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BVI[1] Position on the ESAs' Consultation Paper on Draft Regulatory Technical Standards to specify the elements which a financial entity needs to determine and assess when subcontracting ICT services supporting critical or important functions as mandated by Article 30(5) of Regulation (EU) 2022/2554

We take the opportunity to present our views on the consultation paper of the ESAs on Draft Regulatory Technical Standards to specify the elements which a financial entity needs to determine and assess when subcontracting ICT services supporting critical or important functions as mandated by Article 30(5) of Regulation (EU) 2022/2554.

***Question 1**: Are articles 1 and 2 appropriate and sufficiently clear?*

Principle of proportionality (Article 1 draft RTS): The elements listed for risk assessment in Article 1 of the draft RTS are sufficiently clear and helpful. However, the draft RTS does not yet sufficiently consider the proportionality principle, in particular for asset managers and investment firms providing services such as portfolio management or investment advice. In particular, there are no legal consequences foreseen in the event that a financial entity identifies a reduced risk in terms of proportionality. Also in this case it would be obliged to apply all articles of the draft RTS comprehensively without any simplifications. The effort for the risk assessment is not justified by any benefit. An explicit provision is therefore required which grants simplifications as a consequence of the principle of proportionality in the meaning of Article 4(2) of the DORA Regulation. This applies all the more if the ESAs continue to adhere to the proposed framework for monitoring subcontracting in Article 5 of the draft RTS (including throughout the chain, cf. our answer to question 5).

We therefore suggest, at least, to implement the following clear statement in Article 1 of the draft RTS such as:

"Considering the wide variety of financial entities covered by Regulation (EU) 2022/2554 regarding their size, overall risk profile, the nature, scale and complexity of their services, activities and operations, as specifically provided for in this Regulation, financial entities should apply the requirements defined in this Regulation in a proportionate manner, taking into account the increased or reduced elements of complexity or the overall risk profile."

It also seems appropriate to title Article 1 of the draft RTS '*Principle of proportionality*' instead of '*complexity and risk considerations*'. As another risk assessments are to be carried out in other articles of the draft RTS (e.g. Article 3), it is easier for the user to categorise the respective processes based on the specific designations.

[1] BVI represents the interests of the German fund industry at national and international level. The association promotes sensible regulation of the fund business as well as fair competition vis-à-vis policy makers and regulators. Asset managers act as trustees in the sole interest of the investor and are subject to strict regulation. Funds match funding investors and the capital demands of companies and governments, thus fulfilling an important macro-economic function. BVI's 114 members manage assets of some EUR 4 trillion for retail investors, insurance companies, pension and retirement schemes, banks, churches and foundations. With a share of 27%, Germany represents the largest fund market in the EU. BVI's ID number in the EU Transparency Register is 96816064173-47. For more information, please visit www.bvi.de/en.

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Group application (Article 2 draft RTS): In principle, we support the approach that it is the responsibility of the parent company to implement the requirements for subcontracting ICT services that support critical or important functions uniformly in the subsidiaries and to apply them appropriately. However, it is unclear whether a parent company should also be obliged to consolidate if it is not a financial entity within the meaning of the DORA Regulation. The ESAs should therefore examine whether a reference to the respective sector-specific consolidation rules would be more appropriate.

Moreover, Article 2 of the draft RTS extends the group approach for sub-contracting to the entire Article 30(2) DORA Regulation, while the ESA mandate is limited to Article 30(2)(a) DORA Regulation. We therefore request that this be adjusted accordingly in Article 2 of the draft RTS.

Question 2: *Is article 3 appropriate and sufficiently clear?*

No. We see the need for further improvements and clarifications of Article 3 of the draft RTS such as:

- **Article 3(1)(a) draft RTS**: It is not clear who is meant by 'it', the financial entity or the ICT third-party service provider who should be able to select and assess the abilities of prospective ICT subcontractors to provide the ICT services (*'a financial entity shall decide [...] after having assessed at least: a) that the due diligence processes implemented by the ICT third-party service provider ensure that* ***it is able*** *to select and assess the abilities, both operational and financial, of prospective ICT subcontractors to provide the ICT services supporting critical or important functions, including by participating in operational reporting and operational testing as required by the financial entity').* We assume that 'it' refers to the ICT third-party service provider. Clarification is important because otherwise the processes would have to be set up and implemented differently.

