POSITION PAPER

ESBG response to the BCBS consultative document on third-party risk management

ESBG (European Savings and Retail Banking Group)

Rue Marie-Thérèse, 11 - B-1000 Brussels

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General comments

ESBG welcomes the consultative document on third-party risk management, proposing principles for the sound management of third-party risks in the banking sector, issued by the Basel Committee on Banking Supervision (BCBS). We also think the holistic approach on risks from arrangements with third-party service providers (TPSP) makes sense.

However, we are concerned some of the requirements of the draft will be too far-reaching and not sufficiently differentiated according to risk- and materiality aspects of the arrangements commonly used by banks. Banks often have hundreds to thousands of TPSP contracts of various types and levels of importance. Besides "classical" outsourcing, there are usually numerous arrangements of a non-material scope and/or with minor risks, in addition to so-called "no alternative" services. We would like to mention a few examples below:

- Contracts with municipal utilities (water, waste)
- One-off and temporary consultancy contracts
- Obtaining short-term support (temporary workers, temporary employment agencies)

Given these circumstances, we consider the level of requirements of the draft TPRM principles as a whole to be very high, or even excessive. According to the consultation paper, the vast majority of the requirements are foreseen for all arrangements, and go in some areas even beyond what is currently required for critical/material outsourcing only (e.g., the provision for exit strategies). Possible side effects of overly strict requirements for all types of arrangements should be considered when finalizing the principles:

- Arrangements with smaller service providers and individuals could effectively be hindered because they are not capable of meeting all the requirements. Also, larger service providers are likely to be unwilling to accept banking sector requirements and contractual conditions that are deemed too strict and unreasonable.
- The use of third-party services - which in principle makes sense - could be avoided altogether in certain areas. This results in increasing concentrations and higher costs and could also limit the innovation of banks.
- Disruptions in competitiveness may arise from corresponding disadvantages for banks compared to non-banks (e.g., insurance companies, NBFIs) to which these requirements do not apply. In addition, smaller regional banks may be at a disadvantage within the banking sector due to the comparatively higher fixed costs of the TPRM and weaker negotiating power vis-à-vis service providers.

In addition to a clearer, appropriate gradation of the requirements according to the risk content of different TPSP arrangements, we also believe that initial clarifications and restrictions to the scope of application are urgently needed (see our specific comments). In addition, introducing a category of "non-critical/non-material TPSP arrangements" could be considered, setting out only a few principle-based requirements for these to take the proportionality principle into account.

Depending on the design of the final principles, extensive challenges will arise during the implementation period. These include an adaptation of regulatory architectures (which are currently geared towards "classical" outsourcing) by legislators and supervisory authorities. For banks, in addition to new strategies, guidelines, tools, et cetera, it would also mean the review/evaluation and re-negotiation of hundreds (up to thousands) of existing arrangements. This requires a sufficient implementation period of several years.

Specific comments

Definitions (paragraph 11)

TPSP
It would be difficult or even impossible to apply many of the requirements formulated in the principles to individuals. These should be taken out of the definition.

TPSP arrangement
From a risk perspective, many of the proposed principles are not necessary for all types of arrangements or, in some cases, could not be fully implemented. The following additional exceptions should be incorporated into the definition:

- The use of one-off or occasional services and/or services of minor extent
- Legally/officially prescribed or otherwise obligatory services (e.g., external audits)
- Services that banks typically do not (or cannot) provide themselves, such as facility management, utilities, inhouse medical care, catering, purchase of goods

Critical TPSP arrangement
For classification as a "critical" TPSP arrangement and the associated application of extended requirements, a materiality should be given, not just any (possibly only indirect) connection to critical services. We would welcome corresponding clarification.

Key nth party
When determining "key" nth parties, the classification should not have to be based on a minor contribution to the provision of a critical service. Likewise, an nth party's access to confidential information should not automatically have to result in classification as "key". The circumstances and significance of the nth party for the provision of critical services by the TPSP should be considered as a whole.

Third-party risk management principles

Paragraph 15 (Key concepts)
The options for a proportionate design of the TPRM should be further clarified. For example, it could be added that significantly simplified approaches are permissible for certain types/classes of low-risk arrangements, such as

summarized brief assessments. See also our general comments and notes on the overly broad definitions.

Paragraph 22 (Risk management)
The requirement to map dependencies and interconnections related to arrangements should not mean that banks have to maintain separate tools for this purpose. Proportionate solutions should be possible. The corresponding wording in paragraphs 45 and 49 should also be reviewed.

