



David Howson
President
Cboe Europe

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Mr Stephen Maijoor
Chair, ESMA
103 Rue de Grenelle
75007 Paris
France

Re: Draft Guidelines on Outsourcing to Cloud Service Providers

Chair Maijoor,

Cboe Europe greatly appreciates the opportunity to respond to the European Securities and Markets Authority's ("ESMA's") draft guidelines on outsourcing to cloud service providers. As one of the largest pan-European equities exchanges with operations in the UK and the Netherlands and an affiliate of pan-European equities clearinghouse EuroCCP, Cboe Europe understands the benefits that can accrue to European investors through cost reductions and improved operational efficiencies as a result of outsourcing arrangements. We also understand that cloud outsourcing raises particular risks and agree that it may be helpful for ESMA to publish guidelines for firms as they "identify, address and monitor the risks that may arise from their cloud outsourcing arrangements."¹

It is critically important, however, that the guidelines are not overly prescriptive or require rote implementation as this will harm the ability of firms and National Competent Authorities ("NCAs") to achieve proportionate outcomes with regards to outsourcing oversight. We believe the guidelines must be flexible and principles-based to allow individual firms to design risk mitigation processes specific to their operations; yet, the guidelines must also be sufficiently detailed to prevent disparate application by NCAs. Absent this balance, enforcement of the guidelines could interfere with efficient market mechanics and harm competition and innovation while creating an insular Europe, not a dynamic Capital Markets Union fit for global competition. Below are recommendations for the proposed guidelines that we believe will help strike this important balance.

Definition of "Critical or Important Function"

Differentiating between critical or important functions and non-critical or less important functions is helpful to the overall objective of taking into account the risk underlying the outsourcing of the functions in question; however, we believe a more specific definition of "critical or important functions" may be necessary to prevent inconsistent application of the guidelines by NCAs. In particular, the concept of what is "Important" can be subjective and imply a range of materiality thresholds. Thus, we believe the guidelines would be well-served by more detailed information in this area. In fact, we

¹ The European Securities and Markets Authority. "Draft Guidelines on Outsourcing to Cloud Service Providers." Esma.europa.eu. March 2020. <https://www.esma.europa.eu/press-news/consultations/draft-guidelines-outsourcing-cloud-service-providers>.

recommend referencing definitions in existing legislation and more detailed guidance² to the greatest extent possible as it will provide important context for criticality determinations and lead to greater certainty for firms and more consistent NCA oversight.

Guideline 2. Pre-outsourcing analysis and due diligence

Paragraph 33(a)(vi) requires regulated entities to assess the “political stability, the security situation and the legal system, in particular the law, including insolvency law and enforcement as well as the requirements concerning the confidentiality of the firm’s business related and/or personal data.” We believe that this requirement is overly broad and potentially disproportionate to the value and criticality of the outsourcing. Many aspects of such an assessment would also be highly subjective. We recommend that this requirement be reduced in scope or more well-defined. For example, paragraph 33 (a)(vi) could be amended to simply require that firms assess the enforceability of any CSP arrangement.

Paragraph 33(a)(vii) requires regulated entities to assess all relevant risks related to, among other things, “possible concentration within the firm ... caused by multiple cloud outsourcing arrangements with the same CSP as well as possible concentration within the sector, caused by multiple firms making use of the same CSP or a small group of CSPs.” We have a number concerns.

- Risks arising from the concentration of supply of services by one CSP within a specific sector would have to be evaluated by National Competent Authorities (“NCAs”). Individual firms cannot access the sort of data necessary to make an evaluation. That said, it is unclear what criteria would be applied by an NCA and what the relationship would be between regulations related to concentration risk and the competition law of each Member State. EU-level guidelines may be inappropriate for such complex matters.
- It is important that firms are generally permitted to use the same CSP across many affiliates. Once a firm has identified a preferred supplier, it seeks to maximize the advantages of using that supplier by consolidating services across affiliates where feasible. Doing so results in large scale operational and cost efficiencies. Using non-preferred suppliers to avoid a potential concentration risk is not, in our opinion, a better outcome.
- It may be difficult, in general, for regulated entities to select qualified CSPs and still comply with this aspect of Guideline 2. The reality is that, independent of any plans made by a regulated entity, there are simply few qualified CSPs, and regulated entities may not be able to fulfill their responsibilities while outsourcing to untested and potentially unqualified CSPs. Individual firms should not be required to outsource to less qualified CSPs simply because firms in the same sector are outsourcing to the same, more qualified CSPs.

