Outsourcing Risk Management

UniCredit Group Experience

Stefano Alberigo – Unicredit Head of Operational & Reputational Risk Oversight

Francesco Mottola – Manager Accenture Finance & Risk

Agenda

A   **Context & Background**

B   Outsourcing Risk Management in UniCredit

Banks business model evolution is radically re-shaping key aspects of the banking industry and management of suppliers is becoming increasingly complex

Customers no longer expect banks to be a simple transaction provider, but to also play the role of…

A | *Advice Provider* — Provide specific buying suggestions, based on **deep customers knowledge and purchasing algorithms**
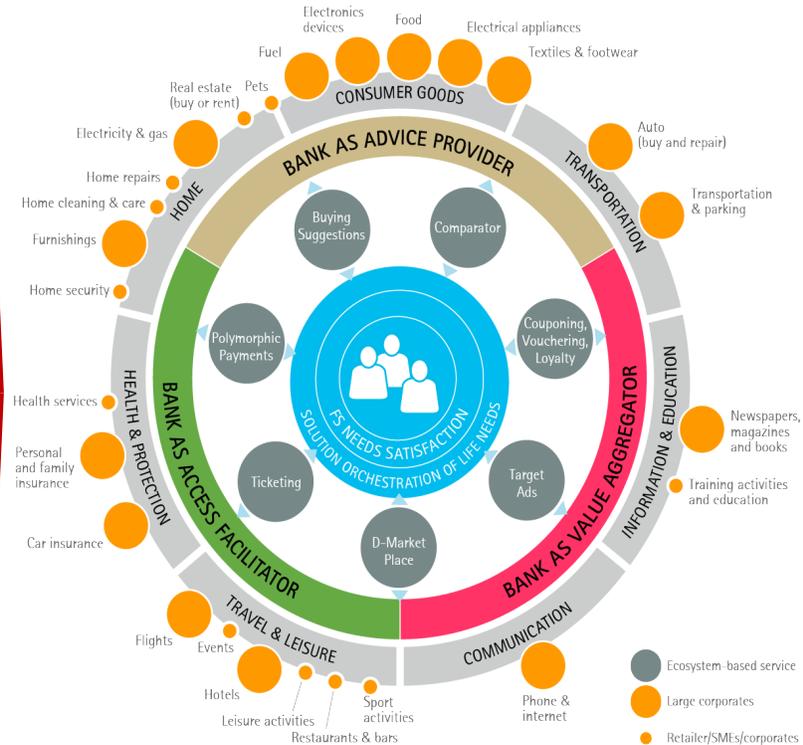
B | *Value Aggregator* — Assemble components (financial and non financial, own and third parties) to create an integrated solution for **"real world" customer needs**

C | *Access Facilitator* — **Support the customer in "everyday/everywhere"** buying processes (shopping, access to daily services)

Understanding who you are doing business with, partnering with and who is supplying your organization will make managing outsourcing risk harder than ever

What are the main issues to be managed?

Lack of Information / Transparency in a wide supplier network

Growing Reputational Risks due to outsourcing of services close to customers

Higher Regulatory Pressure on suppliers management

Increasing of security risk to be managed on Company assets (e. g customers data)

Possible Actions

Know your suppliers

A consistent and thorough approach to **evaluate suppliers and their vendors** (e.g. financial data, ownership)

Certification

A standard form to **certify suppliers eligibility criteria**

Continuity Plans

Ensure **Business Continuity/ Contingency plan** in case of supplier disruption

Ongoing Monitoring

Periodic monitoring of Suppliers services against SLAs and **changes in suppliers processes/ practices**

