FMI STANDARDS CONSULTATION: SUMMARY OF SUBMISSIONS

July 2023

Reserve Bank of New Zealand
Te Pūtea Matua

FMA
FINANCIAL MARKETS AUTHORITY
TE MANA TĀTAI HOKOHOKO

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BACKGROUND

The Financial Market Infrastructures Act 2021 (the **Act**) became law on 10 May 2021. The Act provides that the Reserve Bank of New Zealand - Te Pūtea Matua (the **RBNZ**) and the Financial Markets Authority - Te Mana Tātai Hokohoko (the **FMA**) are jointly the **regulator** of Financial Market Infrastructures (**FMIs**).[1]

The Act empowers the regulator to issue standards for designated FMIs if it is satisfied such standards are necessary or desirable for one or more purposes of the Act. In July 2021, the RBNZ and FMA sought views from stakeholders on how aspects of the Act should be implemented, including the framework for assessing systemic importance and the proposed policy approach to the design of standards. In January 2022, the RBNZ and FMA published a response to submissions on the consultation. More information is available at: Implementing the new regime for financial market infrastructures.

In September 2022, the RBNZ and FMA released an exposure draft of the proposed FMI standards, along with a draft guidance note for how the regulator will make equivalence assessments for overseas-based FMIs that are designated under the Act.

We sought feedback on both documents by 18 November 2022. We received submissions from eight submitters, including New Zealand and overseas based stakeholders.

This paper provides a summary of the submissions we received and our responses to these submissions. The table in the Annex provides a more detailed presentation of stakeholder feedback along with responses from the regulator.

APPROACH TO DRAFTING THE STANDARDS

The FMI standards and related guidance is largely based on the *Principles for Financial Market Infrastructures* (the **PFMI**) issued by the Committee on Payments and Market Infrastructures (**CPMI**) and the International Organisation of Securities Commissions (**IOSCO**). Where necessary, we have modified the language used in the PFMI to make it more appropriate for secondary legislation in New Zealand.

In some areas we have elaborated on the PFMI to make the FMI standards more applicable to the New Zealand operating environment. This includes detailed requirements for contingency planning, management of third-party critical service providers, and cyber resilience, as well as disclosure and notification requirements.

In the cover note published with the exposure draft of the FMI standards, we outline the modifications that have been made to the PFMI language, as well as the standards that are additional to the requirements in the PFMI (including standards relating to operational risk management, namely Standards 17A: Contingency plans, 17B: Critical service provides and 17C: Cyber resilience and those relating to notification and disclosure such as Standards 23A: Disclosing compliance with the FMI Standards and 23B: Notifying the regulator).

TRANSITIONAL ARRANGEMENTS

As part of the consultation, we considered what kind of transition period would be needed for currently designated FMIs to adopt the new FMI standards. We noted that a long designation period is likely unnecessary, given most of the FMI standards are a translation of the existing PFMI which the operators of FMI's currently designated in New Zealand are already largely

[1] Unless the FMI is a pure payment system, in which case the RBNZ is the sole regulator.

compliant with. We signalled that we would be looking to provide 4-5 months between the Standards being finalised and published, and coming into effect, and asked stakeholders to indicate any particular FMI standards that may require a longer period to implement.

The responses we received to this question were largely provided by currently designated FMI operators in New Zealand. They indicated that we should consider timeframes for compliance in light of business changes required, external audit requirements, and information requests. In addition, they suggested that the necessary transitional arrangements may change depending on policy positions reached in the final iteration of the FMI Standards, for example whether Cover One or Cover Two[2] would be a requirement under Standard 4: 'Credit Risk', and Standard 7: 'Liquidity Risk'.

We have considered the submissions made and have delayed the commencement of the FMI standards to 1 March 2024[3] (except Standard 23A: 'Disclosure Framework', which commences a year later).

