



**Committee of European
Banking Supervisors**

Brussels, 30 July 2004
VH/vh/B2/8948

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Consultation Paper 02 : High Level Principles on Outsourcing

Ladies, Gentlemen

The European Association of Cooperative Banks (EACB)¹ welcomes the CEBS's initiative to develop High Level Principles on Outsourcing in order to ensure convergent supervisory practices regarding this very important issue.

Outsourcing, as described in the document, is a very important issue for Europe's co-operative banks. Due to their decentralised "division-of-labour" structures, common bodies or central institutions provide numerous services for the primary banks. Such structures have strongly contributed to the success of co-operative banks.

Accordingly the EACB decided to bring forward its comments, which are set out below.

We are ready at any time to continue our discussions with CEBS on these issues.

Yours sincerely

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Secretary General

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¹ The European Association of Co-operative Banks represents over 4.500 co-operative credit institutions active in all the EU Member states and serving over 100 Million customers. Its member organisations are decentralised national networks of small-sized Co-operative banks' networks, which have a strong presence on a local or regional level. They account for a large part of the SME and private household credit market (17%) and thus play a crucial role within the Internal Market.



The EACB appreciates that the High Level Principles “set out in broad terms” what supervisory authorities expect and that they could be used as “guidelines”. A *convergent* approach to outsourcing should not force national authorities to adopt identical solutions at all times, but rather target equivalent solutions. In fact, a number of member-states already dispose of supervisory standards regarding outsourcing, which are well-adapted to the particularities of the national banking-sector. As long as convergence with the high-level principles is ensured, national authorities should be able to maintain their respective practices.

Definitions

It seems that the document is based on the presumption that the supplier (“another entity”) either is a separate body within a consolidated group or an independent entity. It has to be recalled that in many member states, co-operative groups consist of independent banks, which jointly control certain service providers (payment systems, central banks, data processing centers, etc). These providers may be considerable in size and serve a multitude of (smaller) banks. Not all banks hold shares in the provider. By conclusion, specific governance structures were developed to ensure control and the quality of services.

The wide definition “contractual supply of goods, service or facilities that form part of the business processes and which are necessary to support the provision of banking or other financial services” requires to define exceptions to the rule. Possibly it would be preferable to make a more specific reference to “banking processes” and thereby come to a more precise definition.

In the absence of such wording we think that apart from purchasing contracts the following contracts should not be covered either:

- Renting contracts (e.g. business locations, car park, etc.)
- The hiring of temporary or permanent employees through staffing organizations
- Services not linked to the banking business (restaurant services, cleaning services, medical services, etc.)

Furthermore, the question needs to be raised whether “supply on a structural basis” should not imply certain duration of the underlying arrangements and a certain quantity of cases. It might be inappropriate to submit contracts concluded for individual cases (e.g. the services of a lawyer in a specific court case) under the principles in question.

The Value Chain /

Certain business activities/transactions require the cooperation of different entities (providers) within a value chain of interlinked business processes. This is the case in co-operative groups as well as in other financial groups. A too stringent and formal application of the High Level Principles could make such outsourcing more complicated, more expensive and cut up interlinked processes. Very often, the different providers in the chain are supervised entities themselves. Accordingly, transactions and businesses like the following ones should be exempt from the principles:

- Clearing functions (securities / payments)
- Authorisation bodies for electronic payments
- The activities of the central banks within consolidating/non-consolidating banking-groups
- The involvement of lead-managers, arrangers and agents in syndicated loans.



We suggest that supervisors develop a list of transactions, which should not fall under the principles.

Apart from these cases, the banking business implies the division of labour between banks and/or other supervised entities, as well as the provision of services by regulated professionals (auditors, lawyers, doctors, real estate experts, etc.) The question needs to be raised, whether the outsourcing of services to such providers, should be subject to the high level standards as well. The providers in question are themselves supervised/controlled, so that the added value of the full application of the High Level Principles does not seem evident.

