UK Retail Banking Newsletter*

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Driving benefits from regulation is a theme which will resonate for many executives in the retail banking industry, and it features in several topics in this fourth edition of the PricewaterhouseCoopers 'UK Retail Banking Newsletter'.

A number of the articles in this edition touch on the drive for efficiency which is commanding the attention of most organisations in the sector today. Our first article, 'Taking the grind out of Sarbox', examines how banks can learn from the US experience in s404 compliance to achieve a focused, risk-based approach, reducing the compliance burden and establishing a framework which will deliver benefits going forward. The subject of 'making compliance work for you' also runs through our article on 'Internal Audit – top of the agenda' in which David Lukeman considers the rise in profile of internal audit, and challenges internal audit functions to work effectively with compliance departments to deliver real value.

The results of the CSFI's annual 'Banking Banana Skins' survey are discussed in our second article, where regulation again emerges as a key theme, this time highlighted by bankers as the top risk faced by today's institutions, particularly in the costs to the banks and the management time and attention taken by the constant flow of new regulations.

In the article 'Covered bonds – a new source of funding for UK lenders', Mark Davis and Dave Haley of our Structured Finance Group examine the potential benefits to lenders of using a covered bond structure as an alternative to securitisations, and finally, in 'Leading the pack: Managing effective multi-sourcing', members of our advisory practice share their experience of the practical challenges in making multi-sourcing arrangements work to deliver a cost-efficient and streamlined operation.

I hope you enjoy this edition. We welcome any feedback on topics and issues you would like to see covered in future editions.

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*connectedthinking

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Taking the grind out of Sarbox

By Nicola Shield and Chuck Teixeira

Larger UK banks listed in the US now face the full weight of Sarbanes-Oxley (‘Sarbox’) and the exacting Section 404 in particular. Yet, experience in the US suggests that a more streamlined and risk-based approach to the demands of Section 404 could greatly reduce the burden and help provide a platform for sustainable compliance.

In August 2006, the Securities and Exchange Commission (SEC) announced plans to ‘minimise the burden’ of Section 404 on smaller FPIs by delaying and/or staggering the deadline for compliance. However, large ‘accelerated filers’ (market value of more than $700 million) whose financial year ends on or after 15 July 2006 still need to provide Section 404-compliant management and auditor reports as part of their next annual filing to the SEC. Although smaller ‘accelerated filers’ (market value $75 million to $700 million) still need to provide management reports as part of their next SEC returns, they have an extra year to enter their auditor reports.

Experience in the US, where larger companies have now completed their second year of Sarbox filings, has underlined the scale, complexity and, not least, the cost of compliance. The original architects of the reforms believed that even the biggest firms would not need to spend more than $600,000 to bring their internal controls up to speed. In reality, however, the bill for assessing controls, mapping audit trails and drawing up the necessary documentation has run into tens of millions of dollars in many large organisations. A number of UK banks are known to be spending upwards of £30 million.

The good news from our research is that the proportion of US firms receiving adverse reports identifying material weaknesses fell from 15% in 2004 to 6% in 2005. The results for banks are especially encouraging, with the proportion of adverse reports decreasing from 12% to just 4%.

The improvements would suggest that much of the initial hard work is now bearing fruit. The interpretation of the rules has also become a little

The first and in many ways most important step towards smart compliance is simply allowing enough time. From judging what are the ‘key’ controls through to verification and documentation has taken US firms far longer than most originally envisaged.

less zealous over time. However, the costs and diversion of management resources are still needlessly high within many organisations. In particular, it would appear that many companies and their auditors are identifying and testing more controls than may be necessary. The documentation of internal controls is also often excessive and may be difficult to maintain on an ongoing basis. More generally, Sarbox still appears to be a ‘one-off’ project within many organisations and more effort may be needed to develop a sustainable framework for compliance.

Less is more

The first and in many ways most important step towards smart compliance is simply allowing enough time. From judging what are the ‘key’ controls through to verification and documentation has taken US firms far longer than most originally envisaged. Ironing out any problems can also often take more time than expected. It is telling that 40% of the adverse opinions in year two related to weaknesses that had yet to be corrected from year one.

Effective scoping and direction from the top can help to define priorities and ensure that resources are targeted where they are needed most. This includes enabling institutions to avoid needless duplication by establishing what monitoring is already being carried out as part of their existing risk management framework.

