BANK OF ENGLAND

February 2017

The Bank of England's response to the Independent Evaluation Office's evaluation of its approach to financial market infrastructure supervision

1 Introduction

1 The Bank of England (Bank) is responsible for supervising a range of financial market infrastructures (FMIs) that are systemically important both within the United Kingdom and to a range of international markets and jurisdictions. The Bank takes its responsibilities very seriously and is firmly committed to delivering world class supervision of FMIs to protect and enhance financial stability and the smooth functioning of the financial system within the United Kingdom and internationally. As a result the Bank has proactively enhanced its supervision to address the implications of a post-crisis, G20-led regulatory reform agenda which has placed increasing weight on the role of FMIs in financial markets.

2 The Bank therefore welcomes the Independent Evaluation Office's (IEO's) thorough and independent assessment of its approach to FMI supervision,(1) which recognises '*the Bank is an acknowledged world leader in the field of FMIs and the framework put in place for supervision has dealt effectively with the risks of the past few years*'.(2) The Bank also welcomes the constructive recommendations of the Report, and is committed to implementing them, as they represent pragmatic ways in which the Bank can further enhance its supervision of FMIs.

3 The IEO's assessment builds on the very positive outcomes of two recent external reviews, one by the International Monetary Fund (IMF),(3) and one jointly by the Committee on Payments and Market Infrastructures (CPMI) and International Organization of Securities Commissions (IOSCO).(4) The IMF review, in particular, found that: '*supervision of financial market infrastructures (FMIs) in the U.K. has significantly strengthened in recent years; the Bank of England (BoE) is one of the leaders worldwide in shaping reforms in this area*'.(5)

4 Chapter 2 of this response sets out a brief description of the supervisory responsibilities of the Bank for FMIs, and a high-level overview of the approach it takes to them. Chapter 3 sets out the background to the IEO's evaluation, and Chapter 4 is a summary of its main findings. Chapters 5–6 set out the IEO's recommendations and the Bank's response and conclusion.

2 The Bank's responsibilities for, and approach to, supervision of FMIs

5 The Bank has significant responsibilities for supervising FMIs(6) that underpin the vast majority of financial transactions in the United Kingdom, as well as a range of markets which are vital to other jurisdictions and the global economy. Market functioning, and therefore financial stability, is dependent on the resilience of these FMIs. In line with its mission to maintain monetary and financial stability, the Bank takes these responsibilities very seriously and has recently implemented a major programme of enhancements to its supervisory approach, the key attributes of which were outlined in the 2016 annual report on *The Bank of England's supervision of financial market infrastructures*.(7) This programme, in part, reflects the increasingly important role played by FMIs as a result of post-crisis regulatory reforms,(8) including the G20 commitment that standardised over-the-counter (OTC) derivatives should be cleared through central counterparties (CCPs). The Bank is fully committed to supervising FMIs to a standard which maintains its position as a world leader in this field and is consistent with the global standards drawn up by central banks and securities market regulators working together through the CPMI and IOSCO. The Principles for financial market infrastructures (PFMIs)(9) published in April 2012 therefore form a key foundation stone for the Bank's supervisory approach which is set out in more detail in *The Bank of England's approach to the supervision of financial market infrastructures*.(10)

(1) This is available at www.bankofengland.co.uk/about/Documents/ieo/evaluation0217.pdf.
(2) Page 5; www.bankofengland.co.uk/about/Documents/ieo/evaluation0217.pdf.
(3) This is available at www.imf.org/external/np/fsap/fsap.aspx.
(4) This is available at www.bis.org/cpmi/publ/d139.pdf.
(5) Page 4; www.imf.org/external/pubs/ft/scr/2016/cr16156.pdf.
(6) Comprising central counterparties (CCPs), securities settlement system, and payment systems.
(7) This is available at www.bankofengland.co.uk/publications/Pages/fmi/annualreport2016.aspx. An update on further progress on such enhancements is available in the 2017 Annual Report: www.bankofengland.co.uk/publications/Documents/fmi/annualreport2017.pdf.
(8) This is available at www.g20.utoronto.ca/2009/2009communique0925.html.
(9) These are available at www.bis.org/cpmi/publ/d101a.pdf.
(10) This is available at www.bankofengland.co.uk/publications/Documents/news/2012/nr161.pdf.

