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Financial Stability Board
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Dear Sir/Madam

Re: Regulatory and Supervisory Issues Relating to Outsourcing and Third-Party Relationships - Discussion paper published on 9 November 2020

1. The EMA is the EU trade body of FinTech and BigTech firms engaging in the provision of a broad range of payment services and payment instruments. Our members include leading payments and e-commerce businesses issuing electronic money, providing online/mobile payments, card-based products, electronic vouchers, virtual currency exchanges, electronic marketplaces, merchant acquiring services and a range of other innovative payment-related business activities including the issuing of crypto currencies, and similar crypto assets and providing related wallet, custodian, exchange and other services. Most EMA members operate across the EU and globally on a cross border basis. A list of current EMA members is provided at the end of this document.

2. We very much welcome the opportunity to respond to the FSB's Discussion Paper on Regulatory and Supervisory Issues Relating to Outsourcing and Third-Party Relationships ("DP") addressing a broad range of issues of key importance for the EMA and its members, and for the industry's contribution to the massive innovation in financial services over recent years. EMA members have played a key role in driving the development of a ecosystem of payment services and of new emerging payment instruments across and beyond the EU. EMA members continue to be at the forefront of the ongoing technology-driven changes in the global financial services' industry and contribute significantly to the emergence of new ecosystems. These ecosystems leverage Big Data, Distributed Ledger Technology (***DLT***) , Artificial Intelligence (***AI***) and Machine Learning (***ML***), as well as "platformification" to transform traditional financial services' business models and value chains. These developments - brought about by technological innovation and the rapid digitalisation of our economies - depend crucially on the availability, affordability and accessibility of services provided by third parties that are often located in other jurisdictions.

3. As the DP rightly points out "in recent years, the extent and nature of FIs' interactions with a broad and diverse ecosystem of third parties has changed" offering "multiple benefits to FIs, including: enhanced operational resilience; faster and more tailored financial products and services; cost reduction; greater innovation; and improved internal processes." We agree with the analysis that outsourcing and other third-party relationships benefit in particular "small and medium FIs that often lack the scale of larger FIs, particularly in technology investment". Accordingly, the use of third party services enable the speedy scale up of new service propositions and result in much enhanced competition in financial services to the benefit of all users. The more flexible operational models of new financial services ecosystem participants - together with the rapidly advancing digitalisation of financial services - also promote financial inclusion and service offerings for the un/under-banked in less developed markets. We are, therefore, grateful and very much commend the FSB for its timely initiative to address the related regulatory and supervisory issues at the global level of the G20 economies. We trust the FSB's initiative will help develop a framework for cross-border supervisory and regulatory coordination and cooperation that facilitates improved access, availability (and choice) of reliable third-party service providers across all financial services ecosystems.

4. The remainder of this note provides comments on each of the 4 questions put forward in the DP.

Question 1: What do you consider the key challenges in identifying, managing and mitigating the risks relating to outsourcing and third-party relationships, including risks in sub-contractors and the broader supply chain?

5. We concur with the comprehensive analysis in the DP and have little to add to the discussion of key challenges and risks it provides. There are, however, a few comments we would like to offer.

6. In our view the FSB initiative is paramount for responding at the G20 level to the enormous challenge of shaping a flexible, principles-based regulatory and supervisory approach that strikes the right balance between containing relevant risks whilst helping to maximize the enormous benefits outsourcing and third-party services can bring about. As the DP points out, third-party relationships and support services can be instrumental in improving operational resilience at the level of individual firms, ecosystems, and national and international markets. Regulators should bear in mind that overly stringent requirements will have a potentially major adverse impact upon the availability and accessibility of third-party support services, resulting in additional operational risks, potentially higher costs, stifled innovation and eventually poorer financial services' choices for all users.

7. We acknowledge regulators' concerns regarding the challenge of identifying, monitoring and managing potential systemic risks related to financial institutions' use of outsourcing and third-party support services. It is undeniable that concentrations in the provision of third-party services - often operated at an international and global level - can amount to potentially systemic threats. To identify, assess, and contain such risks, financial services providers require access to relevant information that is made available in a form that lends itself to aggregate analysis. Thus, we believe regulators should aim to define an internationally uniform set of key information to assist firms' risk management processes and support regulators' objectives to assess firm-specific and any potentially systemic risks. An internationally agreed, consolidated and streamlined set of outsourcing risk information and reporting requirements would improve the identification, management and mitigation of risks at the level of individual firms, and of domestic and international ecosystems. As importantly, proportionality should be applied at all levels to ensure a targeted, risk-based approach that focuses on material outsourcing and third-party risks but also to allow for flexibility in the regulatory and supervisory approach to the management of such risks by smaller firms whose business activities including any related outsourcing or third-party relationships do not pose systemic risk.