Increasing pressure is placed by Regulators on outsourcing topics aimed at mitigating impacts of outsourcing risks on the Banks services
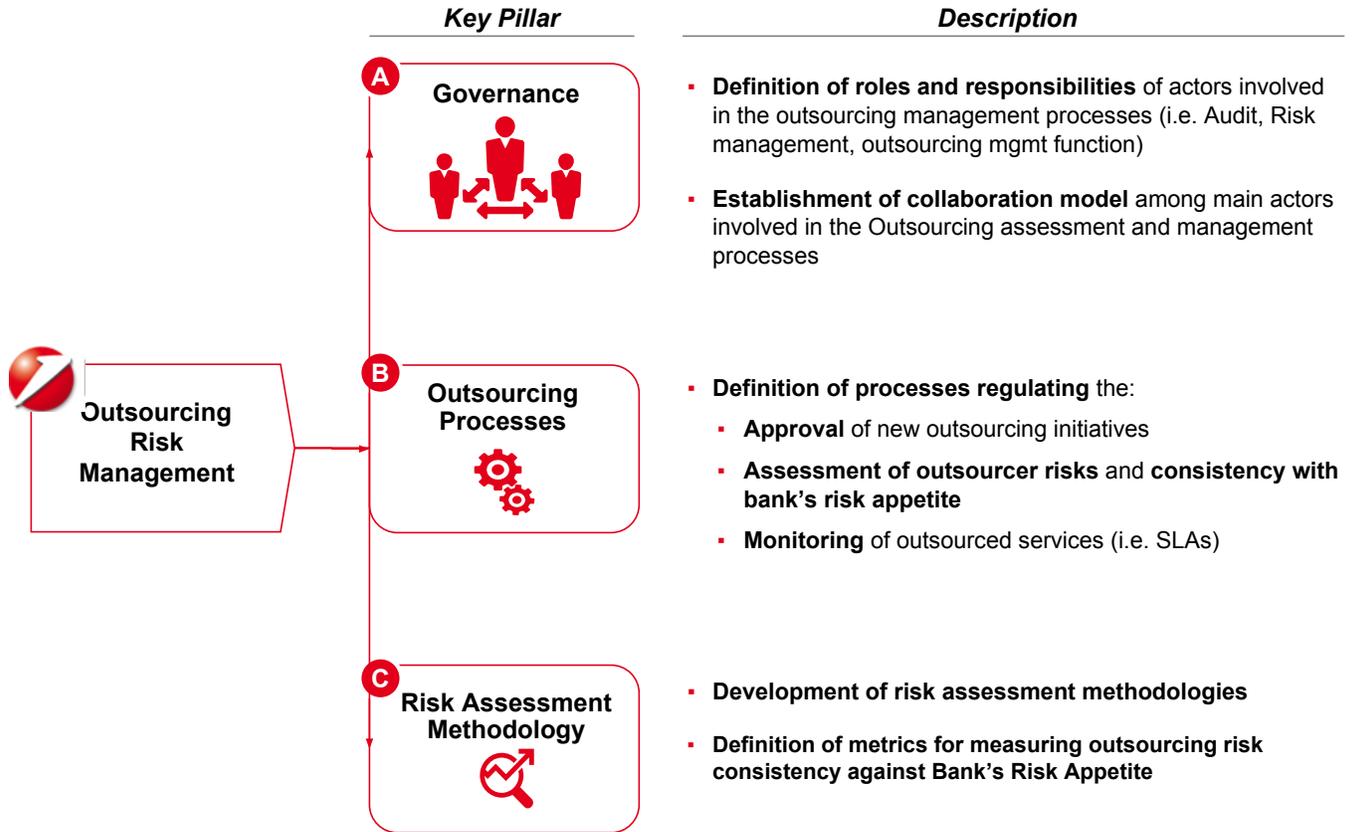
Regulation	Key Provisions	Objectives

UniCredit

EBA Guidelines on Outsourcing

- Definition of **formal Service Level Agreements** regulating services provided
- Development of **exit strategies and contingencies plans**
- **Establishment of Supplier monitoring systems** (e.g. Key Risk Indicators)