6 Within the Bank, it is the Financial Market Infrastructure Directorate (FMID) that has responsibility for supervising FMIs. Recognising the importance of FMIs to a wide range of markets and jurisdictions the Bank is firmly committed to ensuring effective collaboration, in line with the international expectations as enshrined within the PFMIs, with other authorities that have an interest in the resilience of FMIs supervised by the Bank. Domestically this includes co-operation with the Prudential Regulation Authority and the Financial Conduct Authority in relation to the supervision of markets and market infrastructure, and with the Payment Systems Regulator in relation to payment systems, including under memoranda of understanding.(1) Internationally, the Bank chairs EU supervisory colleges for all of the UK CCPs, and global supervisory colleges for its most internationally active CCPs. It also conducts extensive bilateral engagement with other authorities on FMI-related issues and participates in the international supervisory arrangements for Continuous Linked Settlement (CLS) and the Society for Worldwide International Financial Transactions (SWIFT).

7 The FMI sector continues to evolve. Regulatory initiatives, such as the G20 commitment that standardised OTC derivatives should be centrally cleared through CCPs, mean FMIs are becoming increasingly important to the financial system. The development and use of new financial technologies also presents important new opportunities, challenges, and risks. The Bank fully recognises the need to be on the front foot in responding to these challenges. It therefore plays a leading role domestically, with the other UK financial authorities, and internationally, in particular through the CPMI and Financial Stability Board, in reviewing and developing regulatory policy with respect to FMIs.

8 The IEO's evaluation of FMID's approach to the supervision of FMIs follows closely on two recent external reviews in the period 2015–16. CPMI and IOSCO published a report on their assessment and peer review of 28 jurisdictions' application of the five responsibilities included in the PFMIs, and confirmed that the Bank's approach is fully consistent with these international standards. More recently, the IMF undertook a Financial Sector Assessment Programme (FSAP) review of the United Kingdom, including the supervision and systemic risk management of FMIs. This concluded that supervision of FMIs has significantly strengthened in recent years; that the Bank is one of the leaders worldwide in shaping reforms in this area; that supervisory practices have become more formalised, disciplined and standardised; and that the current approach enables an ability to focus on the resilience of FMIs in a broader context.

3 Summary of aims and scope of the IEO's evaluation

9 In February 2016, the IEO was asked by the Bank of England's Court of Directors to assess the Bank's approach to the supervision of FMIs. The IEO evaluation was conducted primarily between April and October 2016. The overall aim of the review was to give the Court assurance about the Bank's approach to its statutory responsibilities for FMI supervision, focusing particularly on inputs, supporting infrastructure and internal governance. Evaluation criteria of the review were whether:

a. the Bank has articulated its strategy and objectives clearly;
b. there are clearly defined success criteria for the supervisory approach;
c. staff and resources are appropriately and effectively organised;
d. governance arrangements are effective; and
e. there is an appropriately agile and forward-looking approach.

10 At the request of Court, the review also assessed whether recent investments made in FMI supervision, including as part of the Bank's 2014 Strategic Plan, are on track to deliver the step change that was intended. Given that the IEO's review follows closely on the Bank's implementation of a major programme of enhancements to its supervisory approach, it provides an early opportunity to take stock of measures already taken, and consider whether there are other aspects that could be further strengthened.

(1) These are available at www.bankofengland.co.uk/about/Pages/mous/default.aspx.

