

Senior arrangements, Systems and Controls

Chapter 8

Outsourcing

8.1 General outsourcing requirements

[Note: ESMA has also issued guidelines under article 16(3) of the ESMA Regulation covering certain aspects of the MiFID compliance function requirements. See https://www.esma.europa.eu/sites/default/files/library/esma35-36-1946_final_report_guidelines_on_certain_aspects_of_the_mifid_ii_compliance_function.pdf

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Application to a common platform firm

8.1.-2

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For a *common platform firm*:

- (1) the *MiFID Org Regulation* applies, as summarised in ■ SYSC 1 Annex 1 3.2G, ■ SYSC 1 Annex 1 3.2-AR and ■ SYSC 1 Annex 1 3.2-BR; and
- (2) the *rules and guidance* apply as set out in the table below:

Subject	Applicable rule or guidance
General requirements	SYSC 8.1.1R, SYSC 8.1.2G, SYSC 8.1.3G, SYSC 8.1.12G

Application to an MiFID optional exemption firm and to a third country firm

8.1.-1

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For a *MiFID optional exemption firm* and a *third country firm*:

- (1) the *rules and guidance* in this chapter apply to them as if they were *rules* or as *guidance* in accordance with ■ SYSC 1 Annex 1 3.2CR(1); and
- (2) those articles of the *MiFID Org Regulation* in ■ SYSC 1 Annex 1 2.8AR and 3.2CR apply to them as if they were *rules* or as *guidance* in accordance with ■ SYSC 1 Annex 1 3.2CR(2).

General requirements

8.1.1

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A *common platform firm* must:

- (1) 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* (in this chapter "relevant services and activities") on a continuous and satisfactory basis, ensure that it takes reasonable steps to avoid undue additional operational risk; and
- (2) not undertake the *outsourcing* of important operational functions in such a way as to impair materially:
 - (a) the quality of its internal control; and

(b) the ability of the *FCA* to monitor the *firm's* compliance with all obligations under the *regulatory system* and, if different, of a *competent authority* to monitor the *firm's* compliance with all obligations under *MiFID*.

[**Note:** article 16(5) first paragraph of *MiFID*]

- 8.1.1A** **G** Other *firms* should take account of the outsourcing *rule* (■ SYSC 8.1.1 R) as if it were *guidance* (and as if should appeared in that *rule* instead of must) as explained in ■ SYSC 1 Annex 1 3.3R(1).
- 8.1.2** **G** The application of ■ SYSC 8.1 to relevant services and activities (see ■ SYSC 8.1.1 R (1)) is limited by ■ SYSC 1 Annex 1 (Part 2) (Application of the common platform requirements).
- 8.1.3** **G** ■ SYSC 4.1.1 R requires a *firm* to have effective processes to identify, manage, monitor and report risks and internal control mechanisms. Except in relation to those functions described in ■ SYSC 8.1.5R and (for a *common platform firm* in article 30(2) of the *MiFID Org Regulation*), where a *firm* relies on a third party for the performance of operational functions which are not critical or important for the performance of relevant services and activities (see ■ SYSC 8.1.1 R (1)) on a continuous and satisfactory basis, it should take into account, in a manner that is proportionate given the nature, scale and complexity of the *outsourcing*, the *rules* in this section in complying with that requirement.
- 8.1.4** **R** For the purposes of this chapter an operational function is regarded as critical or important if a defect or failure in its performance would materially impair the continuing compliance of a *firm* (other than a *common platform firm*) with the conditions and obligations of its *authorisation* or its other obligations under the *regulatory system*, or its financial performance, or the soundness or the continuity of its relevant services and activities.
- 8.1.5** **R** For a *UCITS investment firm* and without prejudice to the status of any other function, the following functions will not be considered as critical or important for the purposes of this chapter:
- (1) the provision to the *firm* of advisory services, and other services which do not form part of the relevant services and activities of the *firm*, including the provision of legal advice to the *firm*, the training of personnel of the *firm*, billing services and the security of the *firm's* premises and personnel;
 - (2) the purchase of standardised services, including market information services and the provision of price feeds;
 - (3) the recording and retention of relevant telephone conversations or electronic communications subject to SYSC 10A.
- 8.1.5A** **G** Other *firms* should take account of the critical functions *rules* (■ SYSC 8.1.4 R and ■ SYSC 8.1.5 R) as if they were *guidance* (and as if should appeared in those *rules* instead of must) as explained in ■ SYSC 1 Annex 1 3.3R(1).

