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Discussion paper: Regulatory and Supervisory Issues Relating to Outsourcing and Third-Party Relationships

I. Introduction

IHS Markit (NYSE: INFO) is a world leader in critical information, analytics and solutions for the major industries and markets that drive economies worldwide. The company delivers next-generation information, analytics and solutions to customers in business, finance and government, improving their operational efficiency and providing deep insights that lead to well-informed, confident decisions. Headquartered in the UK with offices throughout the EU, US and Asia, IHS Markit has more than 50,000 key business and government customers, including 80 percent of the Fortune Global 500 and the world's leading financial institutions.

IHS Markit services and products provide our clients with a number of tools that allow them to make informed decisions, manage risks and meet their regulator obligations more efficiently and effectively. Many of these services could be considered outsourcing. For example, IHS Markit has products to help clients meet their reporting obligations (under regulations such as SFTR, EMIR, MIFID), improve their capital allocation (FRTB) and ensure they meet their customer obligations (KYC and best execution). Importantly, IHS Markit can also help clients manage their own outsourcing and supply chain risk through its KY3P product.

IHS Markit is pleased to provide comments to the FSB on its Discussion Paper on Regulatory and Supervisory Issues Relating to Outsourcing and Third-Party Relationship (the DP).

II. Summary

As a provider of data and information services and solutions, IHS Markit welcomes the DP. We support the FSB's work to encourage dialogue around this very important topic, which we agree is an area undergoing rapid evolution. We believe that global consistency of approaches is needed if regulators are able to effectively manage the risks of outsourcing while also ensuring the economic benefits (including resilience) from best in class services and innovation can be obtained.

Generally, we support the DP and the approaches it proposes and recognise the importance of the objectives it is intending to meet. We set out our comments in more detail in answering the specific questions below. However, to summarise, IHS Markit encourages the FSB and its members to:

- keep a razor-sharp focus on the practicality and proportionality of the application of their rules. Critical outsourcing requirements should be only for genuinely critical activity. Without such an approach, the extra burden on providers will increase costs, reduce competition and make services uneconomical;
- focus on promoting the maximum consistency and efficiency of approach between sectors and jurisdictions (including on assurance and audit processes);
- recognise that Regtech solutions have been developed that allow the efficient identification, management and reporting of third-party risks by financial institutions; and
- be more active in supporting and working with industry utilities to grow and strengthen the pooled or shared assessments approach.

The DP aims at encouraging dialogue between financial institutions, regulators and third parties. We would be happy to further discuss any aspect of our response or the DP.

III. Answers to Questions

Q1. 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?

Business can have a huge number of suppliers and outsourcing relationships, often spanning many jurisdictions. Identifying, managing and mitigating the risks relating to these third-party relationships is a daunting and potentially onerous task, particularly as these entities often have their own multi-jurisdictional third party and outsourcing arrangements. Such arrangements can lead to difficult to identify risks, including concentration risk if these third parties rely on a limited number of providers (particularly with IT and cloud providers). Manually trying to track and monitor outsourcing risks is virtually impossible given the complicated nature of many suppliers' own third-party relationships, the inconsistency of any manual inputs from firms and the need to effectively track changing situations. It is, therefore, important that firms set aside sufficient resources and adopt appropriate technology to make the process of identifying and managing such risks as effective and efficient as possible.

Q2. 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?

As set out above, businesses can have a huge number of suppliers and outsourcing relationships. Identifying, managing and mitigating the risks relating to these third-party relationships is a daunting and onerous task, particularly where these entities have their own complicated third party and outsourcing arrangements. However, RegTech solutions (such as IHS Markit's KY3P and Counterparty Manager) that automate processes to provide effective and efficient solutions have been developed. These solutions allow the collection of consistent, standardised information that facilitate the relevant analysis of the risk, including concentration risk. Such tools also enable firms to quickly assess changing circumstances (such as the impact of technological evolution or events such as pandemics or Brexit), to automate notification for the regulator and to manage the process of ensuring outsourcing arrangements are appropriately concluded and renewed. Furthermore, KY3P has automated and standardised (based on industry best practice) the collection and analysis of data security and other cybersecurity factors.

The DP correctly identifies, providers can often help individual regulated firms afford to access higher quality solutions as the provider is able to mutualise the cost among its clients. This is something which can be particularly beneficial for smaller institutions. Given the important benefits of outsourcing, it is vital that requirements do not place disproportionate costs on such arrangements. This would make it uneconomical to access the best in class expertise and innovation available through specialist third party providers.

Outsourcing also ensures that firms have less incentive to compete on a race to the bottom when it comes to compliance, especially on customer facing processes like AML, KYC, record management and other burdensome regulatory requirements firms might face. This helps policymakers as it will promote better regulatory outcomes and avoid pressure to reduce regulatory standards or rigour to reduce costs or boost competitiveness. Policymakers and supervisors also do not have to deal with different approaches to compliance from each firm, which should make compliance more efficient and facilitate the monitoring of how the market is adapting to regulatory requirements.

As set out above, we fully agree that firms should be able to understand and manage their risk, including supply chain risk caused by sub-outsourcing and intra-group outsourcing. However, regulation should be assessed on a cost and benefit basis and applied where the benefits outweigh the costs. When it comes to outsourcing, it is particularly important to consider the risk that the benefits of outsourcing are lost as it becomes uneconomical for firms to access third-party expertise and services. We would understand that there should be a higher level of control (and thereby increased costs) for genuinely critical outsourcing risk. However, regulators should be clear that only outsourcing that could present a genuine risk to the firm's threshold conditions, financial stability or consumer protection should be considered as critical and subject to the most onerous requirements.

Q3. 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?

Third-party providers, like the financial firms they service, often operate across many jurisdictions and competing, duplicative or incompatible standards

between jurisdictions can be particularly problematic. Third-party providers, such as IHS Markit, are committed to help their clients meet their regulatory requirements and to work with their regulators and auditors. However, the FSB should be cognisant that differing standards and the need to provide constant access to premises and systems for all clients, their regulators and their auditors would be completely impracticable and unworkable. This would quickly overwhelm providers. The FSB should be promoting a focus on consistency and proportionality in approaches, particularly to access and assurance. There is no wish to cut standards, but pooled audits and other assurance processes should be used wherever possible, including on a multi-jurisdictional basis. This would help manage the burden of these process, which we agree are necessary (and is something many regulated firms are already doing), and avoid passing increased costs on to regulated entities or making services uneconomical for some jurisdictions.

IHS Markit believes that it is important for regulators to have a systemic view of outsourcing risks and, through KY3P, would also like to offer to support initiatives to create centralised repositories or registers of outsourcing arrangements. This could include sharing the lessons we have learned through our own solution's design and development as well as exploring the potential to enable organisations to use KY3P as one of the portals to up-load data into a central repository.

Q4. 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?

Generally outsourcing and the stability of remote services have provided resilience to the financial sector during the COVID-19 pandemic. The FSB should consider that, without specialist providers, the ability of markets and financial service firms to continue to operate under these unprecedented circumstances would have been greatly reduced. This highlights the need to ensure regulators do not make access to such services (which might often be only for contingencies) uneconomical. However, we would agree that it remains extremely important for firms to identify, manage and mitigate risks relating to outsourcing in a proportionate manner.

We hope that our comments are helpful to the FSB. We would be more than happy to elaborate or further discuss any of the points addressed above. In the event you may have any questions, please do not hesitate to contact myself, David Cook, Executive Director for Regulatory and Government Affairs at david.cook@ihsmarkit.com.

Yours faithfully,

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