4 Summary of the IEO's findings

11 The Bank welcomes the findings of the IEO assessment, which recognise that the Bank has strengthened its supervisory approach, improved its governance framework, and increased awareness of FMI-related issues around the Bank.

a. *Supervisory approach*: The IEO review found numerous examples of good practice and no evidence of material shortcomings, which is consistent with the outcome of the recent IMF FSAP and CPMI-IOSCO reviews. It also confirmed that the investments in FMI supervision are on track to deliver the step change in supervision that was intended.

b. *Governance framework*: Noting the changes made since 2014, the IEO review found that the framework has been effective, with good evidence of discussion, challenge and decision-making at appropriate levels.

c. *Awareness of FMI-related issues*: When noting that the Bank has chosen to employ a specialist model for FMI supervision (with FMID as a 'quasi-standalone regulator'), the IEO observed that FMID has made significant efforts to raise awareness of FMI-related risks across the wider Bank.

These findings confirm the significant progress and positive results arising from the major programme of enhancements made to enhance the Bank's supervision of FMIs.

12 Alongside these positive findings, the IEO review identified a series of constructive recommendations through which it considers the Bank could further enhance its approach to the supervision of FMIs. These are set out in Section 5.

5 The IEO's recommendations and the Bank's response

13 The IEO has set out its recommendations under three broad themes:

a. Clarify objectives and responsibilities of FMI supervision at the Bank more fully;

b. Support the specialist unit that is the FMI Directorate (FMID) by leveraging the wider Bank as effectively as possible; and

c. Continue to strengthen governance, including by revisiting the question of third-party challenge.

14 The six high-level recommendations and 16 detailed recommendations that arose from these themes are set out below, followed by the Bank's response to them.

Theme: Clarify objectives and responsibilities of FMI supervision at the Bank more fully

High-level recommendation 1: Ensure a clear and shared understanding of strategy, objectives and risk tolerance

Detailed recommendations:

- *The Governors, supported as appropriate by the Bank's policy committees, to rearticulate the Bank's strategy to protect and enhance financial stability through supervision of FMIs. This should include an articulation of the links between FMI supervision and the Bank's other responsibilities.*

- *The Governors to agree the Bank's tolerance for risks arising from FMIs. This should include both financial risk and operational resilience.*

- *FMI Directorate to explain what the concept of 'systemic risk manager' means for each type of FMI, building on the forthcoming Code of Practice for Payment Systems.*

- *Following from the above, FMI Directorate to revise the Bank of England's 2013 Supervisory Approach document, working closely with other relevant stakeholders.*

15 The Bank accepts this recommendation, and will review its strategy, objectives and risk tolerance in the supervision of FMIs. FMID, working in conjunction with other areas (and in consultation with the relevant policy committees) of the Bank, will propose to the Governors a rearticulation of these by the end of 2017. The development of an approach to take this forward has already commenced. Once complete, formal training and informal awareness-raising sessions will follow, to ensure this is embedded among supervisory staff and committee members.

16 In its review and rearticulation of strategy, objectives and risk tolerance, the Bank will remain mindful that there are significant and increasing expectations of continuity of service (and hence of operational resilience) placed upon FMIs, to promote the effective functioning of the markets they support, and that they also have important responsibilities as systemic risk managers. To this end (and to address another IEO recommendation above), FMID has established a working group to examine supervisors' and FMIs' understanding of their systemic risk management responsibilities, and to ensure this is framed with equal clarity (including publicly, as necessary) for central counterparties (CCPs), central securities depositories (CSDs) and payment systems. This work is expected to be completed by the end of 2017.

17 When both of these reviews are complete (but no later than 2018), *The Bank of England's approach to the supervision of financial market infrastructures* will be updated.

High-level recommendation 2: Further improve supervisory practices

Detailed recommendations:

- *FMI Directorate to further align its supervisory model and practices to reflect the Bank's overall financial stability objective and the relative significance of operational resilience.*

18 As the review notes, the Bank's supervisory approach — and the model, materials and metrics through which it articulates and implements it — has been significantly and successfully expanded and enhanced in the period 2014–16. Supervisory models and practices require ongoing review and enhancement, and undertaking the actions to address recommendation 1 above would, in any case, trigger a review of these. This represents a valuable opportunity for FMID to reassess and update the model, metrics and materials through which it implements its supervisory approach. Consequently, after completion of the actions under high-level recommendation 1 (ie to further clarify strategy, objectives and risk tolerance), but no later than 2018, FMID will undertake this action too.

