Outsourcing, today and tomorrow

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Outsourcing: a continual work in progress

As the financial markets continue to evolve, financial institutions are working to grow and maintain profits while adjusting to ever-changing regulations and the effects of the downturn on profitability and performance. Successful institutions will need to reassess their operating models and address the effects of regulatory reform, competitive dynamics, evolving markets and increased expectations from stakeholders. The main challenges currently faced by banking institutions can be categorised as follows:

Banking industry strategic challenges

Although not spared by the European crisis, the Luxembourg financial centre still remains a major player in the international environment.

Banks in Luxembourg have to face significant strategic challenges. Private banking industry professionals need to reinvent themselves in order to cement Luxembourg's position as a leading centre for private banking services. Retail bankers also have to face growing competition from abroad as well as from non-traditional institutions.

Asset management and investor services institutions need to prepare themselves for significant changes in infrastructure, regulatory frameworks and their competitive landscape.

Institutions will have to improve their understanding of their clients and re-examine the value and marketing of their products to ensure they remain competitive in this new environment.

Banking industry regulatory challenges

The constant evolution of local and international regulations is a major driving force in the banking and securities industry.

The introduction of the OECD's Multilateral Convention on Mutual Administrative Assistance in Tax Matters by Luxembourg in May 2013 and the subsequent announcement that the automatic exchange of information will be implemented by 1 January 2015, for example, will have a major impact on the way institutions run their business. A sustainable business model must be based on transparency. The introduction of new oversight rules and bodies may also have far-reaching implications for the industry.

Implementing all these rules can be an issue, yet the real challenge is more about optimising your regulatory investments than merely complying.

Banking industry operational efficiency challenges

To address strategic and regulatory challenges appropriately, immaculate execution is a must. Constantly improving operational efficiency has to be high on the agenda of bankers. Now more than ever, institutions have to optimise their processes, control their cost structure, and explore new operating models using all the tools currently at their disposal.

Analysing the opportunity to mutualise operations or IT systems across entities or regions, outsourcing non-core activities and improving risk management frameworks and tools are some of the areas where financial institutions can find the levers to reach excellence.

Banks in Luxembourg have to face significant strategic challenges

Leveraging the value of outsourcing

Overcoming compliance challenges

Demands on compliance functions are rapidly increasing and so are the risks associated with failing to meet these demands. An organisation's non-compliance with regulatory requirements can result in legal sanctions, consent decrees, prosecution, liability suits, failed business strategies and damage to reputation and brand. In extreme cases, non-compliance can threaten the very existence of the organisation.

Compliance is not a revenue-generating business function. However, it is a core component of managing enterprise risk and successfully executing business strategies. Hence, due to the extent of compliance demands, many organisations maintain large and growing compliance functions that increase their overall operational costs.

Each organisation must develop and consider its individual business case for outsourcing compliance versus supporting compliance with an in-house operation, which may require ever-increasing investment in talent and IT resources

The increasing volume and complexity of regulations, an ongoing talent shortage and constant pressure from shareholders to reduce operating costs make this a good time to consider alternative sourcing strategies.

Compliance outsourcing can help organisations to address compliance demands while staying focused on their core business functions and go-to-market strategies.

What is compliance outsourcing?

Compliance outsourcing is the outsourcing of business functions and processes associated with compliance to a party other than an in-house compliance department —usually to a third-party provider or vendor located domestically or offshore. Compliance processes may be outsourced to a captive organisation, such as a subsidiary owned by an organisation or its parent company, or to a third-party provider. On the scale between a wholly-owned captive and a third-party provider there are several variations.

Organisations unfamiliar with compliance outsourcing might view the practice as impractical or even impossible. Challenges in areas such as data privacy, regulatory complexity, reporting accuracy, responsiveness and infrastructure might initially appear to rule out compliance as a candidate for outsourcing. Yet, some of those challenges actually argue in favour of compliance outsourcing, as they may in fact be addressed more effectively by specialists outside of the organisation. Having challenges addressed effectively and economically is a major benefit of compliance outsourcing.

A strategy of selective outsourcing – choosing which compliance processes to conduct in-house and which to outsource – can enable the organisation to improve the allocation of its resources. This reflects the overall goal of outsourcing: to place operational functions with a third party who can execute them at high levels of quality, with responsiveness, cost-effective delivery model and to free up internal resources for revenue-generating activities.

