Law proposal to facilitate external and intra-group outsourcing in the financial sector

One of the key principles of Luxembourg financial regulation is the obligation of professional secrecy ("banking secrecy") laid down in Article 41(1) of the 1993 Financial Sector Act (a similar obligation exists for insurance companies). Outsourcing arrangements and especially IT outsourcing operations which can lead to the disclosure of confidential data and thus to a potential breach of the "banking secrecy", are subject to rather strict conditions.

Article 41(5) of the 1993 Financial Sector Act provides for an explicit exception to the banking secrecy on the basis of which outsourcing for financial service providers can in principle only be carried out by credit institutions and duly authorised "support" financial service providers under a service agreement. A similar exception exist for insurance companies.

On 29 July 2016 the Minister of Finance has introduced a law proposal which will provide more possibilities to outsource activities both to external and intra-group undertakings. If accepted, the law proposal will allow regulated financial and insurance service providers to outsource activities to:
(i) other Luxembourg based regulated entities ;
(ii) group related entities ;
(iii) other entities (subject to the clients' consent).

(i) Other regulated entities

The obligation of secrecy would not cover disclosure of confidential information to:
- entities established in Luxembourg;
- supervised by the CSSF (financial sector regulator), the ECB or the Commissariat aux Assurances (insurance sector regulator);
- which are under a professional secrecy obligation
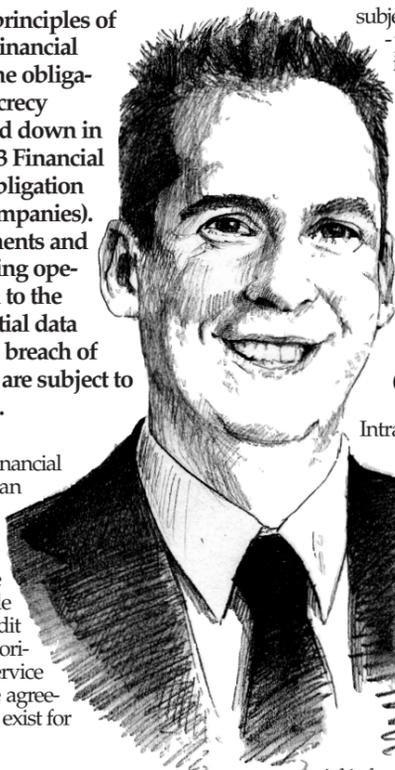
subject to criminal sanctions;
- provided that a service agreement is in place.

Therefore, if the law proposal would be adopted in its current version, the group of regulated entities to which financial and insurance service providers can outsource activities would be significantly extended and will be much larger than credit institutions and authorised support financial service providers.

(ii) Intra-group outsourcing

Intra-group outsourcing is currently possible on the basis of the CSSF Circular 12/552 (at least for credit institutions, lending companies and investment firms) but requires the consent of the clients concerned if such outsourcing could lead to the disclosure of confidential information.

Thus, disclosure of confidential information without violating the banking secrecy would be possible towards entities belonging to the same group than the outsourcing entity supervised by the CSSF or the ECB provided that:
- such entities are in charge of the performance of services that are entirely outsourced within the group;
- persons having access to confidential information, must be subject to a professional secrecy obligation or at least be bound by a non-disclosure agreement; and
- clients are duly informed beforehand in writing about the services outsourced to these entities, the information transmitted within the context of such outsourcing as well as the country of establishment of such entities.

The law proposal would thus abolish the consent requirement (which was often difficult to meet for the whole client base) and replace it by a simple

information to the clients concerned and thus facilitate successive intra-group outsourcing operations. Contrary to the regulated entities referred to under (i), the intra-group entities to which activities can be outsourced, do not have to be established in Luxembourg. The law proposal does not explicitly require the conclusion of an agreement but it is very likely that such requirement will continue to exist on the basis of CSSF circulars.

