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Submitted via email to: [outsourcingfeedback@centralbank.ie](mailto:outsourcingfeedback@centralbank.ie)

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Dear Sirs,

**AIMA Response to the Central Bank of Ireland's discussion paper 8 entitled "Outsourcing – Findings and Issues for Discussion"**

The Alternative Investment Management Association Limited (AIMA)<sup>1</sup> appreciates the opportunity to provide feedback in response to the questions posed in the Central Bank of Ireland's discussion paper 8 entitled "Outsourcing – Findings and Issues for Discussion" and dated November 2018 (the 'discussion paper').

An increasing number of AIMA members are becoming subject to the Central Bank's outsourcing requirements either directly because they are entities regulated by the Central Bank or indirectly because they are acting as outsourced service providers to those regulated entities. As a result, members have reviewed the discussion paper with interest.

The continued ability to outsource is important to our members. Given the relatively small size of most of our member firms, compared for example to a bank or insurance company, the best way to access technologically sophisticated and cost effective support is often to find high quality external service providers. These external service providers have expertise and scale to manage complex technology and train and retain staff with specialised expertise. Many investors request or require that firms use third party administration service providers to ensure there is a separate set of eyes on the asset valuations, fund redemption and other key operational processes. In addition, both the AIFMD and the UCITS Directive require firms to use outsourced service

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<sup>1</sup> AIMA the Alternative Investment Management Association, is the global representative of the alternative investment industry, with around 2,000 corporate members in over 60 countries. AIMA works closely with its members to provide leadership in industry initiatives such as advocacy, policy and regulatory engagement, educational programmes, and sound practice guides. Providing an extensive global network for its members, AIMA's primary membership is drawn from the alternative investment industry whose managers pursue a wide range of sophisticated asset management strategies. AIMA's manager members collectively manage more than \$2 trillion in assets.

providers ('OSPs') as depositaries and custodians. We acknowledge that outsourcing can create additional risks that need to be identified, managed and mitigated where they cannot be avoided, but prescriptive risk management requirements around outsourcing should be imposed with care so they do not stifle outsourcing unnecessarily.

The concept of outsourcing and the practical operational aspects of beginning, managing, monitoring and exiting outsourcing arrangements are receiving considerable attention currently at the level of the European Supervisory Authorities, including most recently by the European Banking Authority (EBA), and at the level of several EU member state competent authorities. Outsourcing has also been a particular area of attention in other countries such as Singapore, which has in place some of the most prescriptive requirements for outsourcing arrangements.

As a result of this interest from regulators, the operational risks for individual firms and the reputational risks to firms and the industry as a whole if outsourcing arrangements fail, AIMA will be publishing its own Guide to Sound Practices for Outsourcing by Investment Managers and a related Illustrative Questionnaire for the Due Diligence of Outsource Service Providers in early February. Work on this guide started months before the discussion paper was released, but the ongoing work on the guide made the discussion paper particularly timely for members. We hope that the publication of this guide will encourage our members to take a fresh look at their own outsourcing programmes.

While much of the information in the discussion paper was not a surprise, members did have some comments in a few areas:

1. With respect to ensuring that regulated entities have sufficient knowledge/expertise within their own organisation to effectively challenge and gain assurance that their data is being managed securely by OSPs, we believe that firms ought to be permitted to participate in pooled audits of OSPs and should be able to place reasonable reliance on the reports generated by the expert who undertakes the pooled audit. This will help firms to pool their knowledge and resources.
2. With respect to how systemic concentration risk related to outsourcing can be effectively monitored and managed by both regulated firms, we would note that concentration risk is not transparent, and firms are not well-positioned to measure this risk across OSPs. We would suggest that regulators are best placed to obtain the necessary information from local regulated entities. In any event, we believe that the Central Bank should not place specific obligations in respect of concentration risk on Irish firms that go beyond any relevant requirements finally adopted by the EBA.
3. With respect to the management of risks related to chain outsourcing, our members would appreciate clarification that if a group's parent entity is subject to either the Central Bank's outsourcing requirements or the outsourcing requirements applicable under the requirements of another EU national competent authority, the fact that the parent company's national competent authority is satisfied with a group level outsourcing should count toward the assessment of such outsourcing being reasonable at the level of Irish subsidiaries.

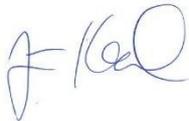
In addition to responding to some the questions posed by the Central Bank in the Annex, we wanted to express a couple of overarching concerns with the discussion paper's approach.

In a number of places in the discussion paper, the Central Bank cites to the draft guidelines from the EBA that were published in June and which are still under review in light of public comments. We believe that the Central Bank may be premature in adopting those *draft* requirements as requirements for Irish regulated entities and runs the risk of inadvertently gold plating the eventual EBA guidelines as a result, which we would view as unfortunate. Firms will have more success inducing OSPs to agree to the terms required if firms are governed by the same requirements. We would also urge the Central Bank not to gold plate the final EBA requirements either, as to do so may make compliance more difficult for Irish regulated entities.