Cboe believes that Guideline 2 should be amended, so that firms are not required to assess concentration risk. Instead, firms should be required to assess the substitutability of a CSP and, if necessary, to participate in periodic benchmarking or formal RFI processes.

Guideline 3. Contractual requirements

According to the proposed guidelines, any arrangement with a CSP that is entered into, renewed or amended on or after June 30, 2021 is expected to be in compliance with the guidelines, and firms are

² See e.g., European Banking Authority, *Final Report on the Guidelines on Outsourcing*, February 2019, available at, <https://eba.europa.eu/sites/default/documents/files/documents/10180/2551996/38c80601-f5d7-4855-8ba3-702423665479/EBA%20revised%20Guidelines%20on%20outsourcing%20arrangements.pdf>.

expected to review and, if necessary, to amend arrangements not in compliance with the guidelines by December 31, 2022. There are in fact a number of contractual provisions that may be beneficial to include in CSP outsourcing arrangements, such as, for example, clauses requiring CSP cooperation when the CSPs customer firm is satisfying regulatory obligations or requiring CSPs to have conflict management processes in place, especially as it relates to prioritizing customer requests. However, the ability of a firm to secure contractual rights will be largely dependent on the specific CSP and the relative negotiating position of the firm. In light of these potential limitations it may not be appropriate for the guidelines to mandate such clauses on customer firms. We instead recommend ESMA, and the European Supervisory Authorities (“ESAs”) as whole, consider publishing Standard Model Clauses that can be voluntarily adopted by providers and firms to bring an additional measure of consistency and harmonization to the implementation of the proposed guidelines on contractual requirements. Beyond Standard Model Clauses we also recommend ESAs explore whether access to certain cloud services should be provided on a fair, reasonable, and non-discriminatory basis.

Paragraph 41(f) requires regulated entities to include a contractual provision on the locations where data may be stored and processed. While it is certainly desirable for a firm to stipulate that data only be stored and processed in certain places, we are concerned that an individual firm will not be able to require that a CSP remain in specific countries. Since the entities regulated by ESMA are not the only customers of CSPs, CSPs may simply refuse service. We recommend that Guideline 3 be amended, such that firms may comply with the guidelines while outsourcing to large, well established CSPs. Instead of mandating a provision on the location of data facilities, ESMA could simply require that firms are prepared for an unforeseen relocation.

Guideline 5. Exit strategies

Paragraph 44(a) suggests that a regulated entity should “test” their exit strategy, using a risk-based approach. It is important that regulated entities are not required to transition outsourced activities to another CSP as part of a test as this would be unduly burdensome, prohibitively costly, and may interfere with the responsibilities of a regulated entity.

Outsourcing to Affiliates

The proposed guidelines do not appear to make any distinction between outsourcing arrangements with affiliates and outsourcing arrangements with non-affiliates. In contrast, IOSCO’s proposed principles on outsourcing recognize that, when outsourcing to affiliates, “the risks may ... not be as pronounced.”³ We strongly agree with this assessment. Outsourcing between affiliates requires different analysis and will often lead to risk mitigation processes that differ from those applicable to non-affiliates. For example, mandating a complex system of contracts between affiliates would be unnecessary, ineffective, and costly where risks are mitigated through other means. IOSCO recommends that, “while the Principles on Outsourcing should be applied to affiliated entities where relevant, it may also be appropriate to assess and apply them with some modification.”⁴ Specifically, the application of outsourcing principles should account for the “control structures and arrangements” currently in place.⁵ We recommend that ESMA adopt similar language. While we understand this recommendation may be more relevant for general outsourcing guidelines, as opposed to CSP specific guidelines, we believe it is important for all outsourcing guidelines to explicitly recognize that affiliate

³ The Board of the International Organization of Securities Commissions, *Principles on Outsourcing*, May 2020, available at, <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD654.pdf>.

⁴ *Ibid.*

⁵ *Ibid.*

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relationships may lead to less pronounced outsourcing risks and should be accounted for accordingly. This will help prevent rote application of guidelines to affiliate outsourcing relationships, where such application would be unnecessary and unduly burdensome.

Cboe Europe greatly appreciates the opportunity to provide comments on the proposed guidelines and encourages ESMA to consider the recommendations herein. We believe these recommendations, if adopted, will help ensure firms and NCAs achieve proportionate outcomes with regards to outsourcing oversight.

Sincerely,

A handwritten signature in black ink, appearing to read "D. Howson".

David Howson
President
Cboe Europe