Bankit 263*

- **Definition of criteria** for the assessment and approval of relevant outsourcing transactions (e.g. outsourcing of operating functions)
- **Definition of inventory of suppliers in order** to have a consolidated view of outsourced services
- **Establishment of information flows** to effectively govern outsourced services

1 *Definition of an internal Governance model*

2 *Implementation of outsourcing risk management processes*

3 *Formalization of risk assessment methodology*

4 *Establishment of outsourcers monitoring and reporting system*

Bank of Italy update issued on 2th July 2013

Agenda

A	Context & Background

B	Outsourcing Risk Management in UniCredit

Structured Governance, Processes and Methodologies were developed in UniCredit Group for the outsourcing risk management

Key Pillar

Description

Outsourcing Risk Management

A **Governance**

- **Definition of roles and responsibilities** of actors involved in the outsourcing management processes (i.e. Audit, Risk management, outsourcing mgmt function)
- **Establishment of collaboration model** among main actors involved in the Outsourcing assessment and management processes

B **Outsourcing Processes**

- **Definition of processes regulating** the:
  - **Approval** of new outsourcing initiatives
  - **Assessment of outsourcer risks** and **consistency with bank's risk appetite**
  - **Monitoring** of outsourced services (i.e. SLAs)

C **Risk Assessment Methodology**

- **Development of risk assessment methodologies**
- **Definition of metrics for measuring outsourcing risk consistency against Bank's Risk Appetite**
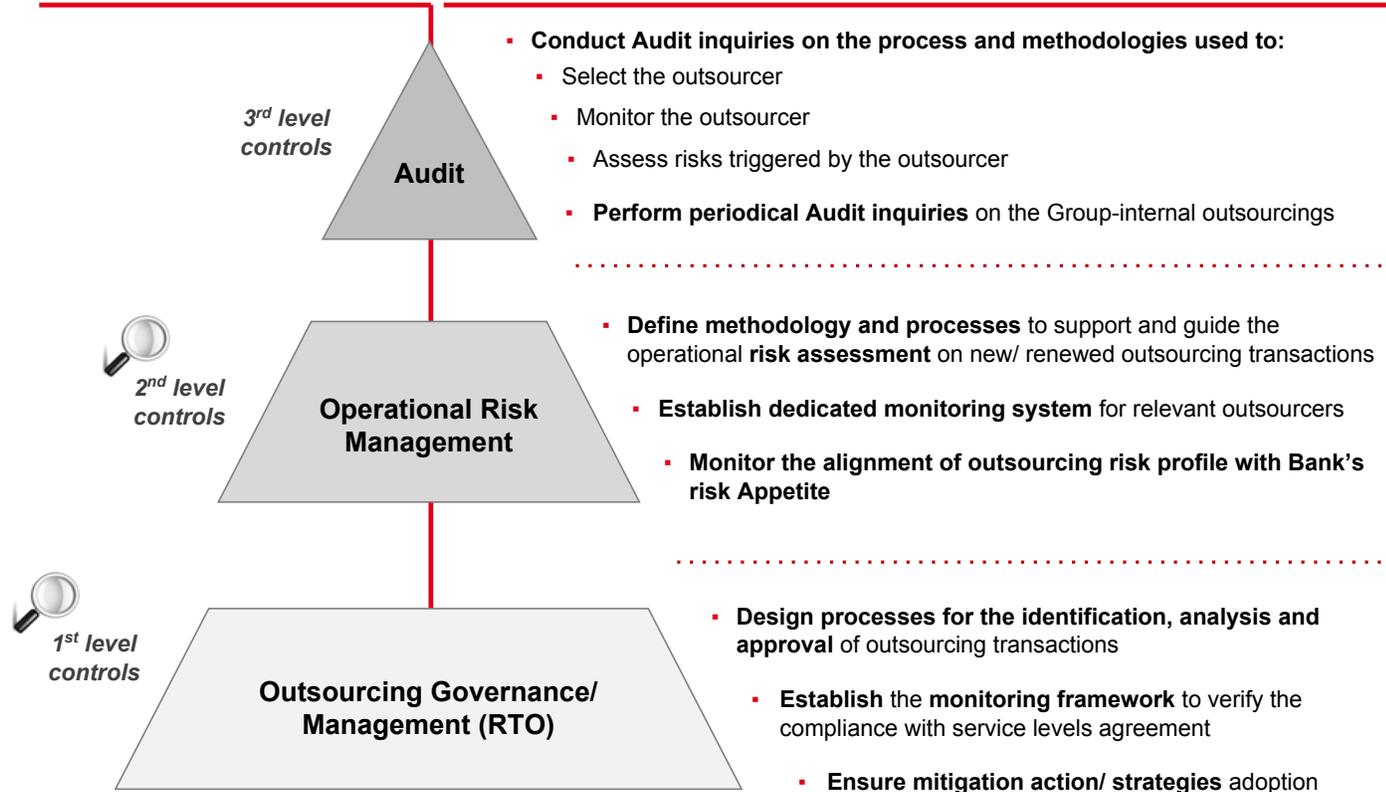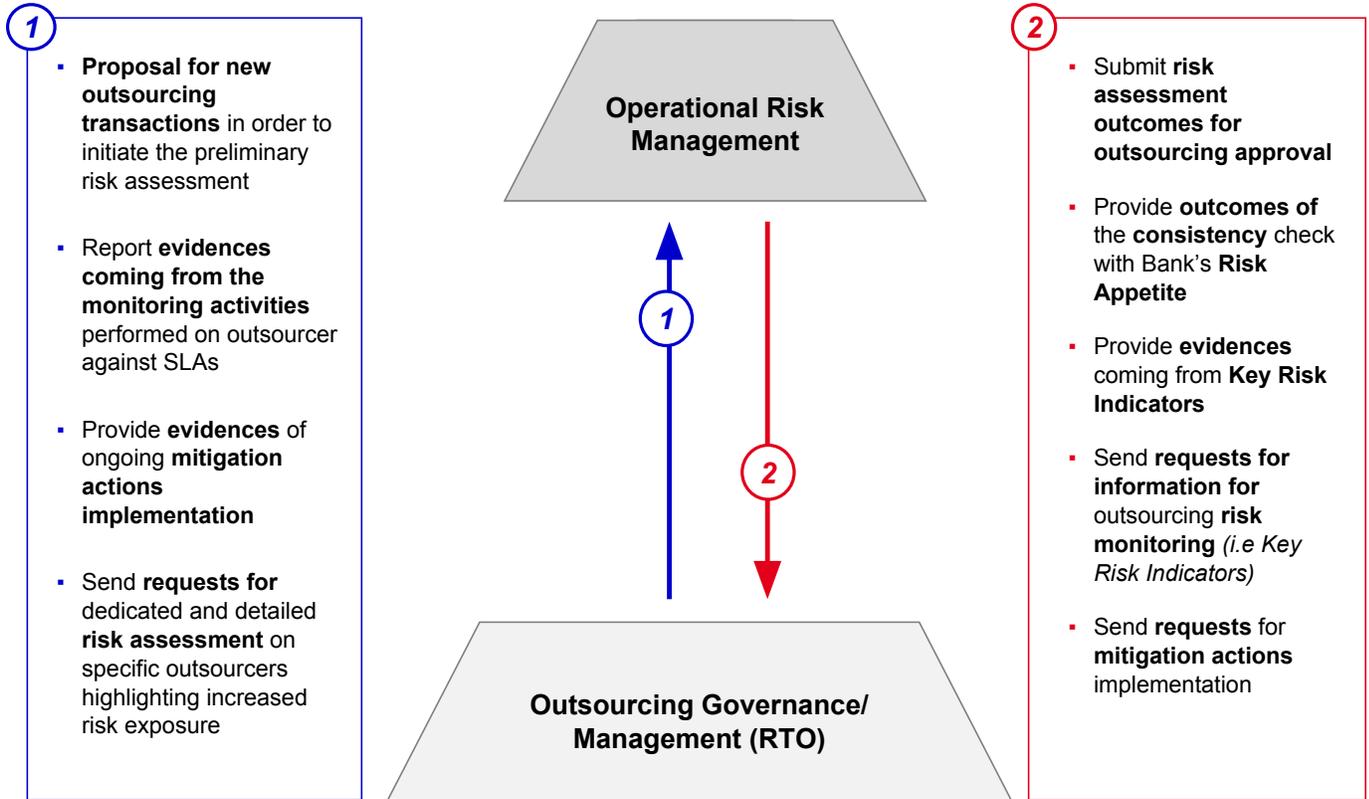
A sound and robust governance model for the management of the Outsourcing risks must be based on three levels of control

