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Submitted via the EBA web portal

24 September 2018

Dear Sir or Madam,

AIMA/ACC Response to the Consultation Paper – EBA Draft Guidelines on Outsourcing arrangements

The Alternative Investment Management Association Limited (AIMA)[1] and the Alternative Credit Council (ACC)[2] welcome the opportunity to provide feedback to the consultation from the European Banking Authority (EBA) on its new Draft Guidelines on Outsourcing ('draft guidelines'). Outsourcing is a well-established mechanism routinely used throughout the asset management industry, ensuring access to the best talent in pursuit of returns to the benefit of both investors and the real economy.

Our member manager base comprises alternative investment fund managers (AIFMs) and UCITS managers, as well as an increasing number of MiFID investment firms subject to the CRR for certain parts of their business (especially CLO managers). Although most would be more directly impacted in the majority of (but not all)[3] circumstances by an equivalent intervention from the European Securities and Markets Authority (ESMA), we feel a response at this juncture to the EBA

[1] AIMA, the Alternative Investment Management Association, is the global representative of the alternative investment industry, with more than 1,900 corporate members in over 60 countries. AIMA's fund manager members collectively manage more than $2 trillion in assets. AIMA draws upon the expertise and diversity of its membership to provide leadership in industry initiatives such as advocacy, policy and regulatory engagement, educational programmes and sound practice guides. AIMA works to raise media and public awareness of the value of the industry. AIMA is committed to developing skills and education standards and is a co-founder of the Chartered Alternative Investment Analyst designation (CAIA) – the first and only specialised educational standard for alternative investment specialists. AIMA is governed by its Council (Board of Directors). For further information, please visit AIMA's website, www.aima.org.

[2] ACC, the Alternative Credit Council, is a group of senior representatives of alternative asset management firms and was established in late 2014 to provide general direction to AIMA's executive on developments and trends in the alternative credit market with a view to securing a sustainable future for this increasingly important sector. Its main activities comprise of thought leadership, research, education, high–level advocacy and policy guidance.

[3] The fact the draft guidelines are set to apply on a solo, sub-consolidated basis and consolidated basis as set out in Articles 21 and 108 to 110 of Directive 2013/36/EU ('CRD') means AIFMs/UCITS managers as part of a wider group would face direct implications in certain circumstances.

remains essential. Whatever recommendations are adopted here are likely to inform any similar work undertaken by ESMA affecting AIFMs and UCITS management companies, thus directly impacting upon the wider AIMA membership.[4]

By way of context, the impressive brand recognition enjoyed not only by UCITS, but also AIFs in ever increasing numbers across the world is dependent on continuing access to, and viability of, outsourcing and delegation arrangements. This goes beyond ensuring asset managers can access local expertise when making investment decisions, although this is naturally of paramount importance. Enabling an AIFM or UCITS/UCITS management company to outsource administrative or back-office functions, by way of example, frees up otherwise committed time and resources, allowing for a greater focus on the asset manager's core brief of generating returns to clients by making investments into the real economy. Unfortunately, we remain concerned that the tone in certain parts of the draft guidelines could be read as stigmatising outsourcing and delegation arrangements, despite the range of benefits outsourcing and delegation can bring.

This applies to the process of internal, as much as external, outsourcing. Asset managers often rely on being able to access firm-wide support platforms, or "centres of excellence", capable of offering a given service to an exceptional standard. It is unfortunate that the EBA has not highlighted the benefits of intra-group outsourcing at any point in its draft guidelines, a situation that could again lead one to infer the EBA is sceptical of the tangible benefits on offer to all parties within such arrangements.

In the interests of clarity, we have not expanded on these points below – focussing instead on certain technical and procedural issues that we feel best able to address – but hope these concerns are acknowledged nonetheless.

We would stress, however, that we do not dispute the key contention of the draft guidelines, namely that, when an outsourced function is of a material nature, additional safeguards and increased scrutiny on the part of the outsourcing institution and national competent authorities (NCAs), respectively, will be necessary. This is a principle that is, quite correctly, recognised not only with this initiative but in its two forerunners[5] as well.

