



EUROPEAN SAVINGS BANKS GROUP
GROUPEMENT EUROPEEN DES CAISSES D'EPARGNE
EUROPÄISCHE SPARKASSENVEREINIGUNG

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European Savings Banks Group (ESBG)

Response to CEBS's Consultation Paper on High Level Principles on Outsourcing

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Profile European Savings Banks Group

The European Savings Banks Group (ESBG) represents 24 members from 24 European countries representing 968 individual savings banks with around 65,000 branches and nearly 757,000 employees. At the start of 2003, total assets reached almost EUR 4,355 billion, non-bank deposits were standing at over EUR 2,080 billion and non-bank loans at just under EUR 2,195 billion. Its members are retail banks that generally have a significant share in their national domestic banking markets and enjoy a common customer oriented savings banks tradition, acting in a socially responsible manner. Their market focus includes amongst others individuals, households, SMEs and local authorities.

Founded in 1963, the ESBG has established a reputation as the advocate of savings banks interests and an active promoter of business cooperation in Europe. Since 1994, the ESBG operates together with the World Savings Banks Institute (WSBI, with 109 member banks from 92 countries) under a common structure in Brussels.



GENERAL COMMENTS

The European Savings Banks Group (ESBG) welcomes the opportunity granted by the Committee of European Banking Supervisors (CEBS) to comment on its views regarding how convergence in supervisory approaches and practices can be increased. In this section, we would like to make some general comments on the approach followed by CEBS.

SCOPE OF THE GUIDELINES

We strongly believe that the definition of outsourcing, which directly determines the scope of application of the guidelines, should be clarified as follows:

- **Permanent transfer of activity:** As a general principle, only those activities which have been transferred to other bodies permanently or at least for a long term period should be considered outsourcing. In contrast, individual tasks/orders, i.e. the request to undertake a study in a specific area, should not be considered as outsourcing, as the application of the relevant guidelines would be out of proportion with the benefits which could be potentially achieved. Moreover it is feared that the application of the outsourcing guidelines on an individual transfer of activities would rather hamper the relevant activities.
- **Strong link between outsourced activity and banking activity:** The outsourced activity should be closely connected with the undertaking of banking or financial services activities.
- **Exemptions to be extended:** While it is clearly welcome that the proposed definition of outsourcing does not cover purchasing contracts, it is believed that this exemption is insufficient: In particular, the distinction between outsourcing and purchasing should be subject to a thorough analysis, especially with regard to advisory services and tailor-made solutions such as data processing applications. The example of individual data processing is a good one: Firstly, software development cannot be considered a core banking service and should on these grounds be excluded from the definition of outsourcing. Secondly, account should be taken of the fact that individual software solutions which have been developed specifically for individual credit institutions, do not necessarily carry a higher risk than standardised software. It is not relevant for the safety of a banking operation



whether standard or individual software is being used, rather that the software has been thoroughly tested before being used. Along the same lines, the definition of outsourcing should exclude activities such as leasing and renting/hiring agreements, which should accordingly not be covered by CEBS' framework.

- **Interim workers:** Finally, clarification is sought that interim workforces, that are fully integrated in the credit institution's daily operation do not qualify as outsourcing.

INTRA-GROUP/INTRA-COMPANY OUTSOURCING:

A lighter regime of outsourcing, i.e. a less stringent application of the outsourcing guidelines should be foreseen for cases in which functions or activities are outsourced to bodies within the European Union, which require for this activity or function their own banking licence or an equivalent authorization and are accordingly subject to supervision by their responsible authorities. Examples that could be given in this context are the provision of a contractual guarantee that the outsourced functions/activities are subject to the same standards as the outsourcing institution.

Moreover, the transfer of activities to intra-group or comparable subordinate bodies should not be considered as outsourcing according to the CEBS guidelines as long as the outsourcing body is supervised. Such an interpretation seems appropriate in view of the fact that the requirements of the CEBS guidelines are already met in these cases: The outsourcing service provider is fully subject to the instructions of the outsourcing institution. Against this background, there is no risk that the instruction and control possibilities of the management of an outsourcing institution are restricted/reduced to such an extent that correct implementations of the banking activities are no longer assured. In view of the increasing trend to intra-group transfer of activities, the interpretation of these activities as outsourcing would have little or no impact on reducing the risk but would place an onus on the outsourcing body in terms of cost and administrative burdens.