8. We very much concur with the concerns expressed in the DP regarding supply chains and the use of sub-contractors. Our members are finding it increasingly difficult to assess and manage risks associated with the supply chain of large, ICT service providers. Such risks comprise cybersecurity, data protection, operational resilience and concentration risks and relate to the use of sub-contractors/sub-outsourcees by these ICT service providers through often opaque service delivery arrangements. These sub-contractors are often not bound by the service level agreements established with the prime outsourcer covering topics like cybersecurity, service quality and incident notification. Additionally, such sub-outsourcees are not always subjected to the due diligence process that firms apply to direct outsourcing relationships. The ability of firms to ask their direct outsourcees to assume responsibility for the sub-optimal behaviour/performance of such outsourcees is constrained by the power differential between many small/medium size firms and the global 3rd party ICT service providers.

9. In contrast, we would guard against the expectation of regulators that established Exit Plans are capable of ensuring the expedient, seamless substitution of under-performing Critical 3rd party service providers. Given the (i) Growing complexity of services delivered by such providers through a range of distributed models (SaaS, IaaS, PaaS) and (ii) The limited number of available alternative service providers, capable of offering identical or equivalent services, swift and seamless substitution remains, to say the least, an important challenge.

10. Regarding, more generally, the issue of the power differential referred to above, we note that some regulators have resorted to mandating the use of certain contract clauses, which, in the past, in particular smaller firms found difficult to push through in their negotiations with market-leading 3rd party service providers. This indirect regulatory approach can assist in

particular where service providers have not yet subscribed to existing industry standards ensuring full compliance with regulatory requirements applicable to financial institutions. However, a more direct regulatory approach introducing some form of oversight of 3rd party service providers as recently proposed in the European Commission's draft regulation on digital operational resilience for the financial sector ("DORA")[1] is likely to be a more effective regulatory approach albeit focused at this stage on critical service providers where concentrations can pose systemic risks.

11. Finally, we would like to highlight the specific challenges related to the rapid pace of change regarding what the DP refers to as "*the extent and nature of FIs' interactions with a broad and diverse ecosystem of third parties*". We would urge regulators to closely monitor the evolving arrangements (and related multilateral and potentially mutual dependencies) between financial and non-financial firms that participate in the emerging new financial services' ecosystems and platforms. Such arrangements often comprise the sharing of commoditized support and back-office functions through new integrated and "de-verticalized" value chains. We would again expect these developments to generate more of the multiple benefits set out in the DP. However, they may also call for a more integrated and joined up approach to risk management/governance among all financial services firms that use them. The issue appears to go beyond the legitimate question of the proper "regulatory scope". Regulators may have to consider moving away from the traditional firm-specific supervisory perspective and acknowledge that evolving outsourcing service delivery models call for integrated and genuinely joint forms of risk management encompassing all financial and non-financial firms that use them. We believe that a more flexible regulatory and supervisory approach to assessing outsourcing arrangements established by financial services providers should be developed as a matter of urgency. Such an approach should accommodate and ideally promote integrated multilateral forms of risk management well beyond the acceptance of pooled audits. For example, these could include the use of standardized risk assessments/audits of Outsourcing Service providers by independent 3rd parties, and the publication of the relevant results.

Question 2: What are possible ways to address these challenges and mitigate related risks? Are there any concerns with potential approaches that might increase risks, complexity or costs?

12. As set out before, we believe the FSB initiative should aim at shaping a regulatory and supervisory approach that combines:

[1] Proposal for a Regulation of the European Parliament and of the Council on Digital Operational Resilience for the Financial Sector and amending Regulations (EC) No 1060/2009, (EU) No 648/2012, (EU) No 600/2014 and (EU) No 909/2014; https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52020PC0595&from=EN

- Flexible, principles-based, internationally agreed regulatory standards, with
- Much enhanced supervisory coordination and cooperation.

Moreover, systemically relevant concentrations of critical third-party services should give rise to multilateral, college-type supervisory cooperation involving the competent authorities of all relevant jurisdictions.

