December 5, 2022

Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Re: Notice of Proposed Rulemaking Financial Market Utilities (Docket No. R-1782; RIN 7100-AG40; 87 Fed. Reg. 60,314)

Dear Ladies and Gentlemen:

Better Markets[1] appreciates the opportunity to provide comments on the above-captioned Notice of Proposed Rulemaking ("Proposal")[2] regarding amendments to the requirements relating to operational risk management in Regulation HH of the Board of Governors of the Federal Reserve System ("Board"), which applies to certain financial market utilities that have been designated as systemically important ("designated FMUs") by the Financial Stability Oversight Council ("FSOC") under Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("DFA"). The proposal would update, refine, and add specificity to the operational risk management requirements in Regulation HH. Better Markets supports these efforts and their goal of addressing changes to the technologies utilized by FMUs and their clients, regulations, and financial markets since Regulation HH was last updated in 2014.

The authority of the FSOC to designate systemically important institutions provided in the DFA serves a very special and important purpose for ensuring the safety and stability of our financial system. With this designation authority organizations that are outside the regulatory perimeter can be brought within the perimeter if they present systemic risks to our financial system. Considering the importance of FMUs to our financial system and the concentration of financial transactions that are conducted through FMUs, they indeed are of systemic importance to our financial system. Thus far the FSOC has designated two FMUs, making them subject to the

1 Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans' jobs, savings, retirements, and more.

2 Financial Market Utilities, 87 Fed. Reg. 60,314 (October 5, 2022).

supervision and regulation by the Board – The Clearing House Payments Company, L.L.C. ("TCH") and CLS Bank International ("CLS").

Both FMUs facilitate a significant amount of financial transactions. TCH operates payments networks that clear and settle more than $2 trillion each day through wire, the automated clearinghouse system, check image, and real-time payments. TCH is owned and utilized by the world's largest commercial banks, including the U.S.'s largest banks, and by extension their clients and customers. CLS operates a global multicurrency cash settlement system that similarly processes over $6 trillion dollars of currency transactions each day. Activities that facilitate the movement of money are critical to the functioning of the financial system, and the scale of these activities that these institutions conduct unquestionably makes them systematically important.

As noted in the Proposal, Regulation HH has not been updated since 2014. There have been many technological and market changes since then that would affect the management of operational risks at designated FMUs. There have been significant technological advancements in the ways bad actors attempt to exploit these systems for their own gain or to cause disruptions in their services and by extension the financial system. That is, cybersecurity threats have become more sophisticated and frequent.[3] Also, there have been significant technological advancements in the ways these designated FMUs conduct their activities, in many cases in response to consumer demand. For example, in 2017 TCH started offering real-time payments through its RTP® system, which now has over 280 participating banking organizations.

The regulatory landscape has changed as well. The Proposal highlights that regulations regarding operational risks has advanced for banking organizations and their service providers but are lagging for designated FMUs. For example, rules were adopted by the banking agencies in November of last year that require banks and their service providers to notify their supervisors within 36 hours of "computer-security incidents."[4] However, designated FMUs notably were intentionally excluded from these rules when they were proposed and finalized. Similarly, other updates have been made to rules regarding the management of operational risks that exclude designated FMUs.

Therefore, changes to the rules for designated FMUs are necessary and overdue, and Better Markets fully supports the updates that are outlined in the Proposal. The most important enhancement within the Proposal is around incident management and notification. When there are material operational incidents, timeliness is extremely important to minimizing the effects as much as possible. Early notification to all affected parties and regulatory agencies allows for corrective action similarly to be taken early, which, if taken, greatly reduces the probability and scale of any resulting damage. Such damage could be massive and widespread considering the scale of operations of designated FMUs and the number of direct clients as well as their clients and

[3] *See*, for example, McKinsey & Company, *Cybersecurity trends: Looking over the horizon* (March 10, 2022), https://www.mckinsey.com/capabilities/risk-and-resilience/our-insights/cybersecurity/cybersecurity-trends-looking-over-the-horizon.

[4] 86 Fed. Reg. 66,424

customers. The Proposal judiciously and sensibly would require "immediate" notification to the Board, affected parties, and other relevant entities of "material" operational incidents.

Additionally, the Proposal also rightly increases the expectations around cybersecurity incidents. Specifically, designated FMUs would be required to have plans in place around reconnecting to its participants following a cybersecurity disruption. Again, timeliness is critical to minimizing the damage of such incidents, and business continuity plans that explicitly outline how reconnection would be achieved would greatly improve the timeliness of those efforts. Additionally, the requirement for annual testing of these plans in the Proposal would not only improve the ability of designated FMUs to execute on the plans but also would provide great insights into how the plans could be improved based on updates to technology.

The other aspects of the Proposal also would greatly promote the improvement of operational risk management practices at designated FMUs, namely the increased expectations around review and testing of systems, processes, and procedures as well as the addition of expectations around management of risks originating from relationships with third parties. A regular and robust review and testing process is necessary because there are almost continuous changes in technology and the ways in which operational risks materialize. Adding the management of third party risks to the expectations is particularly important because of the increase in third-party financial technology corporations providing services to designated FMUs and their direct participants.

CONCLUSION

We support the efforts of the Board to improve the operational risk resilience of designated FMUs and look forward to the final rule being implemented largely as in the Proposal.

Sincerely,

Phillip G. Basil
Director of Banking Policy

Better Markets, Inc.
1825 K Street, NW
Suite 1080
Washington, DC 20006
(202) 618-6464

pbasil@bettermarkets.org
http://www.bettermarkets.org