



**ADVISORY**  
Industry Information

## Central Bank publishes Cross-Sectoral Outsourcing Discussion Paper

23 November 2018

### Executive Summary

On 19 November 2018, the Central Bank of Ireland (the “Central Bank”) published a discussion paper entitled “*Outsourcing – Findings and Issues for Discussion*” (the “Discussion Paper”) containing a summary of key issues and risks identified by the Central Bank requiring prompt attention by industry. The closing date for submission of responses to questions posed in the Discussion Paper is 18 January 2019.

The findings in the Discussion Paper are underpinned by both the Central Bank’s supervisory engagements with industry along with responses received from a recent cross-sectoral outsourcing survey (completed by 18 banks, 82 asset management sector firms, 83 insurers and 2 payment institutions).

In its announcement of the publication of the Discussion Paper, the Central Bank noted it has observed:

- » a significant increase in reliance on outsourcing of activities (both on an intragroup and third party basis) by regulated financial service providers;
- » serious deficiencies in board awareness and understanding of the extent of reliance on outsourcing; and
- » major weaknesses in relation to risk management controls and processes, and business continuity planning around outsourcing.

The Central Bank expects all regulated financial service providers to review their current practices against the Discussion Paper.

### Format of the Discussion Paper

The Discussion Paper is split into two sections. Part A deals with the Central Bank’s minimum supervisory expectations around the management of outsourcing risks and sets out the Central Bank’s findings in relation to current practices in the Irish market, while highlighting particular weaknesses that should be promptly addressed.

The Central Bank has noted that its focus on this area has been borne out of increasing concerns in relation to outsourcing practices and a recognition by the Central Bank of a widespread failure of industry to implement governance, risk management and business continuity practices to the standards expected by the Central Bank.

Part B examines some of the keys risks and evolving trends associated with outsourcing while also identifying ways firms might mitigate these risks.

The Discussion Paper also provides a summary of the issues to be addressed by regulated firms engaging in outsourcing while inviting input and discussion from industry on these points.

The Central Bank has also noted that it will hold an outsourcing industry conference in the first quarter of 2019 and that feedback received on foot of the publication of the Discussion Paper will “*inform ongoing discussions around outsourcing trends, key issues and the appropriate regulatory response*” at this conference.



## Key Findings and Next Steps

The Discussion Paper contains a range of detailed and granular findings, statistics and recommendations which should be closely read by all regulated firms engaged in outsourcing.

In a statement accompanying the launch of the Discussion Paper, the Central Bank's Director of Policy and Risk, Gerry Cross, expressly confirmed that the Central Bank expects firms to analyse the content of the Discussion Paper and address any issues relevant to their outsourcing practices. Importantly, Mr. Cross also stated that firms can expect Central Bank supervisors to seek evidence of updates by firms to their risk management frameworks demonstrating consideration of the Discussion Paper and that any relevant findings have been implemented accordingly.

We have summarised at a high level in the table below the Central Bank's findings in terms of both its current supervisory expectations and the key risks and trends associated with outsourcing.

The Discussion Paper also references Brexit noting that the evolving landscape of migrating firms *"is likely to involve a substantial level of intragroup outsourcing as firms seeking to become authorised in Ireland look to outsource to existing group entities located in the UK"*, and notes that the unique risks of this type of outsourcing should be expressly considered.

In addition, the Discussion Paper usefully contains a reference list of applicable legislation/guidance regulated firms should also consider when assessing their legal and regulatory obligations in relation to outsourcing. The Central Bank also points to the ongoing work of the European Supervisory Authorities in producing outsourcing guidance, noting in particular that the EBA Draft Outsourcing Guidelines 2018 are (though still in draft, and not applicable to all sectors) a source of useful information.

## Conclusion

Firms regulated by the Central Bank and engaging in outsourcing practices should promptly carry out and document an exercise in assessing whether their current outsourcing practices require updating or enhancement in order to meet the standards of the Central Bank as outlined in the Discussion Paper.

