OUTSOURCING – Response to CEBS Consultation Paper

Introduction

Overall Fortis and its subsidiaries are subject to an extensive and complex body of laws and regulations in the area of outsourcing. Fortis thus welcomes warmly the efforts of CEBS that will lead to more convergence and transparency.

Fortis will fully support this convergence exercise and promote it where possible.

The ECBS consultation paper takes its inspiration from existing regulations around Europe in matters of outsourcing. As a result, the high-level principles prescribed are in line with overall practices in the Benelux, where we are most familiar with the subject matter.

The high-level principles described are reasonable ones, in the sense that most of them are principles that a well managed company would have difficulty denying. In a nutshell, they lay out that an outsourcing institution top management and board cannot outsource its management responsibility, in particular on matters with strategic, or with material impact on the business. Risk monitoring and risk management are of foremost concern to the ECBS.

High-level principles I-VIII describe an outsourcing institution's responsibilities in more detail. Principles IX-XI outline rights (and to a lesser extent obligations) of supervisory authorities.

Comments on ECBS consultation paper

We hope that the following comments may usefully contribute to refining the principles:

On the Definition of Outsourcing

Part 1 of the ECBS paper defines outsourcing as "the supply to an authorised institution by another entity (either intra-group or independent third party) of goods, service or facilities on a structural basis (i.e. the contractual supply of goods, service or facilities that form part of the business processes and which are necessary to support the provision of banking or other financial services)."

It then proceeds to exclude from the scope of this definition "purchasing contracts, defined [...] as the supply of *services* [...] *without information about or belonging to the purchasing institution coming within the control of the supplier; or of standardized products, such as market information or office inventory"*.

This definition is difficult to understand. What is the meaning of "information about or belonging to the purchasing institution"?

Specifically, the limits of where purchasing ends and where outsourcing starts are not entirely clear to the reader.

In particular, it would be useful to understand whether certain type of services must be considered outside the definition of outsourcing, such as:

- Clearing & Settlement of securities through an (I)CSD, such as Euroclear or Crest.
- Other standardized interbank transaction services such as payment routing and processing (SWIFT, Banksys, Mastercard, etc.)
- Local & global custody through a custodian bank

Some regulators seem to consider these activities to lie outside the scope of the outsourcing definition (e.g., CBFA circular PPB 2004/5).

One can think of different criteria to justify these exclusions. The current text does not, however, provide sufficient insight on the ECBS's reflections on this topic.

Criteria that come to mind include:

- Standardization
- Market practice
- Regulatory oversight of service provider

Could the ECBS provide a set of criteria that in some combination would enable financial institutions to decide whether an activity must be considered as "outsourcing" or not?

Alternatively, could the ECBS provide a list of activities that may legitimately be considered as excluded from the definition by consensus of all European banking regulators?

In this context, it is probably worth noting that the text should make it abundantly clear that each activity has to be considered on its own merits:

> For instance: The fact, say, that SWIFT is not considered an outsourcing provider for payment routing services, does not imply that for other activities and services SWIFT may not have to be considered an outsourcing provider.

On Intra-Group Outsourcing

Intra-group outsourcing seems to get special treatment only under Principle II: "[...] ultimate responsibility for proper management of the risks [...] lies with an outsourcing institution's senior executive management".

A little further on, one reads: "Exceptions for certain types of intra-group outsourcing may be allowed."

Would the ECBS clarify to which statement the exceptions apply? This is not clear from the text. One probably should interpret the exceptions to apply to the preceding paragraph only: "Outsourcing institutions should be encouraged to retain adequate core competence at a senior operational level to enable them to resume direct control [...]." Or should one read that in an intra-group outsourcing, "ultimate responsibility for proper management of the risks [...]" would not lie "with an outsourcing institution's senior executive management".

We believe that intra-group outsourcing should be allowed under less stringent conditions than third party outsourcing, at least within banks in the European Union. Indeed, banking groups are regulated by a set of regulators, which mutually recognize

each other. Thus the quality of services provided to a financial institution in one country should *a priori* be considered appropriate for another group entity that outsources to the first institution. (Formal SLA's and contracts should still be drawn up, at arm's length, for reasons of cost & risk sharing, as well as fiscal propriety.)

In this same context, a clarification, at EU level, of the interplay of various domestic regulators would be helpful. Indeed institutions spanning several European countries should be able to turn to one lead regulator for help in coordinating the actions of all domestic regulators.

On the Overlap of European Supervisory Authorithies

On this same topic, Principle VII might be read as going a step in the opposite direction:

> "[...] outsourcing institution needs to ensure that it is able to give effective rights of access of information to [its] supervisory authority [...]. This may require obtaining the consent from [...] relevant home supervisory authorities."

In the European Union, the burden of obtaining the consent from relevant home supervisory authorities so as to have effective rights of access of information on a regulated provider's services should not be on the outsourcing institution, but on its regulator. Were this not so, it would imply that European regulators do not recognize each other as mutually competent, which can hardly be the intent. The outsourcing institution's regulator should be able to work through the service provider's domestic regulator (again, for banking groups, clearly the concept of a "lead" regulator would be very useful indeed, on a European level).

One solution could be the rephrasing of the paragraph (last bullet) of Principle VII along such lines as:

- "In the case of outsourcing, the outsourcing institution's supervisory authority needs to have effective rights of access to information (see Principle IX) on the provider's services.
  If said service provider is regulated by a home supervisory authority, the outsourcing institution's supervisory authority will exercise its right of access either directly or by proxy through the relevant home supervisory authority.
  If said service provider is unregulated, the outsourcing institution needs to ensure that it is able to give effective rights of access of information to [its] supervisory authority [...]."

Conclusion

Overall, this ECBS consultation paper provides policy makers with useful formal guidelines. The proposals appear to us, with our current level of experience in these matters, largely coherent with the domestic regulatory frameworks in the Benelux.

As outlined above, some improvements in the definitions and a few other clarifications would improve the practical usability of the document to bank senior management, policy makers and compliance officers.