Brussels, 7th October 2024

MR/MM

EACB comments on

Basel Committee on Banking Supervision
Consultative Document on
Principles for the sound management of third-party risk
(d577)

General comments

The EACB welcomes the opportunity to comment on the BCBS Consultative Document on Principles for the sound management of third-party risk.

We appreciate the Committee's work in developing this principles-based approach to improve banks' operational risk management and operational resilience. We welcome the centrality ascribed to the principle of proportionality, considering that the approach took into consideration both the banks' size, complexity and risk profile as well as the nature and duration of the third-party service provided arrangements.

However, the 12 draft principles remain mainly directed at large internationally active banks and their supervisors, and further development and refinement might be required for an adequate application to banks of different sizes and business models, as it may be the wish/approach in different jurisdictions. It remains fundamental considering the specificities of the intragroup arrangements, the socio-economic context in which a bank operates, access to the market, the possibility to develop internal competencies to handle the process, contractual power and (information) asymmetry between third-party service providers and banks.

It is important to stress that these would be general principles, and level plain-field interpretation and application issues may arise if the expectations are calibrated in a way that is not fit for purpose.

It might also be difficult to convert them into action. In practice, it might be difficult to obtain all the information indicated during the so-called risk assessment and due diligence phases. In addition, this could restrict competition among service providers, as some third-party service providers may decide to withdraw from the financial market to avoid disclosing such information or excessive intermediary costs. From the banks' perspective, it might reduce the market supply, increase costs or discourage access to key services and competencies, having the opposite effects of the intended ones by these principles, increasing the risk to which banks are exposed.

Intragroup third-party provider and exit plan

Para. 11 defines a third-party service provider as a provider that is part of a banking group and provides services predominantly to entities within the same group. It may include: a bank's parent company, sister companies, subsidiaries, service companies or other entities that are under common ownership or control.

While para 15. recognises that banks' risk management processes should be proportionate to the unique characteristics of intragroup arrangements, it seems that further analysis should be made to evaluate if the

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riskiness is comparable to other third-party service providers and if the same processes and diligence might/should be followed for this kind of arrangements.

In particular, the detailed due diligence of intragroup arrangements might create redundancy at the group level. A detailed analysis might be necessary only at the highest level of consolidation, given that apex bodies in cooperative groups might already be monitoring the risks in other entities.

Finally, further reflection might be needed on how to address those situations where an exit plan is not possible, especially for intragroup third-party arrangements.

Supply chain, access to information and concentration

It is key to underline that a third-party arrangement is a formal relation between a bank and a third-party service provider governed by a legally binding written contract. Therefore, the relation between the third-party provider and the supply chain should not be considered under the bank's responsibility in any form or circumstance.

It is clear the importance of monitoring/understanding the network of entities that provide inputs utilised for the delivery of a service to a bank, especially considering key n-th parties. However, it would be unrealistic to envisage that banks can constantly have access to all the necessary information to monitor and manage the supply chain risks through any line. Similarly, it is difficult to justify the need for suppliers to know and extend the contract provision beyond the second level (material subcontractors) if not specified in the regulation. Also, the technology providers that are subcontractors would need special recognition, as cloud service providers or licenses are often not seen as "material subcontractors".

An extended interpretation of Principles 3 and 4 to the supply chain should consider the following:

- It would be necessary that the regulators indicate the timing (daily/quarterly/yearly) of each metadata point. It should be considered that with periodical updates some of the data points may not be up to date in case of ad hoc reporting requests. Moreover, the taxonomy under which the services are reported should also be specified as well as harmonisation between terms used across authorities and sectors will be needed.
- Access to information might not solve the problem of information asymmetry given that banks may need more competencies or complementary information to evaluate the riskiness of n-th parties. It also exposes the banks to additional operational and legal risks.
- A more complex contracting phase might increase banks' costs but also reduce the availability of services they can access, especially in contexts of a lack of alternatives related to economies of scale or access to the market.
- Given additional transitional costs, third-party services may be excluded from the market regardless of their appropriateness. In practice, extensive control of the supply chain and requiring further information will favour the big players and exclude the smaller ones, incentivising third-party service provider concentration, especially for small and medium banks.

Finally, it is important to stress that the reference to the geographic concentration of third-party service providers as a parameter to evaluate the risks might be problematic for small and medium sized banks given their local dimension and, indeed, the Committee could elaborate further on how to manage these circumstances.

Critical Third-party service providers

It is critical to stress the material difference between third-party service provider, critical third-party service provider, and intragroup third-party provider.

Despite some differentiation included mainly in para. 42 and 65, further specifications and analysis should be conducted to better understand how to facilitate the management of third-party provider arrangements that are not considered critical. It should also be noticed that for this kind of arrangement, industry-recognised certification and standards, or similar, might play a more central role, reducing the bordering for the small and medium banks, at least.

Contracting

When there are regulatory changes that imply amendments to existing agreements, it is key for the industry to have available model contract clauses before the banks are expected to start the implementation of the new requirements, and by consequence begin amending the existing agreements.

Banks need certainty as to the timeline of supervisory scrutiny on revised contracts and new requirements.