In addition, we have clarified that external audit requirements under the FMI standards apply from the date the FMI standards come into force (i.e., if there is a requirement for a two-yearly assurance engagement, the operator must complete the engagement within two years of the FMI standards commencing).

OVERSEAS EQUIVALENCE FRAMEWORK

We also requested feedback on the overseas equivalence framework, which will be applied when considering whether an overseas-based designated FMI falls into the class of "overseas-equivalent FMI" for the purposes of the standards. In the case an FMI is an overseas-equivalent FMI, the standards (except Standard 23B: 'Notification') will not apply to it.

The responses we received to this question were largely provided by overseas-based stakeholders. Submitters supported the equivalence assessment criteria as both reasonable and comprehensive, and noted that the framework strikes the right balance between protecting the New Zealand financial system, but not imposing undue regulatory burden.

We have made minor edits to the framework to provide examples of documents that the regulator will consider for the purposes of determining whether the home jurisdiction regime is broadly equivalent, and have removed the requirement to have a contingency plan under the framework, given this is already a legislative requirement. We have also amended the guidance on notifying the regulator to ensure it is consistent with Standard 23B.

MODIFICATIONS TO THE PFMI – SUBMISSIONS ON OBLIGATIONS

As noted above, we modified the language of the PFMI in order to translate these principles into standards that are consistent with New Zealand conventions around secondary legislation. While many of these changes are technical in nature and do not necessarily change the substance of the obligation, there were a number of specific changes made to the PFMI obligations that we received submissions on. We have summarised below the areas where submissions were made on the substance of the obligations in the FMI standards, and our response to these submissions.

[2] The requirement to have assets to cover the failure of the two largest participants of the FMI.

[3] 1 March 2024 is also the commencement date for those parts of the Act that are not yet in force.

Requirement to obtain a legal opinion under Standard 1: 'Legal Basis'

We proposed an additional obligation in Standard 1 requiring an operator to obtain a legal opinion demonstrating the enforceability of the FMI's rules, procedures, and contracts. We noted that this additional requirement provides assurance that the FMI has a sound legal basis in all jurisdictions in which it operates.

We received submissions regarding inconsistencies between the definition of "relevant jurisdiction" in the Standard (being any jurisdiction in which the FMI operates), and reference in the guidance (at paragraph 1.3) to obtaining a legal opinion regarding enforceability across all jurisdictions where an FMI has participants. Submitters suggested that this broadened the meaning of "relevant jurisdiction", as simply having a participant that is domiciled in another jurisdiction wouldn't generally mean an FMI was operating in that jurisdiction. We considered this feedback, and have amended the guidance to provide a list of factors at paragraph 1.4 that an operator should consider when assessing whether a jurisdiction is a 'relevant jurisdiction'.

How the requirements of Standard 2: 'Governance' apply to FMIs with multiple operators

We received a query from one submitter regarding how the requirements of Standard 2: 'Governance' would apply to FMIs with multiple operators. This submission sought clarification on whether the operators could reach their own decision about which of them discharges an obligation, and whether any of the obligations needed to be satisfied by each operator.

We have provided additional guidance at paragraph 2.3 around this issue. Specifically, while the requirements apply to each operator specified in a designation notice, an operator will be taken to have complied with the requirements if they ensure that another operator of the same FMI is discharging the obligation. We note that this does not apply to clauses 2(c), 2(d), or 2(e), which are obligations that each operator must comply with as they apply to the operator's Board.

Requirement to cover the losses of the two largest participants (Cover Two) Standard 4: 'Credit Risk' and Standard 7: 'Liquidity Risk'

We proposed a change to the graduated requirements in the PFMI around financial resources covering credit and liquidity risk, and instead proposed a single requirement that all designated FMIs must hold financial resources sufficient to cover defaults by the two largest participants. This was to simplify the nature of the requirements under the standards. We welcomed feedback on this requirement, which was relevant to Standard 4: 'Credit Risk' and Standard 7: 'Liquidity Risk'.