Risk-based approach

In setting their priorities, banks need to ascertain what aspects of their business pose the greatest risks to the reliability of their financial reporting. Year-end reconciliations are likely to be a particular focus as the most frequent material weaknesses within financial institutions in the US have related to audit adjustments or restatements. As such weaknesses are often pinpointed after the year-end, there is also little opportunity to remediate them before they generate adverse reports.

At the other end of the risk spectrum, areas such as accounts payable or premises have little impact on financial reporting and are therefore likely to require limited assessment or documentary evidence. Indeed, it may be possible to use the work of others as the basis for the assessment of less risky and more straightforward controls.

Certain considerations are unique to FPIs. This includes whether to use local GAAP financial statements and/or US GAAP figures as the basis for their internal control of financial reporting evaluation. While the general view is that the local reporting should be the focus, institutions will also still need to look closely at the design and operational effectiveness of their US GAAP

reconciliations. They will also need to decide what should be included in the scope, such as whether they need to include FIN 46 entities, joint ventures or associates.

Dialogue with external auditors can prove particularly helpful in identifying and prioritising the most serious risks. Banks may also want their auditors to review draft financial statements before finalisation to help identify any deficiencies. Some institutions may be wary of consulting their auditors about the application of accounting standards for fear of compromising independence. However, such interaction is appropriate as long as management has reasonable controls to interpret accounting rules, the final say over the accounting used and the auditors are not part of management's control process.

Control framework

We believe that a more systematic risk-based approach to Sarbox could help to reduce the cost and effort of compliance by up to 30%. It could also provide the foundations for an integrated control framework that not only streamlines and sustains the verification of financial reporting but also contributes to other key aspects of compliance and risk management such as the Basel II Advanced Measurement Approaches. The essential features of the framework include timely and reliable management information, a robust technology infrastructure and appropriate standardisation of testing and documentation. Underpinning this is investment in staff training and competence.

The overall objective is the elimination of material weaknesses. If a bank is facing an adverse report, however, it should be completely open about setting out the nature, implications and plans for remediation. The market reaction to material weaknesses in the US has tended to be reasonably muted as long as there was plenty of advanced warning and explanation. The rating agency Moody's categorises weaknesses as either specific, which auditors can work around, or pervasive, which may trigger a downgrade. Around a third have fallen into the latter category.

Reaching the summit

Many banks may feel that they have a mountain to climb as they seek to comply with Sarbox. Yet more attention to defining the most important priorities including the most serious risks could help to take the grind out of the process. While many firms in the US initially found themselves looking at the full gamut of their internal controls, it is those that are key for relate to financial reporting that require detailed attention. Of these, experience indicates that the year-end processes present the greatest risks. The ultimate aim is a framework of internal control that not only sustains compliance and can be embedded into the day-to-day operations of the bank, but can also provide greater assurance and improved management information for the business.

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Banking Banana Skins 2006: A challenge for the regulators

By David Lascelles and John Hitchins

‘Banking Banana Skins 2006’ provides a thought-provoking insight into the concerns and priorities of bankers, regulators and observers of the banking industry across the globe, from the emerging markets as well as from leading players in the developed world.

The Banana Skins survey is carried out annually by the Centre for the Study of Financial Innovation in association with PwC, and attracts respondents from a wide range of institutions in an increasing number of countries – this year 468 respondents from 60 countries. The survey asks respondents to describe their main concerns about the financial system over the next 2-3 years, to rate a list of potential risks and also to rate the preparedness of financial institutions to deal with those risks. The results give a fascinating picture of the concerns of the banking industry.

The top three

There has been little movement in the top three risks, with the top two unchanged from 2005 and the third, derivatives, only moving up one place. For the second year running, too much regulation comes out as the top banana skin. The most frequently mentioned risk was the cost of regulation, particularly since few bankers saw a compensating benefit. Other concerns were the distractions caused by a constant flow of new regulations, and the anti-competitive aspects of regulation, especially for smaller banks. In some instances regulation was criticised for being inappropriate, for example focusing on micro-regulation at the expense of the big picture and big risks.

The prescriptive nature of regulation, removing judgement and potentially breeding a box-ticking attitude and reluctance to give customers advice, were quoted as sources of concern, and there is growing concern about the politicisation of regulation and interference by governments.