In at least one of the places where the draft EBA guidelines are cited (e.g., see text at footnote 34 of the discussion paper), the Central Bank notes that it has observed instances where the quoted requirements of the draft guidelines were not met. We respectfully suggest that the Central Bank should not expect firms to be complying with requirements that are not yet in effect or with requirements that do not apply to the particular type of regulated entity (i.e., the EBA requirements do not apply to management companies under AIFMD or the UCITS Directive) unless those requirements have been incorporated directly into Irish regulations.

We would be happy to elaborate further on any of the points raised in this letter. For further information please contact Jennifer Wood, Global Head of Asset Management Regulation & Sound Practices ([jwood@aima.org](mailto:jwood@aima.org)).

Yours sincerely,



Jiří Król

Deputy CEO  
Global Head of Government Affairs

## ANNEX

There are a number of specific questions posed in the discussion paper. We have included the answers to some of these below listed in the order the questions appeared in the discussion paper. Where we had no comments on a particular question, we have omitted that question from the list below for brevity.

### ***Sensitive Data***

**How are regulated firms ensuring that they have sufficient knowledge/expertise within their own organisation to effectively challenge and gain assurance that their data is being managed securely by OSPs, including CSPs (how and where it is being stored, processed, used, located etc.)?**

Regulated firms should be permitted to participate in pooled audits of OSPs and should be able to place reasonable reliance on the reports generated by the expert that undertakes the pooled audit. The pooling of resources among similarly situated firms would allow those firms to have greater leverage to get the access and answers needed to make the required risk assessment and provide the potential leverage to induce vendors to make changes to bring them in line with required data management standards.

**What issues/challenges are regulated firms encountering in gaining assurance that their sensitive business and customer data is being managed securely in outsourcing scenarios?**

Our members report that gaining assurance about the security of their sensitive business and customer data is more difficult where the OSP is large and the regulated entity is individually relatively unimportant to the OSP's business.

### ***Concentration Risk***

**How are regulated firms seeking to reduce their exposure to concentration risk both from the perspective of providers and geographical locations?**

Regulated firms seek to reduce their concentration risk exposure through contingency planning.

**Do regulated firms have views, as to how systemic concentration risk related to outsourcing, can be effectively monitored and managed by both regulated firms in all sectors and the Central Bank?**

Concentration risk is not transparent and firms are not well-positioned to measure this risk across OSPs. Although firms may ask OSPs about their clients, the level of detail the OSPs are willing to provide is not often sufficient for the regulated firms to make any truly informed conclusions about systemic risks that may exist. Indeed OSPs may not even know with any accuracy how much of a market share they have given that there is no single source of reliable data on market size.

We would suggest that regulators are best placed to obtain the necessary information from local regulated entities. If such information were to be collected by regulators, it should be made available at least on a headline basis to regulated firms if they are to be required to avoid this risk rather and acknowledging that it exists and managing the arrangement in light of that risk.

In any event, we would request, however, that the Central Bank avoid placing specific obligations in respect of concentration risk on Irish firms that go beyond any relevant requirements finally

adopted by the EBA. Concentration risk limits would be difficult to operationalise and may ultimately limit a regulated firm from choosing the OSP best suited to provide the applicable services.

### ***Offshoring and Chain Outsourcing***

#### **What steps are regulated firms taking to ensure they have full sight of any chain outsourcing which may be occurring within their outsourcing arrangements and how are they managing risks associated with this?**

With regard to chain outsourcing, members would find it helpful for there to be a clarification that any chain outsourcing requirements will only apply with respect to critical/important or material/significant arrangements, e.g., the outsourcing entity would not have to audit who performs basic building maintenance.

Our members would appreciate clarification that if a group's parent entity is subject to either the Central Bank's outsourcing requirements or the outsourcing requirements applicable under the requirements of another EU national competent authority, the fact that the parent company's national competent authority is satisfied with a group level outsourcing should count toward the assessment of such outsourcing being reasonable at the level of Irish subsidiaries.

#### **How are firms ensuring that contractual rights of access are the same with all parties to a chain-outsourcing arrangement, as those granted by the primary third party OSP?**

Assuring that there is access to business premises can be a challenge for firms, especially where the regulated entity will be a relatively small client to the OSP (e.g., cloud services). As we have explained to the EBA, in response to its recent outsourcing consultations, requiring physical access to where data is stored may make it impossible for asset management firms to use public cloud services. We therefore consider that data centres should be specifically carved out of the references to business premises and/or operations centers in the right of access requirements or the right of physical access to data centres should be substituted for a right of access to the relevant systems information. In other words, seeing racks of blinking lights is of little use but being able to see infrastructure diagrams and setup might be useful. Increasingly physical infrastructure is being replaced with Software-defined Infrastructure so there is nothing to actually see – or it could be split over multiple locations on shared physical infrastructure. It would be helpful if the requirements for the right of access to information for the supervising authority was clarified to mean the access would be sought via the outsourcing entity, i.e., the Central Bank requests the information from the outsourcing institution who must have the access and pass the information on, rather than direct access to systems of the OSP.

### ***Substitutability***

#### **What are the risks/challenges where there is no substitutability or it is not possible to bring the service back in house? How are these being addressed?**

In these scenarios, the risk would be that the firm would not be able to continue in business if the service could not be brought back in house or a suitable replacement OSP could not be identified.