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P 138 - Consultation on Cross-Industry Guidance on Outsourcing

Supervisory Risk Division

Central Bank of Ireland

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by e-mail to outsourcingfeedback@centralbank.ie

Date: deadline 26 July 2021

Dear sir/madam,

Thank you for the opportunity to engage with you on the topic of Cross-Industry Guidance on Outsourcing through your recent Consultation Paper 138 ('the CP').

Financial Services Ireland (FSI) represents c.150 companies across all sectors of financial services, including banking, insurance, funds and asset management, payments, and leasing. Our objective is to become a global top 20 financial centre by 2025, by ensuring Ireland is the strongest business environment and best location to tackle future challenges for the financial services sector. As the third largest exporter of financial services in Europe, our position is dependent on a robust regulatory system that provides a stable environment for local and global businesses, who in turn uphold high standards of governance, compliance, and risk management.

Having consulted with our members, we are pleased to set out our view on the proposals on this important topic.

General Comments:

1. Most of what is being set out in the Guidelines is familiar to certain sectors, such as controls over appointment of OSPs (outsourcing policy; due diligence; risk appetite etc); contractual terms; pre—notification to the Central Bank when outsourcing of critical and important functions.

   However, some additions may have some serious impacts, such as:
   a. The guidance should recognise that there are differences between the sectors, and the proportionality principle should be applied to take these into account.
   b. the application of the requirements in the Funds Industry to;
      (i) Fund Manager appointment of a Fund Administrator/Registrar, in particular with regard to concentration risk; exit strategies; and sub-outsourcing
      (ii) Fund Manager engagement of Depositary - clarity is needed that that is not outsourcing
      (iii) Fund Administrator outsourcing/offshoring, which is already governed by the Central Bank Investment Firms Regulations

(iv) Fund Manager appointing Investment Manager, which is already governed by UCITS/AIFMD and regulatory guidance
(v) Investment Manager appointing a sub-investment manager
(vi) Fund Manager appointing a Distributor
(vii) Self-managed funds
(viii) Third part ManCos, with multiple appointments of administrators and investment managers and distributors

c. MiFID application: If a MiFID asset manager has a global equity mandate and wants to hire, for example, a Japanese manager to manage the Asia/Pacific exposures, and it complies with the MiFID obligations, why would it have to meet a pre-notification (in reality a pre-approval process) that is not found in MiFID?
d. Timing: Is there a grandfathering for all outsourcing contracts currently in place? It would be a challenge to ensure that all current contracts have to be amended to fit the new Guidance.

2. Other practical issues include:
    a. examples of the main "critical and important" outsourcings that the different sectors see regularly would be valuable
    b. where the OSP or sub-OSP is a regulated entity, does the Central Bank expect to be able to go to its home state to carry out an inspection? Does it need to engage with the OSP's regulator first? What about EU competent authority rules?
    c. where current legal/regulatory requirements for a fund, for example, only allow the appointment of a single AIFM, a single Administrator or a single Depositary, concentration risk is embedded by the law – this should be recognised in the Guidance.
    d. will group co-ordination of outsourcing be allowed? If parent group applies European standards when outsourcing, why not have single outsourcing unit?
    e. for OSPs, why does the Guidance not allow for annual independent written evaluations to be provided which the clients of the OSP can rely on? We believe that this is the purpose of SOC 1, SOC2s etc. Having 100 clients of the same Fund Administrator repeat 100 sets of annual due diligence seems unnecessary.
    f. does the Guidance have any application to Irish branches of EU regulated firms?
    g. what Exit strategies does the Central Bank expect to deal with unplanned service failures?

Responses to specific questions:

1. Areas requiring more clarity:
    a. Definitions in relation to section 10.1, Notification & Reporting, would be helpful for:

        (i) In the event of Recovery and Resolution Processes, what the specific expectation is in relation to continuation/extension of existing outsourcing arrangements.

(ii) What constitutes a “material event” in relation to material events which affects the provision of critical or important services.
(iii) What constitutes a “material breach” of SLAs.

b. further detail on the expectation for the application of new requirements to existing outsourcing arrangements (contractual requirements, arrangements, due diligence etc) would be helpful.

2. Other topics to be covered:
   a. A common definition on outsourcing at EU level. If a firm is part of an EU wide group, we believe it is best that there be one set of clear rules to which all in the group are subject. This should be guided in the first instance by the ESAs. There are currently differences on definition and interpretation, and a classification of services that would generally be identified as outsourcing would be valuable.

3. Significant issues/unintended consequences:
   a. The outsourcing register requirements may pose a challenge due to the level of information that is required to be held in a single register. Guidance would be helpful on:
      (i) the minimum risk-based requirements that is expected to be held in a single register
      (ii) whether consolidated regulatory reporting can be considered an alternative option to evidence the oversight requirements

   b. More clarity/guidance is required in relation to:
      (i) what requirements need to be considered mandatory regulatory expectations or non-compliance with which would be considered a breach of regulation
      (ii) what requirements can be considered subjective with room for interpretation and flexibility based on the nature of the arrangement
      (iii) what requirements can be considered good practise
   c. The addition of a page for each section on the ‘minimum supervisory expectations’ from the regulator for the Sections 1-10 would be helpful

4. Aspects of the Guidance at odds with existing requirements that could lead to misinterpretation:
   a. How does the Guidance interact with/overlap/exceed current sectoral regulatory requirements? How does each sector know exactly what it has to follow? This is relevant given that the Guidance covers all sectors of financial services. For example, which pre-notification rules apply – these new ones or the processes already in place for the different sectors? How do requirements from different European Supervisory Authorities interact?
   b. 2015 EIOPA Guideline Clause 2.294 on intermediary activities (subject to IMD regulations): this appears to conflict with the view on outsourcing expressed in the Guidance on delegated arrangements. Should delegated arrangements be treated as outsourcing for compliance with Solvency II requirements?
   c. 2015 EIOPA Guideline Clause 2.298 on intra-entity outsourcing: “*where the service provider is a legal entity from the same group as the outsourcing undertaking, the examination of the service provider may be less detailed*

provided that, on one hand, the undertaking's AMSB has greater familiarity with the service provider and, on the other hand, the undertaking has sufficient control over, or can influence the actions of the service provider." This appears to conflict with the guidance that Intra-Group arrangements require the same rigorous assessment as third-party outsourcing arrangements.

If you have any questions or would like more detail, please feel free to contact me.

Yours faithfully

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Paul Sweetman

FSI Director