One submission noted that a requirement to cover the default of its two largest participants would result in additional capital costs, which could create a higher barrier to participation in its FMI. It also noted that this FMI was highly concentrated with the two largest participants making up 50% of its market. When comparing this to other FMIs overseas that have more participants and lower concentration, this would result in the New Zealand FMI requiring proportionally greater contributions from participants and overall financial resources when compared with overseas FMIs.

While we consider that cover two requirements would provide greater certainty and better ability for the market to recover from a crisis, we also consider that this need to be balanced against the burden to the market of maintaining additional risk capital, and the impact this could have on innovation.

As such, we have updated Standards 4 and 7 to align with the PFMI by requiring designated FMIs maintain cover two risk capital only where those FMIs are systemically important in

multiple jurisdictions or have complex risk profiles. We have also provided additional guidance on what we would consider to be a "complex risk profile".

Segregation requirements at Standard 11: 'Central Securities Depositories' and Standard 14: 'Segregation and Portability'

We received feedback that it was unclear whether we were intending on changing the PFMI requirements in relation to segregation. Clarification was requested as to whether an FMI must *require* segregation of participant accounts, or whether an FMI must have operational processes in place to *permit* segregation where a participant has requested it.

We did not intend to modify the requirements in the PFMI around segregation of positions, and understand that some of the relevant language used in the PFMI (for example "operationally support" and "enable") may be less than clear. As such, we confirm that our intention is for:

- A participant's client's assets to be mandatorily segregated from the assets of the participant (i.e., separating a participant's "house" account)
- Individual client assets to be segregated where a participant has requested this (i.e. not making it mandatory)

We have updated the guidance at paragraph 14.1 to clarify that an operator may hold customer assets in individual or omnibus accounts.

Portability requirements in Standard 14: 'Segregation and Portability'

We received feedback that portability may be unnecessary for very short-dated positions, where the applicable client positions would settle before porting has been completed. It was also noted that anti-money laundering (AML) and know your client (KYC) requirements could present issues for portability, as well as questions about the availability of general clearing participants to take on positions being transferred.

We consider that portability is important in the case of participant insolvency as it will reduce the chance of needing to close out positions, particularly in times of market stress. While the CPMI-IOSCO guidance refers to short-dated positions, the Standards should account for a time where the New Zealand market may have more activity in financial products that are not short-dated.

The intention of the Standard is not to require positions be ported in all circumstances (i.e, when considering short-dated positions), but to require an FMI's rules and procedures support portability should this be required. We have added further wording in the guidance at paragraph 14.16 around short-dated positions.

External assurance requirements – Standard 17: 'Operational Risk' and Standard 17C: 'Cyber Resilience'

A number of submitters provided feedback on the assurance requirements contained in the exposure draft of the standards. These additional obligations require operators to:

a) seek an external assurance engagement by a qualified auditor of their operational risk management framework at least every two years, or otherwise when a material incident or outage has occurred (Standard 17: 'Operational Risk'); and

b) ensure their cyber resilience strategy and framework, and compliance with such, are assessed every two years by way of an external engagement by a qualified auditor, or otherwise whenever a cyber incident occurs that impacts, or could impact, the FMI's continuing operations (Standard 17C: 'Cyber Resilience').

Submitters requested we consider both the frequency and scope of these assurance requirements, noting that entities may have a number of other external assurance engagements that may overlap.

Additionally, clarification was requested in Standard 17 to ensure that any assurance report required after a material incident or outage is limited in scope to areas of the operational risk management framework that were impacted by such an incident.

We were also asked to consider adding a materiality threshold to the extent of a cyber incident that would trigger a review under Standard 17C, as it is conceivable that a cyber incident could impact operations without having a material impact on the FMI.

