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By email: outsourcingfeedback@centralbank.ie - Consultation Paper 138 response

26 July 2021

Dear Gerry

Re: Consultation Paper 138 – “Cross-Industry Guidance on Outsourcing”, February 2021 (“CP”) and attached “Schedule 1 – Draft Cross-Industry Guidance on Outsourcing” (“draft guidance”)

The EMA is the EU trade body representing electronic money issuers and alternative payment service providers. Our members include leading payments and e-commerce businesses worldwide, incl. FinTech and BigTech as well as a large number of smaller firms, together providing a wide range of payment-related services, including online payments, card-based products, electronic vouchers, and mobile payment instruments. The vast majority operate across the EU, most frequently on a cross-border basis, and a large number have obtained – or are applying for - licences from the Central Bank of Ireland to provide domestic and cross-border services from Ireland. A list of current EMA members is provided at the end of this document.

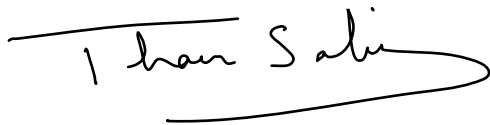
Many of our members have an important role in driving the ongoing technological innovation and more generally the digitalization of financial services in Ireland and the EU. Given our broad membership and the importance of Ireland as a jurisdiction for the provision of payment-related service we very much welcome the opportunity to comment on the CBI’s consultation and the draft guidance attached to it.

As the CP rightly emphasises “outsourcing presents significant and wide ranging benefits to regulated firms” but “also poses risks if not effectively managed”. Outsourcing can contribute to improved operational resilience, and well-balanced supervisory guidance will therefore bolster the positive impact of this contribution. In our response we highlight the need for proportionality in the formulation and implementation of supervisory guidance on outsourcing. This will facilitate access by smaller firms to high-quality services delivered by specialised service

providers, which in turn will enable them to operate in an effective, efficient and secure manner when providing payment/e-money products and services to their customers.

We would be grateful for your consideration of the more detailed comments and proposals in our attached response to the CP.

Yours sincerely,

A handwritten signature in black ink, reading 'Thaer Sabri'. The signature is written in a cursive style and is underlined with a long horizontal stroke that extends to the right.

Dr Thaer Sabri
Chief Executive Officer
Electronic Money Association

EMA response to CP138 and draft guidance

General comments:

The EMA welcomes the CBI's CP and draft guidance, and fully supports its initiative to implement the related EBA, ESMA and EIOPA Guidelines in a transparent manner, based upon consultation with the industry and all concerned sectors.

We welcome the provision of supervisory guidance on outsourcing, given its significant and growing importance in a rapidly changing market environment, and its beneficial role in assisting technological innovation in financial services as well as improved operational resilience.

Many firms in the payments and e-money sectors contribute to the competitive financial services' landscape in Ireland, offering alternative solutions to traditional services provided by banks. These firms are also often smaller players providing specialised or niche products and services, for whom outsourcing plays a significant role in the provision of these services. We consider therefore that a proportionate approach to the application of this guidance is essential and the CBI should make ample use of the supervisory discretion offered by the ESA Guidelines.

We invite the CBI to communicate when publishing its final guidance how it intends to make use of its remaining discretionary powers, and where it would see areas of potential flexibility in its supervisory practices during and after the implementation of its guidance.

We also invite the CBI to prepare and circulate an annual report of OSP Risk Trending and Exposures. This will provide a benefit to both regulators and the industry and improve the industry's ability to manage and address operational and outsourcing risk.

Timeline

We acknowledge that the CBI is bound by the related ESA Guidelines to implement compliant supervisory practices by the end of 2021. However, full implementation by firms in line with the CBI's supervisory expectations set out in the draft guidance will require generous transitional arrangements, and we invite the CBI to make use of its jurisdictional discretion in this regard. Operational resilience and safe, well-managed outsourcing relationships stand to benefit significantly from the granting of additional time for firms to ensure full compliance with the new standards, rather than having to deploy hastily arranged quick fixes.