Types of outsourcing

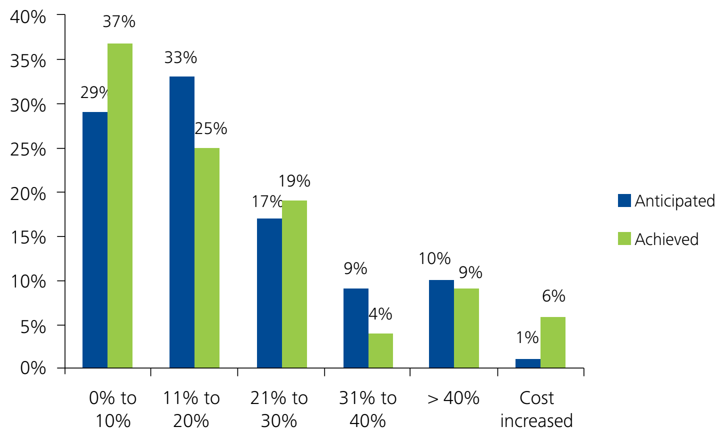
Compliance outsourcing is a type of Knowledge Process Outsourcing (KPO), which in the past few years has joined its long-established counterparts – Information Technology Outsourcing (ITO) and Business Process Outsourcing (BPO) – as an accepted practice. KPO activities tend to be more complex than those associated with ITO and BPO. KPO calls for the application of knowledge, such as industry knowledge, understanding of regulations, compliance frameworks, valuation, actuarial experience and data analytics to generate knowledge-intensive deliverables.

Over time, the organisation can foster strategic relationships with the right outsourcing providers, relationships that add strategic value—that is, value beyond simple provision of services. For example, providers of outsourced services can encourage innovation and increase competitiveness. They can do so not only by providing leading practices in their areas of specialisation, but also by enabling management to focus on the true strategic agenda of the company.

Management can do this because outsourcing frees up executives' attention and 'intellectual bandwidth', as well as financial, human, IT and other resources. This can also enable leaders to pursue the strategic agenda more vigorously and with fewer distractions.

In addition, outsourcing provides well-documented cost benefits. Deloitte research has revealed that 57% of companies having outsourced business functions achieved cost savings of more than 10%.

Figure 1: anticipated and achieved cost reductions from outsourcing



Source: Deloitte research

What are the driving forces for compliance outsourcing?

The decision to outsource may be driven by one or more of the specific challenges currently faced by compliance functions, including the following:

- **Coping with talent shortages:** increased regulatory compliance complexity requires individuals who are skilled in risk management and have knowledge of regulatory and compliance operations. These professionals are in short supply and high demand. Organisations have to deal with increased operational budgets to provide training, an extended talent pool to manage continued compliance and high attrition issues.
- **Sub-optimal compliance processes:** organisations want to focus on improving and streamlining to make their compliance processes predictable. However, constant changes to the regulatory landscape can make investments in compliance processes reactive. This often leads to a challenge for the organisation whereby compliance processes may not follow the leading practices. This can result in a higher cost of compliance, lower quality levels and possibilities of rework.
- **Investing in technology infrastructure:** organisations are continually investing in technology and related infrastructure to help facilitate meeting compliance needs. With the constant changes to existing regulations, as well as new regulations, technology investment needs are both one-time and recurring.
- **Addressing global compliance needs:** international organisations are investing extensively in hiring and training a global talent pool. Additional investment is needed to develop a global knowledge base and expertise to address differences in regulatory requirements and successfully drive their global compliance operations.
- **Increasing operating costs:** increased resource requirements (people, processes and technology) due to significant changes in regulatory environments are having a major impact on operating costs.

What is the business case for compliance outsourcing?

Each organisation must develop and consider its individual business case for outsourcing compliance versus supporting compliance with an in-house operation, which may require ever-increasing investment in talent and IT resources. Demand for compliance systems and talent has raised the cost of maintaining compliance infrastructure. Even with proper funding, an organisation’s ability to scale up compliance operations may be limited by the availability of adequately qualified people to an in-house compliance function.

Outsourced compliance providers can offer several potential advantages over in-house compliance functions, mainly owing to the specialisation and systems they must maintain as service providers.

Considerations	In-house	Outsourced
Cost	Fixed	Variable/reduced
Staffing flexibility	Limited	Just-in-time
Competency/skills	Constrained	On-demand
Talent availability with industry knowledge	Limited	Readily available
Training impact	Time and cost	None
International challenges (language, local laws, travel time and costs)	Significant	Minimal
Leading practices	Siloed	Holistic
Speed of change	Slower	Proactive

In contrast, external providers focus on developing and maintaining the required knowledge as a core competency, often by hiring former regulators and compliance officers and developing industry-aligned talent pools. The external providers also bring their process frameworks, knowledge from performing similar services for other clients and accelerators to the delivery of value-based compliance outsourcing services.

In providing compliance as a service, compliance outsourcing providers develop and maintain the necessary talent, knowledge base, industry knowledge, process frameworks, scalable infrastructure and global presence. They devote resources to monitoring and understanding regulatory demands, and amortise the costs of compliance across their client base. As a result, compliance needs can be addressed cost-effectively and liberate resources moved to higher value activities. In a nutshell, this is how efficient compliance outsourcing works.

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