



The new Guidance on Outsourcing published by the Central Bank

Keith Waine, a partner in Dillon Eustace's Financial Regulation Unit provides an overall assessment of the provisional Guidance on Outsourcing in the investment funds industry that has been set out by the Central Bank of Ireland, and which is now in the process of being finalised, with a view to final publication later this year.

Background

In recent years, the Central Bank of Ireland ("CBI") has significantly increased its supervisory focus on outsourcing. In February 2021, the CBI published a Consultation Paper containing draft Cross-Industry Guidance on Outsourcing ("the Guidance") applicable to all regulated financial services firms. The Guidance follows the publication, in November 2018, of its paper 'Outsourcing - Findings and Issues for Discussion'. The CBI is currently seeking feedback from industry on the Guidance and intends to publish the finalised Guidance later in the year.

This supervisory focus has been replicated at EU level with the publication in recent years of various sectoral guidelines on outsourcing, including by the European Banking Authority, the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority.

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The CBI has recognised that while the increasing reliance by firms on outsourced service providers ("OSPs") can be considered central to the successful delivery of a firm's strategic objectives, it also poses risks if not effectively managed. The CBI has also noted that the Covid-19 pandemic has increased the need for resilience in the operation of outsourcing arrangements.



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CBI's expectations

The Guidance sets out in detail the expectations of the CBI in relation to outsourcing under ten headings.

Assessment of criticality/importance

The CBI expects firms to assess the criticality or importance of the function to be outsourced, in line with factors set out in the Guidance. This assessment is important as it will determine the risk management measures which should be adopted.

Intragroup arrangements

The CBI expects that the Guidance will be applied to both intragroup outsourcing arrangements and arrangements with third party OSPs. Firms must consider risks inherent to such arrangements such as conflicts of interest and the appropriateness of the application of group-wide policies and procedures to the firm.

Delegation

The CBI is of the view that outsourcing and delegation are not different concepts and expects delegated

arrangements to be treated to the same level of oversight as other outsourcing arrangements. This will be of particular relevance to investment funds and their management companies.

Governance

The Guidance reminds boards and senior management that they retain responsibility for outsourced functions, and it is their role to ensure the appropriate oversight and risk management structures are in place in order to fulfil their responsibilities. Additionally, the CBI expects that firms will have a documented outsourcing strategy and policy in place, will ensure that appropriate skills and knowledge are maintained within the firm to oversee its outsourcing arrangements, and will ensure that appropriate records are kept in relation to their outsourcing arrangements.

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Outsourcing risk assessment and management

The CBI expects that a firm's risk management framework will appropriately consider any outsourcing arrangements and will ensure that such risk assessments are tailored to take account of the specific risks associated with outsourcing, such as sub-outsourcing risks and sensitive data risks.

Due diligence

The CBI expects firms to undertake appropriate due diligence in respect of outsourcing arrangements prior to entering into an arrangement and

periodically thereafter. The Guidance sets out the criteria which firms are expected to consider when carrying out this due diligence, for example the OSPs' regulatory status.

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Contractual arrangements

The CBI expects to see formal contracts or written agreements in place with OSPs, preferably that are legally binding and supported by Service Level Agreements. The CBI also sets out the key contractual provisions it expects to be included in contracts regarding critical or important outsourcing arrangements. Firms are expected to monitor these agreements and review their terms when appropriate.

Ongoing monitoring

The CBI expects that firms will conduct regular, comprehensive monitoring of the delivery of the outsourced activities and that firms will incorporate outsourcing assurance into their three lines of defence.

Disaster recovery and business continuity

The CBI expects that firms will have robust disaster recovery and business continuity management plans in place, particularly in relation to critical or important outsourced functions. Firms are also expected to have a viable exit strategy in place in respect of each outsourced function.

Reporting requirements

The CBI expects to be notified in respect of planned critical or important outsourcing arrangements and of material changes to such existing arrangements. The CBI also expects to be notified when adverse incidents occur, such as the occurrence of a material event affecting the provision of critical or important services. Firms are

expected to establish and maintain a register of all outsourcing arrangements and to submit the data contained in the register by way of periodic regulatory returns to the CBI with a proposed starting date of January 2022.

Comment

The CBI considers the Guidance to be supplemental to existing sectoral legislation, regulations and guidance (a list of same is included at Appendix 1 to the Guidance). The increasing complexity of the regulatory framework applicable to outsourcing and the heightened regulatory scrutiny means that boards would be well advised to review their outsourcing arrangements. Appropriate measures should be taken to improve the firm's outsourcing framework and its management of outsourcing risk so that the firm is in a position to demonstrate that it meets the CBI's supervisory expectations.

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