EBA guidelines impact on financial institutions’ approach to outsourcing

Financial institutions must now meet tightened EBA guidelines in their outsourcing arrangements. Bringing processes and contracts into line with the guidelines will be challenging for those financial institutions that have outsourced business activities and IT solutions or plan on doing so.

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Recent tightening of the European Banking Authority (EBA) guidelines for outsourcing arrangements requires actions by financial institutions that wish to maintain current outsourced contracts and continue to benefit from the cost reductions and innovation that outsourcing partners can bring.

Compliance with the EBA regulations on outsourcing agreements is absolutely critical for banks and insurance companies in Europe. But given that current cost structures for financial services institutions are not favourable, the new regulations will be an added challenge for many organisations.

In this whitepaper we discuss the obligations that financial institutions must now meet under the guidelines, the challenges they face in bringing their processes and contracts into line with the guidelines and solutions with which they can fulfil the new requirements.

What are the EBA outsourcing guidelines?

But first of all, what are the regulations and what are they trying to achieve?

Essentially, the EBA's outsourcing guidelines came into effect in September 2019 and apply to all European banks and building societies, as well as branches of overseas banks operating in Europe. They are a set of rules that govern all outsourcing arrangements, whether to third-party suppliers or intragroup. They have a broader scope than their 2006 predecessors in that they apply to payment and e-money companies for the first time. The guidelines put in place a regime similar to the Solvency II regulations that apply to insurance and reinsurance companies.

Under the guidelines, all new outsourcing agreements entered into after 30 September 2019 must follow the guidelines and organisations with existing outsourcing agreements have until the contract renewal date or 31 December 2021 to bring them into line with the guidelines.

The purpose of the guidelines was to ensure that outsourcing by financial institutions does not introduce risks to financial services companies and the sector as a whole. The guiding principles are that outsourcing agreements must never transfer senior management responsibility of core management functions. Nor should they impair the supervisory body's control of the agreements or impair risk management obligations.

The obligations set out in the guidelines generally fall into two categories - governance requirements and process requirements. The governance aspect of the guidelines requires financial organisations to have written outsourcing policies. They must also maintain a written register and make it available to the regulator where required.

Assessing outsourcing agreements: what’s required?

According to the guidelines, when a financial institution discusses a new service with a supplier, it needs to conduct a pre-outsourcing analysis. This means carrying out appropriate due diligence and identifying relevant risks. It needs to assess whether the proposed arrangement can be viewed as an outsourcing agreement and evaluate whether the functions to be outsourced are “critical or important functions”.

If a financial institution is renewing or amending an existing service agreement, it must analyse the agreement to determine if it’s an outsourcing agreement and ensure proper analysis is carried out in accordance with its obligations under the guidelines. If the financial institution is planning on entering into an outsourcing agreement, then it needs to assess if it has captured the appropriate information about the supplier.

Entering into outsourcing agreements: the obligations

Obligations on financial institutions do not end at the supplier selection stage of the process, however. If a contract is being agreed with a new supplier, the financial institution then must ensure that specific clauses are included in the contract. For example, it must have the ability to terminate an agreement in the case of 'undue sub-outsourcing' (where a proposed sub-outsourcing will result in material increase of risk to the financial institution).

This has a flow-on effect. The institution must have a process in place for assessing existing outsourcing agreements to ensure if the material impact of the agreement has changed - due to any amendments or developments to the service provided.

Financial institutions agreeing to a contract with a new supplier must include specific clauses, such as the ability to terminate an agreement in the case of 'undue sub-outsourcing'. They also need to assess existing contracts in case the material impact of the contract has changed.

Proof of process or financial institutions?

The practical implications of the guidelines for financial institutions are that there is now greater control around the processing and management of outsourcing agreements. They obviously affect those financial institutions that had increasingly outsourced business activities and IT solutions.

The compliance requirements of the EBA guidelines impacts all aspects of the outsourcing contractual process - the purchase, the contract and the supplier. Large and complex financial institutions will find it particularly onerous to align their processes when each process is owned by specialised and siloed units within their organisations. Achieving compliance by amending multiple and disconnected internal IT platforms will be almost impossible.

The challenge for financial institutions in ensuring they are compliant with the guidelines is having a flexible and robust IT-based solution that will help them meet their obligations. Many financial organisations are currently using spreadsheets and network file shares to capture data and to monitor compliance. However, these tools are proving insufficient.