13. In addition, a dedicated international forum at the G20 level should be mandated to assist the practical supervisory cooperation by:
    - monitoring and analysing outsourcing industry trends and any material changes in the structure and the risk profile of financial institutions' interactions with third party service providers across all relevant jurisdictions;
    - reviewing and updating the agreed international regulatory standards informed by the outputs of the ongoing monitoring and analysis process outlined above;
    - providing guidance on the practical application of the issued principles-based regulatory standards; and
    - orchestrating and leading an ongoing dialogue between regulators, the financial services industry and third-party service providers. In the context of the growing importance of emerging financial services ecosystems, we would urge the FSB to include in this ongoing dialogue the non-traditional service providers represented by the EMA.
14. The governance, structural set up and workings of the multilateral college-type cooperation and the standard-setting international forum referred to above could draw on the oversight framework of Critical ICT third-party service providers as proposed in the European Commission's DORA referred to above. However, we acknowledge that the delegation of supervisory and regulatory powers proposed in DORA is not possible at the G20 level. The related workings and powers would have to be replicated as much as possible by voluntary commitments in MoUs between participating jurisdictions and competent authorities.

15. In the absence of binding regulatory powers, we still believe an FSB initiative could go a long way to facilitating convergence of relevant regulations, standards and supervisory practices and, at the same time, enable cross-jurisdictional supervisory coordination and cooperation. We would urge the FSB to discourage jurisdictions from embarking upon a regulatory approach that results in fragmentation by resorting to effectively extra-territorial prohibition of cross-border outsourcing or subcontracting to third country service providers as proposed for instance in the EC's DORA[2]. We remain convinced that - subject to effective regulatory and supervisory coordination and cooperation - the evolving financial services ecosystems stand to benefit from the use of outsourcing and other third-party relationships to service providers in third country jurisdictions.

[2] e.g. proposed Articles 28 (3) and 31 (d)(iv) DORA

Question 3. What are possible ways in which financial institutions, third-party service providers and supervisory authorities could collaborate to address these challenges on a cross-border basis?

16. We believe that effective cross-border collaboration between these stakeholders requires strong public leadership at the international level. As set out in our response to question 2, it is our view that a dedicated and properly mandated regulatory forum at the G20 level, operating under the auspices of the FSB, would be best placed to take that lead. This forum should provide a permanent structure for dialogue and collaboration with all stakeholders, ensure proper representation of all relevant players and, at the same time, allow for sufficient flexibility to respond to the specific issues at hand.

Question 4. What lessons have been learned from the COVID-19 pandemic regarding managing and mitigating risks relating to outsourcing and third-party relationships, including risks arising in sub-contractors and the broader supply chain?

17. For the business activities of the vast majority of EMA members, the COVID-19 pandemic did not have the disruptive impact experienced by many other financial institutions. All businesses supporting online and mobile payments benefitted significantly from the enormous surge of online shopping (with the obvious exception of very few firms serving specifically the travel and hospitality industry). There were COVID-19 related issues and we would note specifically that EMA members reported delays due to issues with the swift scaling up of the provision of 3rd party services where the pandemic resulted in sudden jumps in the demand of remote services (e.g. related to the online on-boarding of customers). However, as can be expected from an industry spearheading the move towards a digital economy, the shift to remote working and other remote operations and service delivery measures aimed at mitigating the risk of contagion did not present major problems.

18. The EMA monitored closely the impact of the pandemic on its members including in our monthly members' meetings. This ongoing monitoring exercise aligned with published supervisory guidance on how to respond to the Covid-19 pandemic including in particular guidance from the UK Financial Conduct Authority published in July 2020.[3] We agree that subject to proportionality and to a risk-based approach such reviews should include sub-contractors and the broader supply chain. However, the EMA's joint monitoring did not provide evidence of any related materialised risks. So far, EMA members have been able to

[3] Coronavirus and safeguarding customers' funds: additional guidance for payment and e-money firms, 9 July 2020, paragraph 1.13

rely on outsourced and third-party services and their service providers have indirectly benefited from the business growth EMA members experienced.

We would be grateful for your consideration of our comments.

Yours faithfully

Thaer Sabri

Chief Executive Officer

Electronic Money Association

Members of the EMA, as of January 2021

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Airbnb Inc
Airwallex (UK) Limited
Allegro Group
American Express
Azimo Limited
Bitstamp
BlaBla Connect UK Ltd
Blackhawk Network Ltd
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CashFlows
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