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FINANCIAL SERVICES FACULTY
HELPSHEET

OUTSOURCING AND ITS APPLICABILITY TO THE FINANCIAL CONDUCT AUTHORITY'S CLIENT ASSETS SOURCEBOOK (CASS)

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Firms regulated by the Financial Conduct Authority (FCA) are more commonly making outsourcing arrangements which affect how they comply with the CASS rules and the FCA is increasingly focussing on this area. While initial work by the regulator considered resilience risk as well as monitoring and oversight, there has been more focus recently on CASS outsourcing arrangements. As cloud outsourcing becomes a bigger issue within the CASS audit, the guidance outlined in this helpsheet equally applies to these arrangements.

OUTSOURCING

The FCA's standards on Senior Management Arrangements, Systems and Controls (SYSC) set out specific rules covering outsourcing arrangements and make clear that a firm's regulatory responsibilities cannot be outsourced.

SYSC 3 Systems and Controls requires that firms take reasonable care to establish and maintain systems and controls that are appropriate to its business, and in order to comply with the regulations.

SYSC 8 Outsourcing sets out that firms who rely on a third party for the performance of operational functions, that are critical for the performance of regulated activities on a continuous and satisfactory basis, must take reasonable steps to avoid undue operational risk.

Firms may not outsource important operational functions in such a way that impairs materially or the quality of its internal control. Functions which allow the ability of the FCA to monitor the firm's compliance also cannot be outsourced.

SYSC 8 also states that an operational function is seen as critical if a defect or failure in its performance would materially impact the continuing compliance of a firm. This is in relation to the conditions and obligations under the regulatory system, or the continuity of its relevant services and activities.

This means that, where firms outsource operations that impact the firm's CASS compliance, they must have regard to those requirements in SYSC 8. They must ensure that their internal controls are not affected, and they remain compliant with the CASS rules.

OUTSOURCING UNDER MODEL A OR B

Model A	Model B
In more typical arrangements, the outsourcer performs operations on behalf of the firm, but the firm retains the agreement with the customer, and therefore the firm retains its regulatory responsibilities. This is including for CASS compliance. Such outsourcing arrangements are commonly referred to as ''Model A Arrangements".	In order to meet this requirement, the outsourcing firm must have appropriate CASS permissions in order to take on the responsibility from the firm. They must assume some or all of the responsibility for complying with the CASS rule, and the arrangements with the firm's customers must include a direct relationship between the outsourcer and the customer.

SELECTION OF THE OUTSOURCING PARTNER

When outsourcing critical CASS activities, the firm should be exercising due skill, care and diligence over the selection of the outsourcing partner.

There should be an appropriate due diligence process. CASS firms should already be familiar with the due diligence process, given they are required to perform due diligence over custodians and banks with which the firm deposits custody assets and client money with.

Aspects of an appropriate due diligence process
Check that the outsourcer has the appropriate capabilities and skills to perform the work to the required standard.
Consider the financial stability and reputation of the outsourcer, its risk appetite and the maturity of its offering.
Consider the systems operated by the outsourcer and how the operating model will be executed.
Ensure the outsourcers systems are fit for purpose.

There should be an appropriate legal agreement in place, and the firm should establish appropriate CASS key performance indicators ("KPIs"). This is in order to properly measure the performance of the outsourcer, in addition to operational measures. Relevant CASS Management Information ("MI") should also be obtained on a regular basis.

ESTABLISHING EFFECTIVE OVERSIGHT

The firm will need to consider how it will perform oversight of the outsourced operations. During their thematic work undertaken in 2013 ("TR 13-10 Outsourcing in the Asset Management Industry"), the FCA noted that some firms had outsourced all of their skilled resource to the outsourcer as part of the new arrangement.

In order to provide effective oversight, the firm should retain sufficient, skilled, individuals who can provide operational oversight, in order to ensure that the outsourcer is undertaking the work effectively. This will manage the risks of outsourcing and meet the firm's regulatory obligations, in particular those relating to CASS compliance. These individuals should have appropriate operational understanding of the outsourcer's operations, and how they impact the firm's operating model.

In addition to skilled individuals, the firm should consider:

- **Effective CASS management information**: Management information must be appropriate, relevant, valid and properly prepared. The firm should ensure this through challenge and testing. Firms should assess the compliance monitoring and internal audit capabilities of the outsourced provider, and ensure that any issues identified are being remediated and addressed promptly while addressing risk.

  Oversight processes must be rigorous. Simply reviewing management information and attending service meetings is unlikely to constitute sufficient oversight. The firm should undertake appropriate analysis of the KPIs and management information provided by the outsourcer and testing and validate information provided.

- **Monitoring visits**: Firms should undertake oversight monitoring visits. This will enable them to properly understand the processes being performed, and to assess and test the controls in operation as well as the skills of those performing the outsourced procedures.

- **Second and third line oversight**: Firms should consider how second and third line oversight should be involved in assessing the work of the outsourced provider. Second line monitoring should be monitoring the compliance of the firm with the procedures, and ensuring that the firm is compliant with the CASS rules.

Internal audit can provide assurance to the firm’s audit committee that the firm is compliant and that the outsourced provider is doing appropriate work. Both compliance monitoring and internal audit have a role to play in ensuring that the first line oversight is appropriate.

- **Visibility and assessment of controls**: In line with the requirement to have appropriate mapping of their CASS risks and mitigating controls to the applicable CASS rules, firms should ensure that they have appropriate visibility of the controls operating at the outsourced provider.

  This should assess how the provider believes that they are assisting the firm to comply with the CASS rules. As part of the firm’s oversight procedures and associated controls, these should be mapped to ensure that there is appropriate coverage by those performing oversight to address the key CASS risks.

  The oversight risks and the mitigating controls should be overlaid on the mapping produced by the outsource provider, and the firm should review and keep this up to date. The firm should look to test the adequacy of the controls operated by the outsourcer as part of their programme of monitoring.

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