The sheer volume of documents - such as contracts and requisition orders - that must be tracked, along with the compliance touch points across the full source-to-pay process, make it near impossible. Organisations have had to rely on multiple IT systems to try to deliver EBA compliance, including source-to-pay systems that do not give full visibility across the supplier and contracting process.

What does it mean for procurement within financial services?

While the demands for cost reduction within the financial services sector are increasing due to greater competition, procurement functions have yet to be a driver of change. This is because historically there has been a lack of focus on procurement within financial organisations.

But with the focus on compliance in relation to outsourcing arrangements, procurement now requires greater attention from financial institutions. What if there was a procurement solution for the financial services sector that could also achieve compliance with the EBA guidelines?

This is where a digital procurement solution comes into it. A digital solution can cover the full source-to-pay process within an organisation and be configured to meet very specific business needs, while accommodating the processes and requirements of a highly regulated sector.

Ivalua and EBA compliance in financial services procurement

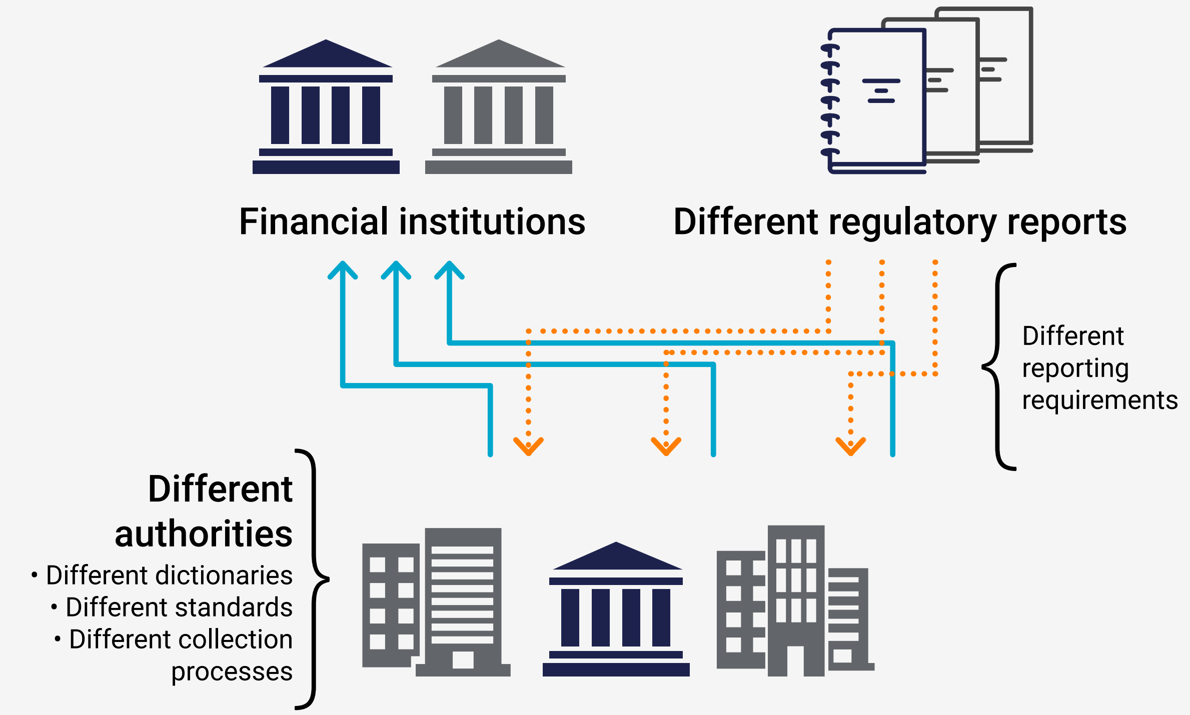
The Ivalua solution provides a financial institution with a controlled process through which it can source, contract, manage and assess its supplier agreements in compliance with the EBA Guidelines.

Let's take an example: a request is raised for a new service. Based on the information provided in the request form, the Ivalua platform captures the necessary information and then initiates the processes required to ensure that engaging the supplier is in line with the Guidelines. After determining that it is, Ivalua will ensure that the correct contractual clauses are used for the specific type of outsourcing agreement.

