

# Practical Guidance on Writing an Outsourcing Policy

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Businesses that operate within the regulated sector often rely heavily on outsourcing to third parties. This can operational and regulatory risks. This article provides general practical guidance on how to write an outsourcing policy.

## Regulatory requirements

For businesses that operate within the financially regulated sector, there are invariably detailed and often prescriptive rules that apply to outsourcing arrangements. These rules aim to ensure that the firm retains appropriate control or oversight of the activities it outsources, with the ultimate objective of protecting clients (and, in some instances where it is a systemically important institution, contributing to the overall stability of the financial system).

Rules requiring the firm to appropriately monitor and control additional operational risk arising from services or activities performed by third parties are set out in Chapter 8 of the Senior Management, Systems and Controls Sourcebook (SYSC) in the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA) Handbooks. SYSC Rules about outsourcing arrangements therefore apply (in slightly different ways) to most

regulated firms; for instance, to banks, fund managers, investment firms and insurance companies.<sup>1</sup> Although an outsourcing policy is not specifically in these rules, best practice may dictate that in practice firms have outsourcing policies to comply with them.

## Guidance

Some firms struggle with writing Outsourcing Policies and we are frequently asked to advise on this topic. Here is our guidance on writing an outsourcing policy.

### Scope

The outsourcing policy needs to describe its scope. This usually means defining outsourcing. It may also mean explaining that the outsourcing policy will be applied, where relevant, to key supplier relationships or material partnerships.

### Financial regulation

The outsourcing policy needs to be compliant with the specific FCA or PRA outsourcing rules

that apply to the relevant firm. It needs to explain how the firm will comply with the relevant outsourcing rules, whilst at the same time being clear and concise.

We generally prefer to include full extracts of all relevant rules in the outsourcing policy, as footnotes/endnotes at the end of the outsourcing policy, so that people can refer to them when they want to do so. This also helps readers to distinguish between provisions in the outsourcing policy that are required by a specific rule and other provisions designed to reflect best practice or the needs of the business.

### Practical

The outsourcing policy needs to be practical. What we mean by this is that the outsourcing policy should focus on setting out the specific actions that the firm intends to comply with, where relevant. For example, instead of saying that the firm will consider

the risks involved in outsourcing, it is better for the policy to say that the firm will prepare a risk register and for the outsourcing policy to describe:

- the information to be included in the risk register;
- how it will be monitored and maintained; and
- who will approve it.

It may also be useful for the outsourcing policy to set out guidance on when it may be appropriate to consider outsourcing.

#### Accountable

The outsourcing policy needs to state, with regard to each action, which function or functions in the firm will be responsible for carrying out the actions referred to e.g. Group Credit will check the financial status of the supplier before the agreement is signed.

#### Short and concise

The outsourcing policy needs to be as short and concise as possible, so that all relevant people within the business will be able to familiarise themselves with it and ensure that they comply with it, where relevant. It is better to have a short outsourcing policy that everyone complies with than to have a long outsourcing policy that no one or few people comply with.

It helps if each paragraph states who is responsible for carrying out the relevant action, so that people reading the outsourcing policy can concentrate on the paragraphs which are particularly relevant to them.

We generally find that a good length is for the main body of the outsourcing policy to be under 30 pages. The outsourcing policy can then have annexes with:

- detailed checklists e.g. of due diligence, terms to be included in outsourcing agreements, transition activities, impact assessment activities, exit activities etc.; and
- model documents e.g. of non-disclosure agreements, business cases, requests for proposals, escalation procedure; and
- processes e.g. the approvals needed for each action or stage.

#### Comprehensive

The outsourcing policy needs to be comprehensive and include all relevant information that people within the firm need to deal with outsourcing projects at four different stages, namely:

- managing the procurement, preparing for the outsourcing agreement and drafting the outsourcing agreement;
- on-going management of the outsourcing agreement after signature;
- extending the outsourcing agreement; and
- managing the termination of the outsourcing agreement.

#### Flexible

The outsourcing policy needs to be flexible, so that provisions can be applied where they are necessary and relevant.

#### Easy to read

The outsourcing policy needs to be drafted in Plain English so that it is easy to read.

#### Consistent

The outsourcing policy needs to be consistent in its treatment of different issues. For example, it needs to deal with how the firm will:

- prepare the business case before the agreement signed;
- update the business case as part of the on-going management of the outsourcing agreement after signature; and
- prepare a business case to justify the early termination of the outsourcing agreement.

#### Other policies

The outsourcing policy needs to include cross references to other relevant policies, e.g. Gifts and Hospitality Policy and Security Policy.

#### Up-to-date

As the business changes, or arrangements with third parties are altered, so the outsourcing policy will need to be reviewed and updated from time-to-time, so that it maintains its relevance to the business and so that it reflects current regulatory requirements. While the FCA and PRA rules on outsourcing are relatively high-level, they are also changed periodically, often in response to new domestic or EU legislation. We would therefore recommend that an outsourcing policy is reviewed at least annually to ensure it is up-to-date so far as both the business and regulatory requirements are concerned.

#### Version control

The outsourcing policy should be subject to version control, with details of who has approved it and the next expected review date.

#### Conclusion

This article provides practical guidance on how to draft an outsourcing policy. No doubt, however, much of the guidance will be equally applicable to the drafting of other policies by firms.

## Contacts

### Amanda Lewis

Partner

D +44 20 7320 6680

M +44 7980 802 262

[amanda.lewis@dentons.com](mailto:amanda.lewis@dentons.com)



### Nicholas Ralph

Managing Associate

D +44 20 7320 6211

M +44 7469 350960

[nicholas.ralph@dentons.com](mailto:nicholas.ralph@dentons.com)



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<sup>i</sup> For "common platform firms" (i.e. firms subject to the Markets in Financial Instruments Directive 2004/39/EC and/or the Capital Requirements Directive such as banks and investment firms), SYSC 8 applies and requires that:

"a common platform firm must ... when relying on a third party for the performance of operational functions which are critical for the performance of regulated activities, listed activities or ancillary services on a continuous and satisfactory basis, ensure that it takes reasonable steps to avoid undue additional operational risk". SYSC 8.1.9R states: "a common platform firm must ensure that the respective rights and obligations of the firm and of the service provider are clearly allocated and set out in a written agreement".

A related rule in SYSC 4.1.1R requires firms to have effective processes to identify, manage, monitor and report risks and internal control mechanisms.

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