(iii) Other entities

Outsourcing to other entities than credit institutions or "support" financial service providers is currently possible on the same basis than intragroup outsourcing and thus requires in principle the consent of the clients concerned. Such consent based approach was founded on a CSSF circular.

If the law proposal would be adopted in its current version, the consent based approach would be explicitly foreseen in the 1993 Financial Services Act and constitute a more legally certain basis.

Indeed, the law proposal allows the outsourcing of activities to:
- subcontractors which are subject to a professional secrecy obligation or bound by a non-disclosure agreement;
- provided that the clients concerned accepted beforehand in writing the outsourcing of the relevant services, the information transmitted within the context of such outsourcing as well as the country of establishment of such subcontracting entities.

Even when this is not explicitly required in the current version of the law proposal, it is self-explanatory that these subcontractors will need to have concluded a written agreement with the outsourcing financial and insurance service providers.

Conclusion

The law proposal offers many more possibilities for financial and insurance service providers to outsource activities as it enlarges the group of regulated entities to which activities can be outsourced. Yet, it will most probably be above all the specialised support financial service providers that will be the best placed to outsource activities to, certainly when it comes to IT outsourcing activities. The real added value of the law proposal is the facilitation of intra-

group outsourcing. However, it is not entirely clear how the requirement that the services concerned must be entirely outsourced within the group, must be interpreted. If interpreted strictly, this requirement could constitute an undue hurdle to the possibility to outsource on an intra-group level. Finally, it remains to be seen whether and, if so, how the CSSF would change its different circulars which have also an impact on outsourcing arrangements. Indeed, these circulars exist in addition to Article 41 of the 1993 Financial Sector Act and are extremely important in the shaping of an outsourcing arrangement.

For example, CSSF Circulars 12/552 and 05/178 state the key principles of IT outsourcing in terms of
- the consistency of the outsourced activity with a predefined policy based on a risk assessment;
- the main liability of the outsourcing institution to its clients;
- the confidentiality of data;
- the institution's ability to control all stages of the outsourcing process; and
- the institution's ability to continue its business in times of crisis or other exceptional situations.

Another example is the CSSF Circular 13/554 on the use and control of IT resources and the management of access to these resources on an intra-group level. When a multinational financial group with a Luxembourg entity wishes to use a general access tool for IT resources (e.g., user accounts, printers, computers, IT services, etc.) at a group level, this circular requires the Luxembourg entity to introduce a formal, detailed authorisation request to the CSSF, proving it still has full control over the IT resources for which it is responsible.

Therefore, even if the discussed law proposal would facilitate IT outsourcing on a group level, this does not give a blank authorisation to consolidate all IT elements on a group level without the Luxembourg financial sector entity having any control over the elements that it uses.

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A new release once a century

Do you use standard software from the major manufacturers? If you do, this surely operates perfectly and follows a well-organised procedure which may look like this: Release deliveries are provided every six months. However, you cannot make use of each release because you always have to make sure that your own specific business transactions still operate properly with the software. Probably, you only accept a release once a year or even every two years. If you intend implementing a dynamic business model, your software requirements will have to be defined for the standard software provider. As a basis for calculating a possible time span, let us assume that an enhancement would take a programmer an additional four weeks to complete.

Step 1: The IT department is usually a standard software provider's point of contact. However, before an order can be completed, accurate specifications in writing from the specialist department are required, without which, it would be impossible to specify a price. This can take up to eight weeks before the specialist department defines the requirements because this is a process that runs concurrently to daily routine activities.
Step 2: Consequently, the standard software provider has to check the requirements before informing the customer of the price and the delivery date. For this purpose, a specialist from the standard software provider will have to be involved since an industry expert is always needed for specific requirements. However, as these experts always have a full schedule, arranging an appointment can take up to four to six weeks. When a meeting is finally organised, another four weeks can pass before the requirements have been defined and verified.
Step 3: On the basis of the concept in question, the IT department can negotiate the price and place the order. If the price is too high, which is usually the case for special small enhancements, other alternative solutions may have to be analysed and roughly another four weeks will be needed for this.
Step 4: Once the order has been placed, the development board at the standard software provider's company plans the development. Roughly a fur-

ther four weeks pass, before a programmer can be deployed to work on the order, also needing four weeks to complete the programming, as planned.