Co-operative Groups

Particular attention should also be paid to decentralised co-operative groups, and their division-of-labour structures, which aim at creating economies of scale. In fact, different situations can be distinguished in this respect:

- *Outsourcing to “superior” entities (multi-service providers)*

In numerous cases, larger banks within co-operative groups provide, as multi-service providers, an important amount of financial services to intra-group units, which are other parts of the group or affiliated at the same central entity. In consolidating groups, parent banks are obliged to ensure and maintain a proper risk management, ensure adequate structures and respect standards regarding organization on group level. Furthermore, the service providers are subject to internal control and audit systems. Accordingly, the outsourcing to such central units in such a group should not be subject to the High Level Standards, since it would increase the bureaucratic burden and lead to a duplication of regulation. In many cases, when both are regulated entities, supervisors will equally have access to both the outsourcing entity and the service provider. Accordingly the respect of supervisory standards in all entities is ensured.

- *Outsourcing to subordinate entities (multi-service providers)*

The same should apply when services are outsourced to multi-service providers as subordinated entities within a group. These subordinated entities may not always be consolidated. However, typically, these subordinated entities are subject to the immediate influence of the co-operative group and its well-defined governance structures. In particular, the service providers are subject to internal control and audit systems of the group. Accordingly a proper management of the risk involved is ensured. Prudential supervision ensures the possibility of direct control of all entities involved. An application of the High Level Principles to these cases would equally seem inappropriate.

- *Outsourcing to non-consolidated entities in non-consolidating groups (multi-service providers)*

In many decentralised co-operative groups specific “sector” providers provide certain business activities as well as certain services for a large number banks, while the latter do not have direct control over the service providers (non-consolidating groups). In general, the services provided to sometimes several hundred banks are highly standardized in order to achieve economies of scale. Control over the multi-service provider, which typically serves banks of “its” sector only, is executed via specific and sound governance structures of the co-operative organisations in question.

It would not be practicable, under such circumstances, that banks retain powers of instruction, control or inspection towards the multi-service provider. In fact, such powers



of banks would counter the underlying aim, which is to create economies of scale as well as lean and efficient business processes. The High Level Principles should reflect this by exceptions for such “multi-providers ».

In fact, the supervisory standards regarding outsourcing of a number of countries dispose of rules, which are well adapted to such particularities of the national banking-sector.

As long as convergence with the aims of the high-level principles is ensured, there should be sufficient flexibility that national authorities can maintain their respective practices.

Responsible Unit,

Under principle V it is suggested that banks should specify an internal unit for supervising and managing each outsourcing measure. We suggest to clarify this passage: It is not clear whether it is intended to oblige banks to indicate different specific units/persons responsible for supervising and managing of outsourcing measures or whether the supervision and outsourcing is to be centralised in one unit.

While the members of the EACB agree that arrangements need to be made for the purpose of a proper organisation of processes, they oppose the idea of a centralisation. It will not lead to increased efficiency if one unit has to manage and control the outsourcing. The management of the outsourcing measures, at least, should remain in the hands of the relevant competent units (e.g. payments, securities)

Concentration Risk

Principle X seems to be based on the presumption that the outsourcing of services to one specialised provider, who serves a wide amount of entities implies increased risk. This approach has to be seriously questioned. In fact, such providers are generally very well equipped, dispose of a better know-how and are well-organized. Accordingly, there should be further clarification as to when such risks require management on the systemic level.

Furthermore, it has to be underlined that service providers, which serve a multitude of banks, e.g. in one group, may not give very far-reaching powers of instruction or control to every customer. The bank therefore only has very limited influence on the handling of the processes. In fact, far-reaching powers of banks would counter the underlying aim, which is to create economies of scale and lean management processes. The High Level Principles should consider this.

Outsourcing to beyond national borders

We suggest that the problem should focus on some aspects of outsourcing beyond national borders. In order to avoid a duplication of inspection and control of outsourced services, supervisors should conclude cooperation arrangements according to which the authority, which has best access the provider, will become active. By no means should the outsourcing entity be held responsible for a national supervisor’s difficulties to access a provider within the EU.

When banking services, which require a banking license, are outsourced to an entity within the EU, the provider will equally have to be a regulated entity established and licensed according to the relevant national legislation. It should be clearly referenced which standards should be fulfilled in this case. If, however, the provider is not a EU-regulated entity, (e.g. a third country provider) it has to be ensured that there is no “prudential arbitrage” and that equivalent standards are maintained.