



1 October 2020

Giles Ward
International Organization of Securities Commissions (IOSCO)
Calle Oquendo 12
28006 Madrid
Spain

By email: consultation-01-2020@iosco.org.

Dear Mr Ward

Re: IOSCO Principles on Outsourcing

The Australian Financial Markets Association (AFMA) welcomes the invitation to provide comment to IOSCO on the proposed fundamental precepts and seven principles on outsourcing in financial markets. AFMA's membership includes a wide range of global and domestic financial market participants. Outsourcing forms a substantive component of business activity undertaken by our members and as such the Principles are of significant interest to our members.

AFMA promotes high standards and integrity in the financial markets including in relation to outsourcing activities. Sound financial markets in turn support economic growth.

AFMA agrees with IOSCO that outsourcing provides important broad-based efficiencies in costs, operations, business activity and security. While there are some risks associated with these benefits, the efficient provision of services by third parties can also have mitigating impacts on these risks, particularly where they can bring scale and best practice to operations. In AFMA's view, the updated principles are well-founded in that they are technology-agnostic and support proportionality of assessments based on the degree of materiality and criticality of the outsourced tasks.

The proposed principles provide a robust underpinning for regulated entities to build their outsourcing policies, arrangements, contracts, due diligence and improvisation practices upon. In effect, the precepts and principles are well-embedded by APRA in its existing prudential standards and practice guides, particularly CPS 231, which are also pertinent to cloud computing services.

Mitigating the risks associated with outsourcing arrangements from operational resilience and cyber security to over-reliance, is not just rooted in regulatory compliance and stakeholder protection, but also motivated by strong commercial and reputational goals.

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Financial market participants thus have the highest level of interest in ensuring optimal outsourcing arrangements and should be accorded sufficient space to innovatively address market issues without excessive regulatory intervention.

In the following letter, AFMA makes specific comments responding to questions related to the proposed principles. We trust they are of assistance.

Please contact Nikita Dhanraj either on +61 2 9776 7994 or by email ndhanraj@afma.com.au if further clarification or elaboration is desired.

Yours sincerely

A handwritten signature in blue ink that reads "David Love". The signature is written in a cursive, flowing style.

David Love
General Counsel & International Adviser

Reponses to questions on the proposed fundamental precepts and seven principles on outsourcing in financial markets

Fundamental Precepts

1. *Do you consider the scope of the application of the Principles to entities is clear? If not, why not?*

Yes, the scope appears to be clear.

2. *Do you consider the concepts used to explain the application of the Principles on Outsourcing to be clear and adequate? If not, why not?*

Yes, the principles of outsourcing and their application appear to be clear and adequate.

3. *Do you have any comments on the benefits, risks, and challenges of the use of outsourcing? Are there any additional factors which should be considered or described in the document?*

Financial institutions gain from the overall cost and competitive benefits of outsourcing. There are inherent scale benefits in outsourcing certain services that often allow these services to be provided at the highest levels of quality by the third-party provider. Institutions outsource for a variety of reasons, including access to specific knowledge, greater focus on core processes, scalability, and greater service-level performance. While there are risks that come with outsourcing, outsourced service providers are often best suited to address them as noted by IOSCO in terms of cloud service providers and cybersecurity issues. Provided the appropriate due diligence, monitoring and clearly defined contractual arrangements measure are taken to minimise risk and optimise resilience, the benefits of outsourcing in the financial services industry are highly likely to outweigh the risks.

AFMA also notes from experience in the Australian context that while the regulatory onus of ensuring outsourcing resilience rightly sits with the regulated entities, commercial pressures often drive third parties that are not within the scope of regulation to make their services aligned with best practice and regulatory expectations across jurisdictions.

4. *Does the description of materiality and criticality clearly and adequately address the proportional application of these principles? If not, why not?*

AFMA supports the comprehensive consideration of factors that may influence materiality and criticality assessments of outsourced functions. We continue to support risk-based applicability of principles as a best-practice approach. Implementing a risk-based methodology on a foundation of broad-based robust risk management and resilience framework allows the appropriate allocation of resources to promote efficiency in an entity's operations.

