

# Third Party Outsourcing Risk: The Role for Board Oversight

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ONLINE SEMINAR, PART OF THE  
FBF BANK BOARD ACADEMY FOR NON-EXECUTIVE DIRECTORS



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# Speakers

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# AGENDA

- Introduction and Background on Outsourcing
- Regulatory Policy and Focus
- Practical Implications for Financial Institutions and Board Members
- Open Discussion

# What is Outsourcing?

## Outsourcing means

- an arrangement of any form between
- an institution, a payment institution or an electronic money institution and
- a service provider by which that service provider
- performs a process, a service or an activity
- that would otherwise be undertaken by the institution itself.

*Source:* European Banking Authority, “EBA Guidelines on outsourcing arrangements” (25 February 2019)

*Implementation* expected by 31 December 2021

# Why Does It Matter?

**Outsourcing** oversight is about operational risk management

Consider risks and risk mitigation, including in context:

- Continuity of Operations / Business Continuity Management
- Resiliency and Resolution
- Impact on Revenue
- Cyber security
- Data Protection / Confidentiality
- Reputational aspects



Increased focus on Cloud Providers, and chains of sub-outsourcing or sub-contracting

# Why regulators focus more on outsourcing?

## **Microprudential drivers**

- Changes to banks business models and distribution channels
- More use of outsourcing – efficiency, access to new technologies
- Ensure compliance with banking and other regulation, e.g. GDPR