Theme: Support the specialist unit that is the FMI Directorate by leveraging the wider Bank as effectively as possible

High-level recommendation 3: Ensure FMI Directorate is a priority customer for Bank-wide work on operational resilience
High-level recommendation 4: Wider Bank to invest more fully in FMI Directorate engagement
High-level recommendation 5: Design a workforce model that is flexible, encourages the development of deep FMI expertise and enables FMI Directorate to respond to future change in the FMI environment

Detailed recommendations:

- *FMI Directorate and PRA to continue to develop jointly an approach to supervising operational resilience at FMIs, as part of the Bank wide work on the topic.*

- *FMI Directorate to articulate its desired future resourcing model, dependent on the outcome of other recommendations and the skills requirements arising from the changing FMI environment.*

- *FMI Directorate and PRA to agree a more formal approach for the use of specialist PRA resources.*

- *FMI Directorate and PRA to co-ordinate talent management and succession planning to support the development of an experienced cadre of FMI supervisors.*

- *Governors and Court to reconsider the Bank's position on levying fees for FMI supervision as part of any wider discussions on the Bank's medium-term funding structure.*

19 The Bank accepts the proposal that FMID become a priority customer for specialist resources in operational risk and resilience. It is committed to ensuring that Bank-wide resources and expertise available to FMID are made available and utilised effectively, and both FMID and the PRA have consequently already taken actions and created plans to carry this forward. These include:

a. FMID has since 2016 Q4 committed a substantive increase in supervisory time and resource to work with the PRA on jointly developing a micro-supervisory approach to operational resilience.

b. FMID has also in the latter half of 2016 undertaken a thematic work programme that will support and inform the above-mentioned joint PRA/FMID work, by exploring contingency planning and risk tolerance for operational outages at certain types of FMI.

c. The Bank's Information Security Division has since 2016 Q4 added to its Sector Cyber team an advisor with FMI supervisory experience.

d. The PRA and FMID have agreed and are implementing a more formal approach to the use of PRA resources, and covering use of Supervisory Risk Specialists (SRS), Senior Advisors, and the Supervisory Oversight Function (SOF). This agreement specifically acknowledges that resources with operational risk and resilience expertise are likely to form a significant proportion of future FMID requests for SRS support.

e. The PRA (supported by FMID) will increase the level of FMI knowledge and expertise among its operational risk and resilience specialists by the end of 2017, and has already added new resource with FMI experience to this team.

f. FMID will also by the end of 2017 have increased the proportion of its supervisory staff that has operational risk and resilience expertise.

20 The Bank also accepts the proposal that other areas with expertise, resources or industry intelligence relevant to the supervision of FMIs (ie beyond operational risk and resilience expertise) should invest more fully in engagement with FMID. Increased access to broader Bank-wide resources and expertise would significantly complement what is already available at a directorate level, and thereby strengthen the supervision of FMIs. Consequently, the following actions have been taken or are under way:

a. As stated above, the PRA and FMID have agreed and are implementing a more formal approach to FMID's use of PRA resources across SRS, Senior Advisors, and SOF. This extends FMID's access to such resources and expertise beyond the area of operational risk and resilience.

b. FMID has since 2016 Q3 appointed a business area contact to co-ordinate between FMID and SRS, facilitating improved access to specialist expertise. The PRA/FMID agreement, mentioned above, has further formalised the role and responsibilities of this business area contact.

c. In 2016 Q3 SRS rearticulated to FMID supervision the specialist resources available to them, and reconfirmed the process for accessing such expertise. Following the establishment of the agreement between the PRA and FMID, further awareness-raising sessions are planned for 2017.

d. There are other areas in which existing PRA or cross-Bank work and initiatives can be leveraged to accommodate the supervisory needs of FMID. These range from supervisory stress testing to FinTech to desktop applications to support supervisory oversight. The Bank is committed to taking these forward in a co-ordinated manner, and in the three examples cited above has already done so.