- **Article 3(1)(d) draft RTS**: We propose that the requirements for the provider should not be limited to monitoring the subcontractor but should also include an obligation to monitor the 'ICT services'. In many cases, ICT third-party service providers also qualify as financial entities (e.g. rating agencies, data providers) and are supported in their services to other financial entities by other ICT third-party providers, which in turn can be considered subcontractors for the other financial entity in the chain. Such an approach would also be in line with the condition of Article 4(a) of the draft RTS according to which the ICT third-party service provider is required to monitor all subcontracted ICT services.

- **Article 3(1)(e) draft RTS**: We request that the words '*or, where possible and appropriate, the subcontractors directly*' at the end of Article 3(1)(e) draft RTS be deleted. Even if the restriction '*where possible and appropriate*' is included, we still see the additional effort of having to prove that these requirements are neither accomplishable nor appropriate. In fact, there is no contractual relationship between the financial entity and the subcontractor, meaning that direct monitoring of the subcontractor by the financial entity is not possible at all. In this respect, we also refer to our comments on question 4.

Question 3: *Is article 4 appropriate and sufficiently clear?*

In principle, we see the following need for improvement in Article 4 of the draft RTS:

- Art. 30(2)(a) DORA Regulation firstly requires a general description of **all** functions that the ICT third-party service provider must provide (i.e. including those that do not support critical/important functions). Article 4 of the draft RTS, on the other hand, is limited to a description of the functions

that support critical and important functions. It should be made clear that a description is also necessary for non-critical and important functions, but that no additional requirements for subcontracting are imposed in these cases.

- It is very difficult for users of the regulatory requirements to work their way through the multitude of rules regarding the minimum content of the contracts. It would therefore be helpful to list all the conditions for sub-contracting in one place and not to spread additional requirements across other articles. Therefore, we suggest including provisions in Article 4 of the Draft RTS which deal with material changes to the subcontract (cf. **Art. 6 draft RTS**). Otherwise, it could be very difficult in practice to enforce the requirements contained in Article 6 of the draft RTS and addressed to the financial entities against the ICT third-party provider.

- In addition, it is contradictory to contractually oblige the ICT provider to monitor all subcontracted ICT services in accordance with **Article 4(a) of the draft RTS** on the one hand and to transfer the monitoring of the ICT subcontracting chain to the financial company itself in Article 5 of the draft RTS on the other. In this respect, we also refer to our comments on question 4.

- In any case, we understand the provision in Article 4(j) of the draft RTS on termination rights to be independent of the additional termination rights pursuant to Article 30(2)(i) DORA Regulation. It could be helpful to clarify that.

Question 4: *Is article 5 appropriate and sufficiently clear?*

We reject the proposal to transfer the monitoring of the subcontracting chain to the financial entity as proposed in Article 5 of the draft RTS. This leads to a significant change in existing practice and is also not covered by the previous agreements in existing contracts. Rather, the EBA and ESMA guidelines assign such a monitoring obligation solely to the ICT provider (cf, paragraph 42 (f) of the ESMA guidelines on outsourcing to cloud service providers, ESMA50-164-4285, and paragraph 80 of the EBA Guidelines on outsourcing arrangements, EBA/GL/2019/02).

The ESAs' objection that this transfer of monitoring to the ICT provider does not correspond to the DORA framework is not further substantiated. It is also unclear from which provision of the DORA Regulation this would be derived. In fact, there is no contractual relationship between the financial entity and the subcontractor, meaning that direct monitoring of the subcontractor by the financial entity is not possible at all. Furthermore, it is also practically impossible to monitor the entire subcontracting chain (especially in the case of large ICT providers) down to the last link.

More importantly, the proposal to transfer the monitoring of the subcontracting chain to the financial entity contradicts existing sector-specific delegation rules. Consistent rules should apply here. Otherwise, this can no longer be mapped contractually and practically.