Regarding the frequency and scope of assurance requirements, we believe that external assurance is the best way to ensure that these fundamental aspects of risk management are properly assessed within FMIs. It is up to the FMI as to how they meet the requirements of these engagements, and if the scope of an existing assurance engagement already covers the scope (or part of the scope) of the engagement required by Standard 17 or 17C we do not expect a separate engagement to be undertaken, but we would expect if that existing engagement only partly met the scope then it would be expanded to cover in full.

We have clarified in the guidance at paragraph 17.17 that the scope of an assurance report that is obtained after a material incident or outage under Standard 17 may be limited in scope to areas of the operational risk management framework that were impacted by such an incident.

We have also amended the requirement in Standard 17C to state that assurance must be sought after a cyber incident that *materially* impacts, or could *materially* impact, the FMI's continuing operations. We have not provided a definition of "material", as we consider this will differ depending on an FMI's specific circumstances and should be assessed by operators on a case-by-case basis.

In addition to the changes above, we have introduced an "*if not, why not"* approach to obtaining assurance reports after material incidents, outages, or cyber incidents, under both Standards 17 and 17C. This provides for circumstances where it may not be reasonable for an operator to obtain an external assurance engagement, and allows the operator to explain the reason for this to the regulator. This change has been made with consideration to the burden on entities of obtaining these reports, and to allow entities to provide a justification for why such an engagement might not be necessary.

Standard 17B: Critical Service Providers

Concerns were raised regarding wording in the draft guidance to Standard 17B requiring critical service providers to undertake comprehensive consultation with an operator and, where relevant, its participants, when the critical service provider proposes to change its technology.

We note that this point is in guidance, and sets out international best practice, and therefore is not a requirement on the operator (and the Standards and associated guidance do not impose obligations on a critical service provider directly). We have amended the wording slightly to clarify that this should be completed where "appropriate".

Additionally, a concern was raised regarding the requirements of Standard 17B clause 3, requiring an operator to disclose the FMI's critical service providers, and the FMI's dependence on those providers, to the regulator and its participants. The concerns were around security risks if an operator was required to disclose certain providers to participants.

We have updated the wording in Standard 17C, clause 3, to require disclosure to participants "where appropriate", allowing for disclosure not to be made if there are security issues.

We note that a number of the submitters seemed concerned that Standard 17B and the associated guidance was applying obligations on critical service providers directly. For clarity, we note that the FMI standards apply to designated FMIs only.

Standard 17C: 'Cyber Resilience' and Cloud Service providers

Some submitters were concerned with the way the draft FMI guidance for Standard 17C appeared to imply that using cloud services was inherently riskier for FMIs, and that the guidance creates the impression that using any third-party service provider will inherently weaken an FMI's cyber resilience and make the FMI an easier target for cyber criminals.

We believe that the draft guidance, including from paragraph 17C.77, provides a balanced view of cloud services (i.e., provides for the benefits of cloud services). Standard 17C and its supporting guidance are intended to ensure operators take a risk based approach in managing critical services for all outsourced arrangements and across all platforms.

We also note that Standard 17C and the supporting guidance is not specific to one provider's cloud capability – it is intended to ensure that operators consider risks and the capability of its external providers when extending data access to outsourced providers, and ensuring suitable limitations and controls are in place.

We do not propose amending the supporting guidance of Standard 17C for the above reasons.

ADDITIONAL SUBMISSIONS REQUIRING CLARIFICATION AMENDMENTS

There were a number of submissions providing feedback where the FMI standards or draft guidance required further clarification. At a high-level, these points included:

- Consistency regarding use of terms and language
- Consistency regarding use of defined terms
- General feedback regarding spelling and grammar
- Queries specific to a particular entity's operations

We appreciate all the feedback provided by submitters. We have completed amendments to both the FMI standards and the guidance to ensure consistency in use of language, and defined terms, and have taken on board feedback regarding spelling and grammar within the documents.