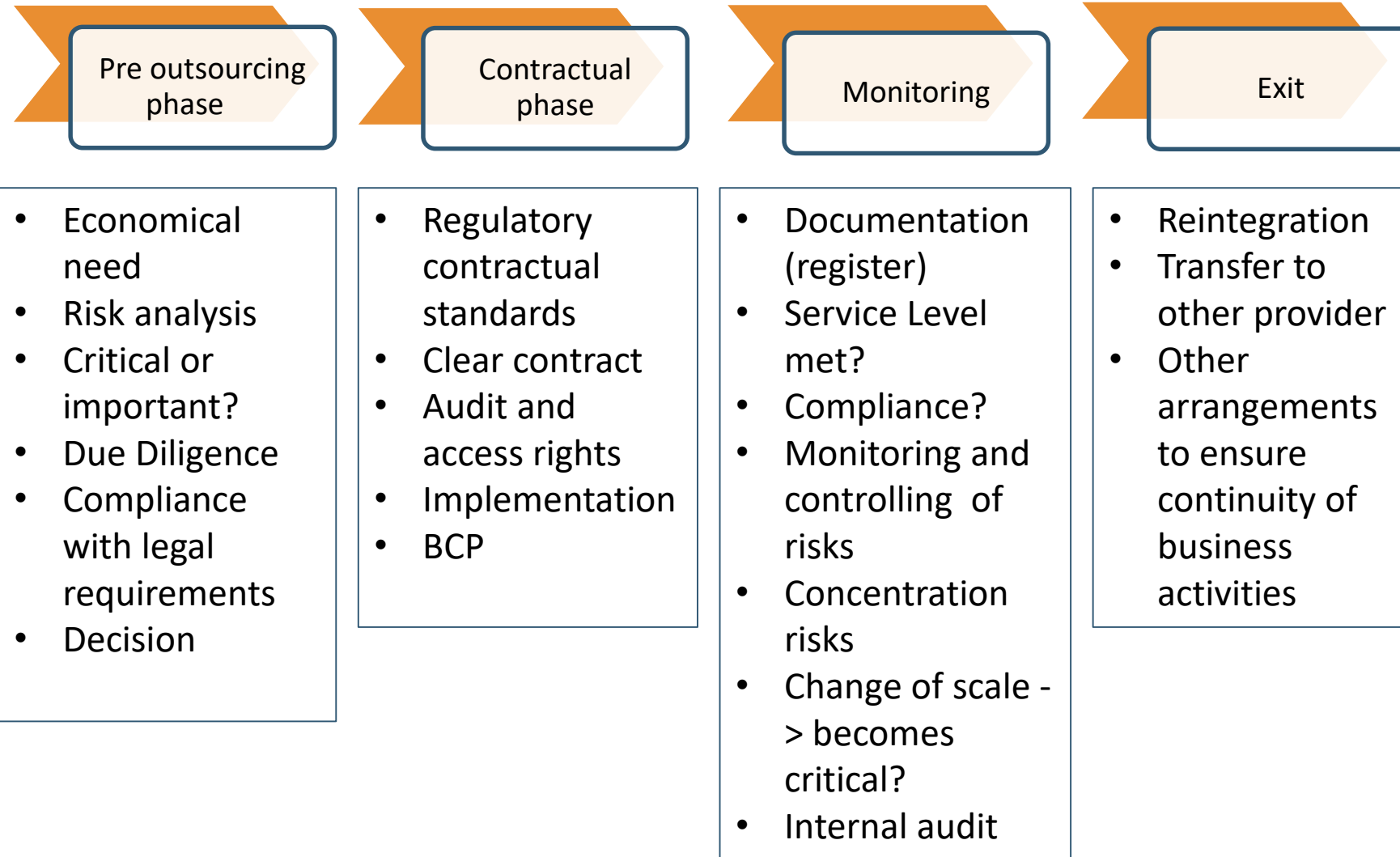
## **Macroprudential drivers**

- Concentration of risks at service providers (Bigtechs and others)
- Contagion in case of operational risks (e.g. business disruption)

## **Regulatory objectives**

- Maintain ability to effectively supervise banks
- Ensure resolvability of banking groups that use intragroup outsourcing
- Ensure stability of the financial sector by ensuring sound outsourcing arrangements – keeping risks under control

# Summary of the outsourcing process under the EBA Guidelines on Outsourcing



## What next?

### Supervisory Review and Evaluation Process

- Review also at service providers
- Identification of potential concentration risks

### EU Digital Financial Strategy

### Digital Operational Resilience Act

*Key building blocks*

ICT risk  
management

ICT-related  
incidents

Digital  
operational  
resilience testing

ICT third party risk  
management





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# Outsourcing – what challenges do banks face?

- Volume – increasing number of service providers
- Timing – review cycle versus real-time dependency
- Market power and ability to influence service offering
- Sub-contractors and sub-outsourcings
- Cross-border aspects (including regulatory requirements, notwithstanding trend towards harmonized principles)
- Outsourcing and activity allocation within a group
- Proportionality / possible unintended consequences (checklist approach)
- Availability of shared solutions (due diligence, monitoring, audits)

# Practical Aspects: Focus on *Critical* Activities

## EBA

**Critical** (or important) functions include

where a defect or failure in its performance would materially impair :