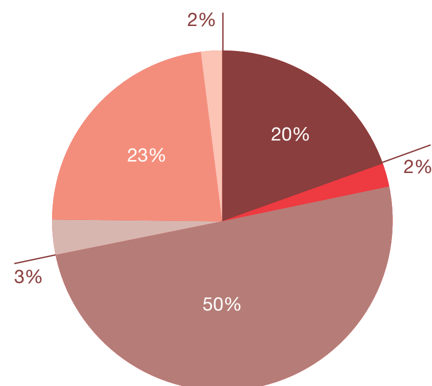
Other concerns were the distractions caused by a constant flow of new regulations, and the anti-competitive aspects of regulation, especially for smaller banks.

Banana skins 2006 (2005 ranking in brackets)

Rank	Risk	2005
1	Too much regulation	(1)
2	Credit risk	(2)
3	Derivatives	(4)
4	Commodities	(14)
5	Interest rates	(12)
6	High dependence on technology	(8)
7	Hedge funds	(5)
8	Corporate governance	(3)
9	Emerging markets	(15)
10	Risk management techniques	(9)
11	Fraud	(6)
12	Equities	(18)
13	Currencies	(7)
14	Macro-economic trends	(10)
15	Political shocks	(22)
16	Conflicts of interest	(-)
17	Banking market overcapacity	(20)
18	Money laundering	(13)
19	Merger mania	(27)
20	Legal risk	(17)
21	Business continuation	(19)
22	Retail sales practices	(23)
23	Insurance sector problems	(11)
24	Back office	(26)
25	Environmental risk	(28)
26	Management incentives	(21)
27	Rogue trader	(24)
28	Competition from new entrants	(29)
29	Payment systems	(25)
30	Too little regulation	(30)

Source: CSFI

Nationality of institution



Source: CSFI

Unsurprisingly, banks and bankers were the most vociferous in highlighting over-regulation as a risk, and particularly so in Europe, although this was also highlighted by non-banking businesses (who placed it second), and it came in the top 10 (at number 9) even from the regulators.

Brussels was widely blamed for much of the burden and cost, with respondents citing the new directive on markets in financial instruments (MiFID). Basel II also came in for criticism, although many respondents from emerging markets felt that Basel II is encouraging better management practices and controls.

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Credit risk remains the number 2 concern, coupled with rising interest rates (up from number 12 to number 5). Particular aspects of credit risk highlighted were over-borrowing in the consumer debt market, with consequent reputational damage over irresponsible lending, and housing bubbles in the mortgage industry. Credit risk concerns were not confined to the consumer sector, however: leverage in private equity firms and hedge funds, and the extent to which businesses are fully geared, were also highlighted. Conversely, a number of respondents felt that credit risk was over-emphasised, and some felt that the banks were managing credit exposure well.

Derivatives continue to be a strong source of concern, and in particular credit derivatives. Bankers were conscious of the potential for volatility in the event of an economic downturn, and the possibility of a default by a large issuer, investment bank or hedge fund with a knock-on effect on liquidity in the markets. The complexity of derivative products, leading to difficulty in understanding the market and even in properly understanding and managing risk from the Board, were also cited as factors increasing risk.

The big movers

Although the top few risks are relatively unchanged, there have been some significant moves in the risk rankings. The risks moving up the list were:

Commodities – price volatility driving the risk up 10 places to number 4, with concerns largely stemming from the energy sector (high oil prices, terrorism, political unrest in the Middle East, and China's voracious appetite for oil) and particularly strongly voiced by the G7 countries;

Merger mania – worries coming back relating to increasing market concentration and stretch on management structures, the creation of uncontrollable entities and the elimination of smaller players;

Emerging markets – concerns about stability are again rising, with heavy exposures at fine prices, and particular concerns over Russia and China;

Political shocks – the political tension in the Middle East, continued violence in Iraq, the Iranian nuclear question and North Korea were all quoted in a widespread concern that the banking industry could suffer from unexpected shocks;

Equities – the recent good performance in equities has led to some nervousness that there could be a correction in the market, with a particular effect on the private equity sector.

The decreasing concerns were in a number of the perennial risks where it is felt that procedures and controls are succeeding in managing risk: fraud, which, while it will always feature in the industry, has received a great deal of attention; money laundering, which is generally considered to be an over-rated problem; management incentives, where better governance is reducing concern; currencies, a market which is better understood and where the US dollar is now less of a concern; and the insurance sector, where problems highlighted previously are felt to be being addressed.

