

**ABN AMRO RESPONSE ON CEBS CONSULTATION PAPER ON
HIGH LEVEL PRINCIPLES ON OUTSOURCING****I. Introduction**

ABN AMRO welcomes the opportunity to comment on CEBS' consultation on the High Level Principles (HLPs) on outsourcing. We believe that this initiative to work on further convergence on supervisory practices in relation to outsourcing represents an important step forward to promote the necessary convergence of supervisors' practices at EU level. Outsourcing is becoming a key component of financial institutions' business.

These HLPs on outsourcing should also serve as a basis for any international regulatory definition of outsourcing and commonly accepted principles at global level. International co-operation on practices between supervisors is of the utmost importance to ensure consistency in the supervisory treatment of any EU company operating globally.

II. General Comments

ABN AMRO would like to give the following general comments, before detailing the proposed HLPs set out by CEBS.

2.1 Three-tier classification

CEBS is proposing a three-tier classification of activities:

- strategic or core activities which cannot be outsourced;
- non-strategic but material activities, which should be pre-notified to the supervisory authority;
- non-strategic and non-material activities, which do not have to be pre-notified but for which the institution must remain responsible for ensuring any supervisory guidelines are still met.

CEBS acknowledges that further work should be done in developing more guidance on what (i) may be regarded as strategic or core activities and (ii) on the concept of a materiality test.

ABN AMRO would indeed like to see "strategic/core activities" and "materiality" better defined and would suggest the following comments:

- There should be no reference to a list of specific strategic functions (for instance it is generally accepted by a number of supervisors that functions such as Risk Management, Compliance, Internal Audit should never be outsourced) but instead CEBS should include reference to principles of evaluating 'strategic/significant or core functions'.
- Instead of limiting the outsourcing possibilities, CEBS should focus on the process of outsourcing, because ultimately management is always responsible and whether activities are outsourced is not the issue. An institution can never outsource accountability for service delivery, but instead may outsource responsibility. In turn, management should then appraise the risk of changing services delivery models in the context of the nature of the service under review.
- A clear distinction between "management of the activity" and the activity itself should be made. The language "Strategic and core management responsibilities and functions can not be outsourced" leaves confusion. Is it about the activity, or managing the activity, or either, or both? As said above, accountability can never be outsourced, activities can/might be.

2.2 Scope of the consultation paper

The paper's primary focus is on financial institutions' own risk management in the area of outsourcing, but there is little emphasis on supervisory measures. On supervision, we would like to provide the following comments:

- **Co-operation with/between supervisors**

Outsourcing is a subject that gives rise to changes in the outsourcing institution's operational risk profile. We suggest that oversight, supervision or approval of outsourcing proposals and activities is solely a matter for the outsourcing institution's leading supervisor. Where the activity is material and is the responsibility of a locally-incorporated subsidiary, the (host) supervisor for the subsidiary should take account of the views of the lead supervisor of the group.

- **Intervention of the supervisor**

The paper does not address the circumstances under which the supervisor might intervene. We welcome this, and believe that the supervisor should only intervene through the outsourcer to secure adequate controls, as the contractual relationship and accountability sits with them. If there are insufficient controls or they are updated, then the organisation should work with the third party to understand the impact and change the control mechanism and contract as appropriate.

- **Rules should not be too detailed**

We support the High Level Principles-based approach adopted by CEBS, since we believe a rule-based approach with too many details would not be appropriate given the diversity of outsourcing activities. This can be achieved by a set of principles that are focused on the real material issues of outsourcing and are aligned with the responsibilities of respectively the supervisors and the financial institutions.

III. Details comments on HLPs

3.1 Part 1- Definition of outsourcing

We would suggest that when applying those HLPs, CEBS draws a clear distinction between outsourcing to a third party and intra-group (or in-house) as they carry different risk profiles. The regulatory demands should be lower for intra-group or in-house outsourcing, sometimes referred to as “offshoring”.

Ideally, the operational risks attached to outsourcing to a group company are minimised, as one would expect unhindered management control of the outsourced activities.

3.2 Part 2- HLPs on outsourcing addressed to institutions

HLP 1 - Strategic and core management responsibility and functions cannot be outsourced.

Before implementing the HLP1, supervisory authorities should make a clear distinction between “accountability” and “responsibility” in outsourcing: an institution can make a third party responsible for service delivery whilst retaining accountability within the organisation.

The HLP1 sets out as a principle that “core management functions” should not be outsourced. We believe that this notion of “core management” functions needs further clarification through referencing principles of evaluating ‘strategic/significant or core functions’ (see our general comments).

HLP 2 - The ultimate responsibility for proper management of the risks associated with outsourcing lies with an outsourcing institution’s senior executive management.

Under the HLP2, it is stated that outsourcing institutions should be encouraged to “retain adequate core competence at a senior operational level to enable them to have the capability to resume direct control over an outsourced activity, in extremis”. We believe that such a requirement will be difficult to comply with since it should be recognised that this core competence may not exist within the organisation and so recruitment or additional training would be required in this instance. This should therefore be addressed contractually with the service supplier.

HLP 3 - An outsourcing institution should take particular care when outsourcing material activities, i.e. activities of such importance that any weakness or failure in the provision of these activities could have a significant affect on its ability to meet its regulatory responsibilities and/or to continue in business. In such cases the outsourcing institution should pre-notify its supervisory authority.