It is expected the Central Bank may prioritise inspections of regulated firms' outsourcing practices in 2019 following completion of this engagement with industry stakeholders. It is also noteworthy that the Central Bank has previously imposed substantial fines under its administrative sanctions procedure for breaches of outsourcing and IT governance requirements.

## Contacts

If you have any queries on the content of the Discussion Paper and/or the impact that it may have on you and your business, please speak to your usual contact in Walkers or contact:



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## Table of Principal Findings, Focus Areas and Trends

The Central Bank identified Governance, Risk Management and Business Continuity Management as the areas requiring the immediate attention of regulated firms entering into outsourcing arrangements.

The Central Bank has highlighted the following specific points that regulated firms should consider and ensure are sufficiently addressed by their outsourcing practices and policies:

<b>Governance</b>	The board of directors of regulated firms should be engaged with and fully informed regarding the level of outsourcing being employed and the risks associated with the firm's reliance on outsourcing. The Central Bank noted that the board of a regulated firm should exercise control regarding the decisions as to the particular activities that are outsourced. Regulated firms should also address relevant outsourcing risks in their outsourcing risk management frameworks.
	Regulated firms should ensure that applicable regulations and guidelines relating to outsourcing are identified in the firm's outsourcing policy document, with consideration being given in the policy document to the level of outsourcing and the nature of the roles and functions being outsourced, in order to identify where particular sensitivities and exposures to risks exist and to inform the firm's outsourcing strategy.
	Regulated firms should develop and employ a risk management framework that allows the firm to allocate responsibility for oversight of particular elements of the firm's outsourcing arrangements.
	All outsourcing arrangements entered into by regulated firms should be formalised and documented by service level agreements which set out service levels and include measurable performance metrics and remedies for performance shortfalls.
<b>Risk Management</b>	Regulated firms should ensure that, prior to entering into outsourcing arrangements, a comprehensive analysis of all associated risks is undertaken. This analysis of risks should also be the subject of ongoing periodic review and update.
	Prior to entry into outsourcing arrangements and on an ongoing periodic basis, outsourcing service providers and related entities should be subjected to financial and operational due diligence by or on behalf of the regulated firms.
	Regulated firms should engage in an exercise of evaluating the nature and importance of outsourced activities to ensure an appropriate level of risk management is applied to particular outsourcing arrangements.
	Regulated firms must ensure that adequate resources are allocated to ensure appropriate monitoring, management and on-site inspections of outsourcing service providers and the services provided to the firm.
	In adopting a strategy whereby various functions and activities are outsourced, regulated firms should ensure that staff with an adequate knowledge and understanding of the functions being performed by outsourcing service providers and the appropriate level of service to be provided are retained, thereby allowing the firm to accurately assess outsourcing service provider performance and if changes to services or outsourcing providers are required.
<b>Business Continuity Management</b>	Regulated firms should engage in ongoing testing and assessment of business continuity arrangements to ensure sufficient contingencies are in place or to identify weaknesses and deficiencies.
	Regulated firms should develop effective 'exit strategies' or repatriation contingency plans. These 'exit strategies' must be documented and subjected to trials and assessments.



The Discussion Paper also identifies the following trends and developing risks in the area of outsourcing of which regulated firms should remain cognisant and of which the Central Bank will no doubt be vigilant going forward.

<b>Growth of Outsourcing</b>	The growth in the level and breadth of outsourcing being implemented by regulated firms.
<b>Outsourcing of Risk Management and Internal Controls</b>	The increasing prevalence of the outsourcing of functions such as risk management and internal control.
<b>Reliance on Outsourcing of Sophisticated Activities</b>	An increasing reliance on outsourcing of functions related to IT services and on innovative fintech, regtech and corporate service providers.
<b>Data Sensitivity</b>	The high percentage of outsourcing arrangements that involve the transmission of sensitive customer and business data and the associated risks and obligations.
<b>Diversification</b>	A lack of sectoral and geographic diversification of outsourcing service providers used by regulated firms and the risk associated with such an outsourcing model.