



**Jersey Financial
Services Commission**

Themed examination programme 2019:

Outsourcing

Issued: 17 July 2019

Glossary of terms

All defined terms used in this feedback paper:

| | |
|------------------------------|---|
| Codes of Practice (or Codes) | Means, collectively, the › Banking Code › FSB Code › IB Code › TCB Code |
| CP | Core Principle |
| DC | Deposit-Taking Business |
| DD | Due Diligence |
| FS(J)L | Financial Services (Jersey) Law 1998 |
| FSB | Fund Services Business |
| IB | Investment Business |
| IR | Information Request |
| JFSC | Jersey Financial Services Commission |
| OA | Outsourcing Arrangement |
| OPGN | Outsourcing Policy and Guidance Notes issued by the JFSC on 1 March 2017 |
| Registered person | means a Person that is Licensed or holds a permit or certificate, as applicable, under one or more of the Regulatory Laws |
| SEU | Supervision Examination Unit |
| SP | Service Provider |
| TCB | Trust Company Business |

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1 Introduction

In response to the industry's request to define key terms and include a glossary to remove ambiguity, on 1 March 2017, the JFSC issued a new 'Outsourcing Policy and Guidance Notes' (**OPGN**), which came into effect on 1 June 2017 for all new Outsourcing Arrangements (**OAs**). Registered Persons with existing OAs were also required to ensure adherence to the new OPGN within 15 months from the date of its publication, that deadline being 1 June 2018.

The main changes introduced by the new Outsourcing Policy were:

- › Amending the scope of the policy to include Outsourced activity (regulated and non-regulated) that has a material impact on Regulated Activity
- › Removing the distinction between 'delegation' and 'outsourcing' as used in the Outsourcing Policy in relation to Certified Funds and Fund Services Businesses
- › Updating the core principles to provide clarity and align with international standards
- › Defining key terms and inclusion of a glossary to remove ambiguity, in particular to introduce a definition of 'material'
- › Providing additional guidance, including FAQs
- › Restructuring the format of the policy to separate principles from guidance and the FAQs
- › Effecting minor updates and consequential changes.

As communicated in August 2018, the JFSC set out in high-level terms its planned thematic examination programme for the second half of 2018, to be undertaken by the JFSC's Supervision Examination Unit (**the SEU**). The programme identified the theme of Outsourcing for Q4 2018 / Q1 2019. This allowed those affected by the new OPGN to have had sufficient time to implement the new requirements for both new and existing OAs.

The SEU therefore examined whether Registered Persons who have OAs, have taken adequate measures to counter any material risks relating to those arrangements and have appropriate systems and controls to exercise oversight over the OAs, in accordance with the OPGN.

This paper provides the key findings from the Outsourcing themed examination.

2 Scope and regulatory requirements

In terms of the requirements of the OPGN, the thematic examinations reviewed and assessed:

- › The Registered Persons' 'Fit and Proper' assessment process for any new Service Providers (SPs)
- › Whether the Registered Persons had in place appropriate written agreements
- › The Registered Persons' arrangements to assess and monitor the performance of SPs
- › The Registered Persons' terminations rights and provisions
- › The effectiveness of the Registered Persons' internal control systems in respect of the above.

The examinations also considered the Registered Persons' compliance with relevant Codes of Practice, which require a Registered Person to comply with the JFSC's policy on outsourcing, in order for the JFSC to reach an overall view as to whether the Registered Persons understood the new requirements, and adopted the applicable actions and observed the specified deadlines in respect of all of its OAs.

3 Limitations

The JFSC regularly undertakes on-site examinations on specific themes to: (1) assess the extent to which regulated entities are operating in accordance with their regulatory obligations under the respective Laws, Orders, Code and Guidance Notes; (2) provide direct feedback to the entities examined; and (3) issue related guidance for the wider industry.

The JFSC's on-site examination programme is designed to:

- › Assess the risks faced by individual entities and review the controls, procedures, policies
- › Assess the processes in place to mitigate those risks.

The purpose of this paper is to summarise the key findings from this themed examination, and also to provide, where noted, areas of good practice observed by way of example¹. It is not intended to comprehensively describe all risks that may be associated with non-adherence to regulatory obligations and not all entities face the issues described below. However, the observations made reflect areas of potential risk and are provided for general guidance.

As a result of conducting a thematic examination, where there is a view that any Law, Order, Code or Guidance Note needs revising or updating, this will be factored into the JFSC's processes.