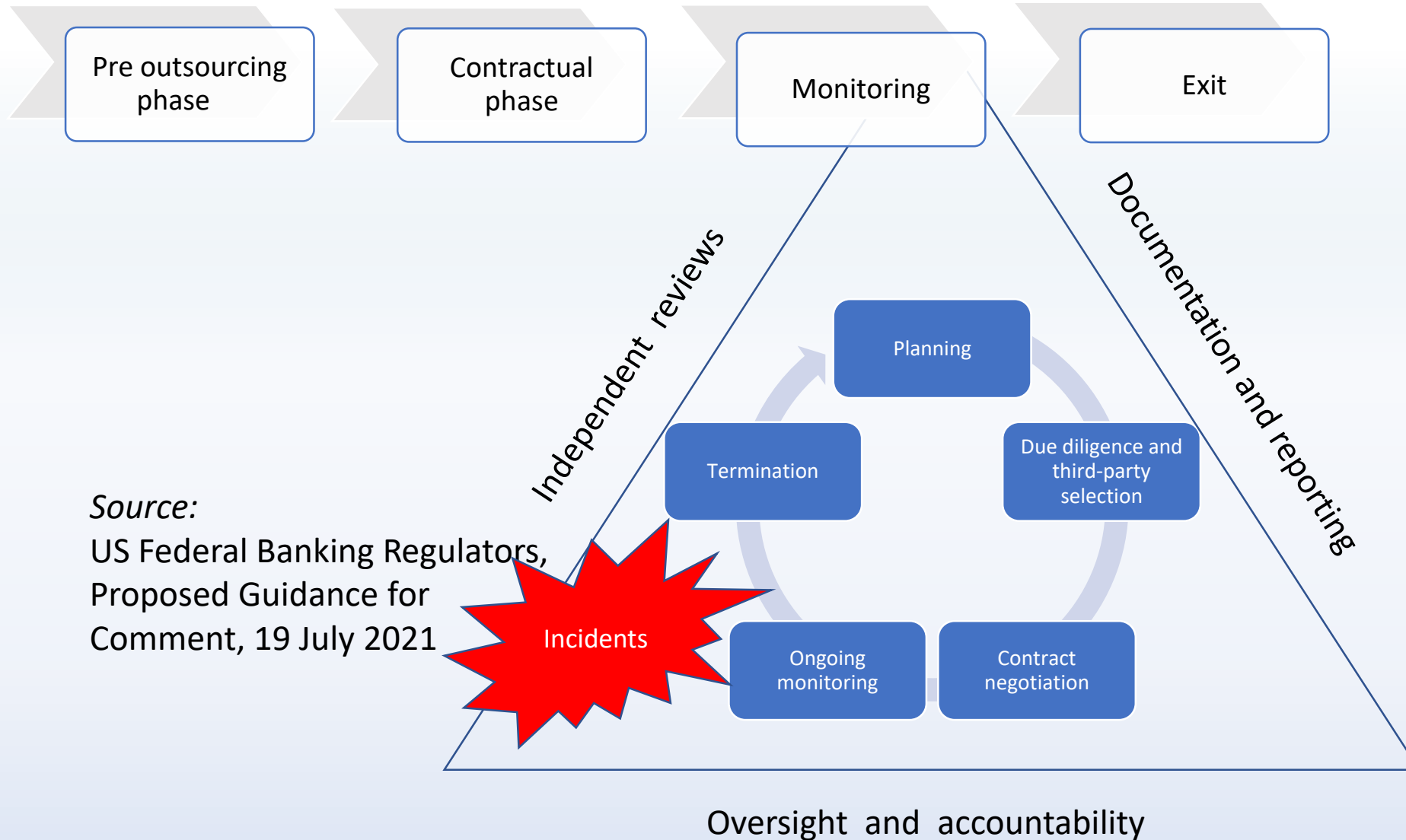
- i. performance of their regulatory obligations
  - ii. their financial performance; or
  - iii. the soundness or continuity of their banking activities;
- operational tasks of internal control functions

## US Banking Agencies

**Critical** functions include those which

Could cause a banking organization to face significant risk if the third party fails to meet expectations;  
could have significant customer impacts;  
require significant investment to manage or to bring in-house.

# Outsourcing Risk Management Lifecycle



*Source:*

US Federal Banking Regulators,  
Proposed Guidance for  
Comment, 19 July 2021

# Aspects of Board Oversight of Outsourcing

**Policies and procedures** – risk management framework through the lifecycle

**Governance** – who are the responsible management officials?

**Risk assessment and risk tolerance**

- Overall, and what are the criticality thresholds?
- Who are the critical service providers? (register)
- Are there concentration risks / sub-outsourcer risks?

**Audit findings and remediation plans**

**Incident management and lessons learned** (cf. DORA)

**Reporting framework** – cyclical/annual and incident based

# Key Takeaway

➤ You can outsource services and functions, but you can not outsource responsibilities!

EBA: The responsibility of the institution's management body for the institution and all its activities can never be outsourced.

**Wish to learn more about  
Outsourcing risk management solutions?**

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