Step 5: Subsequently, the standard software provider integrates the software into releases and deliveries and includes it in the overall system test. If no major modifications are necessary, the process can be wound up after four to eight weeks.
Step 6: Now, the software is delivered to the customer who sets up the test scenarios and carries out the tests on the test data set. The software can then go live after another eight weeks, but only if the programming is Step 7: Following this, the IT department plans the switch to productive operation.

In the company in our example, the new releases are installed in the annual company holidays in August when only a skeleton staff is working. Surely not the best time to implement new software?

Now have you been counting? In what month does the business unit in question have to start work, if it wants the delivery installed in August?

October	Use of the investment
September	Introduction of the software to the business unit
August	Installation and test in the IT department
July	Frozen period/manufacturer test phase
June	Development
May	Development planning
April	Product Management Board
March	Meeting with the consultant
February	Discussing the concept with the IT department
January	No project work because of end-of-year tasks
December	Business unit works on the concept
November	Business unit works on the concept

A normal cycle lasts twelve months. However, if this only takes six months in your company, this could almost be considered as quick. In practice, this takes up to 18 months.

The reaction to these lengthy cycles, which we are all aware of, is usually that the standard software cannot cover all urgent requirements. But what does urgent mean in this case? By definition, "urgent" means all requirements needed by the Board, the owner, the legislators and the supervisory bodies. When there are enough "urgent" requirements, the business units hardly have the time to write the functional concept/enhancement requirements for the standard software.

So what does this tell us?

Standard software is only adjusted to a company's requirements to a minimum degree and essentially operates in the same way for the next five to ten years. The intended rationalisation has not come about, as was hoped, because more staff would inevitably be required to implement the "urgent" requirements in addition to the standard software.

After five to ten years, you realise that only approximately 40% of the processes are IT-supported. Then a new IT manager comes along with a new tendering process which is verified by ROI calculations. Then the product is purchased from a major manufacturer because only major manufacturers can supply a lot of functions at a relatively low price. Ultimately, functional concepts/enhancement requirements are developed for those functions that do not satisfy your company's needs.

Is the IT industry really so bleak and stagnant?

Unfortunately, it is. Thankfully however, a parallel world for mobile phones and devices has been in existence for some years now. Apps that update automatically and innovations that are provided on the basis of the user profile. Security measures are automatic, back-ups are always available and users often fail to realise that these devices are so user-friendly because of the software. At this point, you might be thinking that you cannot really compare mobile apps to powerful software such as that for materials management, accounting or human resources. But this is indeed the case.

Just have a look at how simple some functions for business software are: tax calculations, aggregation of positions and printing of invoices. In contrast, some games software is much more complicated. The reason for the existence of two software worlds is another. The designers of mobile apps had very limited computer resources, tiny monitors and a self-defined target group. App designers have to know exactly what they are doing so that the first application is a success. Nowadays, if users cannot operate the app after one minute, they will not download or use it.

With major standard software, it's a completely different story. Users are trained for four weeks until they master the art of writing an invoice while their employers insist on them using the software.

Can you see the difference?

As far as apps are concerned, users are in control of how they use them which is not true for standard software. For strategic reasons, a decision is made for or against a particular manufacturer. Would you like to know what these strategic reasons are?
1. A release is guaranteed once a year
2. Manufacturer's Product Management Board
3. Defined change processes
4. Any number of others use the software

You don't think these are strategic reasons? Neither do I.

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The company FERNBACH Financial Software S.A. is providing the service and the software is delivered by Jabatix S.A.