EPIF response to the EBA consultation on the draft Guidelines on outsourcing arrangements

September 2018

ABOUT EPIF (EUROPEAN PAYMENT INSTITUTIONS FEDERATION)

EPIF, founded in 2011, represents the interests of the non-bank payment sector at the European level. We currently have over 190 authorised payment institutions (PIs) and other non-bank payment providers as our members, offering services in every part of Europe. EPIF thus represents roughly one third of all authorised payment institutions in Europe. Our diverse membership includes a broad range of business models, including:

- 3-party Card Network Schemes
- Acquirers
- Money Transfer Operators
- FX Payment Providers
- Mobile Payments
- Payment Processing Service Providers
- Card Issuers
- Third Party Providers
- Digital Wallets

EPIF seeks to represent the voice of the PI industry and the non-bank payment sector with EU institutions, policy-makers and stakeholders. We aim to play a constructive role in shaping and developing market conditions for payments in a modern and constantly evolving environment. It is our desire to promote a single EU payments market via the removal of excessive regulatory obstacles.

We wish to be seen as a provider for efficient payments in that single market and it is our aim to increase payment product diversification and innovation tailored to the needs of payment users (e.g. via mobile and internet).

EPIF RESPONSE

We welcome the EBA Draft Guidelines and the work done by the EBA to update the existing provisions and clarify the scope as well as the main definitions to establish a more harmonized framework for financial institutions.

According to the EBA, outsourcing allows Financial Institutions to improve cost efficiency. However, certain provisions, as currently drafted, will have the opposite effect – they will increase costs and impose additional burdens on businesses to invest in order to ensure the application of the Guidelines.

We believe that those provisions will have a financial impact on the companies, will impose additional compliance requirements on businesses and to this end, the business community would welcome greater detail on certain points to ensure that resources are properly allocated when building out the appropriate outsourcing framework.

Please see below EPIF's response to the consultation, which highlights specific points of concern identified by the Payment Institutions' industry:

Definitions

- The definition of outsourcing (paragraph 11 of the draft Guidelines) notes that 'outsourcing' means an arrangement of any form in which a service provider performs an activity/service/process that would otherwise be undertaken by the financial institution itself. We would appreciate more clarity on what is meant by "would otherwise be undertaken". Innovative payment institutions (PIs) typically focus on core activities and will partner with other financial institutions for the performance of activities that the PI itself does not undertake. This could be due to the prohibitive costs associated with those activities, or the regulatory and technical complexity of setting up such activities in the first place, or the lack of having the appropriate licence. We believe that there should be a reasonableness test incorporated in the definition of outsourcing. There are many activities that a PI could perform but which it does not, for example, reasonably do for the reasons set out above. These could include, for example, credit or data checks, sponsor bank services, payment processing or settlement. The theoretical possibility of being able to perform the activities – for example by having the appropriate licence – does not mean that a payment institution would be outsourcing when it makes use of service providers to provide services which it does not reasonably wish to do itself. Leaving an overly broad and ambiguous definition of outsourcing could stifle innovation. It also leads to a lack of clarity as to roles when service providers contract with PSPs or other financial services players.

Title II – Outsourcing arrangements

- Paragraph 24 requires that the acquisition of services that are *not* considered outsourcing (described in paragraph 23) be included in the due diligence process (Paragraphs 53 and 55) and the risk assessment (Section 9.3) of outsourced services. Such inclusion does not seem appropriate, given the fact that these services are not considered outsourcing. Furthermore, they should not be covered by these guidelines on outsourcing.
- Paragraph 25 – Outsourcing of regulated services. This paragraph introduces the requirement that banking or payment services that require authorisation or registration by a Competent Authority (CA) in the Member State where the firm is authorised outsource only to a service provider located in the same Member State or in another Member State if (a) the service provider is authorised by a competent authority to perform such services; or (b) the service provider is otherwise allowed to carry out those services or activities in accordance with the relevant national legal framework.