Under the HLP3, it is mentioned that outsourcing institution should inform its supervisory authority on any “important activity” to be outsourced. We believe that what could be considered as “important activity” clearly needs a more precise definition. This broad term could provide the supervisory authorities with too powerful and arbitrary a tool if it is not better defined. We therefore think that the “materiality” concept should be used for this requirement rather than introduce additional terms such as “important activities”.

Furthermore, we would suggest not to include a formal notification obligation, but to indicate that the supervisor expects the outsourcing institution to notify as soon as possible in an appropriate manner of decisions and developments, or of disasters, which are of material concern. Indeed, we see no purpose in having a pre-notification obligation unless the supervisor wants to use it as a prior-approval for outsourcing, which does not seem to be CEBS’ intention.

HLP 4 - There should be no restrictions on the outsourcing of non-material activities of an outsourcing institution.

The HLP4 stipulates that “no requirements or conditions should be imposed on institutions that wish to outsource non-core activities that have little or no implications for internal control or key authorised functions”. By “non-core activities”, it is specified areas which do not potentially constitute “relevant risks”.

Again, we would like to see a focus on the process of outsourcing instead of restrictions in outsourcing possibilities.

HLP 5 - The outsourcing institution should have a policy on its approach to outsourcing, including contingency plans and exit strategies.

We do not have additional comments to the previous ones on the HLP5.

HLP 6 - An outsourcing institution's policies should require it to manage the risks associated with its outsourcing arrangements.

Complying with this principle includes notification to the supervisory authority of "all serious problems". We would want more details on what could be considered as a "serious problem" here, to ensure that institutions know exactly when communication with the supervisory authority is warranted/necessary.

Please see also our comment under HLP3 (we would suggest not to include a formal notification obligation).

HLP 7 - All outsourcing arrangements should be subject to a formal and comprehensive contract.

One of the requirements of the HLP7 is that "the outsourcing service provider's ability to meet performance requirements in both quantitative and qualitative terms should be assessable in advance". We believe that this can only be done on a best efforts basis through the 'due diligence' process.

It is also stated that the contract should consider "granting the outsourcing institution's internal auditing department and its external auditors full and unrestricted rights of inspection and auditing at all times". Again we think that practicalities drive this and appropriate wording should be included within the contract to cover audit rights. This requirement appears therefore to be unduly onerous, and the key element should be to ensure that sufficient access is granted.

Thus, we would suggest the following text: "*Provisions for the outsourcing institution and its supervisors to perform necessary audit activity must be included in the contract. Such provisions should provide the outsourcer and its supervisors with sufficient authority to obtain information about the outsourced activities from the Service Provider or from its external auditor and, if deemed necessary, to carry out an examination of the external Service Provider*".

HLP 8 - In managing its relationship with an outsourcing service provider an outsourcing institution should ensure that a service level agreement (SLA) is put in place.

We do not have specific comments on the HLP8.

3.3 Part 3- Other supervisory principles on outsourcing

HLP 9 - Supervisory authorities should aim to establish a right to information, and to conduct, or order, on-site inspections in an outsourcing service provider's premises.

One of the powers of the supervisory authority set out by the HLP9 is that "the supervisory authority should be able to cancel the outsourcing measure if the outsourcing institution cannot ensure the exercise or enforcement of the rights of supervisors". ABN AMRO believes that this statement can be problematic in some EU countries from a contractual perspective. Details on how this principle will be put into practice by supervisory authorities need to be clarified.

HLP 10 - Supervisory authorities should take account of concentration risk, where one outsourcing service provider provides outsourcing services to several authorised outsourcing institutions

We do not have specific comments on the HLP10.

HLP 11 - Supervisory authorities should take account of the risks associated with “chain” outsourcing (whereby the outsourcing service provider sub-contracts elements of the service to other providers).

We do not have specific comments on the HLP11.

Proposal for a new HLP in Part 3

We would like to propose an additional High Level Principle in Part 3 – “Other supervisory principles on outsourcing”:

HLP 12 - "Outsourcing arrangements should not give rise to a duplication by the outsourcing institution (= 'outsourcer') and the outsourcing service provider (= 'insourcer') of activities designed to meet the regulatory obligations of the outsourcing institution."

Where an institution outsources services and activities that are covered by the institution's authorisation to an outsourcing service provider that has authorisation comparable to that of the outsourcing institution, regulatory obligations relating to the services and activities are retained by the outsourcing institution, and do not need to be duplicated by the outsourcing service provider.

The monitoring of performance against those obligations can be carried out by the outsourcing service provider, as long as decisions are then made by the outsourcing institution. We have in mind particularly requirements such as “KYC” (“Know Your Customer”) obligations. If a bank provides payment services to a third party bank, this bank should be obliged to undertake KYC on their clients, and not the bank that provides payment services. It should remain the outsourcing institution's obligation to monitor for unusual transactions and freeze payments. The service provider can operate the monitoring process, but the decisions as to what activity is unusual, or what payments should be made or frozen, must remain with the outsourcing institution itself.

IV. Conclusion

To conclude, we would like to highlight further that ABN AMRO is supportive of CEBS' Principles-based approach, since we believe that it firstly allows for a more consistent approach of supervisors' practices at EU level, and secondly it gives the necessary flexibility to supervisors when considering outsourcing activities.

We therefore look forward for any further developments that CEBS will undertake on outsourcing, and welcome once more this consultation process on such an important issue for the industry.