

Perspectives on the EBA Guidelines - overhead or opportunity?

By Mike King (TORI Global) and Martin Cotterill (Taylor Wessing), October 2019

THE EBA GUIDELINES ON OUTSOURCING

The EBA Guidelines on Outsourcing, which came into effect on 30 September 2019, are designed to provide a harmonised framework to promote greater consistency in the assessment, selection, contracting and management of outsourced services across the EU and its various regulatory bodies. The approach taken in the Guidelines will continue to apply in the UK regardless of the Brexit outcome. This article is the first in a series of articles, webinars and events on how what appears to be a significant overhead may turn into opportunity.

Focussed on a financial institution's governance to effectively manage outsourcing arrangements, the Guidelines provide comprehensive foundations upon which institutions must build robust policies and processes. They cover specific and detailed sets of requirements that must be implemented when contracting for outsourcing services, including intragroup arrangements.

Since the Guidelines were first published for consultation, the focus has been on the increased burden on impacted firms and, by extension, the supply market and Fintech community. However, while additional requirements invariably lead to more work, there is an alternative perspective that is worth exploring.

OPPORTUNITY KNOCKS

The EBA Guidelines might be considered long overdue. Indeed, given the increased role that outsourcing arrangements play in the financial services sector's access to transformational technology, services and products, they were undoubtedly inevitable. It is positive that regulators have taken a harmonised approach to the rapidly emerging technologies and services deployed by financial institutions. While a large part of the financial services community – most notably the insurance industry – is not yet affected by these Guidelines, EIOPA's recently concluded Guidelines on outsourcing to cloud service providers follow the same path taken by the EBA. It would be reasonable to expect that similar provisions will apply in the insurance industry in the near future.

In a global economy undergoing significant fragmentation and pressures on profitability, any alternative would likely have a far bigger impact on growth. Imagine a world where the likes of cloud services, machine learning and blockchain technologies were somehow curtailed or discouraged by regulators, against a backdrop of current imperatives such as open banking, operational simplification and increased

transparency demands. A set of consistent requirements that assist with risk management can only be an advantage.

With this in mind, implementing the Guidelines may also provide significant opportunities for financial institutions and Service Providers alike.

ACCELERATING AWAY FROM THE PACK

When you have a single, consolidated reference point for defining what is good practice on an industry-wide scale, you might also take the view that you have just been handed a blueprint to exceed the mandate and develop best practice in a way that might assist in accelerating away from your competitors; enabling innovative, transformational deals, creating delivery ecosystems rather than just supply chains. If you understand how to truly manage risk in a sophisticated manner, you will be able to harness the best of innovation and leverage contracts that work to achieve desired outcomes, rather than just shift risks contractually while you police the contract, as opposed to managing the project.

Instead of merely going through the compliance motions, perhaps the better approach is to see the Guidelines as a resource and a starting point for defining policies, frameworks and processes that unlock the capability of your organisation to drive better outcomes, obtain greater value from the community that delivers services and, most importantly, deal with risks actively rather than passively.

This shift of perspective should not necessarily just apply to financial institutions but should extend to the supply organisations and Fintechs whose services will feel the sharp end of the Guidelines' requirements. There is much to gain by embracing the Guidelines, even perhaps creating market responses that enhance the service offering. Can we envisage a future in which a Fintech could carry an "EBA Compliant" kite mark on its brochure?

THE FINANCIAL INSTITUTIONS' PERSPECTIVE

Building effective internal governance, drafting and implementing relevant policies and processes, managing and mitigating risks, are not new concepts and nor are the regulatory requirements that form the genesis for significant elements of Guidelines. You can track inputs from SYSC 8¹, GDPR², BRRD³, MiFID II⁴, PSD2⁵ among others. The requirements for governance and risk management frameworks essentially existed before the Guidelines came into effect. Implementing the Guidelines in time for their effective date was, for most, incremental to existing, established structures.

¹ Senior Management Arrangements, Systems and Controls sourcebook (SYSC) of the FCA Handbook.

² Regulation (EU) 2016/679 (General Data Protection Regulation)

³ Directive 2014/59/EU - Bank Recovery and Resolution Directive

⁴ Markets in Financial Instruments Directive 2004

⁵ Payment services (PSD 2) - Directive (EU) 2015/2366

If, however, the approach to such incremental analysis and compliance exercise has been to take existing systems and processes and update them so they comply with the Guidelines, then perhaps you might be encouraged to consider this as merely the first step in the process, not the closing one.

If you implement the obligations in the Guidelines effectively, not just as a one-time compliance project to build ongoing capability, you are more likely to derive optimum value from your supply chains. You can benefit from enhanced risk management (supplier risk being better identified, analysed and mitigated) and sophisticated leveraging of supplier capabilities (effective risk management that supports a more rapid and productive use of leading technologies, speed to market and cost optimisation opportunities).

Perhaps more important still is to take a critical look at the structures that have been put in place by your own institution through contracting policies and updated standard terms and positions that have been developed through your compliance drive to the 30 September. The Guidelines contain mandatory and specific requirements that must be in any contract, including restrictions on sub-contracting, mandatory audit rights and termination triggers. However, the contracting requirements in the Guidelines also allow for an institution to craft their own requirements, provided they achieve the desired outcomes. They are not prescriptive but are designed to address the identification and management of risk through topics such as performance management business continuity, exit planning and execution, and reporting and governance, among others.