Where stakeholders had queries or comments specific to their operations, including whether or not particular entities will be "called-in" under the new regime, the regulator will liaise directly with these entities.

ANNEX: STAKEHOLDER FEEDBACK AND RESPONSES FROM THE REGULATOR

Question	Theme	Summary of responses received	Regulator response
Q1	Transitional arrangements	Submissions received largely from operators of existing designated FMIs stating that it was difficult to provide a proper submission on transition requirements without knowing the final on some policy points. Submissions also requested the regulator consider timeframes for compliance with FMI standards in light of business change requirements, external audit requirements, and information requests.	We understand that some transitional requirements may be needing depending on the requirements of the final version of the FMI Standards. We will work with existing designated FMIs directly to consider these requirements.
Q2	Overseas-equivalence framework	Submissions received primarily from overseas-based stakeholders, with broad support for the framework.	No material changes intended to be made to the framework.
Q3	Cover two requirements	Strong opposition to the proposal to require all designated FMIs to maintain capital to cover the default of the two largest participants. Significant additional capital costs will result in barriers to participation, along with decreased efficiency. The size of the New Zealand market will also result in greater contributions and coverage being required that other markets, coming at a cost to New Zealand.	While we consider that cover two requirements would provide greater certainty and better ability for the market to recover from a crisis, we also consider that this needs to be balanced against the burden to the market of maintaining additional risk capital. We have concluded that the increase in certainty provided by imposing cover two requirements is not significant enough to justify the extra burden to the market, from both a cost and efficiency perspective. We have amended the requirements in Standard 4: 'Credit Risk' and Standard 7: 'Liquidity Risk' to align with the PFMI requirements.
Q4	Legal basis	Clarification sought around the definition of "relevant jurisdiction" and the apparent expansion of this definition in the guidance to be any jurisdiction where an FMI has a participant domiciled.	Further guidance provided at paragraph 1.4, and amendments at paragraph 1.3, to provide examples of factors that an operator should take into consideration when assessing which jurisdictions are "relevant jurisdictions" for the purposes of legal risk.

Question	Theme	Summary of responses received	Regulator response
Q4	Governance	Clarification sought around how the requirements of Standard 2: 'Governance' apply to FMIs with multiple operators.	Further guidance provided at paragraph 2.3 of the guidance to state that an operator will be taken to have complied with the requirements of Standard 2 if they ensure that another operator of the same FMI is discharging the obligations imposed by the standard (subject to clauses 2(c), 2(d), and 2(e) applying to each operator individually).
Q4	Segregation	Clarification sought regarding segregation requirements in Standard 11: 'Central Securities Depositories' and Standard 14: 'Segregation and Portability' and whether these are intended to deviate from the PFMI requirements by making segregation mandatory.	We did not intend to modify the requirements around segregation from the PFMI position, and understand that some of the language used in the PFMI (for example "operationally support" and "enable") may be less than clear. As such, we confirm that our intention is for: • A participant's client's assets to be mandatorily segregated from the assets of the participant (i.e., separating a participant's "house" account) • Individual client assets to be segregated where a participant has requested this (i.e., not mandatorily) We have updated the guidance at paragraph 14.1 to clarify that an operator may hold customer assets in individual or omnibus accounts.
Q4	Portability	We received feedback that portability has been identified by CPMI-IOSCO as unnecessary for very short-dated positions, where the applicable client positions would settle before porting has been completed. The submitter also noted that AML/KYC requirements could present issues for portability, as well as the availability of general clearing participants to take on positions being transferred.	We consider that portability is important in the case of participant insolvency as it will reduce the chance of needing to close out positions, particularly in times of market stress. While the CPMI-IOSCO guidance refers to short-dated positions, the Standards should account for a time where the New Zealand market may have more activity in financial products that are not short-dated (for example, derivatives).

