

Luxembourg, 22 June 2023

Subject: ALFI's response to the ESAs discussion on DORA: criteria for critical ICT Third-party service providers and oversight fees levied on such providers

Introduction

The Association of the Luxembourg Fund Industry (ALFI) represents the face and voice of the Luxembourg asset management and investment fund community. The Association is committed to the development of the Luxembourg fund industry by striving to create new business opportunities, and through the exchange of information and knowledge.

Created in 1988, the Association today represents over 1,500 Luxembourg domiciled investment funds, asset management companies and a wide range of business that serve the sector. These include depositary banks, fund administrators, transfer agents, distributors, legal firms, consultants, tax advisory firms, auditors and accountants, specialised IT and communication companies. Luxembourg is the largest fund domicile in Europe and a worldwide leader in cross-border distribution of funds. Luxembourg domiciled investment funds are distributed in more than 70 countries around the world.

We thank the ESA for the opportunity to participate in this consultation on the assessment of DORA criticality criteria.

Our members appreciate the interest in setting clear criteria for assessing the criticality of the service providers they make use of, in the context of DORA.

In order to provide evidence of the industry considerations with regards to criticality criteria of the service providers in the context of DORA, answers will be given on a number of selected questions focusing on the high-level assessment and spotted industry-related consideration

Part I: Criticality criteria

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.*

With regards to the relevance of the service provided by the third-party service provider to the financial market participants, ALFI members agree that the number of financial entities making use of the services of any given service provider could be of relevance.

Meanwhile, making use of the asset under management (net asset value) figures to assess the relative weight of the financial entities using that service provider would base the measurement on easily available and reliable data.

With regards to the relative market share information, ALFI considers although this information would be relevant in assessing criticality, a substantial shortcoming would be the lack of complete and reliable data.

This being said, and as a general principle, ALFI is in the views that identifying the criticality level of the delegates and service providers is an exercise that financial entities have performed recurrently within the

scope of non-financial risk management. In particular, ALFI investment fund manager members and fund administrator members highlight a criticality assessment of delegates and third-party services providers performed:

- Within the scope of the *business impact analysis*
- Within the scope of the *business continuity management*

When performing such analysis, financial entities would be using a risk-based approach, assuming the impact of the unavailability of a delegate or service provider.

For the sake of consistency among the various assessment exercises performed, ALFI is in the views that using a similar risk-based approach in assessing the criticality level of service providers within the scope of DORA would allow the financial companies to benefit from an existing risk assessment framework while setting up a level-playing field across the industry for all delegates and service providers. From a risk management perspective, it is to be noted that the proposed risk-based approach is an overarching and governing principle. Under certain specific situations, the focus would shift from the risk-based approach to a risk mitigation. This is for instance the case when ICT TPPs are within the same group - as excluded per Art 31(8) DORA - or when the ICT TPPs landscape is characterized by a significant concentration of providers.

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.*

Please refer to the above response to question 6, addressing the existing risk-based approach when identifying the criticality of service providers with the non-financial risk management framework applied by management companies.

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

An overview of existing data highlights the following three main sources:

- Self-reported data from ICT third party provider
- Self-reported data from financial entities
- Third party data provider
- National competent authorities

In the investment fund industry, the data driven approach to supervision provides with a rich set of information streamlined and available at the national competent authorities. Leveraging to the greatest extent on this already existing data stream would prove efficient and avoid duplicates. This recommendation might be particularly relevant in the context of quantitative information with limited subjectivity.

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.*

In line with the responses provided in Questions 6 and 8, focusing on a risk-based approach similar to that applied for the identification of critical service providers within the scope of non-financial risk management for the management companies, ALFI considers that the assessment of critical functions should be following a *business impact analysis* and a risk-based approach.

Such analysis, as already performed within the scope of the critical functions' analysis with regards to business continuity, allows for assessing the impact of the temporary loss of critical functions.

Using a similar risk-based approach in the identification of the critical functions served by the service providers within the scope of DORA would allow for an enhanced overall consistency within the various areas of service outsourcing for the financial entities.

