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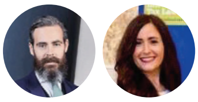

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Transfer pricing considerations for outsourcing arrangements in the financial services industry

Financial services providers are increasingly using related and unrelated parties to undertake certain activities previously performed in-house to reduce costs and enhance efficiency. Due to the risks and challenges of outsourcing arrangements, regulators have set precise guidelines to ensure financial institutions have proper governance in place.

The European Banking Authority (EBA) issued its guidelines on outsourcing (EBA/GL/2019/02), which different EU regulators have adapted further and implemented locally. This is especially the case for the Commission de Surveillance du Secteur Financier (CSSF) in Luxembourg, which recently published Circular 22/806 on outsourcing arrangements (circular).

This article addresses the main transfer pricing (TP) implications of intragroup outsourcing activities.

The circular

While the circular implements the requirements of both the EBA guidelines and the European Securities and Markets Authority (ESMA) guidelines on outsourcing to cloud service providers, it also makes specific distinctions. The circular's key features are as follows:

- Personal scope: While the EBA guidelines only apply to credit institutions, investment firms, and payment and electronic money institutions, the circular's widened scope includes other professionals in the financial services industry and certain entities—including their respective branches—that perform information and communications technology (ICT) outsourcing. The entities covered are defined as "in-scope entities."
- Objective scope: The circular provides detailed rules for in-scope entities that engage in outsourcing arrangements. These include:
  - General principles relating, inter alia, to the adoption of appropriate oversight, monitoring, and auditing of outsourcing arrangements, the responsibility of the management body, etc.; and
  - Rules to ensure sound internal governance for planning, implementing, monitoring, and managing outsourced activities relating, among others, to contractual requirements.
- Effective date: The circular enters into force on 30 June 2022; thus, in-scope entities must ensure that any outsourcing arrangements reviewed, amended, or entered into comply with the new requirements as from this date. Existing outsourcing arrangements must be aligned with the new provisions no later than 31 December 2022.

TP implications

It is important to note that the circular does not apply only to services outsourced to third parties; its principles and requirements apply equally to arrangements between related parties. Chapter 3, "General principles governing outsourcing arrangements and intragroup outsourcing," states that intragroup outsourcing is no less risky than outsourcing to an uncontrolled entity. Therefore, intragroup outsourcing "is subject to the same regulatory framework and conditions as outsourcing to service providers outside the group." The circular further requires that in-scope entities set all the conditions for intragroup outsourced services at arm's length.

To fulfill this requirement, in-scope entities must carefully consider the general principles of the OECD TP guidelines (i.e., perform an accurate delineation of the transaction, a functional and risk analysis, a comparability analysis, etc.) and local regulations.

When setting the contractual terms at arm's length, entities must give special consideration to the "parties' financial obligations" and select an appropriate TP method, depending on the outsourced services' economically relevant features.

While entities can explicitly reference a TP method and arm's length remuneration in the "parties' financial obligations," the circular does not expressly require this *per se*. Instead, entities often make broader reference to the applicable TP policy—supported by the relevant documentation—in the intragroup outsourcing arrangements. This allows for greater flexibility (e.g., when transfer prices are revisited) while remaining fully compliant with the circular (to the extent, of course, that transfer prices are at arm's length).

This can prompt additional questions for in-scope entities, including:

- How can we price the services to ensure we comply with the arm's length principle?
- How should we address potential group synergies in the pricing?
- Do additional considerations apply if branches are involved?
- How can we reflect and disclose the pricing policy in the agreements?
- Should we remunerate the outsourced services' oversight function? If so, how?

Conclusion

Although financial services providers generally should expect scrutiny of tax matters, primarily from tax authorities, the risk of regulators challenging TP-related aspects—in particular, the absence of the parties' financial obligations—regarding intragroup outsourcing arrangements during audits cannot be excluded.

Therefore, in-scope entities must consider the relevant TP implications and have proper TP documentation and policies in place to ensure that they comply with the arm's length principle, minimizing the potential risk of tax and regulatory challenges.

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