4 Methodology

Having reviewed and analysed data held by the JFSC, together with supervisory knowledge of Registered Persons with OAs previously notified to the JFSC, a selection of 18 entities was made to represent a cross-section of all licence types. The sample included seven Deposit-taking (**DC**) Businesses, three Investment Businesses (**IB**), six Funds Services Businesses (**FSB**) and two Trust Company Businesses (**TCB**).

The themed examination was conducted over two phases:

Phase One – This was by the way of a formal information request (**the IR**) sent to the identified Registered Persons seeking the provision of the following documents:

- › Register of all OAs - detailing inter alia, the name of the SP / regulatory status of the SP / jurisdictional exposure of the SP / summary of the arrangement / materiality assessment / date of commencement of the arrangement and whether sub-outsourcing is permitted;
- › Policies and procedures – including assessment tools / supporting forms and checklists; and
- › Documentary evidence – illustrating compliance with Core Principle (**CP**) 1 / CP 2 / CP 3 / CP 4 / CP 5 and CP 6.

Phase Two – encompassed a series of follow up 'desk-based' reviews of the information provided by the Registered Persons and entity discussions whereby the JFSC sought clarification in respect of specific responses to the Phase One IR. On-site meetings were then held with Registered Persons' management and staff to clarify any outstanding points following on from the Phase One data analysis and to determine whether procedures were being adequately followed and to establish the extent of any control deficiencies.

¹ The areas of good practice observed and referenced herein should not be taken as formal guidance issued by the JFSC as they may not be relevant or appropriate to every Registered Person.

In the event that any findings were identified, these were based upon information provided by the Registered Person and evidence available at the time of the on-site examination. Those findings are being separately addressed by the individual entities and are subject to a formal remediation plan having been submitted to, and agreed by the JFSC, setting out actions to be taken and timescales to complete.

The JFSC takes this opportunity to thank the 18 entities who provided a response to the Phase One IR and also the courtesy and assistance shown during the Phase Two examinations.

5 Executive summary

It is of concern that of the 18 Registered Persons examined, 15 failed to comply with at least one aspect of the OPGN, with only 3 Registered Persons receiving a 'no findings' report. Where those Registered Persons failed in one or more CP requirements these are detailed below:

CP 1 - JFSC officers noted that 13 out of 18 examined Registered Persons were unable to evidence full compliance with CP1.

In general, entities exhibited a good level of understanding of the 'Fit and Proper' requirements where they related to third party arrangements; however, in respect of the arrangements where the SP belongs to a wider Group, 7 of the 13 Registered Persons misunderstood and did not apply the requisite Due Diligence (**DD**) requirements as part of the 'Fit and Proper' assessment.

CP 2 - Overall Registered Persons displayed a good understanding of the requirements of CP2 with only 5 out of 18 entities tested failing to satisfy in full the requirements for an appropriate written agreement, which from the outset should specify important matters such as Terms of Engagement and Service Levels Agreements.

CP 3 - In respect of the requirements of CP3, Registered Persons displayed varying levels of understanding and compliance with the requirements. In total, 10 out of 18 entities examined exhibited deficiencies against the requirements of CP3, with failings identified including inadequate policies and procedures as well as insufficient monitoring or lack of ongoing assessment of fitness and propriety.

CP 4 - In general, Registered Persons displayed a good level of compliance in respect of the requirements of CP4. JFSC officers noted that 6 out of 18 examined Registered Persons were however unable to display full compliance with the requirement as they did not have adequate termination arrangements in place allowing the entity to manage the consequences of such termination without undue delay and with minimum disruption to its business.

CP 5 – One of the highest levels of compliance was displayed by Registered Persons in regards to requirements of CP5, with only 3 out of 18 entities examined being unable to evidence the full compliance with the requirements. In those limited circumstances of non-compliance this related to, for example, a Registered Person notifying the JFSC of an incorrect name of the SP or in another case the entity not recognising that an arrangement was in scope of the OPGN.

CP6 – It was pleasing to note that the review did not identify any areas on non-compliance in respect of the requirements of CP6.

In respect of Registered Persons who were only partially compliant with the requirements of the OPGN, findings of non-compliance with the sector specific Codes of Practice (**the Codes**) were therefore recorded against 15 out of 18 examined Registered Persons.

JFSC officers noted several examples of good practice in relation to compliance with the requirements of the OPGN, which are included in section 6.2 below.

The JFSC takes this opportunity to encourage those Registered Persons which have OAs to carefully consider the content of this paper and review their current processes to ensure they are able to evidence full compliance with the OPGN.