Resultingly, ALFI would not welcome a taxonomy-based approach in the form of a list of critical activities, which completeness and suitability could be questioned within the context of specific activities and / or entities. ALFI would rather encourage capitalising on the criticality identification already in place in non-financial risk management business continuity exercises.

Indeed, the individual appraisal exercise conducted by the Investment Fund Managers (IFMs) and fund administrators when assessing the activities and critical functions business continuity risk management framework would encompass the specificities and unique business model and mitigation plan of each management companies, thus providing a better-fitting outcome in term of criticality identification than a global "fit-for-all" taxonomy.

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

It has been observed that indicators related to the share of financial entities using ICT services have the same unique threshold, namely 10%. This regards :

- **Criterion 1 - Indicator 1.2** - Share of financial entities using ICT services provided by the same ICT TPP
- **Criterion 3 - Indicator 3.1** - Share of financial entities using ICT services provided by the same ICT TPP where these ICT services support critical or important functions
- **Criterion 4 - Indicator 4.1** - Share of financial entities reporting that no alternative ICT TPPs are available or have the required ability and / or capacity to provide the same ICT services as the existing ICT TPP

All three indicators adopt the same ratio of total value of assets divided by total assets-equivalent per type of financial entity in the EU.

Under the current wording the denominator is the same across the indicators and only the numerator is changing capturing the reduced scope of entities for *Indicator 3.1* (only for critical function) and *Indicator 4.1* (only for hardly substitutable services). Since the numerator of *Indicator 3.1 and 4.1* is a subset of the one of *Indicator 1.2* it appears inconsistent to have the same threshold for all three. Indeed, overshooting any of the threshold for *Indicator 3.1 and 4.1* will automatically result in the threshold for *Indicator 1.2* also being overshoot. It is therefore recommended to calibrate the thresholds differently implying a larger number for *Indicator 1.2* to avoid being redundant with *Indicator 3.1 and 4.1*.

It is also further noted that the proposition for the denominator being calculated per type of financial entity is coherent to account for the sizeable industry differences across financial sectors.

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

As detailed in question 18 above, ALFI considers that the industry would not benefit from an indicative 'ICT services' taxonomy.

When assessing the criticality of the functions covered by the services of the ICT service provider within the scope of DORA, our members would consider more appropriate building on the risk assessment framework already in place in the non-financial risk management framework of each management company specifically.

Indeed, this individual exercise conducted by the management companies when assessing their business continuity risk management framework would encompass the specificities and unique business model and mitigation plan of each management companies, thus providing a better-fitting outcome in term of criticality identification than a global "fit-for-all" taxonomy.

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

Please refer to the consistency argument made in response 19.

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.*

ALFI is in the views that the criteria 4.1 and 4.2 include a certain degree of subjectivity, which may lead to potential bias in the overall substitutability assessment. Indeed, maintaining a taxonomy like list of non-substitutable activities would result imprecise and subject to controversies, due to significant business-subjective elements, specific to the history of each company. ALFI members suggest that risk assessment and exit plan analysis could be considered as better suited approaches overall.

Indeed, indicators applying a principle based / risk-based approach with regards to substitutability, and focusing on the concepts of cost of substitutability as well as defining a *reasonable time frame* to be considered in case of substitutability could be more appropriate, as these indicators would offset the subjectivity factor in the assessment.

In providing this assessment, the financial entities would rely on the risk assessment analysis performed in the context of each critical outsourcing, as such assessment exercise is taking into consideration the exit strategy and the project plan to migrate from one service provider to a substitute. In industry best practices, the corresponding migration timeframe would, in general, appear specified in the service provider / delegation contract. To this respect, within the scope of DORA, it would be required for each TPP the financial company is contracting with, to present an exit plan and a time frame for this exit plan.

In general, and as presented within the ALFI's responses to this consultation, our members would welcome a pragmatic and consistent approach, that would build the criticality criteria and indicators on the existing assessments for service providers, following a risk-based approach.

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

Please refer to the consistency argument made in responses 11 and 19.