  In most cases, firms would not be outsourcing a banking or payment service in its entirety but would outsource parts thereof (for example: the settlement between different entities involved in the provision

of the payment service). We would ask the EBA to confirm that this provision only applies to a banking or payment service that is fully outsourced. Alternatively, if it applies also to the outsourcing of "parts" of regulated services, we would ask the EBA to specific which parts would be deemed to be subject to this provision.

Furthermore, we would ask the EBA to confirm that EU PIs (Payment Institutions) may engage service providers to offer regulated services through a system of chain outsourcing which also includes non-regulated entities.

- Paragraph 26 - Outsourcing to services providers located in third countries. This paragraph introduces the requirement that banking or payment services that require authorisation or registration by a CA in the Member State where they are authorised only outsource to a service provider located in a third country if certain conditions are met. The PSP (Payment Services Provider) outsourcing to a service provider located in a third country should ensure that outsourced service provider is authorised to provide banking or payment services activities in that country and is effectively supervised by the local CA. It also requires the existence of an appropriate cooperation agreement in the form of a memorandum understanding between the CA of both countries. The CA of the outsourcing PSP should be able to obtain the information, access to documents, premises or personnel, cooperate on enforcement in case of breach.

  Preliminarily, we would like to recall the questions posed under Paragraph 25, which are also relevant for Paragraph 26. We note that while outsourcing within the EU is allowed under the relevant national legal framework of the service provider (see above), outsourcing outside the EU is subject to a much more stringent set of rules.

  First of all, the service provider must be authorised and effectively supervised even if, for example, such activity does not require a specific authorisation or supervision in the service provider's country.

  Secondly, the service provider must be located in a country where an appropriate cooperation agreement exists between the firm's supervisory authority and the service provider's supervisory authority. We would like to ask the EBA to clarify what type of cooperation agreements should be considered as valid and we believe that the list of the existing list of cooperation agreements must be made publicly available and regularly updated by the public authorities. We would also ask to clarify if those agreements should be signed with the European Union authorities or at Member States level? If confirmed at Member States level, as discussed during the Public Hearing the EBA will provide a template for this MOU and will support the CA while negotiating their MOU with the CA counterpart in the third country. The timing to get those MOU signed and into effect needs to be taken into account in the Guidelines.

  This EBA provision has a "extraterritorial reach" and imposes European legal obligations on third countries. We believe, that this requirement would be very difficult to apply in practice due to the following reasons:

  (1) Lack of cooperation agreements between Member States and certain third countries where the European PSPs are currently outsourcing their services. Currently highly developed operational activities, technical and technological knowledge, or suitable infrastructure capacities of third countries attract European Financial Institutions, however due to the lack of cooperation agreements, this will not be possible after the Guidelines' enter into force. This would have a severe impact on current organisation/operations/outsourcing, which are already outsourced to various non-EU countries. As a result, these Guidelines will give rise to the need for significant

investments in relocation – this is an unjustified interference in matters that hitherto have always been within the realm of commercial practice. This extra territorial reach is an unjustified encroachment into private commercial matters and of dubious legality.

(2) Potential difficulties related to the obligation, imposing on a third country PSP to allow the European Competent authority to access its premises and personnel. In certain countries that type of requirement could appear to be particularly intrusive into the company's activity and raise questions about the country's sovereignty.

(3) Regarding the timing, it will be not realistic to require the industry to comply with the Guidelines requirements of this provision from its entry into force in 30 July 2019. This short timeframe does not allow Member States or European Institutions to negotiate, agree and sign Memorandum of Understanding with what might be a considerable amount of third countries, obliging European firms outsourcing to these third countries to terminate existing contracts. Therefore, we suggest introducing the transitional period for this requirement.

The EBA in its impact assessment indicates that for the requirements of outsourcing to third countries two options were considered.

Option A which only allows outsourcing to third countries if the service provider is authorised or registered and if appropriate cooperation agreement between the EU CA and that country's CA exists has been retained.