Question	Theme	Summary of responses received	Regulator response
			The intention of the Standard is not to require positions be ported in all circumstances (i.e., when considering short-dated positions), but to require an FMI's rules and procedures support portability should this be required. We have added further wording in the guidance at paragraph 14.16 around short-dated positions.
Q4	External assurance requirements	We note that a number of entities provided feedback on the assurance requirements contained in Standards 17: 'Operational Risk' and 17C: 'Cyber Resilience'. Submitters requested we consider both the frequency and scope of these assurance requirements, noting that entities may have a number of other external assurance engagements that may overlap. Additionally, clarification was requested regarding Standard 17 to ensure that any assurance report required after a material incident or outage is limited in scope to areas of the operational risk management framework that were impacted by such an incident. We were also asked to consider adding a materiality threshold to the extent of a cyber incident that would trigger a review under Standard 17C, as it is conceivable that a cyber incident could impact operations without having a material impact on the FMI.	We believe that external assurance is the best way to ensure that these fundamental aspects of risk management are properly assessed within FMIs. It is up to the FMI as to how they meet the requirements of these engagements, and if the scope of an existing assurance engagement already covers the scope (or part of the scope) of the engagements required, we do not expect a separate engagement to be undertaken. We have clarified in the guidance at paragraph 17.17 that the scope of an assurance report that is obtained after a material incident or outage under Standard 17 may be limited in scope to areas of the operational risk management framework that were impacted by such an incident. We have also amended the requirement in Standard 17C to state that assurance must be sought after a cyber incident that *materially* impacts, or could *materially* impact, the FMI's continuing operations. In addition, we have introduced an "*if not, why not*" approach to assurance engagement requirements resulting from material incidents, outages, or cyber incidents, insofar as if the operator believes it is not reasonable to obtain an external assurance report, it can explain the reasons for this to the regulator.

Question	Theme	Summary of responses received	Regulator response
Q4	Critical service providers	Concerns were raised regarding wording in the draft guidance requiring critical service providers to undertake comprehensive consultation with an operator and, where relevant, its participants, whenever the critical service provider proposes to change its technology.	We note that this point is in guidance, and as such is not a requirement on the operator of a designated FMI (and the Standards and associated guidance to not impose obligations on a critical service provider directly). We have amended the wording slightly to clarify that this should be completed where "appropriate", however no obligation is being imposed.
Q4	Critical service providers – disclosure to participants	Concerns were raised regarding the requirements of Standard 17B clause 3, requiring an operator to disclose the FMI's critical service providers, and the FMI's dependence on those providers, to the regulator and its participants. The concerns were around security risks if an operator was required to disclose certain providers to participants.	We have updated the wording in Standard 17C, clause 3, to require disclosure to participants "where appropriate", allowing for disclosure not to be made if there are security concerns.
Q4	Cyber resilience and Cloud	Concerns were raised around the draft guidance implying that cloud services are inherently riskier for FMIs, and that the statement "the third-party ecosystem provides an environment that makes it easier for cyber criminals to infiltrate an organisation" is misleading.	We believe that the guidance, including paragraph 17C.76 provides a balanced view of cloud services (i.e., provides for the benefits of cloud services). The standard and guidance are intending to ensure operators to take a risk based approach in managing critical services for all outsourced arrangements and across all platforms. We also note that Standard 17C and the supporting guidance is not specific to one provider's cloud capability – it is intended to ensure that operators consider risks and the capability of its external providers when extending data access to outsourced providers, and ensuring suitable limitations and controls are in place.
Q4	Notifications by overseas-equivalent FMIs	One submitter noted that the draft guidance note for overseas FMIs states that incident reporting is permitted via the home country regulator, however	We have amended the overseas equivalence framework to ensure it is aligned with Standard 23B.

Question	Theme	Summary of responses received	Regulator response
		Standard 23B only refers to an international regulatory and supervisory college while the guidance is silent.	
Q5	Statutory prerequisites and Financial Policy Remit	No submitters provided views on this.	N/A