NECESSITY TO PROVIDE FLEXIBILITY

The ESBG welcomes CEBS' paper as an opportunity to increase convergence in the way outsourcing is regulated across the European Union. In this context, pan-European guidelines are very helpful. This being said, the ESBG is of the opinion that national supervisors – while



working towards a European level playing field - should retain flexibility in the way they apply the guidelines, taking account of the local specificities of their markets and of particular risk factors faced by local institutions. Therefore, national supervisors should be able to exempt concrete, individual cases from the application of the guidelines.

Certain business activities require a division of labour between different bodies. In cases in which third parties need to be brought in to carry through the activity in a comprehensive and economically sensible manner, or where a division of labour is indispensable on the basis of the structure of the activity or where it would facilitate intra-group co-operation, the formal application of the CEBS guidelines would not only lead to an increase of costs and of the administrative burden but would generally render things more complicated. At times, inter-linked processes might even need to be taken apart, without necessarily achieving material advantages. Against this background, we would propose to exclude the following business functions explicitly from the application of the CEBS guidelines:

- Clearing functions in the processing of payments and securities;
- The use of securities trading systems by credit institutions;
- Authorization centres for electronic cash transactions;
- central banking functions within one banking group;
- Integration of lead managers, arrangers or agents in the area of syndicated credit or similar areas.

Outsourcing is becoming increasingly important for credit institutions, for various reasons, such as the fact that institutions tend to focus more and more on their core activities, or the fact that some banking activities deliver low margins. Outsourcing appears an appropriate solution for banks in these particular cases. Nevertheless, the relevant framework needs to maintain sufficient flexibility, as otherwise institutions might become reluctant to outsource. In conclusion, the rules on outsourcing should not be mandatory, except when this proves absolutely necessary to both institutions and supervisors.



STRUCTURE OF THE GUIDELINES

The ESBG welcomes the structure proposed by CEBS, which differentiates between *core activities*, *material but non-strategic activities* and *non-material activities*. The ESBG nevertheless believes that the distinction between the three categories might be better made by adding examples of activities in each category.

COOPERATION WITH OTHER ORGANISATIONS

Finally, since the question of outsourcing is currently dealt with by different organisations (CEBS, CESR, IOSCO), we would like to stress the importance of ensuring a high level of consistency between the recommendations made by these bodies. This can only be achieved by liaising closely.

PARTICULAR COMMENTS ON THE PROPOSED HIGH LEVEL PRINCIPLES

COMMENTS TO PRINCIPLE I

The ESBG shares CEBS' view that the risk management of credit institutions should be considered a core function, and should accordingly not be outsourced. Based on this principle, ESBG believes that outsourcing should be possible for the purpose of data pooling and the development of rating models, while the actual customer rating process should be retained within the credit institution at all times.

COMMENTS TO PRINCIPLE II

Principle II (paragraph 4) indicates 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*". This requirement covers both the resources at operating level that are necessary to resume the activity, and the amount of time within which an institution should be able to resume the outsourced activity itself.



While ESBG fully agrees with the general principle in CEBS' paper (Principle II), we are of the opinion that the requirement to retain adequate core competences at a senior *operational* level might very often prove too far-reaching, in particular if such a requirement has to take place within a short period of time. In any event, we are not convinced by the necessity of introducing this operational requirement and have doubts on whether this requirement will always be legally enforceable.

COMMENTS TO PRINCIPLE III

Paragraph 5 states that *“an institution may not outsource services and activities that are covered by the institution’s authorization unless the outsourcing service provider either (i) has an authorisation that is comparable to the authorization of the outsourcing institution; or (ii) is acting as agent of the outsourcing institution”*. The ESBG would like to have further details on how this would apply in practice: as an example, could a clearing house activity, on the basis of this principle, be outsourced to an outsourcing service provider that is not member of the clearinghouse itself? Furthermore, the ESBG would like to know how CEBS defines “agent” and which requirements that “agent” would have to fulfil.

