

**Comments on the "Consultation Paper on High Level Principles on Outsourcing" (CP02) prepared by the Committee of European Banking Supervisors (CEBS)**

**I. General remarks**

1. Bank Austria Creditanstalt AG (BA-CA AG) welcomes the opportunity to comment on the proposed High Level Principles concerning outsourcing.
2. BA-CA AG also welcomes the classification of activities as follows:
  - a) strategic or "core" activities which cannot be outsourced,
  - b) non-strategic but material activities, which should be pre-notified to the supervisory authority,
  - c) non-strategic and non-material activities, which do not have to be pre-notified to the supervisory authority.
3. The definition of outsourcing versus purchasing should be subjected to a thorough analysis, especially with regard to advisory services and tailor-made solutions such as data processing applications (see definition of purchasing).
4. From BA-CA AG's point of view – as mentioned in the accompanying letter – a more detailed classification and definition of the terms "core activity" and "materiality" would be desirable.
5. A central issue involved in outsourcing will be the extent to which cooperation and coordination with national supervisory authorities are ensured in the case of cross-border outsourcing. For example, if the national supervisory authority distinguishes between important and unimportant functions (a distinction that has supervisory implications), different interpretations may make cross-border solutions more difficult or even impossible. Or the supervision of companies which are outsourcing service providers but have their registered office in a different member state.
6. Therefore there is a need for an exact definition of strategic, material and non-strategic, non-material activities, as well as for significant coherence in the interpretation by supervisory authorities. We have to be aware of the fact that this will focus further

attention on discussions concerning transnational organisational arrangements of supervisory authorities (e.g. lead supervision).

7. The question of outsourcing is currently being discussed for credit institutions (and groups of credit institutions) in both CEBS and CEPR. Here, too, coherence in principles should be established to avoid a situation in which universal banks become entangled in different legal regulations.

## **II. Core functions**

In line with the CP02 of CEBS, BA-CA AG regards the risk management of credit institutions as a core function. Therefore each credit institution must continue to be responsible for risk management and cannot outsource this function.

The CP02 does not contain a definition of risk management. In this context, BA-CA AG is largely guided by the Brussels draft of the directive<sup>1</sup> and would regard an analogous definition by CEBS as useful.

As set out in the CP02 of CEBS, only non-core functions may be outsourced by banks on a group-wide basis.

Based on this principle, BA-CA AG thinks that outsourcing is possible for the purpose of data pooling and the development of rating models, but the actual customer rating process cannot be outsourced.

This position is also supported by the requirement stipulating that responsibility for the outsourced function must be retained by the outsourcing institution. This requirement would not be met in the case of complete outsourcing of the rating process.

BA-CA AG welcomes the two conditions to be met for "intra-group outsourcing", namely that the outsourcing institution

1. must be able to demonstrate that it can manage the risk and
2. must be a member of a group which is subject to supervision on a consolidated basis.

BA-CA AG thinks that cross-institution outsourcing (outside a group of credit institutions), e.g. outsourcing the entire risk management function, would lead to a market distortion.

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<sup>1</sup> Review of Capital Requirements for Banks and Investment Firms, Commission Services Third Consultation Paper, Working Document.

This means that, from BA-CA AG's point of view, outsourcing is only possible within a group of credit institutions – e.g. in the form of competence centres where specific entities perform specific risk management tasks for the entire group of credit institutions – but not across groups of credit institutions.

In the context of outsourcing "non-material activities", the concept of materiality – as mentioned above – should be defined very strictly to avoid any effects on internal control.

### **III. Other points in detail:**

Page 2: "The paper's primary focus is on financial institutions' own risk management in the area of outsourcing ..."

First of all, risk management should be defined. We propose the definition contained in the EU CP3 dated 1 July 2003.

As mentioned above, we welcome the intention to create special rules.

Page 5: "... group-wide risk management refers to non-core functions ..."

Risk management is defined as a "core management function" which cannot be outsourced, In the context of banking groups, the question arises of how to define the difference between core and non-core functions within risk management. We view outsourcing in the sense of data pooling and the development of rating models as non-core, while the qualitative customer rating process is a core activity. Moreover, the performance by a specific unit of specific risk management tasks for the entire Group would be a non-core function.

Page 5: "... risk-management function on a solo basis ..."

In this context, both the solo basis and the sub-consolidated level should be taken into account.

Page 5: "In the case of outsourcing of non-core functions, domestic supervisory authorities, i.e. the host country, should also be involved in the decision to allow outsourcing, when needed."

It is not easy to see why the supervisory authorities should be involved in the decision to outsource a non-core function. Furthermore, the meaning of "when needed" is unclear.

Page 6: "Outsourcing institutions should be aware that the supervisory authority may distinguish between important and less important activities, and may impose certain conditions on institutions that outsource important activities"

In its current form, the paper does not contain any examples illustrating the meaning of "important". To establish certainty as to the substance of the rule, and to ensure a level playing field, a comprehensive catalogue should be prepared. As to the remaining cases, at least a common methodology should be developed: the section entitled "Further work" (page 2) refers to a – yet to be developed – "concept of a materiality test" ("some jurisdictions operate a scoring system to assess materiality").

Pages 8 and 9: Contingency plans and exit strategies

It should be noted that in the case of intra-group outsourcing, the dimensions of this problem differ from those in the case of external outsourcing.

Page 10: "When drafting the contract the outsourcing institution should bear in mind that the level of... should be proportionate to the risks involved and the size and complexity of the outsourced activity."

In this context, too, one should differentiate between intra-group outsourcing and external outsourcing.

Page 10: "... to give effective rights of access to information to the supervisory authority. This may require obtaining consents from affected parties such as the parent company and relevant home supervisory authorities"

If this means that intra-group outsourcing could require consent from the parent company or its supervisory authorities, this should be explained in more detail and reasons for it should be stated.