DELIVERING RETURNS FOR INVESTORS
Irish Association of Investment Managers
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30th January 2019

Re: Consultation on Outsourcing: Findings & Issues for Discussion November 2018

Dear Sir,

I attach, for your consideration, IAIM's response to this consultation process.

The Irish Association of Investment Managers (IAIM) represents the major investment managers operating in Ireland. The services our members provide, primarily portfolio construction and asset management, are critical to individual and institutional savers and investors alike, allowing them to achieve their financial goals and meet their responsibilities.

Our response and recommendations are geared to be of assistance in formulating policy in relation to outsourcing activities.

Yours sincerely

Regina Breheny
CEO

Introduction

Investment management, a highly regulated sector, represents a fundamental and high-value part of Ireland's financial services offering – and a part that is changing rapidly, driven by technology and other market forces including outsourcing. It is a truly global business with a significant number of large international groups basing their European operations here. These groups are efficiently organised pooling resources and talent.

Investment managers actively seek opportunities to ensure better outcomes for customers, meeting their needs in a cost efficient, flexible and timely manner. In many cases utilising the expertise and benefits of a specialist service provider can help to ensure better outcomes without materially impacting on the risk profile.

Specific Issues

We would like to emphasise the following specific issues that need further consideration:

1. <u>The Benefits of Outsourcing</u>

   Outsourcing (either within a group structure or external) is an inherently valuable practice for industry and for the end-investor. When outsourcing risks are identified, monitored and managed appropriately, it can be a very effective way of:
   - Managing and controlling operating costs, low cost does not mean low quality;
   - Reducing operational risk;
   - Accessing skills, expertise and capability which would be uneconomic to develop internally, facilitating a focus on core specialist areas;
   - Centralising similar capabilities allowing for better training, process improvement and coverage and reducing level of dependency on individuals;
   - Delivering business change particularly in the regulatory space.

2. <u>How Outsourcing is defined</u>

   The Central Bank definition of outsourcing raises questions and highlights issues as follows:
   - The extent to which 'outsourcing' can be said to apply to procurement of services that are not otherwise done by the regulated entity;
   - Rules need to be sensitive to sectoral differences e.g. (a) onsite accessibility may present security risks for financial institutions that exchange trade data for regulatory reporting requirements and (b) 'delegation' in the fund and asset management industry, as distinct from outsourcing, is already subject to special rules under (UCITS and AIFM) Directives and Regulations.

The European Banking Authority (EBA) draft guidelines on outsourcing suggests that a tiered approach to the criticality or importance of outsourcing arrangements should be taken.

3. Proportionality

We agree that the Board and senior management should retain ultimate responsibility for any outsourced functions and activities and for identifying and managing the risks associated with outsourcing. However:

- There is a wide range of outsourcing arrangements in place. We caution against an approach that seeks to implement a standardised governance regime;
- We do not agree that the risks associated with intragroup outsourcing (shared services are not necessarily outsourcing) are the same as those for third party outsourcing. We believe there should be proportionality on the oversight of outsourced arrangements made within a regulated group structure that has common ownership, common governance standards and is ultimately controlled by another regulated entity;
- Outsourcing to another regulated provider may provide some comfort and proportionate oversight should apply;
- Geographical outsourcing may give rise to additional risks particularly if the location is outside the EU.

Questions for Discussion

1. Sensitive Data Risk

There is little point in incurring additional costs replicating the expertise of outsourced providers. However, regulated entities should have enough controls and oversight to manage all the activities that have been outsourced or be able to get external assurance that same is occurring. Specific training may be appropriate to ensure that the required skills are developed within the regulated entity.

The key issues are understanding multiple systems and a reluctance by OSPs to divulge information citing potential breaches of system security policies and guidelines. These issues need to be teased out with the provider to achieve a common understanding.

2. Concentration Risk

In many instances concentration risk cannot be avoided. Identification, management and monitoring of this risk is essential. This process should consider additional mitigation plans e.g. the ability to bring the service back in house if necessary.

3. Offshoring & Chain Outsourcing

Sub-contracting and chain outsourcing can present risks to ‘visibility’ of outsourcing arrangements. The EBA recommends that firms can address this risk by requiring prior notice of any subcontracting, and the delineation in the Service Level Agreement (SLA) of any services that are excluded from potential subcontracting.

Contractual arrangements should provide for (a) minimum regulatory equivalence (like other "third countries") (b) full visibility of any chain/subcontracting and (c) full disclosure and full access, similar to that afforded to the primary provider.

4. Substitutability

The key issue is not finding alternatives but identifying the timeframe required to switch smoothly and efficiently.