- 8.1.6** **R** If a *firm* (other than a *common platform firm*) outsources critical or important operational functions or any relevant services and activities, it remains fully responsible for discharging all of its obligations under the *regulatory system* and must comply, in particular, with the following conditions:
- (1) the *outsourcing* must not result in the delegation by *senior personnel* of their responsibility;
 - (2) the relationship and obligations of the *firm* towards its *clients* under the *regulatory system* must not be altered;
 - (3) the conditions with which the *firm* must comply in order to be *authorised*, and to remain so, must not be undermined;
 - (4) none of the other conditions subject to which the *firm's authorisation* was granted must be removed or modified.
- 8.1.6A** **G** A *UCITS investment firm* should take account of the provisions that apply to a *common platform firm* in relation to its *MIFID business* in accordance with ■ SYSC 8.1.-2G.
- 8.1.7** **R** A *UCITS investment firm* must exercise due skill and care and diligence when entering into, managing or terminating any arrangement for the *outsourcing* to a service provider of critical or important operational functions or of any relevant services and activities.
- 8.1.8** **R** A *UCITS investment firm* must in particular take the necessary steps to ensure that the following conditions are satisfied:
- (1) the service provider must have the ability, capacity, and any *authorisation* required by law to perform the *outsourced* functions, services or activities reliably and professionally;
 - (2) the service provider must carry out the *outsourced* services effectively, and to this end the *firm* must establish methods for assessing the standard of performance of the service provider;
 - (3) the service provider must properly supervise the carrying out of the *outsourced* functions, and adequately manage the risks associated with the *outsourcing*;
 - (4) appropriate action must be taken if it appears that the service provider may not be carrying out the functions effectively and in compliance with applicable laws and regulatory requirements;
 - (5) the *firm* must retain the necessary expertise to supervise the *outsourced* functions effectively and to manage the risks associated with the *outsourcing*, and must supervise those functions and manage those risks;
 - (6) the service provider must disclose to the *firm* any development that may have a material impact on its ability to carry out the *outsourced* functions effectively and in compliance with applicable laws and regulatory requirements;

- (7) the *firm* must be able to terminate the arrangement for the *outsourcing* where necessary without detriment to the continuity and quality of its provision of services to *clients*;
- (8) the service provider must co-operate with the *FCA* and any other relevant *competent authority* in connection with the *outsourced* activities;
- (9) the *firm*, its auditors, the *FCA* and any other relevant *competent authority* must have effective access to data related to the *outsourced* activities, as well as to the business premises of the service provider; and the *FCA* and any other relevant *competent authority* must be able to exercise those rights of access;
- (10) the service provider must protect any confidential information relating to the *firm* and its *clients*;
- (11) the *firm* and the service provider must establish, implement and maintain a contingency plan for disaster recovery and periodic testing of backup facilities where that is necessary having regard to the function, service or activity that has been *outsourced*.

8.1.9 **R** A *UCITS investment 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.

8.1.10 **R** If a *UCITS investment firm* and the service provider are members of the same *group*, the *firm* may, for the purpose of complying with **SYSC 8.1.7 R** to **SYSC 8.1.11 R** and **SYSC 8.2** and **SYSC 8.3**, take into account the extent to which the *UCITS investment firm controls* the service provider or has the ability to influence its actions.

8.1.11 **R** A *firm* (other than a *common platform firm*) must make available on request to the *FCA* all information necessary to enable the *FCA* to supervise the compliance of the performance of the *outsourced* activities with the requirements of the *regulatory system*.

8.1.11A **G** Other *firms* should take account of the outsourcing of important operational functions *rules* (**SYSC 8.1.7 R** to **SYSC 8.1.11 R**) as if they were *guidance* (and as if should appeared in those *rules* instead of *must*) as explained in **SYSC 1 Annex 1 3.3R(1)**.

8.1.12 **G** As **SUP 15.3.8 G** explains, a *firm* should notify the *FCA* when it intends to rely on a third party for the performance of operational functions which are critical or important for the performance of relevant services and activities on a continuous and satisfactory basis.
 [Note: recital 44 to the *MiFID Org Regulation*]

Additional requirements for a management company.....

8.1.13 **R** A *management company* must retain the necessary resources and expertise so as to monitor effectively the activities carried out by third parties on the

basis of an arrangement with the *firm*, especially with regard to the management of the risk associated with those arrangements.

[Note: article 5(2) of the *UCITS implementing Directive*]

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A *management company* should be aware that ■ SUP 15.8.6 R (Delegation by UCITS management companies) and ■ COLL 6.6.15A R (Committees and delegations) contain requirements implementing article 13 of the *UCITS Directive* in relation to delegation that will apply to it.