So what does this mean for the banks?

Banks were seen this year as better placed to handle shocks in the system – 64% of respondents felt that institutions were moderately well prepared or better able to handle the risks, up from 57% last year. Confidence was particularly strong among bankers (73%) but also among regulators – 63% compared with 39% last year, although outsiders were more sceptical, with only 44% thinking that banks were well prepared.

It is clear that, while many of the risks highlighted in the past are now felt to be increasingly under control, there is still plenty of scope for volatility – whether in the commodity market, the emerging markets or in domestic credit losses, compounded by increases in interest rates. The key message from the banks, however, is a challenge to the regulators to show that their regulatory processes are delivering not only a robust regulatory framework but the right balance of cost and benefit.

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Copies of the *Banking Banana Skins 2006* report can be purchased through the CSFI website at www.bookstore.csfi.org.uk or by calling the Centre on 020 7493 0173

Covered bonds – a new source of funding for UK lenders?

By Mark Davis and Dave Haley

Covered bonds look set to become a popular low-cost funding alternative to Mortgage-Backed Securities ('MBS') in the UK, following in the footsteps of other European countries where they have been used commonly as a source of funding, in some cases since the early 1900s.

The continental market is dominated by the German Pfandbrief, with other countries also having introduced legislation to govern covered bond structures. While the UK has no such specific legislation, the market is less developed but, particularly with the expected introduction of an EU-compliant covered bond regime by the FSA, is growing fast.

HBOS pioneered the use of common law to establish a UK covered bond programme in 2003, and since then Northern Rock, Abbey, Bradford and Bingley and Nationwide have all followed.

Covered bonds vs mortgage backed securities

Covered bond programmes share some structural similarities with securitisations. An outline of a typical structure, compared with a securitisation, is shown in the diagram overleaf.

As with a securitisation structure, the over-collateralisation of the pool of assets means that there may be a higher rating for the bonds than for other debt of the originator. Furthermore, the ring-fencing of the assets transferred to the special purpose entity (SPE) means that investors in the bonds have priority over other creditors of the lender in the event of an insolvency. The most significant difference in structure is that the lender itself issues the debt in a covered bond issue, the interest and capital on which is guaranteed by the SPE. In a securitisation the notes are issued by the SPE itself.

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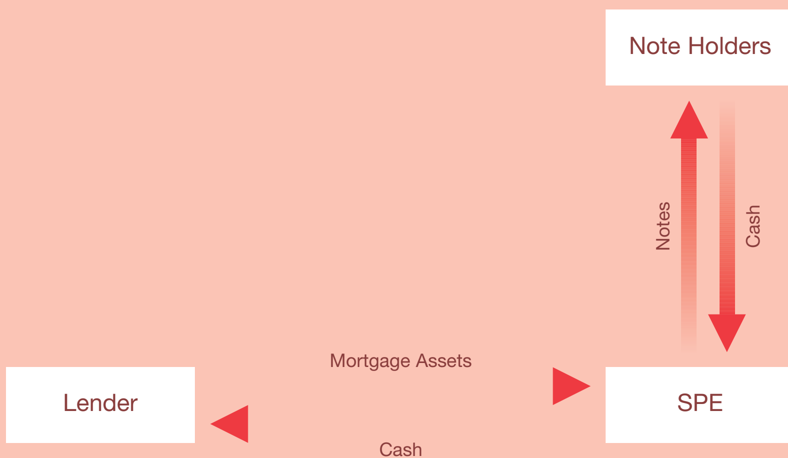