Paragraph 23 (Risk management)
We recommend removing the example given in sentence 3 ("eg testing at more frequent intervals"). It is not clear how more frequent testing could reduce concentration risks. The requirements of this paragraph could be streamlined, as there are overlaps with BCM.

Paragraph 24 (Strategy)
Strategic determinations on the use of TPSP can also be part of a bank's business strategy. We suggest the following wording:

> „The board of directors should approve a third-party strategy (which could also be part of the bank's overall business and/or risk management strategy and should be consistent with these strategies). ~~It should be consistent with the bank's overall business strategy, risk appetite and tolerance for disruption.~~ ..."

Furthermore, the 2nd bullet point should relate to TPSPs, not to a single provider. If the services to be provided are defined, an additional negative distinction is not necessary.

Paragraph 32 (Risk assessment)
Ongoing assessments are neither necessary nor beneficial. We recommend adjusting the wording as follows:

> „Therefore, banks should perform risk assessments regularly and ad hoc, in case of relevant events ..."

Paragraph 38 (Relative benefits and costs)
In our opinion, banks do not need to be subject to regulatory requirements in terms of business considerations; an assessment (does the proposed TPSP arrangement make sense overall?) will be carried out in their own interest. We suggest deleting this section. If deemed necessary, particular risk-relevant aspects could be integrated into the corresponding section (para. 37).

Paragraph 41 (Contracting / all TPSP arrangements)
In order to make proportionality clearer, we suggest the following addition:

> „Banks' contracts governing TPSP arrangements should consider, where relevant and appropriate: ..."

Paragraph 42 (Contracting / critical TPSP arrangements)
The requirement in the last bullet point to prescribe insurance for all insurable risks for the TPSP is too extensive. We suggest the following wording:

> "TPSPs' obligation to take out insurance against material insurable risks"

Paragraph 44 (Onboarding)
The wording of this requirement is unclear. As the core points should already be covered by paragraph 26, we suggest deleting it.

Paragraph 49 (Ongoing monitoring)
Performance-related metrics/indicators cannot and do not need to be collected and monitored for all types of TPSP arrangements (see also our general comments and notes on the overly broad definitions). This should be clarified.

Paragraphs 58 and 59 (Business continuity management)
With regard to proportionality aspects, we recommend only applying these requirements to critical TPSP arrangements or arrangements that support material time-critical processes.

Paragraphs 63 - 65 (Planned termination)
Many TPSP arrangements of banks are designed for a permanent work-sharing. Therefore, detailed steps for termination are defined on an event-driven basis, i.e. when the termination of a specific arrangement is specifically intended. Creating, updating and regularly testing comprehensive termination plans for hundreds up to thousands of arrangements would create an unreasonable administrative burden. It should be clarified that a detailed plan only needs to be drawn up in the event of an intended termination. Normally, summarized descriptions of the bank's termination options and the generally associated process steps should be sufficient.

Paragraphs 66 and 67 (Unplanned termination)
Overall, the provisions on exit strategies should only relate to critical TPSP arrangements. Disruptions or interruptions at other, non-critical service providers are - where necessary - to be covered by BCM. Furthermore, intragroup TPSPs should be excluded from this requirement. Due to the mutual knowledge and sphere of influence, it is very unlikely that an intragroup arrangement will be terminated unilaterally and unexpectedly.

About ESBG (European Savings and Retail Banking Group)

ESBG is an association that represents the locally focused European banking sector, helping savings and retail banks in 28 European countries strengthen their unique approach that focuses on providing service to local communities and boosting SMEs. An advocate for a proportionate approach to banking rules, ESBG unites at EU level some 859 banks, which together employ 620,000 people driven to innovate at 48,900 outlets. ESBG members have total assets of €6.415 trillion, provide €1 trillion billion in corporate loans, including SMEs, and serve 157 million Europeans seeking retail banking services. ESBG members commit to further unleash the promise of sustainable, responsible 21st century banking. Learn more at www.wsbi-esbg.org.

European Savings and Retail Banking Group – aisbl
Rue Marie-Thérèse, 11 ▪ B-1000 Brussels ▪ Tel: +32 2 211 11 11 ▪ Fax : +32 2 211 11 99
Info@wsbi-esbg.org ▪ www.wsbi-esbg.org

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