21 The Report also recommends that FMID articulate the desired future resourcing model for the directorate, and that FMID and the PRA should co-ordinate talent management and succession planning to support future experienced FMI supervisors. The senior management of FMID has therefore commenced an in depth review of its workforce model, with input and support from Human Resources and the PRA. This is scheduled to be completed by the end of 2017. In doing so, it will not just take account of resources and expertise available within FMID, but

also those available across the wider Bank (in particular, the PRA), as well as its ability to access third-party resources and expertise (for instance, via skilled persons' reports under the Financial Services and Markets Act 2000 and experts' reports under the Banking Act 2009).

22 This articulation of a directorate-specific resourcing model will be complemented by FMID's ongoing participation in Bank-wide recruitment and talent management initiatives. These improve co-ordination between FMID and the PRA on recruitment, retention, talent management and succession planning, and thereby also support the IEO's recommendation above that FMID and the PRA should co-ordinate talent management and succession planning.

23 The final recommendation is to consider whether directly levied fees on FMIs should be introduced. Governors and Court have agreed that the Bank will, in 2017, consult on levying fees for FMI supervision, with a view to any changes commencing in 2018 when the Cash Ratio Deposit (CRD) is renewed.

Theme: Continue to strengthen governance, including by revisiting the question of third-party challenge

High-level recommendation 6: Continue to strengthen governance and develop a comprehensive approach to assurance

Detailed recommendations:

- *The Governors to review the responsibilities of the internal governance committees for FMI supervision.*
- *The Governors to review membership of the FMI Board in order to ensure optimal use of resources.*
- *The Governors to consider the role of third-party challenge in the internal governance structure for FMI supervision to increase opportunities for independent challenge.*
- *Court to augment its annual discussion of FMI supervision, including via a structured survey of FMI Board members.*
- *The FMI Directorate to enhance its assurance framework with a particular focus on assessing how well the Bank is meeting its supervisory objectives for FMIs.*
- *The FMI Directorate and PRA to agree an approach for using the PRA's Supervisory Oversight Function in order to bolster the assurance framework for FMI supervision.*

24 The Bank significantly enhanced its governance of FMI supervision during the period 2014–16, and the IEO review gives assurance on the effectiveness of the framework, including that both decision-making and rigorous challenge occur at appropriate levels. The Bank welcomes both the insights and recommendations of the Report with respect to the future development of governance and assurance, and will undertake the following actions to address them:

a. The Governors, supported by FMID, will in 2017 review the responsibilities of internal committees for FMI supervision and the membership of FMI Board.

b. The Bank will add independent members to FMI Board during 2017.

c. FMID will in 2018 review and enhance its assurance framework to ensure that it sufficiently captures the rearticulated objectives arising from high-level recommendation 1 above.

d. As noted previously, the more formal approach on access to specialist resources that the PRA and FMID have agreed and are implementing also covers use by FMID of the PRA's SOF for assurance purposes, thereby addressing this recommendation also.

6 Conclusion

25 The Bank welcomes the IEO's independent assessment, which recognises that the Bank has proactively made major enhancements to its supervision of FMIs in recent years and observes that the Bank is an acknowledged world leader in the field of FMIs. The Bank also welcomes the constructive recommendations of the Report, and is committed to implementing them, as they represent pragmatic ways in which the Bank can further enhance its supervision of FMIs. The Bank will continue to share enhancements to its approach with other authorities via its international co-operative arrangements, thereby supporting ongoing dialogue on regulatory best practice in FMI supervision. This will ensure the Bank continues to deliver rigorously on its supervisory objective to ensure the resilience of services provided by UK FMIs, as well as serving to protect and enhance the stability of the financial system within the United Kingdom and internationally.