How you, as an institution, approach this, particularly as you will now be embarking on the remediation of existing outsourcing arrangement contracts that must be achieved over the next two years (with a deadline of 31 September 2021), will be vital. This may be a determining factor as to how successful you are in acquiring leading technologies and exploiting speed to market and cost optimisation opportunities. Many large corporations approach compliance by creating a set of rules and standards and inflexible contracting policies that shift all or most of the risk and liability onto suppliers. But does such a uniform approach, with very little nuance or flexibility, actually achieve results? Compare that approach with Fintech solutions, where emerging technologies, quite often developed by young companies still in their early growth stages, can deliver game-changing results. You have to question whether it's effective to shift hefty liabilities onto fragile balance sheets that may be unable to meet such liabilities, or young, resource-constrained companies who do not have the depth of experience to support complex process burdens.

A rigid approach may also start to give rise to unintended consequences. You may start out with a business desire to gain access to the development of cutting-edge technology, whereby the Fintech is relying on revenues to attract further investments to fuel such development. But burdening the Fintech with potential liabilities may hamper its ability to attract further investment. One size almost certainly cannot fit all, and institutions should evolve their contracting policies and terms to build in alternative approaches to risk management that can achieve the desired outcome on a safer footing.

In response, Service Providers will be better equipped to support these processes, ultimately benefiting the industry as a whole. If you have developed strong partnerships with key providers, there is opportunity to resolve issues rapidly and ahead of competitors. Ultimately, early adopters will be best placed to optimise these benefits.

THE SERVICE PROVIDER PERSPECTIVE

Each Service Provider supporting financial institutions subject to the Guidelines, is now presumed to need compliant contracting. Failure to meet these requirements means, at worst, lost business and, at best, lengthy and possibly unproductive negotiations and sales cycles while solutions are developed and approved, often through extensive and time-consuming governance processes.

Service Providers who quickly recognise these needs, and adapt accordingly, might be able to provide themselves with a material advantage. This will apply whether you are a Service Provider behemoth, or a small, young company with a limited track record. Any improvement to quell an institution's nervousness at doing business with you by inspiring increased confidence in processes and procedures that specifically address their requirements demanded by the Guidelines, will give you a competitive advantage.

Knowing the questions financial institutions will ask you during any tender process and having demonstrable solutions to compliance issues will help you to be taken seriously. This is not only a helpful way to avoid over-burdensome contracts, it will also certainly be the only way you are going to mitigate any liability.

For example, the audit rights requirements that will now be coming your way, if accepted passively, will result in you having to take on board a variety of individual audit demands from a number of clients. If you multiply this across all contracts, it doesn't take long to become highly disruptive. By taking an active approach, you might consider (and the Guidelines allow) consolidation of auditing through certified external auditors. Here, you self-audit for your entire customer base to the required standards using a trusted third party with robust and rigorous audit processes. This creates something akin to a self-certification scheme that puts you on the front foot and gives you a greater chance of identifying and addressing issues before they become intractable problems.

EARLY COMPLIANCE IS KEY

The EBA Outsourcing Guidelines represent one of the most comprehensive and detailed set of requirements that have been published on an industry level. Compliance may prove a significant effort, but the benefits of complying, and doing so quickly, could be material. There are significant opportunities, particularly for Service Providers, to position themselves as 'compliant-capable' and steal a march on their competition, certainly increasing customer confidence.

Institutions now grappling with the roll-out of their compliance efforts can also gain by evolving their response to the Guidelines and creating value-add, not just to police risk but to manage it actively and effectively.

If you'd like to discuss how we can help, or understand more, please contact us via the details below.

PROFILES

Mike King

Mike is senior Procurement leader with 15 years of experience in Strategic Sourcing and Supplier (Risk) Management, with a specialist focus on IT outsourcing, predominantly in the Financial Services industry. Mike has previously managed deals with values up to £2bn. He has also been responsible for managing complex supply chain integrations as part of deal implementation (with global annual spend of c£200m), having managed Third Party regulatory requirements, as well as Third Party Risk optimisation.

Mike's current focus is advising on the impact of the EBA Guidelines on Outsourcing. Having worked across a number of financial institutions, Mike is now heading the Procurement and Third-Party Management practice at TORI Global, an independent management consultancy specialising in Financial Services.

mike.king@origlobal.com

www.origlobal.com

Martin Cotterill

Martin is a partner in the Technology and Outsourcing Group at Taylor Wessing. He specialises in complex technology and outsourcing transactions, strategic alliances and technology joint ventures, particularly within the financial services sector. Martin leads Taylor Wessing's Outsourcing practice and is a key member of the Fintech practice. Ranked as one of the leading outsourcing and technology professionals in the Chambers UK Guide, Martin has advised on some of the industry's landmark outsourcing deals over the last fifteen years and has led some of the largest IT and business process outsourcing transactions undertaken.

Chambers UK recommends Martin for his commercial awareness, stating he is a "superb outsourcing lawyer" who is "the first port of call for particularly complex matters".

m.cotterill@taylorwessing.com

www.taylorwessing.com