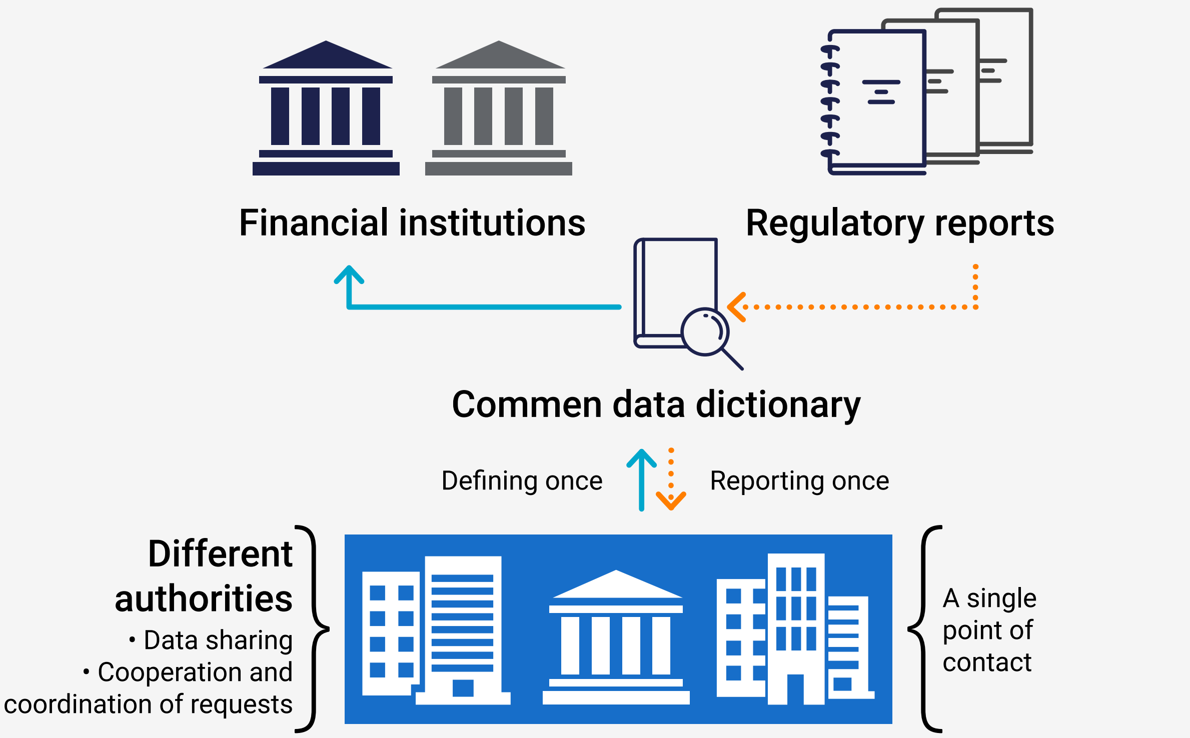
Ivalua is a leading procurement solution that is already being used by several European financial institutions, including Credit Agricole, BNP Paribas and Groupe BPCE. Several other financial institutions are also looking to use the Ivalua solution to control the sourcing and contract management process in a way that meets the EBA Guidelines. From these inquiries, Ivalua has been able to develop its platform to provide an out-the-box solution for those financial institutions needing to meet their obligations under the EBA rules.

In fact, a project for a large Nordic bank is now going live. Through the Ivalua platform, the financial institution's employees have a simple process with which to agree on new services or amend existing services but in a way that is EBA compliant.

CURRENT REPORTING PROCESS



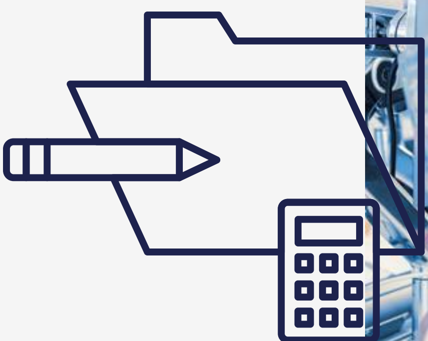
REPORTING PROCESS THROUGH AN INTEGRATED SYSTEM