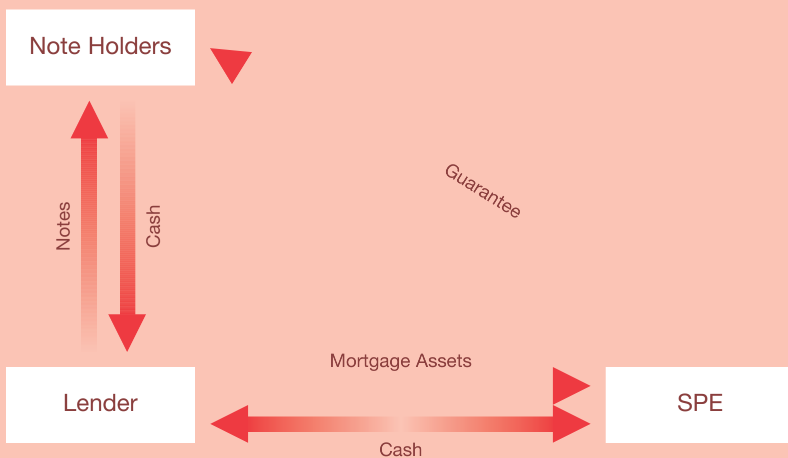

Source: PricewaterhouseCoopers

There is also an obligation on the part of the lender to repurchase defaulting assets, which is not the case in a securitisation.

The more important difference for the lender, however, is in the capital treatment of the structure. In most instances, the principal reason for a securitisation was the capital treatment for the lender, with additional considerations being access to more diverse funding sources and a wider investor base. There is no such capital benefit with a covered bond issue, so the commercial reasons for entering into such a structure are funding and liquidity considerations, in particular the pricing of funding, and also the prospect of a wider investor base as the market develops. The bonds are attractive to investors who want a greater yield than similarly rated government bonds, while maintaining a liquid investment.

Regulatory considerations

There are two key aspects of regulatory treatment which make covered bonds an attractive proposition for the lender.

Firstly, the FSA has, in letters to the British Bankers Association and Council of Mortgage Lenders, issued guidance on indicative limits on issuance for lenders. These are:

- A monitoring threshold: where issuance reaches 4% of total assets, supervisors should be informed;
- An upper benchmark where issuance reaches 20% of total assets, above which the FSA would require an increase in most banks' Individual Capital Ratios (ICR).

This guidance has allayed concerns that the FSA was likely to adjust banks' ICRs to reflect the potential disadvantage to other creditors, particularly depositors, of the covered bond structure.

Under the new approach each issuer will effectively have its own individual materiality threshold, between 4% and 20% of total assets. This threshold will vary and be assessed on a bank-by-bank basis, taking into account issuer-specific factors such as the size of the covered bond, level of issuance relative to size and growth of total assets and mortgage assets, total level of the bank's assets that are encumbered (including any over-collateralisation associated with the covered bond) and the bank's overall funding and liquidity profile.

Secondly, in February 2006 the FSA announced its intention to consult with the Treasury and the industry on implementing an EU UCITS-compliant covered bond regime to the UK.

If implemented this will allow investors in covered bonds to benefit from a 10% risk weighting instead of the 20% current weighting. This has positive implications for the pricing of bonds, and is also likely to widen the investor base for UK covered bonds as they would

The recent developments in the market, and in particular in the regulatory treatment of covered bond structures, mean that this is fast becoming a real alternative source of funding for UK lenders, widening the investor base and complementing mortgage-backed securities and other funding sources.

more commonly meet asset managers' investment policy criteria for covered bonds rather than highly rated corporate bonds.

Practical considerations

As with a securitisation, lenders considering using a covered bond structure need to take into account a number of important considerations:

- Reports will be required for investors. The data needed for these reports may take time to collate, and early planning is essential;
- Similarly, it is important that the issue process, and the expectations of the lead managers in such a deal, are properly understood and can be planned for at an early stage;
- The lender needs to understand the asset portfolio in details. Data on historic performance will be required, with cash-flow analysis for product types, showing both historic and expected cash flows, and the degree of variability in those cash flows. The focus on product characteristics by rating agencies may mean that only certain products are eligible to be included in the asset pool (there may for example be concerns about discounted products which carry a significant prepayment risk at the end of the discount period);
- There are a number of accounting complexities, both for the lender and for the SPE, which must be fully understood. These relate in particular to the fact that the asset transfer will not meet the criteria in IAS 39 for derecognition from the lender's balance sheet, and the treatment of interest rate swaps used as hedges;
- The tax position should be evaluated carefully at an early stage.

The recent developments in the market, and in particular in the regulatory treatment of covered bond structures, mean that this is fast becoming a real alternative source of funding for UK lenders, widening the investor base and complementing mortgage-backed securities and other funding sources.

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Internal Audit – top of the agenda

By David Lukeman

Internal audit has reached a prominence in the retail banks and building societies that reflects both the profile of the profession and the importance placed upon it by Audit Committees, management and the regulator.