Option B is based on an outcome-focused approach and would allow PIs to choose between a bigger variety of arrangements and mechanisms. However, it would not prevent the CAs in their Member State to effectively supervise them. CA would still have the power to step in, if effective supervision would not be possible.

We believe that Option B is preferable to Option A. As the EBA rightly indicated in its impact assessment, Option A would require CAs to enter into multiple, lengthy negotiations with third countries. In contrast, Option B would offer more flexible and a pragmatic approach. We think that this policy objective can be better achieved by including supervisory authority rights and PSP's obligations to respond to request of information/documents, as part of the contractual obligations between the EU PSPs and non-EU service providers.

Title III

- Part 5 - Conflict of interest

  Paragraph 37 requires PSPs to identify, assess and manage conflicts of interest with regards to their outsourcing arrangements. We would ask this to be limited to "critical or material" outsourcing arrangements.

  Paragraph 38 appears very detailed. We would like to ask for it to be less prescriptive, to clarify the terms of "material conflicts of interest" (including examples of material conflict of interest within the same group) and to provide some guidance (in the form of examples) of "appropriate measures to manage the conflict of interest" and its application in practice.

- Part 6 – Business Continuity plans

The guidelines are not clear as regards the application of the business continuity plan requirements to chain outsourcing. We suggest to clarify that these requirements apply to chain outsourcing on a risk based approach (e.g. the plan should apply to material sub-contractors and PSPs should be able to rely on the service provider testing the sub-contractors' business continuity plans, review the results of such testing (if needed) and conduct direct testing of sub-contractors only in situations where PSPs determine that this is appropriate).

In addition, we kindly suggest introducing the requirement that business continuity plans should include an exit strategy, instead of addressing the latter as a separate topic.

- Register obligation. Title III, Part 8 mandates the PSPs to maintain a register of all outsourcing arrangements at institution and group level. The information that should be included in the register is too detailed. In the case of complex chain outsourcing to third parties, it would be very difficult to include details of all sub-service providers down the chain and to manage changes thereto. This would be a very burdensome requirement for PSPs and their service providers. There should be a materiality threshold (e.g. critical or important functions, critical or important sub-outsourcing) where a PI should be allowed to draw the line. The focus must be not on "who" or "where" performs the outsourced service, but "how" it is performed. Contractual arrangements and appropriate oversight should be enough to provide that level of quality assurance.

  Therefore, we believe the requirements stated in parts b) and c) are not necessary and should be removed. In case those sections are to remain, we'd suggest limiting section b) to (i) name and registered address;(ii) the country of registration and LEI, or if unavailable, corporate registration number; and (iv) whether or not the service provider or sub-service provider is part of the institution's group, based on the accounting scope of consolidation. Obtaining details on (iii) their parent company, (v) the country or countries in which the outsourced function will be performed by the service provider or the sub-service provider; and (vi) the country or countries where data will or will potentially be stored would be difficult and burdensome. We'd suggest following a risk-based approach, as defined above, and limiting the requirements to service provider's head office/main place of business and to countries outside the EU/EEA.

  Moreover, additional human and technical resources (and consequently economic investments) will be required to ensure the register's adequacy and the continued update of provided information.

  Ultimately, such additional resource requirements will distract resources and funds from the appropriate governance and oversight of outsourcing. And may well render PSPs less innovative and competitive at a time where there is every greater pressure to provide services in as lean a way as possible.

Title IV – Outsourcing process

- Assessment of the criticality or importance. According to the draft Guidelines, a PI shall always consider a function as critical or important for the purpose of outsourcing if operational tasks of internal control functions are outsourced - without any materiality qualifier. If a compliance provider was to provide inaccurate data/verification, that would indeed impact the AML/CTF processes. We however disagree that a contract with a provider, which services 30% of customers in one country which only makes up 2% of global revenue, should be considered "critical or important". Arguably it is in both the company's and regulator's interests to have a limited list of "critical or important" contracts so that the key risks can be

focused on. We therefore suggest introducing additional materiality qualifiers to assess whether or not an outsourcing arrangement as regards operational tasks of internal control functions shall be considered critical or important.
Additionally, we would welcome further guidance on purchasing of standardised/licensed software or services that support IT platforms, e.g. webhosting, DDoS systems, data back-up processes. EPIF members think that such agreements should not be considered outsourcing as these are not activities a PI would normally undertake itself. Further clarity that such agreements are not covered by the new test of "materially impair the soundness or continuity of the… payments services and activities", e.g. in case of a failure in DDoS protection that could bring down the PI's website, would be helpful.