*Outsourcing Governance*　　　　　　　　　*Roles and Responsibilities*

3rd level controls

Audit

- **Conduct Audit inquiries on the process and methodologies used to:**
  - Select the outsourcer
  - Monitor the outsourcer
  - Assess risks triggered by the outsourcer
  - **Perform periodical Audit inquiries** on the Group-internal outsourcings

2nd level controls

Operational Risk Management

- **Define methodology and processes** to support and guide the operational **risk assessment** on new/ renewed outsourcing transactions
- **Establish dedicated monitoring system** for relevant outsourcers
- **Monitor the alignment of outsourcing risk profile with Bank's risk Appetite**

1st level controls

Outsourcing Governance/ Management (RTO)

- **Design processes for the identification, analysis and approval** of outsourcing transactions
- **Establish** the **monitoring framework** to verify the compliance with service levels agreement
- **Ensure mitigation action/ strategies** adoption

KEY: Focus on next slides

Continuous information flows among involved control functions within Outsourcing Risk Process

1

- **Proposal for new outsourcing transactions** in order to initiate the preliminary risk assessment

- Report **evidences coming from the monitoring activities** performed on outsourcer against SLAs

- Provide **evidences** of ongoing **mitigation actions implementation**

- Send **requests for** dedicated and detailed **risk assessment** on specific outsourcers highlighting increased risk exposure

Operational Risk Management

1

2

Outsourcing Governance/ Management (RTO)

2

- Submit **risk assessment outcomes for outsourcing approval**

- Provide **outcomes of** the **consistency** check with Bank's **Risk Appetite**

- Provide **evidences** coming from **Key Risk Indicators**

- Send **requests for information for** outsourcing **risk monitoring** *(i.e Key Risk Indicators)*

- Send **requests** for **mitigation actions** implementation

Risk assessment methodologies have been shaped considering outsourcing relevance

Assessment Type	*Assessment Approach*	*Owner*	*Example*

Risk Assessment Methodology

Quick Risk Check for Non-Relevant Outsourcing

- **Preliminary analysis** of outsourcing transaction proposal

- **Questionnaire filling in**, providing general information on outsourcing features

- **Questionnaire results indicate** whether it is necessary **to execute an in depth risk assessment**, as used for Relevant Outsourcing (reported below)

Outsourcing Management

Quick Risk Check

ILLUSTRATIVE

Risk Assessment for Relevant Outsourcing

- **Preliminary analysis** of outsourcing transaction proposal

- **Quantitative evaluation** of outsourcing impact on operational risk profile in terms of operational losses

- **Qualitative evaluation** of relevant operational risks emerging from outsourcing implementation

OpRisk Management

Extreme Impact

Expected Impact

ILLUSTRATIVE
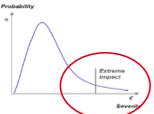
The methodology developed within UCG for the Outsourcing quick check entails the evaluation of a list of criteria based on selected value range