In the spotlight

Recent developments in internal audit are for the most part highly positive and, increasingly, there is a better-informed debate on the role of internal audit, its quality, effectiveness and cost within the retail banking sector. This is creating an environment where the true value of internal audit is becoming recognised and Heads of internal audit should now have greater influence than ever before.

There is inevitably another side to this coin, as with increased recognition and understanding comes increased transparency – and therefore potential challenge. The drivers here are substantial and include the Combined Code and Sarbanes-Oxley; but it is the regulator who is driving the most significant change in internal audit.

As a result, CF15s (the FSA term for Approved Persons with oversight accountability for internal audit) need heightened awareness of regulatory obligations and also of the challenges they face to maintain the effectiveness of their function in a rapidly changing retail banking market.

The FSA is increasing its focus on the effectiveness of internal audit. This is evidenced by the emphasis on internal audit within the ARROW supervisory approach, as well as the scope of recent Section 166 reviews. John Tiner's profile speech at the Institute of Internal Auditors in September last year also indicated that the FSA is seeking to "rely on the oversight of internal audit rather than requiring a prolonged supervisory visit" going forward.

With its ability to influence the reduction of risk and the strengthening of internal control, internal audit is clearly a vital element of the ARROW assessment and can directly contribute to lower levels of regulatory intervention.

This emphasis is maintained in the FSA's Consulting Paper (CP) 06/9 on

The bar has been firmly raised and there are new expectations relating to the quality of internal audit. In the light of this, Audit Committees, and indeed the full Board, should be re-evaluating whether they are getting the right quality of internal audit service for the risk profile of the institution and at the right cost.

'Organisational Systems and Controls', which promotes the role of internal audit as an "important control". Significantly, CP06/9 broadens this debate across all control functions and is likely to be the start of a more rounded discussion on how internal audit, risk and compliance combine to identify, measure and monitor risks.

Internal auditors have been pushed into the spotlight. Some will be better prepared for this than others!

Building confidence

The bar has been firmly raised and there are new expectations relating to the quality of internal audit. In the light of this, Audit Committees, and indeed the full Board, should be re-evaluating whether they are getting the right quality of internal audit service for the risk profile of the institution and at the right cost.

Far from being a compliance exercise, Boards are extracting real business benefit from challenging the purpose and performance of internal audit within the context of the institution's assurance needs, including:

- deep and frequent interaction between internal audit and Audit Committee, thereby improving the Committee's understanding of the risks of the institution, internal audit's coverage of these risks (and any gaps in coverage) and approach;
- the remediation of shortfalls in capability through investing in the right skills to provide assurance over the real risks of the bank, including the less traditional areas of reputational and strategic risk; and
- improved confidence of the regulator in the function and greater recognition by management as to the value a high performing internal audit function provides.

It is this value agenda that has provided the CF15's elevation on both the governance and regulatory agenda.

Integrating assurance

For leading functions this renewed appreciation is, in part, providing some insulation against the pressures of cost constraints which are beginning to be wielded elsewhere in the bank or society. However, the overall 'assurance' cost is coming under greater focus, including the activities of risk management and compliance.

Internal audit improvements may also bring into sharper focus the effectiveness of other control functions and how they work together to meet the assurance needs of the bank.

These are not insignificant challenges and to progress there is a need for control functions to set aside artistic differences that can occur. Internal audit should be playing a lead role in this; not

least in sharing their own professional development experiences, but also in seeking opportunities for greater collaboration and integration of the assurance being provided to the Audit Committee.

While regulators seek greater independence of control functions, these differing reporting lines, mandates and obligations should not be an inhibitor to effectively combining:

- views and assessments on risk;
- planning and co-ordination of coverage; and
- frameworks for reporting and communications.

For successful organisations, the prizes are cost efficiency, an amplification of the comfort being received by the Board and Audit Committee and less intrusiveness from the regulator.

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Key questions on internal audit value:

- Has internal audit been properly assessed against good practice and regulatory expectation?
- Is the benefit of internal audit being communicated sufficiently to the regulator?
- Do the Board and Audit Committee receive an integrated view of internal audit, risk and compliance activities?
- Is the combined investment in the bank's Control Functions cost effective?