Summary of the Bank's response to the IEO's recommendations

Recommendation	Actions taken	Actions proposed
Ensure a clear and shared understanding of strategy, objectives and risk tolerance	**FMID** has established a working group to examine supervisors' and FMIs' understanding of their systemic risk management responsibilities, and to ensure this is framed with equal clarity (publicly, if necessary) for CCPs, CSDs and payment systems. To be completed by end of **2017**, with recommendations to be taken to FMI Board.	**FMID** will update the Bank's *Supervisory Approach* document when these actions are complete, but no later than **2018**.
	FMID to propose to the **Governors** a rearticulation of the Bank's strategy, objectives and risk tolerance in its supervision of FMIs, to be completed by end of **2017**. The development of an approach to take this forward has already commenced. Once complete, formal training and informal awareness-raising sessions will follow, to ensure this is embedded among supervisory staff and committee members.	
Further improve supervisory practices		After completion of the actions above (but again no later than **2018**), **FMID** will reassess and update the model, metrics and materials through which it implements its supervisory approach.
Ensure FMI Directorate is a priority customer for Bank-wide work on operational resilience *Wider Bank to invest more fully in FMI Directorate engagement* *Design a workforce model that is flexible, encourages the development of deep FMI expertise and enables FMI Directorate to respond to future change in the FMI environment*	The **PRA** and **FMID** have agreed and are implementing a more formal approach to the use of PRA resources, and covering use of Supervisory Risk Specialists (SRS), Senior Advisors, and the Supervisory Oversight Function (SOF).	The **PRA** (supported by **FMID**) will increase the level of FMI knowledge and expertise among its operational risk and resilience specialists by the end of **2017**, and has already added new resource with FMI experience to this team.
	FMID has since **2016 Q4** committed a substantive increase in supervisory time and resource to work with the **PRA** on jointly developing a micro-supervisory approach to operational resilience.	**FMID** will by the end of **2017** have increased the proportion of its supervisory staff that has operational risk and resilience expertise.
	The Bank's **Information Security Division** has since **2016 Q4** added to its Sector Cyber team an advisor with FMI supervisory experience.	**Governors and Court** have agreed that the Bank will in **2017** consult on levying fees for FMI supervision, with a view to any changes commencing in **2018** when the Cash Ratio Deposit (CRD) is renewed.
	FMID has since **2016 Q3** appointed a business area contact to intermediate between FMID and SRS, facilitating improved access to specialist expertise.	
	SRS in **2016 Q3** rearticulated to FMID supervision the specialist resources available to them, and reconfirmed the process for accessing such expertise. Further awareness-raising sessions are planned for **2017**.	
	FMID's ongoing participation in Bank-wide recruitment and talent management initiatives has focused on improving co-ordination between FMID and the PRA on recruitment, retention, talent management and succession planning.	
	The senior management of **FMID** has commenced an in-depth review of its workforce model, with input and support from Human Resources and the PRA, to be completed by end of **2017**.	
	In **2016 Q3** investment was approved to enhance the **PRA**'s supervisory desktop solution (RWM) so that it can support a number of core supervisory activities of FMID, with the potential for future convergence of supervisory tools.	
Continue to strengthen governance and develop a comprehensive approach to assurance	The more formal approach on access to specialist resource that the **PRA** and **FMID** have agreed and are implementing (see above) also covers use by FMID of the PRA's **SOF** for assurance purposes.	**FMID** will in **2018** review and enhance its assurance framework to ensure that it sufficiently captures the rearticulated objectives arising from high-level recommendation 1. Recommended changes will be taken to FMI Board.
		The **Governors**, supported by **FMID**, will in **2017** review the responsibilities of internal committees for FMI supervision and the membership of FMI Board.
		The **Bank** will add independent members to FMI Board during **2017**.