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**Thematic Review of Administration Firms compliance with the Requirements on Outsourcing of Administration Activities in relation to Collective Investment Schemes (the “Outsourcing Requirements”)**

Dear [NAME]

During the fourth quarter of 2012, the Central Bank undertook a series of themed reviews of administration firms authorised under Section 10 of the Investment Intermediaries Act, 1995, to review the controls and procedures around outsourcing arrangements and to assess each firm’s compliance with the Outsourcing Requirements set out in Annex II of the UCITS and Non-UCITS Notices.

The Outsourcing Requirements ensure that administration firms maintain a consistent standard of oversight over outsourcing service providers and also retain ultimate responsibility for the outsourced activities. The Requirements aim to mitigate the following key risks:

- Risk that investors subscribe or redeem at an incorrect Net Asset Value (NAV);
- Risk of services being interrupted due to an unexpected contingency event;
- Legal risk relating to inability to enforce contractual obligations;
- Risk of inadequate control and oversight mechanisms;



- Risk to investor confidence arising from a significant regulatory failure within the firm.

The objective of the thematic review was to assess the approach to outsourcing and its inherent risks, compliance with specific Outsourcing Requirements and to evaluate best practice in the industry. This letter delivers on our commitment to provide feedback in relation to the review.

Having analysed the findings from the thematic review, it is apparent that, while firms have generally adopted the Outsourcing Requirements, there are areas requiring enhancement where controls were insufficient or inconsistently applied. The Central Bank has also identified clear incidents of non-compliance with the Outsourcing Requirements.

As a result, the Central Bank is making a number of recommendations which will assist firms in assessing their compliance with the Outsourcing Requirements. These recommendations are outlined in the attached Schedule. The Central Bank requests that administration firms review existing outsourcing arrangements and make any necessary changes/enhancements to ensure compliance with the Outsourcing Requirements. The review of outsourcing arrangements should be ratified by the Board of Directors.

The ultimate responsibility for compliance with all regulatory obligations rests with the Board of each firm. The Central Bank, having issued these recommendations, will in the future seek to deploy the full range of its supervisory tools, including taking enforcement where necessary, where it perceives that firms pose a risk outside the Central Bank's risk appetite and where there is continuing non-compliance.

Yours sincerely

**Patricia Dunne**  
Deputy Head of Investment Firms and Fund Supervision



## **Schedule of Recommendations**

Please note that this is not an exhaustive list of issues identified during the thematic review; rather it is those considered the highest priority based on the specific Annex II Outsourcing Requirements in scope of the review.

### **Recommendation 1:**

Firms should review their outsourcing arrangements to ensure that the NAV review is comprehensive. The Central Bank acknowledges that fund administration has become increasingly automated in recent years. Notwithstanding this, firms must maintain sufficient documentary and/or system evidence of the NAV review and the date of the review. Firms must ensure that the NAV review is completed by a sufficiently experienced staff member of the firm.

### **Requirement:**

*'The Final check and release of each CIS NAV is a core administration activity which must be performed by the administration firm. This review must be completed prior to the release of the NAV for dealing purposes and should be completed, signed and dated by a senior staff member within the administration firm. In exceptional circumstances the administration firm may release the NAV for dealing purposes provided the final check is performed on the following day. Documentary evidence of this review must be maintained by the administration firm and made available to the Central Bank on request.'*

### **Findings:**

While reviewed firms carried out final checks on the NAV, there were differences in the level of review and documentary evidence of the review. For example, in some cases there was either no checklist or insufficient detail on the checklist; no evidence of the timing of the NAV review or no evidence of which reports were reviewed as part of the NAV approval process.



**Recommendation 2:**

Firms are reminded that they must have a documented policy on the approach to outsourcing. The policy should cover all aspects of outsourcing in accordance with Annex II, Requirement 4 to 4.7.

Firms must consider and document contingency plans for worst case/extreme circumstances.

**Requirement:**

*'The Administration firm must have a documented Policy on its approach to outsourcing, including contingency plans and exit strategies'*

**Findings:**

In some cases, no documented outsourcing policy existed. Where an outsourcing policy document did exist, the Central Bank noted that some firms did not have a sufficiently detailed document. For example, the policy document did not specify teams/individuals responsible for monitoring and managing outsourcing arrangements or no consideration was given to the expected or unexpected termination of a contract.

In all firms, there was insufficient consideration given to contingency planning for worst case/extreme circumstances. All firms were found to have deficient or complete absence of contingency planning for worst case/extreme circumstances in their Business Continuity Planning (BCP) documentation.



**Recommendation 3:**

All firms should have a local Risk Management Document referencing outsourcing. If the firm adopts Group Risk policies, these must contain reference to Irish regulatory obligations and requirements, including the Outsourcing Requirements.

**Requirements:**

*'The administration firm must appropriately manage the risks associated with outsourcing arrangements.'*

*'The administration firm must, prior to engaging in outsourcing, consider and set out in a risk management document what alternative measures could adequately mitigate the risks involved.'*

**Findings:**

Only one firm reviewed had a risk management document that referenced outsourcing. The Central Bank considers this to be a serious deficiency amongst those other firms.

**Recommendation 4:**

Firms must ensure that there is a formal and comprehensive contract or service level agreement (SLA) in place for all outsourcing arrangements in accordance with the Outsourcing Requirements.

**Requirement:**

*'All outsourcing arrangements must be subject to a formal and comprehensive contract or service level agreement.'*

**Findings:**

It was identified during the thematic review that some firms did not have a contract or SLA in place covering each outsourced activity. The Central Bank considers this poses additional risk to the firm in the event of failure of the outsourcing service provider to perform its



function. It was also identified that not all existing SLA's were sufficiently detailed. Deficiencies included inter alia, no obligation on the outsourcing service provider to allow direct access by the Central Bank to data and premises; no exit management clause; no provisions allowing the administration firm to terminate the contract if required by the Central Bank.

**Recommendation 5:**

Outsourcing should be discussed as a recurring item at Board meetings to ensure that the Board is satisfied with the on-going effectiveness of the outsourcing policies and procedures. The firm's outsourcing policy document should be approved by the Board. Reviews of outsourcing service providers and arrangements should be discussed at the Board meetings.

**Requirement:**

*'The ultimate responsibility for the proper management of the risks associated with outsourcing or the outsourced activities lies with the administration firm's senior management'.<sup>1</sup> 'Outsourcing arrangements can never result in the delegation of senior management's responsibility'*

**Findings:**

The Central Bank noted that in most cases outsourcing was not discussed at Board meetings. It was observed that while visits to outsourcing service providers had taken place, there was no evidence that issues or findings from these visits were reported to the Board.

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<sup>1</sup> Persons who effectively direct the business of the administration firm, this includes the firm's board of directors and other persons who effectively direct the business of the firm



**Recommendation 6:**

The Annex II Outsourcing Requirements set out the minimum standards which should apply across all locations. The Outsourcing Requirements apply equally to all outsourcing arrangements regardless of:

- Whether outsourcing is within the group;
- Whether outsourcing is to an entity within the State or outside the State;
- Whether the firm directly or indirectly provides fund administration services;
- The location, time zone and regulatory status of the service provider.

**Definition of Outsourcing Service Provider:**

*'The supplier of goods, services or facilities, including another administration firm and/or an affiliated entity within a corporate group.'*

**Findings:**

The Central Bank noted that firms were not applying the same level of due diligence and oversight to all outsourcing service providers.