

# Chrysostomides

ADVOCATES AND LEGAL CONSULTANTS

## **New European Banking Authority Guidelines on Outsourcing**

The European Banking Authority (EBA) has updated the Committee of European Banking Supervisors (CEBS) guidelines on outsourcing that were first issued in 2006 (the “Guidelines”). Whilst the original guidelines applied exclusively to credit institutions, the new guidelines aim to harmonise the framework for all financial institutions within the EBA’s mandate and will also apply to investment firms subject to the Capital Requirements Directive (CRD), as well as payment and electronic money institutions (together with credit institutions, the “Relevant Institutions”). The Guidelines will apply to all outsourcing arrangements entered into, reviewed or amended on or after 30 September 2019.

In the Executive Summary to the Guidelines the EBA notes that over recent years financial institutions have been increasingly interested in outsourcing business activities. The EBA considers that the conditions for the outsourcing of functions of banking activities by credit institutions are not harmonised to the same extent as for investment firms and payment institutions subject to Directive 2014/65/EU (MiFID II) and Directive 2015/2366 (PSD2) and has issued the Guidelines in response.

Even though MiFID II and PSD2 already set out a framework for outsourcing, the EBA decided not to limit the application of the Guidelines to credit institutions and their banking activities as that could have led to inconsistencies of approach between the different frameworks under MiFID II, PSD2 and the Guidelines. As such, the Guidelines also apply to investment firms subject to CRD and payment institutions and are closely aligned with existing outsourcing provisions under MiFID II and PSD2. For example, the definition of “outsourcing” in the Guidelines closely tracks the definition of outsourcing in Article 30 of Regulation 2017/565 supplementing MiFID II.

In accordance with Article 74 CRD (and in line with Article 11 PSD2), Relevant Institutions should have robust internal governance arrangements that include a clear organisational structure. The Guidelines state that outsourcing arrangements are one aspect of Relevant Institutions’ organisational structure and therefore include provisions that aim to ensure, inter alia, that:

- a. There is effective oversight by the management body of the outsourced activity;
- b. There is a sound outsourcing policy and there are sound outsourcing processes;
- c. Relevant Institutions have an effective and efficient internal control framework with regard to their outsourced functions; and
- d. All the risks associated with the outsourcing of critical and important functions are identified, assessed, monitored, managed, reported and, as appropriate, mitigated.

Outsourcing does not lower Relevant Institutions’ obligation to comply with regulatory requirements – each institution’s management body always remains responsible for that institution and all of its activities at all times. Intragroup outsourcing might also be subject to the same regulatory framework as outsourcing to external service providers as, in the EBAs view, intragroup outsourcing is not necessarily less risky than outsourcing to an entity outside the group.

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The Guidelines highlight the risks involved with outsourcing to cloud service providers which often operate a geographically dispersed computing infrastructure. The EBA had previously identified differences in national regulatory and supervisory frameworks for cloud outsourcing and had issued recommendations for outsourcing to cloud service providers in 2017. These recommendations have now been integrated into the Guidelines.

Finally, of particular note is the EBA's concern regarding supervision of concentration risk – Relevant Institutions are required to document all their outsourcing arrangements and engage with competent authorities in a dialogue regarding their outsourcing plans, particularly as regards critical or important functions, which Relevant Institutions are under an obligation to identify before outsourcing.

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