Such prudence should not, however, infringe upon the viability of legitimate outsourcing arrangements – to institutions based within the EU and beyond – that have proven their worth historically in helping investors best meet their asset allocation requirements. In a bid to see this principle better reflected within the draft guidelines, we have offered more detailed feedback in the Annex with respect to each of the posed questions to which we felt able to respond, but the key points we would like to flag in the first instance are as follows:

- **The nature of how outsourcing arrangements should be defined and arranged has typically been a matter dealt with by the European Commission and co-legislators at either Level 1 or Level 2. We would recommend aligning the draft guidelines with the contents of such relevant legislation as much as feasibly possible.**

[4] Especially so given the EBA informed the audience during the Open Hearing on the draft guidelines – held 4 September 2018 – that ESMA had also been consulted during preparation of this exercise.

5 These are the December 2006 Guidelines on Outsourcing from the Committee of European Banking Supervisors ('CEBS guidelines'), and last year's December 2017 EBA Recommendations on outsourcing to cloud service providers ('cloud outsourcing recommendations').

We understand that the draft guidelines – even when finalised – do not constitute legally binding obligations, but as Paragraph 2 states "competent authorities and financial institutions must make every effort to comply" with them, to do otherwise may not be a viable course of action for affected financial institutions, including AIMA members. As such, we would recommend the EBA ensure the contents of the draft guidelines remain fully consistent with relevant Level 1/2 measures – particularly in regards which rights should be contractually framed within an outsourcing agreement – thus maintaining ordinary rulemaking procedure here.

- **The environmental, social and governance (ESG) standards to which service providers must adhere should be left to the discretion of the outsourcing institution.**

  We fully support recognition of the importance of ESG factors but considering the current (and growing) number of standards in this field we would recommend affording discretion to the outsourcing institution to decide which standards the service provider must fulfil – disclosing these where necessary – especially given some service providers may have parents with other regulatory obligations in this regard.

- **The presence of the proportionality principle in the draft guidelines is welcome, but the way in which it can be practically applied and to whom is often unclear.**

  Within the draft guidelines themselves, as well as previous interventions from the EBA, the focus regarding proportionality has more often been on which institutions should be able to avail themselves of the principle. Yet, even considering the presence of such guidelines, the numerous different risk models of agency firms that constitute the AIMA membership would appreciate additional guidance from the EBA regarding the entities that can benefit from such provisions. There also remains certain ambiguity as to what application of the proportionality principle practically entails. For example, it would not seem appropriate for a risk assessment to take place if outsourcing has *not* taken place and presumably this is a scenario in which proportionality would apply, but this is not clear from the current wording of the draft guidelines.

- **A register detailing all outsourcing arrangements appears a disproportionate regulatory burden to place upon outsourcing institutions.**

  While there is always the potential for non-material arrangements to become critical or important (as per the terminology used in the draft guidelines), this reality does not appear to warrant the set up and maintenance costs of such a register as currently envisaged by the EBA. It would remain incumbent upon the outsourcing institution to inform its NCA of any such arrangements that become critical or important should this happen, and the threat of sanction for failing to do so is a legitimate and proportionate way of managing such eventualities.

- **The precise nature of access rights as detailed in the draft guidelines should be tailored in certain circumstances to take account of practical market realities.**

  By way of example, there is little tangible value in ensuring NCAs have the right to inspect rows upon rows of servers that populate the premises of data service providers. Enabling access to organisational charts/illustrative diagrams would be an effective way of maintaining oversight in such circumstances but in a more sensible fashion. It would also be helpful if clarification

was added to the draft guidelines to ensure that any inspection of the service providers' premises could only take place following a formal request to the outsourcing institution in the first instance.