The tight timeline is particularly problematic with regard to those aspects of the proposed guidance requiring interaction and cooperation with 3rd party service providers (“**OSPs**”) including the review and, as the case may be, renegotiation of the current contractual arrangements (i.e. sections 6, 7 and 8 of the draft Guidance). Smaller firms in particular face specific challenges as a result of their limited negotiation power, in particular when dealing with big, market-dominating OSPs.

However, the challenges related to the short timescale are not limited to the contents of the contractual arrangements. In order to comply, for instance, with the initial and periodic due

diligence requirements (Part B, section 6 of the draft Guidance), firms are dependent upon the timely provision of relevant information by the OSPs they are using or intend to use. Even existing explicit contractual obligations may be of little assistance, as in reality the power afforded to firms to enforce such obligations is limited. Similarly, firms may be dependent on the timely provision of information by the OSPs to comply with the requirement to keep the outsourcing register accurate and up to date (see Part B, section 10.2).

For all requirements that presuppose the timely provision of information by OSPs, we would urge the CBI to explicitly allow for compliance in a proportionate and risk-based manner.

In relation to the due diligence requirement, we support the fact that periodic reviews during the lifecycle of firms' outsourcing contracts (in Part B, Section 6) only requires consideration of the outlined criteria "... as deemed necessary ...". However, it remains unclear when firms may deem it necessary, or – more importantly - unnecessary. We encourage the CBI to adopt a flexible and lenient approach in this regard.

The requirements in the proposed Guidance that point to interaction and cooperation with OSPs are further complicated in relation to OSPs located in 3rd countries in particular where sub-outsourcing is involved. These non-EU OSPs tend to be less familiar with the regulatory environment for the provision of outsourcing services prevailing in the EU. At the same time, effectively cutting off EU-authorized firms from the use of non-EU OSPs that provide services directly or indirectly as part of an outsourcing chain would remove the potentially significant benefits they offer. We therefore consider the CBI should allow for more time to achieve full compliance with the final guidance in relation to such non-EU OSPs. This would also support EU and Irish market participants competing with non-EU players in the digitalized global markets for payment-related services.

Gold-plating

We note a number of areas where the draft Guidance sets out requirements that go beyond those required under the related EBA Guidelines on outsourcing arrangements. We acknowledge the stated objective of the Central Bank to build upon these Guidelines and deliver additional guidance to the Irish financial services' industry. However, we are concerned that some of the country-specific requirements in the Guidance place the Irish financial services' industry under a heavier compliance burden than firms in other EU member states and could impact the competitiveness of the industry. Specifically:

1. **The requirement to conduct initial and periodic due diligence of the “financial situation” (Part B, section 6 a), the “financial performance” (Part B, section 6 h) and the “financial health” (in Part B, section 6.2 b) of OSP:** In contrast the [EBA Guidelines on Outsourcing Arrangements](#) only refer to the “financial situation” of the OSP (Section 12.3 para 71. a). Not only is the meaning of the 3 different terms referenced in the draft CBI Guidance unclear, but the reference to financial performance monitoring appears to introduce a more onerous requirement than the reference simply to “financial situation” in the EBA guidelines. In order to avoid any ambiguity or misunderstanding, we invite the CBI to remove, Part B, section 6 h, and to refer to “financial situation” rather than “financial health” in Part B, section 6.2 b. Here, we also reiterate that regulated firms are not well

placed to review the financial health of OSPs, particularly those that are not publicly listed or not under an obligation to disclose comprehensive information on their financial situation to 3rd parties. Regarding this requirement - as well as a number of the other criteria outlined in Part B, Section 6 - we invite the CBI to consider the enhanced oversight capabilities of Critical OSPs afforded to NCAs in the European Commission draft Digital Operational Resilience Act (DORA) Regulation. We also encourage the Central Bank to take on a more active role in assessing the performance/health of Critical OSPs; such a role may include the provision of centralised OSP intelligence to help firms in meeting their due diligence requirements.