Paragraph 6 indicates that *“the managers of the outsourcing institution shall be fully responsible to the supervisory authority for any outsourced area”* and that *“managers should therefore take suitable measures to ensure that the outsourced areas continue to meet the performance and quality standards that would apply if their own institution were to perform the relevant activities in-house”*.

The ESBG's Spanish member suggests that these requirements might be facilitated by the adoption of a **Vendor Governance Approach** (not covered by CEBS' paper) as well as the definition and maintenance of **Service Level Agreements (SLA)** to manage its relationship with an outsourcing service provider as requested in High Level Principle VIII. More specifically, the implementation of a Vendor Governance Approach should be guided by the following standard principles:

1. Understand the final client's objectives and performance requirements.
2. Ensure that the vendor performance is in line with the contractual terms, establishing the contractual terms and conditions so that they respect the final client requirements



and orientate the outsourcing service provider according to the changing needs of the business.

3. Develop contracts that balance performance requirements with business objectives development.
4. Align operational processes with the outsourcing service provider work, and add it in the regular reviews. This requires an internal discipline of the institution.

These principles would cover the four main areas of the Vendor Governance:

- Relationship processes
- Technical processes
- Contract processes
- Performance processes

These areas have been developed to limit the risks inherent to worst-case scenarios. This new Vendor Governance function shall not be outsourced and shall have the appropriate resources to be properly managed.

Finally, in the case of Global Outsourcing (i.e. where the Outsourcing Institution arranges global services for all its locations with a global outsourcing service provider), the Vendor Governance performance measurements must ensure the achievement of the quality of service on a local basis criterion without missing local issues in the large frame figures.

Under paragraph 7, CEBS indicates that *“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”*.

The ESBG believes that the distinction between the two types of activities might be best achieved by providing examples of activities that fall within the two categories. Furthermore, the work that CEBS still wishes to perform regarding the “concept of a materiality test” (see section “further work”) might help in designing a common methodology for the remaining cases.



COMMENTS TO PRINCIPLE V

Under Principle V, institutions are required to have in place a policy including contingency planning and a clear exit strategy. In this case in particular, a clear distinction should be made between intra-group outsourcing and external outsourcing.

Paragraph 5 requires an outsourcing institution to “*specify an internal unit or individual that is responsible for supervising and managing each outsourcing measure*”.

ESBG Members share the view that it might be difficult for an individual unit or individual to gather a sufficient level of knowledge and experience to actually *supervise* and *manage* each outsourcing measure. This is particularly true in the case of institutions that outsource extensively, where acquiring sufficient knowledge might prove impossible. Against this background, the ESBG believes that an internal unit should be responsible for maintaining an *overview* of the outsourcing, whereas the actual *supervision* and *management* should remain at the level of each individual unit where the outsourcing takes place.

Paragraph 11 states that in case of unexpected termination of the contract, “*outsourcing institutions should plan and implement arrangements to maintain the continuity of their business in the event that the provision of services by an outsourcing service provider fails or deteriorates to an unacceptable degree, or the firm experiences other changes.*”

The ESBG believes that this requirement would be difficult to achieve in practice: the contractual and cost implications of this provision would be high in most contracts and the resulting requirements in terms of internal organization would be particularly far-reaching. In actual fact, this would imply having either an alternative provider or equivalent internal resources. Both scenarios would result in extra costs that would turn down the advantages of the outsourcing itself.

COMMENTS TO PRINCIPLE VI

Under Principle VI, outsourcing institutions are requested to “*bring all serious problems with an outsourcing service provider to the supervisory authority’s attention*”.



The ESBG is of the opinion that this recommendation would result in unnecessary additional bureaucratic burdens, and would entail too many costs compared to the potential benefits. In this context, we would suggest distinguishing between very serious problems, which should be brought to the supervisory authority's attention without any delay, and less serious problems, which credit institutions should be required to report on an annual basis, or on the supervisor's request. Finally, credit institutions should not be obliged to report minor problems which they could handle themselves.

COMMENTS TO PRINCIPLE VII

Paragraph 6 addresses the question of the assessment of the outsourcing service provider, stating that *"the contract should ensure that the outsourcing service provider's performance is continuously monitored and assessed so that any necessary corrective measures can be taken immediately"*.

