Central Bank of Ireland Outsourcing Conference: 30 April 2019

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Good Morning Ladies and Gentleman,

It is for me a great pleasure to start this conference that focusses on outsourcing. This topic has received over time more and more interest from both supervisors and the industry alike.

It is important that banks have robust governance arrangements in place, including for their outsourcing arrangements and the management of related operational and reputational risks. It is key that institutions keep all their risks under control, even if the underlying activities are outsourced.

Before I present the EBA's policy work in this area and in particular the key aspects of the recently published EBA guidelines on outsourcing arrangements, I would like to share with you our thoughts on the use of outsourcing by banks in a broader context.

Over the last decades, banking has changed significantly in terms of products and technology used. Customer needs have changed in a globalised world that uses modern information and communication technologies. Consequently banks are offering more and more sophisticated services to the economy making use of many technological advances.

In a competitive and fast changing environment banks must adapt their business models, including the technological infrastructures used to perform their business. In particular, competition from FinTech firms forces banks to continuously invest in new and more consumer friendly technologies. For example todays distribution channels need to provide the flexibility consumers demand and we consequently see an increased use of online and mobile banking solutions. Changes are also triggered as the traditional banking business model and banks profitability are put under pressure by the low interest rate environment. For all those reasons, banks have become increasingly interested in outsourcing business activities, processes or functions to have easy access to new technologies, create a more efficient business model and finally to improve their cost to income ratio.

In this era of digitalisation, globalisation and growing importance of new financial technologies, banks use these technologies to create additional value by optimising their infrastructure, the customer experience and by offering new services. To give you some evidence, the EBA risk assessment report of December 2018 shows that EU banks are gradually adopting new financial technologies, with biometrics, digital/mobile wallets and big data analytics being the most named new technologies, closely followed by cloud computing. The report shows indeed that more than 50 % of the interviewed institutions[1] had already adopted cloud solutions for some parts of their business activities. A further 30 % of the institutions conducted pilot tests or planned to introduce such solutions. Only less than 10 % had no plans for the adoption of cloud services[2].

[1] Sample of 187 banks from 25 EEA countries (150 banks at the highest level of the EU of consolidation)

[2] EBA risk assessment report 2018: https://eba.europa.eu/documents/10180/2518651/Risk_Assessment_Report_December_2018.pdf

The desire of banks to use cloud computing was also a main driver for the development of the EBA Recommendations on outsourcing to cloud service providers. The recommendations aimed at overcoming the high level of uncertainty about the supervisory expectations regarding such outsourcing arrangements and removing the obstacles that this uncertainty caused to the institutions wanting to use cloud services. The recommendations were incorporated into the new EBA guidelines on outsourcing arrangements that apply not only to banks, but also to investment firms and payment institutions. The recommendations will be repealed when the Guidelines enter into force on 30 September 2019.

Outsourcing changes the complexity of banks' organisation and the risk profile. It is important that the public can continue to trust the proper conduct of business by banks and that outsourcing is performed in a safe and controlled way.

While there are clear benefits of outsourcing in terms of flexibility, scalability and enabling innovation by reducing "time to market", we consider that the outsourcing of important or critical functions creates specific risks for banks and must therefore remain subject to appropriate oversight. It is of paramount importance that banks and supervisors alike are aware that receiving services - including IT services - from third parties creates specific risks, while it may at the same time reduce other risks. This is not limited to outsourcing arrangements, but true also for other services received from third parties. Such risks might change over time with the volume of the services received or other changes. Therefore it is important that banks assess before they outsource functions and also on an ongoing basis, the risks stemming from those arrangements.

The EBA guidelines on outsourcing arrangements, that have been published in February 2019, provide for a clear framework that ensures that outsourcing arrangements and the related risks are managed well. As part of the single rulebook the guidelines create a level playing field for different types of financial institutions (investment firms/banks /payment institutions and electronic money institutions) and cross-sectoral consistency.

The Guidelines cover the whole outsourcing process from the initial risk analysis, when entering into an outsourcing contract, to the exit strategies from existing arrangements. Banks must not only assess the risks of outsourcing a function, but also perform due diligence processes that include analysing the ability of the service provider to perform the outsourced function.

The guidelines embrace the principle of proportionality and follow a risk based approach. Outsourcing of critical and important functions has a higher impact on banks' risk profiles or may, if the service is performed inappropriately, lead to severe business disruptions, material financial losses and breaches of regulatory requirements. Due to this, stricter requirements, for example regarding the need to agree audit rights with the service provider and more extensive documentation requirements, are included in the guidelines for such outsourcing arrangements.

Moreover, we see that more and more banks use the same service providers or a limited set of service providers to gain access to new technologies like cloud outsourcing or other FinTech solutions. While those technologies may lead to more efficient processes, such developments can also lead to risk concentrations at certain infrastructures that could become critical for the functioning and stability of the financial market. By requiring a register of all outsourcing arrangements, our work establishes the means for supervisors to monitor such risk concentrations. The register will be useful for both, micro and macro prudential supervision.

The Guidelines take into account specific aspects of intragroup outsourcing and the use of common service providers by saving and cooperative banks. Within a banking group and institutional protection schemes, potential synergies are recognised. Moreover, the guidelines take into account the fact that institutions may have a higher level of control over such service providers. Therefore, banks may rely to some extent on centralised outsourcing processes. However, banks are in general still subject on an individual basis to regulatory requirements and must have enough insight in all outsourcing arrangements to take well informed decisions and manage all their risks.

The application of the proportionality principle within the guidelines also ensures that the implementation costs for banks are kept low. For example the documentation requirements differ depending on the riskiness of an outsourcing arrangement.

Finally, I would like to stress that the EBA's outsourcing guidelines should be seen as an important piece of a broader regulatory framework that is being developed by the EBA. In our view it is of utmost importance to address the technological changes in the regulatory framework. The EBA is therefore also working on ICT risks, operational resilience and other topics identified within the Fintech roadmap.

With the increasing use of IT, banks and their services providers are exposed to the risk of cyber-attacks, which can affect their operational continuity, data security and data protection. Risk concentrations pose an additional level of risk, in particular with regard to cloud services and other critical IT service providers, with only a few dominant existing cloud services providers that are located mainly outside the EU. To address all those risks, the ESAs have published a Joint Advice addressed to the EU Commission regarding potential legislative improvements where it is proposed that the EU Commission considers the establishment of an appropriate oversight framework for monitoring critical service providers when their activities may impact relevant supervised entities.

Thank you very much for your attention.