2. **The assessment of criticality or importance required under Part B, section 1:** We welcome the CBI's proposed approach to include the relevant criticality assessment criteria in Appendix 2. In contrast, the related requirements of formulating a defined methodology (Part B, section 1 a), documenting it (Part B, section 1 b), and periodically reviewing it (Part B, section 1 c) are not present in the EBA Guidelines and we believe in the vast majority of cases such a customised methodology is not needed. Applying the comprehensive list of criteria set out in Appendix 2 is a reasonably straightforward exercise. Only firms with a particularly complex and challenging outsourcing risk profile should be expected to take this exercise a step further and develop a specific (documented and periodically reviewed) methodology. We therefore urge the CBI to remove these requirements from the Outsourcing Guidance. Any related supervisory request should be subject to firm-specific proportionality considerations and possibly linked to the CBI's firm-specific PRISM rating. At the very least, the CBI should make it clear that related generalised requirements are subject to proportionality, and that compliance should be strictly risk-based.
3. Similarly, the requirement to **submit to the Central Bank the regulated firms' "outsourcing register" on a periodic basis** goes beyond the requirements set out in the EBA Guidelines and - from the perspective of proportionality and risk relevance - in the vast majority of cases is not needed. For firms with a comprehensive and complex outsourcing risk profile, the submission of related outsourcing information on a periodic basis may be of supervisory relevance. However, we question the supervisory benefits of this requirement for the majority of firms. Accordingly, here again any supervisory request to submit periodic reports should be driven by firm-specific proportionality considerations and by the CBI's PRISM-rating. The majority of firms should be required only to submit ad hoc notifications of material changes, and to properly maintain their outsourcing register and make it available on request (as provided for in para 55 and 56 of the EBA Guidelines on Outsourcing). A more reasonable approach that the CBI may wish to consider would be to require firms to record the top 5 OSP risks in the Operational Security and Risk Assessment report submitted to the CBI on an annual basis.

Moreover, the requirement to submit compliant Registers by January 2022 effectively amounts to an obligation to maintain an accurate and up-to-date register well before that date. This is simply unrealistic, particularly if the CBI's final Guidance is not published until Q3 2021. In this context, we encourage the CBI to accommodate a proper and thorough

implementation of the Guidance by allowing a generous transitional period (ideally until the end of 2022).

- 4. Exit Strategies required under Part B, section 9.1:** Unlike the requirements set out in para 106 of the EBA Guidelines, the CBI proposes that such strategies should also be developed for the outsourcing of functions that are neither critical nor important (Part B, section 9.1 3rd paragraph: “... b) *Have a clearly defined and documented exit strategy in place (in particular for their critical or important outsourcing arrangements) ...*”). We appreciate that a supervisory request to develop and maintain an Exit strategy and plan for an outsourcing arrangement that is neither critical nor important may be warranted and proportionate in exceptional cases. However, we are concerned that the introduction of a blanket requirement that applies to all outsourcing relationships introduces an unnecessary burden for all firms. We therefore urge the CBI to explicitly limit the requirement of developing and maintaining Exit Strategies to Critical and Important outsourcing arrangements.

Moreover, intra-group outsourcing arrangements call for a specific supervisory approach and treatment. If related to critical or important functions these Intra-group outsourcing arrangements are often an integral element of the business and operational model at the group level, and key for the ongoing viability and sustainability of the business. Accordingly, disruption of the outsourced services for whatever reason could give rise to a commercial decision to cease the business activities of the entire group or parts thereof. In any case, firms monitor such risks through their risk management framework. Regulated firms should have the freedom to take such a commercial decision and hence should not be under the obligation to develop and maintain exit strategies towards 3rd party OSPs that, if implemented, would result in the commercial non-viability of their business. We therefore urge the CBI to allow an exemption from the general requirement to develop an Exit strategy in such cases. We do not believe that intra-group outsourcing arrangements should effectively be prohibited just because the exit to a 3rd party OSP may not be a commercially viable option.