In particular, the AIFMD and the UCITS Directive currently provide for special statutory delegation rules which also cover delegation of certain IT services (cf. recital 82 and Articles 75 et seq. of the Delegated Regulation (EU) No. 231/2013). Only the current AIFMD review will clarify in future that these special delegation rules do not apply to ICT services. However, these requirements will not come into force until spring 2026, so that until then there will be a dual regulatory regime of DORA on the one hand and the AIFMD and the UCITS Directive on the other. This differs from the regulations in the banking sector, where only the EBA provides specific guidelines at Level 3. The delegation rules of the UCITS Directive and the AIFMD do not contain an explicit provision that the outsourcing asset manager is directly

responsible for implementing a review and monitoring process at the sub-outsourcing company. Rather, it only stipulates that sub-outsourcing by the outsourcing company is permissible if the outsourcing asset manager has agreed to the sub-outsourcing and has notified the competent authority of this and the delegation conditions are applied accordingly to the relationship between the outsourcing and sub-outsourcing companies. This means that the delegation provisions of the AIFMD and the UCITS Directive must be complied with, particularly in the relationship between outsourcing and sub-outsourcing companies. If applied accordingly, this would mean that the outsourcing company must continuously monitor the services provided by the sub-outsourcing company and be in a position to effectively monitor the sub-outsourced tasks at all times. This means that the outsourcing company would generally be obliged to carry out due-diligence checks. The outsourcing asset manager would then only have to contractually ensure and verify (if necessary, on an *ad hoc* basis) that the outsourcing company fulfils these obligations.

Question 5: *Are articles 6 and 7 appropriate and sufficiently clear?*

Article 6 of the draft RTS: We do not understand why the provision in Article 6 of the draft RTS on dealing with material changes to subcontracting arrangements deviates from the existing requirements in the ESMA guidelines on outsourcing to cloud service providers (cf. paragraph 42 (f), ESMA50-164-4285) and the EBA Guidelines on outsourcing arrangements (cf. paragraph 80, EBA/GL/2019/02). In our view, the objective remains identical. In any case, the proposed provision requires unnecessary contractual adjustments and process changes. This should be avoided as a matter of urgency. We therefore suggest retaining the existing requirements.

In particular, we cannot see what added value it should have for the ICT third-party service provider to have to be informed of the results of the financial company's individual risk assessments. This obligation in Article 6(2) of draft RTS should be deleted. At the very least, it should be made clear that this information can only relate to the fact that the material change has an impact here, but not what impact.

Moreover, we suggest aligning the term '*advance notice period*' (cf. paragraph 1 of Article 6 of the draft RTS) with the term '*notice period*' (cf. paragraph 2 and 3 of Article 6 of the draft RTS). We assume that this is the identical notice period.

Article 7 of the draft RTS: We ask the ESAs to check whether the reference to Article 28(10) DORA Regulation is a drafting error. Article 28(10) DORA Regulation only mandates the ESAs to determine the content of the guidelines in relation to contracts for the use of ICT services to support critical/important functions, whereby these are limited to requirements for a documented exit plan for each ICT service concerned and for its regular review and testing (cf., Article 11 RTS draft on the third-party strategy). We assume that the correct reference here should be to Article 30(2)(h) DORA Regulation.

6. Do you have any further comment you would like to share?

We support the ESAs' proposal not to add further detailed criteria to the **definition of supporting critical and important functions contained in Article 3(22) of the DORA Regulation**. The definition gives financial entities enough leeway to find sector- and company-/business-specific solutions.

Moreover, we would like to reiterate the need for **standard contractual clauses**, especially for the large cloud and market data providers. Due to the cross-border services of such providers, purely national solutions will not be feasible. In addition, particularly smaller financial entities are not in a position to enforce clauses against the large ICT providers, especially if they come from third countries. Exit strategies are also not a solution due to certain monopoly positions of large ICT providers. We therefore ask the ESAs to take up the issue together with the EU Commission, because such standard contractual clauses should/must be developed by the authorities in accordance with Art. 29(5) of the DORA Regulation. This would also lead to greater acceptance in the market and considerably simplify the adaptation of existing contracts.

Cost-benefit analysis: We disagree with the ESAs' impact assessment that the implementation of the draft RTS would entail relatively low costs and overall expenditure. Rather, we see considerable effort as a result of (not only) the new proposed obligation to monitor the entire subcontracting chain, which would also lead to extensive adjustments to existing contracts and internal processes. Moreover, the new categorisation of services that support critical and important functions under DORA is not identical in practice with the services that were previously classified as outsourcing. It is therefore quite possible that an ICT service was not previously classified as outsourcing but will in future be categorised under DORA as a service that supports critical and important functions. As special requirements for subcontractors (on European level) have also only been defined for asset managers by the ESMA guidelines for cloud outsourcing, they must therefore also subject all other important/critical ICT services outside of cloud services to the new regulations.

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