Practical questions arise here such as who will do the monitoring and the assessment and when it shall be exercised. The questions justify further the necessity to develop an approach of "Vendor Governance" detailed above.

Under this principle, CEBS indicates (paragraph 8) that *"in the case of outsourcing within a group, the outsourcing institution needs to ensure that it is able to give effective rights of access to information to the supervisory authority. This may require obtaining consent from affected parties such as the parent company and relevant home supervisory authorities"*.

The exact meaning of this statement is unclear. Should this actually mean that intra-group outsourcing could require consent from the parent company or its supervisory authorities, then this should be explained in more detail, and the reasons for such a requirement should be provided.

The last paragraph under Principle VII indicates that *"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"*. It is in this context also very important to differentiate between external and intra-group outsourcing.



Furthermore, the ESBG believes that HLP VII should also address cases of global outsourcing. HLP VII should indicate that in such cases, the contractual terms must be aligned with the local requirements of each supervisory authority.

COMMENTS TO PRINCIPLE VIII

Principle VIII relates to the obligation to have a Service Level Agreement (SLA) in place to manage the relationship with an outsourcing service provider.

While it seems indeed appropriate to have such an SLA in place apart from the contract in the case of complex activities, we do not believe that this should necessarily always be a requisite: in the case of non-complex activities, a description of the service in the contract should be sufficient. The decision of whether an SLA is necessary or not should be made depending on the particular case treated and of relevant framework of the country. CEBS' guidelines should accordingly indicate that the service required should be detailed in written form.

COMMENTS TO PRINCIPLE IX

Under High Level Principle IX, CEBS indicates that supervisory authorities should have access to the outsourcing institutions' databases. The ESBG believes that CEBS should clarify the type of access that this covers, i.e. whether the supervisory authorities should be granted direct access to the institutions' databases or not.

Paragraph 5 of this principle contains guidelines in the case of outsourcing to service providers abroad. With view to practice of supervisory functions outside the territorial competence, it is suggested to conclude cooperation agreements amongst supervisors, on the basis of which the relevant responsibilities can be determined. In doing this, it should be assured that the authority which is closest to the matter or has the best "access possibilities" is responsible while – at the same time - avoiding overlap or double supervision by different authorities.

Further to paragraph 6, a "*supervisory authority should be able to cancel the outsourcing measure if (...)*". The ESBG is of the opinion that supervisory authorities should never be entitled to cancel the outsourcing contracts themselves. First, this would conflict with general



civil law principles. Second, such measure would be very difficult to implement in practice. Finally, we do not believe such an action to be necessary: should supervisors reach the conclusion that an outsourcing measure should be cancelled, then they should rather detail their concerns to the outsourcing institution, which should in turn cancel the measure where appropriate. The above-mentioned paragraph should therefore be amended accordingly.

COMMENTS TO PRINCIPLE X

CEBS's High Level Principle X indicates that supervisory authorities should take account of concentration risk, implying that the risk is higher when one outsourcing service provider provides outsourcing services to several authorised institutions.

ESBG Members on the contrary believe that for several reasons, the risk might be lower in the case of such institutions. As an example, such a "multiple" outsourcing service provider probably has a greater know-how and experience than a single outsourcing service provider, making him more able to assess its risks. In addition, a "multiple" outsourcing service provider might find it easier to make changes, since the costs are divided between different outsourcing institutions: adaptation is less of a problem for this type of institution. Against this background, we would have a particular interest in getting additional information on why concentration represents an additional risk for outsourcing service providers.

Moreover, "multiple" outsourcing service providers should be exempted from being subject to unlimited and far-reaching control and instruction rights by the individual outsourcing institution. If such individual instruction and control rights would be given to all individual outsourcing institutions, "multiple" outsourcing service providers would be confronted with different or maybe even divergent instructions. This would render any cost and scale effects or synergies impossible or would at least reduce such effects considerably.

Finally, notwithstanding the former comments, the ESBG believes that HLP X should contain an additional explanation concerning the "worst-case scenario" that should be envisaged in this context. This should include in particular whether a supervisory authority could block an outsourcing contract as a consequence of a risk of concentration.