Leading the pack: Managing effective multi-sourcing

By Amanda Frear, Monica Otten and Sonny Sonnenstein

Many UK banks are entering into multiple outsourcing contracts ('multisourcing') as they seek to engage best-in-class specialists in each particular facet of their operations. Yet, more suppliers heightens the complexity of delivery and relationship management, while adding to the potential points of failure. How can banks take better control of multi-sourcing?

Every year, dozens of intrepid adventurers seek to emulate the feats of Amundsen, Shackleton and other great polar explorers by driving dog sleds across the frozen wastes. The less experienced soon learn that while their huskies possess awesome strength and endurance, they can also be highly recalcitrant and prone to squabbling among themselves unless shown a firm lead. At every stop, Amundsen used to make a point of picking out the most defiant dog and scolding it to ensure that it and the rest of the pack knew who was boss. Although the environment may be less extreme, many banks now find themselves seeking to marshal a diffuse pack of outsource providers, each of whom may want to pull in different directions or vie to be top dog.

Selecting the best

The move to multi-sourcing is a natural progression as banks seek to employ the most efficient and appropriate provider within each aspect of business processes HR, IT, finance and other multifaceted operations. Last year, for example, ABN Amro hired five separate suppliers to help run its IT. IBM is taking care of the infrastructure; while various aspects of development and application support are being shared by Infosys, Accenture, Patni Computer Services and Tata Consultancy Services. ING recently followed suit in what is set to be an accelerating trend across the banking sector.

The ideal foundation for the governance structure is an integrated set of roles and accountabilities – across all service providers.

Although each supplier may be a best-of-breed in its own right, multi-sourcing can multiply the risks and complexities of outsourcing management. Within finance, for example, different providers may be handling a series of interdependent operations such as general ledger journal entries, payroll, accounts payable and tax. The links in the chain may include in-sourced local and offshore service centres, in addition to the outsourced operations. Managing each separate component can be a juggling act in itself. Moreover, if the processing chain or supply of information between the different providers is delayed or breaks down, this could disrupt or hold up vital requirements such as year-end returns. Any lapses in customer-facing operations could be especially damaging to the reputation and revenues of the institution.

Exerting control

Effective multi-sourcing therefore demands consistent and clearly defined roles, governance structures and problem-solving procedures both between client and individual provider and, just as crucially, across the network of suppliers. Indeed, the need for preparation and control of multi-sourcing could be likened to the due diligence required in a merger and acquisition.

The ideal foundation for the governance structure is an integrated set of roles and accountabilities – across all service providers. This needs to be supported by a single set of service standards, monitoring and appraisal processes and remediation procedures that apply across all operations, including all internal and external dimensions of the processes being outsourced. Clients need to define clear ownership and accountability for each link in the service chain and ensure that each provider understands and is proactive in working with the other suppliers within the network. This operational framework is underpinned by clear escalation triggers related to incidents and issues that occur anywhere in the process. This ensures that the outsource providers do not waste time pointing fingers at each other and instead work together to focus on fixing the problem.

A key objective is the creation of seamless peer-to-peer relationships between the different suppliers, rather than each provider referring back to the client every time there is a delay or complication. If there are changes to tax rules, for example, it should be the responsibility of the provider managing taxation to inform all the other suppliers about the nature of the changes, their implications and how they should be addressed by each of the operations. Similarly, different aspects of a multi-sourced IT environment can be at odds

over the cause of an incident – for example, a production system failure occurs and the IT infrastructure provider blames the application coding for the issue whereas the IT development provider blames hardware configuration issues. They could waste precious time arguing back and forth on this, whereas with a clear incident management and escalation between the two, the focus will be on fixing the problem first and performing an integrated post mortem after the problem has been fixed. Clearly some suppliers may be direct competitors, yet this should not be allowed to conflict with their primary obligation to their joint client especially if their working relationships are clearly defined at the start of their respective contracts.

Everything in order

Splitting out outsourced services can ensure that each link in the value chain is managed by dedicated specialists at the right cost. However, if multi-sourcing is poorly and reactively managed this adds to the risks and complicates the relationships between outsourced vendors. Effective multi-sourcing therefore requires the design and implementation of a clear and consistent governance structure that exerts appropriate control, while limiting the risk of failure and demands on client time. As Amundsen said ‘Success awaits those who have everything in order’.

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