

Industry Seminar – 20 October 2011

Outsourcing Thematic Review

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Thank you Andrea and good afternoon everyone. My presentation will provide an overview of the recent thematic review which the Banking Division conducted and you will note from the overview that elements of my presentation will follow on from Andreas presentation earlier at St James. So today we are going to look at:

Presentation overview

- Thematic approach
- Local context
- 3rd party v intra-group
- Main findings
- Board implications
- Key messages



Initially a two-stage approach was adopted. An initial questionnaire was forwarded to all banks on the islands and many thanks to you all for your submissions. We reviewed the survey responses and then selected 6 banks for whom an on-site review was conducted. We selected the banks to provide a good representation of the local banking sector and included both branches and subsidiaries and retail and international banks. Having visited the individual banks we then provided each of them with individual feedback on our findings and endeavoured to highlight areas of good practice and areas where we felt improvements could be made. Again many thanks to those banks who participated in the on-site process. So having completed the survey and on-sites we then published the thematic report which is now available on the Commissions website.

Thematic approach

- Two-stage approach was adopted
- Survey of all licensed banks
- Sample on-site visits
- Individual feedback provided
- Thematic report published



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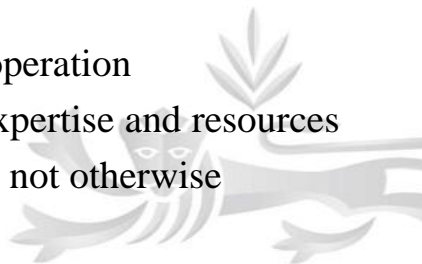
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So having described the process it is important to provide local context within which outsourcing exists. Clearly it is a fundamental element of the local business model as Philip touched on earlier. It is also a vital element of efficient operations in a resource constrained environment such as Guernsey and allows access to expertise, resources and efficiencies which may not otherwise be available.

Local context

- Fundamental feature of the local economic business model
- Vital element of efficient operation
- Allows access to pool of expertise and resources
- Allows economies of scale not otherwise achievable



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We should also consider whether certain activities do or do not actually constitute outsourcing as it was apparent from the survey responses that a consistent view is not held with certain intra-group activities not being considered as outsourcing. Certain activities are easy to categorise as outsourcing such as pure third party activities, for example card processing whereas as certain intra-group arrangements for example internal audit functions or treasury management were often not categorised as outsourcing. We also noted that fewer formalities exist regarding the intra-group arrangements, particularly at the set-up stage.

Outsourcing – internal or external?

- Pure third party outsourcing
- OR**
- Intra group outsourcing
 - Usually fewer formalities with intra group arrangements

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From the survey it was apparent that a belief exists that intra-group outsourcing is inherently less risky than pure third party outsourcing. This conflicts with the view of the Commission that intra-group outsourcing still contains many risk and performance delivery issues which should be addressed head on and not ignored.

Third party v Intra group

- Belief exists that intra group is inherently less risky than pure third party outsourcing.
- Our view:
“intra group outsourcing still contains many risk & performance delivery issues which should be addressed head on & not ignored.”

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So having described the thematic review process and the context within which it exists we can now look at the main findings which the review generated. It was clear and positive to see that practices have improved since our last review of this area which was in November 2008 and that on the whole banks are now far more proactive in managing this area. However it is fair to say that practices and standards still vary and whilst differences in the nature, scale and complexity of various banks explain much of the diversity it does not explain it all and as such there is still some room for improvement.

Main findings

- Practices have improved
- Most banks actively managing their outsourcing arrangements
- However practices vary
- Some banks have much more sophisticated management frameworks than others.
- Differences explain much of this diversity, but not all.

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It is good to see that most, but not yet all, banks now have an outsourcing policy however clearly there is a range in levels of appropriateness. For some it is apparent that a group-wide generic policy has simply been “cut and pasted” from a head office document with little relevance to local conditions. However for other institutions it is apparent that a comprehensive, Guernsey specific policy is in place which reflects local vulnerabilities, regulations and responsibilities.

Findings continued

- Most Guernsey licensed banks have a policy on outsourcing
- Difference in appropriateness
- Some policies are generic, group-wide policies
- For others a Guernsey specific policy is in place

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Elements of good practice which were found are as follows. You should treat your intra-group outsourcing arrangements the same as pure third party arrangements, have a Service Level Agreement in place and even some institutions include penalty trigger events. We would expect you to conduct and collate comprehensive due diligence for new external relationships for example with regards to the corporate governance arrangements and financial soundness of the proposed new outsource supplier. Finally here we would expect you to establish a dialogue with your new supplier at an early stage, with regular service review discussions, rather than waiting for an issue to introduce yourself.

Good practice

- Treat intra-group outsourcing no differently to external arrangements - SLAs in place
- Supplier due diligence - initial and ongoing
- Support with high quality documentation and action planning
- Don't wait for a problem to hold a meeting!

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The Commission would recommend that exit strategies are in place, even for intra-group arrangements and the findings from the survey and the on-site visits showed that, whilst a challenge, it can be done. At the very least we would expect to see an explicit contingency plan in place.

Exit strategies?

- Not all banks have exit strategies especially for intra-group activities
- It can be done, even for intra-group arrangements
- In the absence of an exit strategy the Commission expects an appropriate written contingency plan should be in place

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It was clear from the findings that some banks are still placing a high level of reliance on group central functions however it is for local management, be that the executive committee of a branch or the board of a subsidiary, to proactively monitor and manage their outsourcing arrangements. The final note to mention here is that, not surprisingly, local banks cannot outsource oversight of their own outsourcing arrangements to head office.

You can't outsource responsibility

- Some banks placing high level of reliance on group central functions
- Management to monitor their intra-group outsourcing arrangements
- Guernsey Licensed Banks cannot fully outsource the oversight of their outsourcing arrangements to central functions

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To emphasise and re-iterate the key point here you can't outsource your responsibilities, and indeed legal obligations with regard to outsourcing. Whatever function is being outsourced the responsibility for it remains on the Island.

You can't outsource responsibility

- Local boards or branch management must actively monitor outsourced activities and service providers to ensure that local priorities and vulnerabilities are being addressed.

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So to conclude the key messages from the thematic are: i) that outsourcing is vital for Guernsey ii) it is important to do it well as it can be expensive if you get it wrong and iii) to comply with the Handbook and with your legal obligations you cannot outsource your responsibilities.

As you are aware we also undertook a thematic on data security arrangements using a similar approach to the outsourcing model. An initial questionnaire was sent to all banks, results reviewed and again on-sites were conducted with 6 institutions. We have provided each institution with their individual feedback and are currently compiling our final report which we would expect to be on the website shortly.

Thank you for your time and I will now hand over to Philip who is going to spend some time looking at the regulatory horizon.

Key messages

- Outsourcing is vital for Guernsey
- Important to do it well
- You can't outsource your responsibility