- Paragraph 56 requires PSPs to 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, PSPs 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.

  We don't believe it is appropriate for us to be satisfied re the practices mentioned. Should not be part of our responsibility when outsourcing, especially with regard to sub-service providers. Ifn sub-service providers are to be included, a distinction should be drawn between those that are part of the same group and those that are not and only the first 3rd party sub-contractor in the chain should be included.

- 61. d. While we agree with the requirement to consider the factors listed in general terms, a detailed examination for example of the laws in force in jurisdictions hosting outsourced services, particularly where the party may operate across multiple countries, would be unduly burdensome and cost prohibitive to the benefits gained.

- 61.e. We believe that the PSP should define and decide on the security strategy rather than the specific measures thereby allowing them to benefit from engaging an outsourced partner with specialist expertise in providing technical design support for security of new technologies.

- Contractual phase. Title IV point 63 e) requires PSPs to allocate rights and obligations in a written agreement which should include the location where the critical or important functions will be provided or where relevant data will be kept. This provision will create additional time and financial investments, as locations can change, management of the modification would be burdensome and finally not necessary as long as the service provider agrees to comply with all applicable laws. Very difficult to keep track of locations. We believe this should be limited to registered office and main business office as per the contract or subsequent notifications by the service provider. In any case it should be limited to the sub-contractors within the group and the first 3rd party in the outsourcing chain – not beyond.

- Sub-outsourcing of critical or important functions. Title IV, Part 10.1 of the draft Guidelines requires the PSP that is sub-outsourcing services to be able to control and oversee different levels of sub-outsourcing services providers of critical or important functions and guarantee that the availability, integrity, security of data and systems is ensured. In addition, this provision requires the outsourcing PSP to ensure that sub-outsourced company allow complete access to all relevant business premises as well as unrestricted rights of audit.

This provision will create practical issues related to such high level of control requirements of chain outsourcing service providers such as:

(1) Those requirements would potentially generate a situation where the sub-outsourcing companies would start refusing to sign the contracts with the outsourcing PSP, which results in decrease of flexibility and efficiency within the market.

(2) The EBA in its Executive Summary highlights the importance of outsourcing for development of new technologies. Such prescriptive requirements will have a negative impact on this process and will hamper innovation and growth of the Fintech sector.

- 10.3 Access, information and audit rights.

- Some suppliers might be reluctant to grant such broad access rights as envisaged by the Guidance, especially when not located in the EU (as often the case in technology) and/or not performing any critical or important function. Applying the principle of proportionality, it seems unreasonable to expect that all outsourcing agreements, rather than just "critical or important" ones, would contain such extensive agreements, especially in light of the fact that they may be non-material to the business.

- We would like to recall the questions posed under Paragraph 26 on "extraterritorial reach", which are also applicable here.

- Part 11 – Oversight of outsourced functions

  Section 83 requires PSPs to monitor on an ongoing basis the performance by the service provider and, where applicable, sub-contractors. We suggest applying these requirements to chain outsourcing on a risk-based approach (e.g. oversight should apply to *material* sub-contractors and PSPs should be able to rely on the service provider monitoring the sub-contractor's performance, review the results of such monitoring (if needed) and conduct direct oversight of sub-contractors only in situations where PSPs determine that this is appropriate).

- Part 12 - Exit strategies

  We believe this should form part of the business continuity plan. We suggest it not to be so prescriptive and that in its current form, it is very detailed and rather onerous to comply with. Companies should have more flexibility to form their own exit plans.