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EBA publishes Final Guidelines on Outsourcing

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Executive Summary

On 25 February 2019, the European Banking Authority (the “EBA”) published its [Final Report on EBA Guidelines on outsourcing arrangements](#) (the “Guidelines”). This follows the November 2018 publication by the Central Bank of Ireland (the “Central Bank”) of its [Outsourcing – Findings and Issues for Discussion](#) paper (addressed in [our briefing](#)) and further illustrates regulatory authorities’ increasing focus on the outsourcing of services by financial institutions.

What entities are in scope?

The Guidelines apply to institutions within the EBA’s regulatory scope, including credit institutions, investment firms subject to CRD IV, payment institutions and e-money institutions (“**In-Scope Entities**”).

The Guidelines replace the 2006 [Guidelines on Outsourcing](#) issued by the Committee of European Banking Supervisors and subsume the EBA’s [Recommendations on outsourcing to cloud service providers](#) (the “EBA Cloud Guidance”); and so In-Scope Entities will now only need to consult one set of European guidelines for both non-cloud and cloud outsourcings.

The Guidelines apply from 30 September 2019 and all new outsourcing arrangements or arrangements renewed after that date must be compliant. All current outsourcing arrangements must be compliant by 31 December 2021. Obligations arising from the EBA Cloud Guidance which are currently applicable are not affected and remain in force.

Key Topics covered by the Guidelines

The Guidelines address the following areas:

1. **Proportionality and group application:** In-Scope Entities may apply the Guidelines in a proportionate manner which is consistent with the nature, scale, complexity and risk of both their business model and of the outsourced activities. The Guidelines also detail how they apply in a group context.
2. **Assessment of outsourcing arrangements:** The Guidelines provide criteria to determine both whether a given activity constitutes outsourcing for the purposes of the Guidelines, and also to determine whether any outsourcing is “*critical or important*” and thus subject additional requirements under the Guidelines.
3. **Governance framework:** The Guidelines require an In-Scope Entity engaging in outsourcing to implement an extensive governance framework including:
 - » the development of a risk management framework to monitor and manage outsourcing risk;
 - » the assignment of responsibility for outsourcing;
 - » processes to monitor and manage conflicts of interest;
 - » the maintenance and periodic testing of business continuity plans;
 - » the maintenance of a prescribed form of register of all outsourcing arrangements (which is to be provided to the Central Bank upon request);



- » the adoption of a written outsourcing policy providing for the In-Scope Entity's outsourcing framework; and
 - » the review of the In-Scope Entity's outsourcing framework by the internal audit function.
4. **Outsourcing process:** The Guidelines set out the steps to be undertaken by an In-Scope Entity when outsourcing an activity including: assessing whether a function is critical or important; ensuring that the necessary regulatory conditions are satisfied; undertaking a prescribed form risk assessment and due diligence review; entering into a written outsourcing agreement which contains specific provisions set out in the Guidelines (including in relation to the sub-outsourcing of critical and important functions, the security of data, and access, information, data and termination rights); the oversight of all outsourcing arrangements; and the development of an exit strategy and exit plans for all outsourced activities.
5. **Guidelines addressed to competent authorities:** The Guidelines also provide guidance for national competent authorities in monitoring compliance of institutions' outsourcing arrangements.

Conclusion

The Guidelines represent a significant increase in the regulatory standards applied to outsourcing by In-Scope Entities at a European level and will likely require a review and overhaul of such firms' operational and governance procedures involving multiple internal or group stakeholders (e.g. risk and internal audit functions). In-Scope Entities engaging in outsourcing should review their current arrangements against the requirements set out in the Guidelines.

The Guidelines present a number of potentially significant challenges to In-Scope Entities, such as:

- » The terms (including financial terms) of intra-group outsourcing arrangements should be set on an arm's length basis (subject to limited conditions). This requirement may lead to operational issues and tax consequences.
- » Many requirements of the Guidelines (including provisions to be included in written outsourcing agreements such as the access and inspection rights of the In-Scope Entity, the reporting obligations of a service provider, and the integrated testing of business continuity plans) will affect the negotiation of contracts with service providers, and may require the preparation of checklists or pro-forma contractual riders to ensure the compliance of all outsourcing arrangements by 31 December 2021.
- » Newer market participants, including FinTech entities, may now find themselves within scope of the Guidelines. The additional compliance and contractual burdens could present a challenge to such entities where they seek to remain agile, flexible and innovative. Similarly, FinTech and RegTech service providers providing solutions to In-Scope Entities will need to review their offerings to ensure compliance with the Guidelines.

In light of the increased supervisory focus of regulatory authorities on the outsourcing arrangements of regulated entities and the potential enforcement for breaches of legislative outsourcing governance requirements, In-Scope Entities should take all steps to ensure compliance with the Guidelines to meet the required standards. Regulated financial service providers that are not directly in-scope may also find the Guidelines a useful reference for best practice when outsourcing.

Key Contacts

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



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