6 Key findings

6.1 Key data review

Below is Phase 2 data from the 18 examinations² broken down by non-compliance with the Core Principles by licence type.

CP1



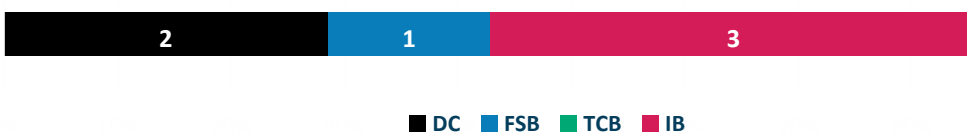
CP2



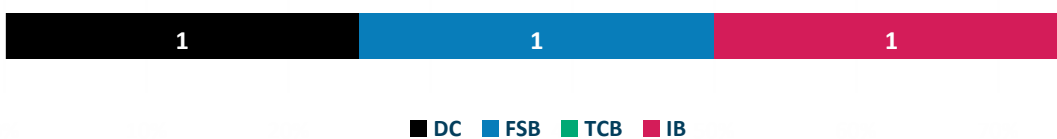
CP3



CP4



CP5



² The 18 examined entities consisted of: Seven Deposit-taking (DC) Businesses, Three Investment Business (IB) businesses, Six Funds Services Businesses (FSB) and Two Trust Company Businesses (TCB).

6.2 Key Findings from the examinations

Core Principle 1 – ‘A Registered Person must satisfy itself at the outset, and on a continuing basis thereafter, that any Service Provider to whom it Outsources activities is Fit and Proper and will perform the Outsourced activities in a responsible, professional and suitable manner’.



Areas for improvement

JFSC officers identified that although it was evident that a DD process was in place for external vendors (third parties), there were numerous instances whereby entities were not able to evidence³ the extent of the DD conducted in respect of identified OAs where the services were provided by an entity within the wider Group. This finding was prevalent across all sectors where OAs used an SP that was within the wider Group. This deficiency was identified in 7 of 13 Registered Persons.

Registered Persons are reminded that in line with section 3.2.1 of the OPGN, ‘the Outsourcing Policy applies to all Registered Persons, in respect of Outsourcing; irrespective of whether it is Outsourced to Persons within the same Group, or to third parties.’

JFSC officers observed two instances where the risk assessments provided did not evidence that a Registered Person had considered all the factors, which may adversely impact the entity and its clients. In both cases, the Registered Persons relied on an assessment conducted on a Group level and failed to document an appropriate local risk assessment, exposing itself to unknown risks, which might be different to those identified by the Group.

JFSC officers further noted three instances where Registered Persons did not demonstrate a sufficient level of Board consideration, challenge and oversight in respect of the approval of new OAs. By way of an example, one examined entity considered a materiality assessment of a particular OA which marginally fell outside of the parameters which would qualify the arrangement as material. JFSC officers would have expected the Board meeting minutes to contain sufficient detail to demonstrate that there had been careful consideration of significant aspects of the arrangement, including the arrangement’s marginal materiality score, which was not evident from the documentation presented for review.

Consideration is being given by the JFSC as to whether the OPGN needs to be revised to be clearer with respect to the requirements of CP1.



Good practice identified

Conducting a gap analysis of the OA against the six Core Principles, including all aspects of the Guidance Notes, in respect of both third party arrangements and arrangements within the wider Group.

It was noted that in certain instances, comprehensive policies and procedures relating to outsourcing were present and their application in practice was clearly demonstrated to JFSC officers during the examination.

³ In the majority of instances the JFSC were informed that the Registered Person had sought the required DD from Group, but due to differences in regulatory requirements in jurisdictions, this was not always forthcoming. Where this had occurred, the Registered Person could not always provide the JFSC with documentary evidence to show that a request had been made together with any response.

Board or Committee minutes reviewed clearly demonstrated allocation of responsibilities and deadlines for follow-up, as well as evidence of challenge and consideration being made of the material risks associated with new OAs.

Core Principle 2 – ‘A Registered Person must have in place appropriate written agreements, with any Service Providers to whom it outsources activities that clearly specify the terms of engagement and the level of services to be provided by the Service Provider’.



Areas for improvement

It was pleasing to note that no instances (outside of inter-group arrangements previously described in CP 1) were seen where written agreements between the Registered Person and the SP had not been used. JFSC officers did however identify three instances where written agreements were in place that did not contain clearly defined terms in respect of the required performance levels and/or prescribed review frequency.