- 5. The requirement for Assurance testing of the effectiveness of outsourcing management arrangements to be carried out by the first/second line of defence of a firm (in Part B, Section 8.1.e).** The effectiveness of these arrangements is already tested by the third line of defence of a firm (Internal Audit function) per Section 8.3. In this context, we consider that this requirement introduces unnecessary duplication of effort; we urge the Central Bank to remove this requirement.
- 6. The requirement to Conduct coordinated testing of business continuity arrangements with OSPs on a regular basis “and report the results to the boards of both the regulated firm and the OSP”.** This requirement fails to acknowledge the power dynamic in the relationship of many firms with the larger OSPs. The ability of the firms’ to mandate “co-ordinated testing” and for the reporting of such testing to form part of the Board information pack of the largest OSPs is very limited. Again, we would encourage the Central Bank to revert to the language in the EBA guidelines that points to the less onerous

requirement to conduct business continuity planning/testing that considers the business continuity measures adopted by the firms' OSPs.

More generally, in order to avoid any further and unintended "gold-plating", we would urge the CBI to make ample use of the approach adopted in Appendix 2. The CBI would of course remain at liberty to apply more or less demanding requirements on individual firms in line with the principle of proportionality and based upon its discretionary powers.

Consultation Questions:

Question 1:

Are there are aspects of the Guidance that are unclear? If so, please advise what these are and provide suggestions on the additional clarity required.

As set out before, the CBI guidance would benefit from more clarity regarding:

- The notion of "... as deemed necessary ..." in Part B, section 6 (see our related suggestions above);
- The terms "financial situation", "financial performance", and "financial health", which we consider are already achieved by retaining the notion of "financial situation" and dropping the reference to "financial performance" and "financial health" (see our related suggestions above);
- Exit strategies, in particular in the case of intra-group arrangements (see our related suggestions above).
- The requirement to retain detail on terminated outsourcing arrangements in the Outsourcing Register for an "appropriate retention period" for Critical/Important business functions. It would be useful to clarify the Central Bank's expectations for the duration of retention of such data.
- The scope of advance notification that firms should provide to the Central Bank related to proposed changes to (or the establishment of new) outsourcing relationships for Critical/Important business functions to afford the CBI appropriate time to perform a supervisory assessment of the risks associated with such a proposal (see Section 10.1.1 of the Guidance).

Question 2:

What, if any, are the other areas/topics that should be covered in the Guidance (specify sections) or in future versions of the Guidance?

We do not propose to include any additional areas or topics in the Guidance, but instead urge the CBI to initiate an ongoing in-depth dialogue with the industry to accompany the implementation phase and transition period. We consider such a dialogue would be helpful for both firms and the CBI, and would contribute to swift and effective improvements to operational resilience across the Irish financial markets and all involved sectors. It would assist

firms in their understanding of, and hence compliance with, the CBI's supervisory expectations, and would assist the CBI in understanding where more specific guidance, or topics for inclusion in future versions of the Guidance, might add value.

Question 3:

What, if any, are the significant issues /or concerns or unintended consequences that might arise due to the provisions of the Guidance?

As mentioned above, it will likely be impossible for firms to meet the short deadline to achieve full compliance, in particular with regard to those aspects of the draft Guidance that require interaction and/or review and renegotiation of contractual arrangements with OSPs, especially if these are located in non-EU countries. Where exits from existing outsourcing arrangements are triggered, continued provision of high-quality services to clients, at current standards of market-wide operational resilience, may well be jeopardized.

Question 4:

The Central Bank has considered existing sector specific legislation and guidance as they pertain to outsourcing and is of the view that this Guidance serves to provide additional clarity on the Central Bank's expectations and best practice when firms utilise outsourcing. Are there any particular aspects of the Guidance that appear to be at odds with existing sectoral requirements and could give rise to confusion/ misinterpretation? If so please provide details on any aspects which you believe may cause confusion and suggest how best to address such issues.

We are not aware of any aspects of the draft guidance that are at odds with existing requirements and therefore could give rise to confusion.

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