- **Anonymised/stylised case studies from the EBA regarding desirable market practice would be helpful.**

  The level of discretion afforded institutions when complying with industry guidelines of this kind is welcome but can breed uncertainty as to which arrangements are permissible. Disclosure of this kind detailing both desirable and undesirable market practice would be extremely helpful to keep institutions abreast of the regulator's latest expectations in this field.

We hope our comments are helpful and would be happy to discuss any of the matters addressed in this letter with you in further detail.

Yours faithfully,

Jiří Król
Deputy CEO, Global Head of Government Affairs
The Alternative Investment Management Association

Annex

Note: we have addressed the questions we feel able to provide constructive feedback on as they appear in the consultation paper. We have omitted the questions with respect to which we had no comment to offer.

Q2: Are the guidelines regarding Title I appropriate and sufficiently clear?

Proportionality

It is welcome that the principle of proportionality is embedded in the draft guidelines, as it was in the CEBS guidelines and cloud outsourcing recommendations previously. Paragraph 16 specifies how Title I of the EBA Guidelines on Internal Governance ("internal governance guidelines") in line with Article 74(2) of Directive 2013/36/EU ('CRD IV') should be considered when applying this principle.

These internal governance guidelines present criteria directed at the "size and internal organisation, and the nature, scale and complexity of their [institution's] activities, when developing and implementing internal governance arrangements". Given the range of different risk models of agency firms that constitute the AIMA membership, members would welcome additional guidance from the EBA as to which entities can apply the principle.

Furthermore, the guidelines cross referenced in Paragraph 24 do not provide clarity as to which of the requirements set out in the draft guidelines it may be legitimate to disapply because of proportionality, which leaves the reader in some doubt as to how the proportionality principle should be applied in practice.

For example, Paragraph 24 appears to suggest that arrangements not considered outsourcing should be subject to a risk assessment. A fair and proportionate approach in this regard would be to clarify that risk assessments need only occur where outsourcing has taken or will take place. We would infer that this was the desired intention of paragraphs such as this and where it is not explicit (we have provided drafting suggestions on this occasion below), such a reading would represent a fair application of the proportionality principle.

AIMA Suggested Amendments

EBA Proposed Text	**Proposed Text Offered by AIMA**
24. The risks, including in particular the operational risks, of all arrangements with third parties, including the ones referred to in paragraph 22 and 23, should be assessed in line with paragraphs 53 and 55 and Section 9.3, taking into account the application of the proportionality principle as referred in Section 1.	24. The risks, including in particular the operational risks, of all **outsourcing** arrangements with third parties, including the ones referred to in paragraph 22 and 23, should be assessed in line with paragraphs 53 and 55 and Section 9.3, taking into account the application of the proportionality principle as referred in Section 1.

Q3: Are the guidelines in Title II and, in particular, the safeguards ensuring that competent authorities are able to effectively supervise activities and services of institutions and payment institutions that require authorisation or registration (i.e. the activities listed in Annex I of Directive 2013/36/EU and the payment services listed in Annex I of Directive (EU) 2366/2015) appropriate and sufficiently clear or should additional safeguards be introduced?

Service examples

The MiFID II Delegated Regulation (DR)[6] details certain services that should not be considered critical or important functions, with the provision of legal advice to the outsourcing firm one such example. In a similar fashion, Paragraph 22 of the draft guidelines spells out how the "acquisition of services" should not even be considered outsourcing, and among others refers to "legal representation in front of the court and administrative bodies" as an example of this in practice.

While we appreciate the sentiment behind introducing illustrative examples, referencing one legal practice but not others leave open to question the status of those not explicitly referenced. As such, if examples are to be used in this fashion we would recommend refraining from citing specific cases as it leaves other – similar – activities in limbo as to their expected treatment.