It was concerning however, that JFSC officers identified two instances where Registered Persons failed to identify that inter-group arrangements fell within the scope of the OPGN and as such were not able to evidence the existence of any form of written agreement.

The JFSC also reminds Registered Persons that in the OPGN it clearly states *‘where the Service Provider is an entity within the same Group as the Registered Person, which provides specialised central support functions to entities within the same Group of companies, the JFSC’s expectation of ‘appropriate written agreements’ may not amount to a written, legally binding agreement that covers the specific nature of the Outsourcing in as much detail as would otherwise be required.’*



Good practice identified

Comprehensive written agreements were noted, detailing the terms of engagement, in respect of the SPs within the same Group as the Registered Persons.

Existence of a written and legally binding agreement with SPs that reflect the complexity, size and risks of the OAs.

Written agreements clearly considering the subject of Sub-Outsourcing. Specifically, containing restrictions in respect of SPs obligation to obtain approval of any proposed sub-contractor by the Registered Person.

Core Principle 3 – ‘A Registered Person must maintain the (i) capacity; (ii) resources; and (iii) policies and procedures to monitor, assess and ensure that any Outsourced activities are being performed adequately and the Service Provider remains Fit and Proper’.



Areas for improvement

JFSC officers noted four instances where Registered Persons were unable to evidence the existence of appropriate policies and procedures in respect of certain aspects of OAs, such as monitoring the SP’s performance or the assessment that the SP remains Fit and Proper.

In a further two instances, JFSC officers observed that the policies and procedures made little or no reference to the Jersey regulatory framework or were not being updated on a regular basis. By way of example, one Registered Person informed the JFSC officers that its new Global risk assessment methodology was introduced in 2018; however, its local procedures had not been updated to reflect the new process.



Good practice identified

Comprehensive policies and procedures, which were able to clearly demonstrate consideration of the Jersey regulatory requirements.

Registered Persons maintaining the capacity and required resources to implement its procedures.

Core Principle 4 – ‘A Registered Person must put in place arrangements that allow it to terminate its Outsourcing arrangements without undue delay and manage the consequences of any such termination appropriately’.



Areas for improvement

JFSC officers identified that in five instances Registered Persons failed to evidence the existence of appropriate contingency plans in the event of the SP failing to perform its contracted services, or consideration of such an eventuality occurring in line with CP4 requirements.

JFSC officers noted one instance where the contingency plans were not periodically tested. In this specific case a Registered Person advised the JFSC officers that the business continuity plans are maintained and tested at Group level; however, it was unable to evidence the existence of the local reporting of the results of any business continuity testing.



Good practice identified

Comprehensive and documented exit strategies, which included, inter alia, exit checklists, clear definition of responsibilities of both parties and timescales for completion.

Defined methodology and schedule of testing for the contingency arrangements, with results being recorded and reported to the Board / Committees.

Core Principle 5 – ‘A Registered Person must provide the JFSC with adequate prior written notice of its intention to outsource activities or make material changes to any existing Outsourcing arrangements. A Registered Person must not enter into any Outsourcing arrangement (save for contingency arrangements) until it has received prior written confirmation from an officer of the JFSC that the JFSC has no objection to such Outsourcing arrangements’.



Areas for improvement

JFSC officers identified that in general Registered Persons exhibited a good understanding of this requirement, with minimal exceptions noted in respect of CP5 requirements. JFSC officers identified two instances where entities had failed to make a notification altogether by not recognising that the services provided fell within the scope of the OPGN. In addition, in one instance a Registered Person made a notification in respect of an incorrect SP.



Good practice identified

Registered Persons engaging with the JFSC at an early stage, allowing the JFSC sufficient time to review and assess the possible regulatory implications of the proposed OA.

Notification of the proposed OA containing complete and accurate information, therefore negating the need for the JFSC to seek further clarification or confirmations.

Core Principle 6 – ‘A Registered Person must ensure that nothing in any Outsourcing arrangements prevents or restricts the JFSC’s ability to exercise the legal or regulatory powers it would otherwise have been able to exercise, in respect of any Registered Persons or Outsourced activity, had the Outsourcing not taken place’.



Areas for improvement

The JFSC was pleased to note no findings were made in respect of this principle.



Good practice identified

Registered Persons ensuring that the JFSC has unrestricted access to information in respect of the OAs, allowing the JFSC to exercise its supervisory function effectively.