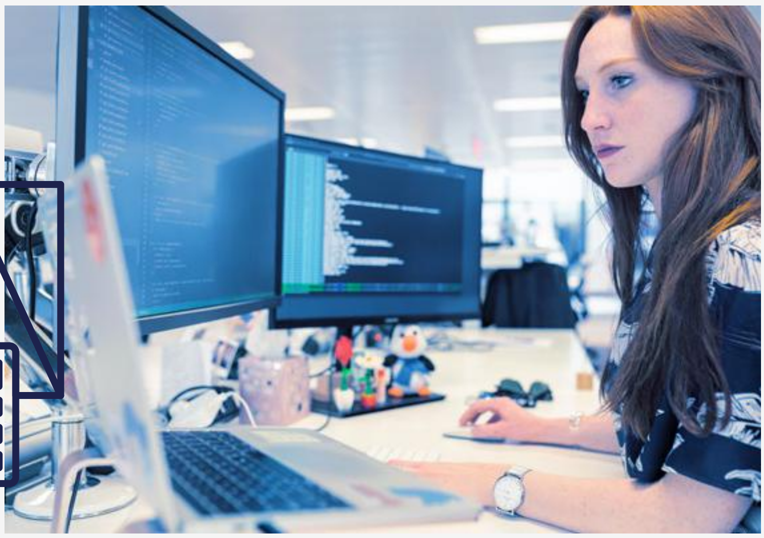


The benefits of choosing a multidisciplinary implementation partner

There's no doubt that the EBA guidelines and other compliance requirements are very complex. It is for this reason that large financial institutions looking to deploy Ivalua are well advised to work with a multidisciplinary implementation partner that understands both banking compliance processes and digital procurement best practices. A third-party organisation that is expert in the application of the regulations as well as the operational impact within the organisation.

For the large Nordic bank mentioned above, Ivalua worked together with PWC to deliver a source-to-pay solution that fulfilled the EBA requirements. Ivalua's pre-configured EBA compliant solution allowed the bank to accelerate the design of the solution. While PWC's extensive banking sector experience could help address those areas where the bank needed advice.





Be ready for a ever changing environment

Finally, it needs to be recognised that regulations develop and new regulatory structures come into force all the time. Take the impact of Brexit, for example, where it's not currently clear if UK banks will need to meet the same requirements of the EBA guidelines as other European states. It's therefore crucial that a procurement tool for financial services has the flexibility to meet not just today, but tomorrow's regulatory environment.

The agility of the Ivalua platform means that new regulatory requirements can be incorporated into the solution. Financial institutions can take comfort that Ivalua can meet their future needs.

Summary

Many banks and insurance companies currently have limited or disconnected procurement technology. But with a smart adaptable procurement tool, these organisations can deliver improvements in their procurement processes while meeting their EBA obligations. With better access to data, more control over spend, higher use of preferred suppliers and tighter contract management processes, digital procurement solutions will make a significant improvement to many financial services institutions.

While the EBA guidelines force financial institutions to focus on compliance issues, many procurement leaders within these organisations are identifying that in meeting their compliance obligations, they also increase the operational performance of their procurement functions. In achieving compliance, they are also able to achieve significant savings for their organisations.

If you want to find out more about how Ivalua's solution can secure compliance and bring more value to your financial services business, click here.

GET IN TOUCH!

STEPHEN CLEMINSON

Stephen Cleminson is the Alliances Director at Ivalua, where he's responsible for recruiting and managing a partner network across Northern Europe. Stephen brings over a decade of experience in commercial roles at a number of P2P vendors. He has built a comprehensive understanding of the benefits and challenges of P2P technology from his close involvement in a variety of projects for large multinational organisations.

Stephen's experience was initially in the use of P2P solutions for indirect spend, but Ivalua's strength in indirect materials procurement has expanded his knowledge and expertise to this important operational area.

THOMAS NJOR

Thomas Njor is head of the Danish Operations Consulting practice in Denmark and partner at PwC.

Thomas has 20+ years of experience in procurement and supply chains at global companies and as a consultant. He also has extensive experience in process and cost optimisation, automation, offshoring and outsourcing, organisational assessment, C-level management, and management of large-scale global transformation programmes.

He focuses on transformation and performance improvement across a wider operational spectrum, from sourcing to process optimisation and customer-facing operational service development.

JESPER BRYLD MØLLER

Jesper Bryld Møller is Senior Manager Operations at PWC. He has led large-scale supply chain transformation projects and developed supply chain strategies to adapt to changes in market conditions. Moreover, he is experienced in S&OP and integrated business planning, including processes related to the introduction of new products, such as business cases, R&D development, and product road maps.

Jesper is experienced in digitalising supply chain and procurement functions, from leading large implementations of global solutions to ensuring data governance and processes are in place to harvest benefits and achieve scale in the digital solutions.