AIMA Suggested Amendments

EBA Proposed Text	Proposed Text Offered by AIMA
23. The acquisition of services (e.g. advice of an architect regarding the premises, legal representation in front of the court and administrative bodies, servicing of company cars, catering), goods (e.g. purchase of office supplies, or furniture) or utilities (e.g. electricity, gas, water, telephone line) that are not normally performed by the institutions or payment institutions are not considered outsourcing.	23. The acquisition of services ~~(e.g. advice of an architect regarding the premises, legal representation in front of the court and administrative bodies, servicing of company cars, catering),~~ goods ~~(e.g. purchase of office supplies, or furniture)~~ or utilities ~~(e.g. electricity, gas, water, telephone line)~~ that are not normally performed by the institutions or payment institutions are not considered outsourcing.

Q5: Are the guidelines in Sections 5-7 of Title III appropriate and sufficiently clear?

Register of all outsourcing arrangements

Paragraph 46 of the draft guidelines specifies that institutions should "maintain a register of all outsourcing arrangements at institution and group level…and record all current outsourcing arrangements, distinguishing the outsourcing of critical or important functions and other outsourcing arrangements".

Echoing a point made in our previous submission to the cloud outsourcing guidelines consultation,[7] it is our view that a registration requirement of this kind on *all* arrangements, rather

[6] *See,* Article 30 and Article 31 of Commission Delegated Regulation of 25.4.2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive

[7] AIMA's Response to Consultation on Draft Recommendations on Outsourcing to Cloud Service Providers under Article

than just those of a critical or important nature, would generate a disproportionate burden on outsourcing institutions to no discernible benefit and therefore should not be required.

While it is of course always possible for an outsourced activity to become critical or important, even if it is not so at that given moment, such oversight as expected in the form of a universal central register appears unwarranted. The responsibility would still be with the outsourcing institution to inform its NCA when an activity becomes critical or important, and if it were found not to have done so relevant sanctions would apply. This appears a more proportionate approach to the issue at hand here.

AIMA Suggested Amendments

EBA Proposed Text	Proposed Text Offered by AIMA
46. Institutions and payment institutions should maintain a register of all outsourcing arrangements at institution and group level where applicable as referred to in Section 2, document and record all current outsourcing arrangements, distinguishing the outsourcing of critical or important functions and other outsourcing arrangements. Taking into account Title I of these Guidelines, for institutions and payment institutions within a group, institutions permanently affiliated to a central body, or institutions which are members of the same protection scheme, the register may be kept centrally, provided that the section of the register relating to each individual institution can be obtained in a timely manner.	46. Institutions and payment institutions should maintain a register of all **critical or important** outsourcing arrangements at institution and group level where applicable as referred to in Section 2, document and record all **such** current outsourcing arrangements, ~~distinguishing the outsourcing of critical or important functions and other outsourcing arrangements~~. Taking into account Title I of these Guidelines, for institutions and payment institutions within a group, institutions permanently affiliated to a central body, or institutions which are members of the same protection scheme, the register may be kept centrally, provided that the section of the register relating to each individual institution can be obtained in a timely manner.

Q8: Are the guidelines in Section 9.2 regarding the due diligence process appropriate and sufficiently clear?

ESG

The second half of paragraph 56 of the draft guidelines signals that institutions should be satisfied that service providers adhere to "international standards on human rights, environmental protection and appropriate working conditions, including the prohibition of child labour".

A multitude of different international standards exist in this field today, with more forthcoming considering the European Commission's May 2018 legislative proposals in this regard (the final outcomes from which cannot be foreseen today). We would suggest that outsourcing institutions be able to choose which set of standards they adhere to, including those that are proprietary. If the service provider complies with these that should constitute adherence to these guidelines.

16 of Regulation (EU) No 1093/2010 (15 August 2017).

