



BRITISH BANKERS' ASSOCIATION

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Dear Sirs

BBA Response to CEBS Consultation Paper on High Level Principles on Outsourcing

The British Bankers' Association represents more than 250 banks from around the world doing business in the United Kingdom, including all the major European banks conducting banking business in London. The BBA and the European Banking Federation, of which it is a member, have been major interlocutors with the Basel Committee and with European banking supervisors with regard to the Basel Accord and its EU implementation over many years.

We welcome the opportunity to respond to the second Consultation Paper issued by CEBS on outsourcing and compliment you on the obvious high degree of internal cooperation that has taken place with a view to achieving supervisory convergence

We believe that the paper provides a useful framework for the supervision of outsourced activities but, in the context of evolving industry practices, would encourage CEBS to recognise Bank's established risk management practices and avoid overly prescriptive principles which could limit flexibility and competitiveness.

Please find attached our detailed comments.

We look forward to working with CEBS to further develop this important area.

Yours faithfully,

S.W. Freeman
Director
British Banker's Association

BBA Response to CEBS Consultation Paper on High Level Principles on Outsourcing

General

The BBA acknowledges that the High Level Principles (HLP's) are a work in progress and, in that context, urges CEBS to be cautious in trying to develop the concepts of "core and strategic activities".

Currently outsource service providers in the UK are unregulated (unless they are performing a controlled function, e.g. selling, trading, etc.). However CEBS appears to suggest that it might be useful to change this. The BBA would be reluctant to support such a stance as it could increase the costs of outsourcing, reduce the number of providers, stifle innovation and act as a barrier to entry for new suppliers.

The BBA believes, as a general point, that an institution should retain the prerogative and power to outsource, on the basis of its own risk and cost/benefit analysis, with ongoing monitoring by the bank of its outsourcing arrangements being required to ensure that the associated risks are managed effectively. Specifically we feel that all outsourced processes will be captured by the Basel Committee's operational risk framework with associated management standards and capital charge

Part 1: Definitions

The BBA agrees that there are a number of possible definitions of outsourcing and that it is difficult to agree a definition which would be acceptable across the EU. However, if there is to be consistent treatment of outsourcing, then there must be clarity of definition. Without this clarity there will be no consistency of treatment of "strategic and core" nor of "material" outsourcing as referred to in the HLPs.

In this context, the BBA believes that the definition provided is too generic in nature to facilitate the objective of convergence. The definition of outsourcing should, in our opinion, only refer to a typical core banking activity, framed from the outsourcing institution's perspective and be based on the transfer of a material internal activity by an institution to a third party entity. It should also recognise a distinction between intra group outsourcing and outsourcing to authorised or unauthorised financial institutions.

Part 2: High level principles addressed to institutions

I. Strategic and core management responsibility cannot be outsourced

Outsourcing practice need to be examined in the context of the size and complexity of the institution as well as changing market practices.

The High Level Principles state that CEBS does not expect to see outsourcing of strategic or core management responsibility "except for in exceptional cases". As

noted above, the BBA believes that this is an excessively conservative position. The current FSA policy on outsourcing has no restrictions on the types of activity that can be outsourced. If principle I is to be introduced this would be a retrograde step in the UK. We therefore believe that this restriction does not strike an appropriate balance between regulatory concerns and legitimate commercial imperatives to outsource. In cases where the outsourcing service provider is an institution authorised by, and under direct supervision of a supervisory authority of an EU member state or a country with equivalent standards, we consider that it should be possible for processes that are considered “strategic or core” to be outsourced.

III. 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.

The CEBS principles usefully raise and define the issue of materiality. We support an approach which is focussed on whether or not the outsourcing is material. Where it is not material, banks should be free to outsource where it is commercially sensible to do so. It will be important for there to be convergence among supervisors in determining the sorts of activities which will be regarded as material. The condition that “an institution may not outsource services and activities that are covered by the institution’s authorisation unless the outsourcing service provider has an authorisation which is comparable...” is, in our view, too restrictive. We believe that it should be permissible to outsource elements of activities which are covered by the banking licence to a non-licensed service provider, provided such elements are not in themselves subject to a licence requirement.

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

The BBA agrees that a firm should have a policy on outsourcing. This should be internal bank policy which a supervisor can review on request.

VII. All outsourcing arrangements should be subject to a formal and comprehensive contract.

The BBA considers that such contracts should clearly define the outsourcer’s rights to audit the outsourced process. The right to information of the supervisory body should stem from the auditing rights given to the credit institution by the outsourcing agreement. The Principles should specify that, in the context of ‘offshoring’, any legal requirements governing the transfer of data across borders should be complied with.

VIII. In managing its relationship with an outsourcing service provider an outsourcing Institution should ensure that a service level agreement (SLA) is put in place

Whilst the BBA believes that it is good practice for SLAs to be in place with an outsourcing service provider, we also consider that there may be times when an SLA is not necessary. As a result we suggest that this principle should be made less prescriptive. For example we suggest that an outsourcing institution should have SLAs ‘where appropriate’.

Part 3. Other supervisory principles on outsourcing

IX 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.

The BBA considers it too far-reaching to give the supervisory authority the right to cancel an outsourcing agreement. This would represent intervention between parties in a contracted agreement and, in our view, may not be legally acceptable. Reliance should be placed on the relevant audit work (see above). Whilst, at the moment in the UK, the FSA have the power to cancel an arrangement 'in extremis' this would only happen where an arrangement has been extremely badly managed.

X Supervisory authorities should take account of concentration risk, where one outsourcing service provider provides outsourcing services to several outsourcing institutions.

The BBA would encourage CEBS to further develop its ideas on concentration risk whereby a number of financial institutions outsource all processes of a particular type to one or two outsourcing service providers as an individual supervisors' review will not cover this risk. We suggest that CEBS, in conjunction with other supervisors, investigate the feasibility of a "global assessment" of outsourcing arrangements to be made across jurisdictions to identify those service providers who could pose critical and connected risks to institutions.

XI 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)

The BBA agree that the sub-outsourcing of activities to third parties (sub-contractors) should be treated like a primary outsourcing measure. However we feel that this would be very difficult to implement in practice and that therefore this principle should be narrowed to include only 'key sub-contractors' i.e. those that would have a material impact on the provision of the outsourced service.