Outsourcing quick risk check

Criteria	Rationale

Dependency on Outsourcer

Internal vs. External
- **Internal Outsourcing ensures lower risks** since controls and influence on outsourcer is more effective

Operating Expenses
- **Higher the operating expenses** impacted by the transaction, **higher the dependency** on outsourcer performance/ fees

Provider's Income
- **Higher the relevance of outsourcing** on provider's income, **higher the potential risk** of provider financial stress

Impacts in case of Risk Events

Processes
- **Higher the number and relevance** of outsourced processes, **higher the risk of losses** due to inadequate delivered services

Employee
- **More employees are involved** in the outsourcing transaction, **higher the exposure to risks** related to employee practices

Customers
- **More clients are involved** in the outsourcing transaction, **higher the potential reputational damage**

Regulation
- **Higher the exposure to regulatory provisions, higher the risk of incurring in sanctions**

Operational risk assessment methodology enables to evaluate in advance risks arising from Outsourcing

Outsourcing Assessment

Key Steps	Description	Owner	Outcome

A — *Preliminary Analysis*	• **Collection and analysis of key information** related to the Outsourcing
	• **Identification of the approach for the assessment** of OpRisk Profile
		OpRisk Function	• Identification of most suitable assessment approach:
			  • **Quantitative; and/ or**
			  • **Qualitative assessment**

B — *Quantitative Assessment*	• **Quantification of Operational Risks** arising from Outsourcing Transaction implementation **in terms of expected and potential operational losses**	**OpRisk Function**	• **Estimation of Expected Operational Losses** • **Estimation of Potential /Unexpected Operational Losses** (e.g. Impact on RWA)
Qualitative Assessment	• **Identification and assessment of new/ increasing Operational Risks** (emerging risks) triggered by the OutsourcingTransaction	**Expert Function***	• **Identification of material emerging Operational Risks** • **Assessment of potential and residual risk** taking into account mitigation in place

*Examples of Expert Functions are: Legal, Compliance, Planning Finance & Administration

Case Study – *Outsourcing of IT Services*

Key Steps	*Key Metric*	*Key Outcomes*

ILLUSTRATIVE

A

Preliminary Analysis

- **Outsourcing of ICT Infrastructure** supporting **commercial banking** (e.g. payments, cards)

- **Relevant changes to internal environment**
  - Processes
  - Internal staff
  - ICT systems

- **Quantitative assessment:**
  - Reduction of OpLosses related to ICT for CBK
  - New extreme scenarios in case of Outsourcer default

- **Qualitative assessment:**
  - Increased risks of External Fraud
  - Increased risks resulting from employee practices
  - Increased risk for ICT failure

B

Quantitative Assessment

- Last **5 years** (average) **operational losses** related to **Event Type 6** on **Commercial Banking** perimeter

- **Scenario Analysis related to emerging outsourcing risk**

- **Reduction of Expected operational losses**   **50 ml€**

- **Decrease of capital requirements** (OpRWA)   **- 200 ml€**

Qualitative Assessment

Event Type	Residual Risk
ET2 – External Fraud	🟨
ET3 – Employee Practices	🟨
ET6 – ICT Failure	🟥

- **ET2 -** Guarantee information security through proper access management process

- **ET3** - Review agreement with local Trade Union to avoid conflicts with employees

- **ET6** - Verify the infrastructure capacity before migrating data

KEY: 🟩 *Low*   🟨 *Medium*   🟥 *High*

Key challenges for an effective Outsourcing management

Key challenges for outsourcing risk management

Strategic Focus

> **Ensure the outsourcing initiative** is aligned with the business and operating model strategies

Risk Management

> **Identify and assess in advance risks** arising from outsourcing transaction set-up/ implementation and become a leading actor for outsourcing approval

Implement new agreements

NEW

> **Implement innovative agreements** entailing flexible prices base on effectiveness (e.g. service quality index) efficiency of delivered service (e.g. number of employee) rather than on fixed prices