AIMA Suggested Amendments

EBA Proposed Text	Proposed Text Offered by AIMA
56. Institutions and payment institutions should take appropriate steps to ensure that service providers act in a manner consistent with their values and code of conduct. In particular, with regard to service providers located in third countries, and, if applicable, their sub-contractors, institutions and payment institutions should be satisfied that the service provider acts in a socially responsible manner and adheres to international standards on human rights, environmental protection and appropriate working conditions, including the prohibition of child labour.	56. Institutions and payment institutions should take appropriate steps to ensure that service providers act in a manner consistent with their values and code of conduct. ~~In particular, with regard to service providers located in third countries, and, if applicable, their sub-contractors, i~~**I**nstitutions and payment institutions should be satisfied that the service provider acts in a socially responsible manner and adheres to **their chosen environmental, social and governance standards and** international~~l~~ standards on human rights and appropriate working conditions, including the prohibition of child labour.

Q10: Are the guidelines in Section 10 regarding the contractual phase appropriate and sufficiently clear; do the proposals relating to the exercise of access and audit rights give rise to any potential significant legal or practical challenges for institutions and payment institutions?

Access rights – Level 2/Level 3 measures

Article 31(i) of the MiFID II DR details how an investment firm, its auditors and the relevant NCA has effective access to relevant data from, and where necessary, the business premises of the service provider. This to ensure effective oversight in accordance with that Article. This provision applies, however, solely to the outsourcing of critical and important functions as defined within MiFID II.

Paragraph 72 of the draft guidelines details how the written outsourcing agreement – not limited to critical or important functions as is the case in Article 31(i) of the MiFID DR – must grant the outsourcing institution and its NCA (among other things) complete access to all relevant business premises, and unrestricted rights of inspection and auditing.

We question the necessity for such rights to be contractually framed in the first instance for *all* outsourcing arrangements, but more fundamentally, whether this is being dealt with in the correct manner procedurally. As the original specifications for critical or important functions were detailed at Level 2, it is not clear how an apparent expansion of the scope of such requirements can come via the form of draft guidelines such as these.

As such, we would recommend the spirit and letter of MIFID DR Level 2 measures be maintained – i.e. access rights only needing to be contractually framed for the outsourcing of critical or important functions – in this regard, thus adhering to normal EU rulemaking procedure

Access rights – data centres

In terms of practical application, and again echoing a point made within our earlier cloud outsourcing submission, we would stress that requiring physical access to where data is stored may make it impossible for asset management firms to use public cloud services. We therefore consider that data centres should be specifically carved out of the references to "business premises" and the right of physical access to data centres should be substituted for a right of access to the relevant systems information. In other words, seeing racks of blinking lights is of little value but being able to see infrastructure diagrams and setup might be useful. Increasingly, physical infrastructure is being replaced with software-defined infrastructure so there is nothing to see, or it could be split over multiple locations on shared physical infrastructure. An amendment such as that proposed below is aimed at making this provision more workable.

Access rights – requests made via outsourcing institutions

The final recommendations should clarify that the right of access for the supervising authority to information would be done via the outsourcing institution, i.e., the competent authority requests the information from the outsourcing institution who must have the access and pass the information on, rather than direct access to systems of the service provider. Again, this would represent a more accurate reflection of reality here.

AIMA Suggested Amendments

EBA Proposed Text	**Proposed Text Offered by AIMA**
72. Institutions and payment institutions should ensure, within the written outsourcing agreement, that the service provider grants them and their competent authorities and any other person, including the statuary auditor, appointed by the institution, the payment institution or the competent authorities the following:	72. Institutions and payment institutions should ensure, within the written outsourcing agreement, that the service provider grants them and their competent authorities and any other person, including the statuary auditor, appointed by the institution, the payment institution or the competent authorities (**following first request to the outsourcing institution)** the following:
a. complete access to all relevant business premises (head offices and operations centres), including the full range of devices, systems, networks, information and data used for providing the outsourced process, service or activity, financial information, personnel and the service provider's external auditors ('access rights');	a. complete access to all relevant business premises, (head offices and operations centres), including the full range of devices, systems, networks, information and data used for providing the outsourced process, service or activity, financial information, personnel and the service provider's external auditors ('access rights'); **aa. The contents of paragraph a) do not apply in regards data centres. Here, complete access to infrastructure diagrams and setup information will be deemed sufficient for the purposes of this article.**