would you propose to use for the indicators under criterion 4? Please explain.*

- Given that substitutability is one of the attributes within the existing Outsourcing Registers, that should be the initial data source for the ESAs to leverage. Beyond that, there is no standardised understanding as to whether a TPP can be easily substituted, in terms of complexity of process.



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