Sub-contracting of Outsourced Tasks

AFMA supports IOSCO in its expectation that the regulated entity should ensure that sub-contracting is not permissible without its prior approval and should consider the ability of the sub-contractor to continuously perform the services. We also support that regulated entity should ensure that it can continue to promptly access data maintained by the sub-contractor.

In addition, as a best-practice principle, AFMA would like to note the Australian prudential regulator APRA has issued standards in the form of CPS 231 in relation of sub-contracting which states –

An APRA-regulated institution that outsources a material business activity must ensure that its outsourcing agreement includes an indemnity to the effect that any sub-contracting by a third-party service provider of the outsourced function will be the responsibility of the third-party service provider, including liability for any failure on the part of the sub-contractor.

This is designed to ensure third parties employ the best suited and sound sub-contractors as a fundamental responsibility towards their clients. In cases where immediate access by the regulated entity to the sub-contractors is not possible, this provision in the outsourcing contract creates the requisite insulation.

Outsourcing Principles

5. *Do you consider the Principle and implementation measures for due diligence are adequate and appropriate? If not, why not?*
6. *Do you consider the Principle and implementation measures for establishing the contract with a service provider are adequate and appropriate? If not, why not?*
7. *Do you consider the Principle and implementation measures for information security, business continuity and disaster recovery are adequate and appropriate? If not, why not?*

AFMA supports that the proposed principles and implementation measures are adequate and appropriate.

8. *What measures for business continuity would be effective in situations where all, or a significant portion, of both the outsourcers' and third-party providers' work force is working remotely? In particular what steps should be taken with respect to Cyber Security and Operational Resilience?"*

As key takeaways from the COVID-19 crisis, AFMA notes that financial institutions should regularly test and update their business continuity plans (BCPs) to account for the evolving technological and operational developments and risk environment. As an industry association, of particular note is the need for seamless industry-wide information sharing framework that allows good understanding of domestic and global best practices in business continuity and resilience against cyber-security. AFMA supports the view that the industry is best placed to innovate and address various issues that may arise when extensive portions of the workforce are working remotely. With regulatory responses providing accommodative support the industry can ensure appropriate resilience.

9. *Do you consider the Principle and implementation measures for the management of confidentiality issues are adequate and appropriate? If not, why not?*
10. *Do you consider the Principle and implementation measures for the management of concentration risk in outsourcing arrangements are adequate and appropriate? If not, why not?*

AFMA supports that the proposed principles and implementation measures are adequate and appropriate.

11. *Do you consider the Principle and implementation measures for ensuring access arrangements are adequate and appropriate? If not, why not?*

AFMA is concerned that Principle 6 is not consistent with good commercial practice for safe guarding data and may promote the introduction of unrealistic and impossible to comply with requirements that carry with them harsh punitive compliance measures.

A regulator's access to high-level documentation and information related to an outsourcing arrangement, where warranted, is a reasonable expectation. In the case that investigative powers are put in place, there needs to be a clearly defined governmental mandate that considers the actual competencies, inter-relationships and advanced nature of the systems used in the financial services industry. This should be a cooperative model of regulation that allows the industry to freely innovate rather than an intrusive punitive one that restricts development and leads to risk averse behaviours.

AFMA notes that prompt access to data, IT systems, premises, personnel of service providers etc. by regulators is an impractical expectation for some types of outsourcing arrangements – notably, concerning cloud services. The term 'prompt' in the Principle is commonly interpreted to mean 'real time' access to highly sensitive, confidential and protected data and systems. This itself may give rise to significant security risks and suboptimal arrangements. Perversely, it could drive a *decrease* rather than an increase in the security and resilience of systems.

The principle thus potentially contradicts Principle 4 which upholds protection of confidential information and data related to the regulated entity and its clients.

12. *Do you consider the Principle and implementation measures for the termination of outsourcing arrangements are adequate and appropriate? If not, why not?*

AFMA supports that the proposed principle and implementation measures are adequate and appropriate.

13. *Do you have any other comments on the Principles and implementation measures? Do you have any suggestions for other areas or risks IOSCO should address?*

AFMA has no additional comments.