

**White Paper
on key issues arising
for Asset Managers
from the
Regulatory Regime
on Outsourcing**

Purpose

On 11 December 2012, the predecessor of the Financial Conduct Authority (FCA) issued a letter to CEOs of Asset Management firms expressing their concern as to the increased level of outsourcing activity among firms in the asset management sector and the sector's compliance with relevant regulatory requirements.

In short, the regulator indicated a concern that effective "recovery and resolution plans" are not in place for the sector as a whole and that, if key service providers suffered financial distress or severe operational disruption, UK asset managers would not be able to perform critical and important regulated activities, with customer detriment arising as a result. This letter from the FCA precipitated considerable debate in the industry as to what, in practice, can be done and the extent to which there can be a perfect level of compliance with all aspects of the applicable regulatory requirements.

This report has been prepared in conjunction with Eversheds to consider the following:

- What types of outsourcing activities occur in practice within IMA member firms;
- Which risks and issues are relevant to the topics discussed in the Dear CEO Letter; and
- Identify ideas that may be used to attempt to address the regulator's concerns.

Acknowledgements

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Also to members of the IMA working group who shared experiences and considered issues in order to provide the information for this white paper.

Finally to Sally Winstanley and Julian Baines for co-chairing the IMA working group and contributing their industry experience, time and ideas.



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The IMA represents the asset management industry operating in the UK. Our Members include independent fund managers, the investment arms of retail banks, life insurers and investment banks, and the managers of occupational pension schemes.

They are responsible for the management of around £4.2 trillion of assets, which are invested on behalf of clients globally. These include authorised investment funds, institutional funds (e.g. pensions and life funds), private client accounts and a wide range of pooled investment vehicles.

Executive Summary

The collapse of Lehmans and the bail out of the banks ushered in a new regulatory and political climate. First, it made apparent that even a global banking brand can experience severe financial difficulties, and be brought to the brink of collapse, if not beyond. And secondly, it turned a spotlight on the problem of “too big to fail”. An array of regulatory reforms have been introduced in response, with politicians signalling that the taxpayer has no appetite for any future bail out, and regulators wanting firms to positively assume that no such solution will be available in the future.

Against this backdrop, it is recognised that a number of asset managers have, over time, looked increasingly to outsourcing arrangements to solve operational, regulatory, risk management and commercial challenges. And a number of the key service providers in the industry who deliver these solutions are global banks or members of global banking groups. An asset manager’s ability to provide continuity of service to their underlying customers is therefore largely dependent on their being able to receive continuity of service from their service provider. Beyond this is the fact that, by the very nature of the services being provided, it takes a considerable period of time to transfer functions from one service provider to another, or for an asset manager to take them back in-house. It is simply not possible for a service provider to fail on Friday, and for relevant functions to be transferred over the weekend so that service can resume as close to normal as practical on the Monday.

The upshot is an element of contagion risk. In other words, the risks that recent events have shown to be capable of arising in the business model of a service provider (usually a global bank) have leaked onto the balance sheet of its asset manager clients.

The FSA (as it was then known) began to have concerns about this following a thematic review in which it looked at 17 asset management firms. The result was the issue of a Dear CEO Letter on 11 December 2012, which expressed its concerns and challenged the industry to consider potential solutions.

It is fair to say that a significant portion of the industry has recognised that these concerns have a legitimate basis, with the IMA forming a working group to consider the issues and commissioning this white paper. To the regulator’s credit, it has also expressed a keen desire to engage with the industry to consider what is possible and practicable, without damaging the competitiveness of the UK asset management industry or adopting a disproportionate approach.

Preliminary points

This white paper sets out the various ideas for further industry consideration and debate, but in advance of that, certain preliminary points should be noted.

- **Assumptions** - In order to address the concerns of the regulator when considering issues relating to outsourcing activities, a number of assumptions were made, as follows: (i) there will be no immediate changes to Insolvency Law (this would require an Act of Parliament); (ii) the FCA has no current plans to regulate service providers carrying out a range of outsourced activities on behalf asset managers (this would mean a change to FSMA); and (iii) Asset managers remain responsible for their outsourced activities, but a failure of a service provider must have minimal impact on the underlying investors.
- **Ideas to operate as a suite** - As all sides of the debate recognise, there is no “silver bullet” to the concerns raised by the regulator. Instead, this white paper takes the approach that a suite of ideas may be viable and useful in mitigating any relevant risks.

- **Industry solutions to industry problems** - A number of the ideas set out in this white paper may only be viable in practice if they result in the development of industry standards or protocols - in particular, to address the situation of asset managers with little bargaining power in negotiations. This reflects a fundamental commercial reality that should not be ignored – that is, the issues flagged by the regulator cannot be solved by individual asset managers acting alone, but require a *collaborative* approach within the industry, and the full and active support of the regulator.
- **Timetable for implementation** - The ideas in this paper involve various time periods for implementation, as should be expected given the nature of the issues addressed. Some can possibly be actioned by asset managers in a shorter time frame, while others involve a medium or long term horizon, requiring extensive work, analysis and considerable industry effort.
- **Collaborative arrangements** - Finally, it goes without saying that a number of the ideas set out in this paper require asset managers to act in partnership with their service providers, pursuant to a strong working relationship.

Suite of ideas

The suite of ideas identified in this white paper is set out in detail in Part C below, and may be summarised as follows:

- **Idea 1:** Asset manager has strong internal knowledge base with regards to its outsourcing arrangements.
- **Idea 2:** Robust business continuity arrangements are in place at service providers.
- **Idea 3:** A robust internal approach exists within the asset management firm for business continuity planning.
- **Idea 4:** There is regular testing and follow up to rectify any issues identified.
- **Idea 5:** Service providers to have a strong user group discipline in place, to provide active oversight on issues set out in this white paper.
- **Idea 6:** Service providers to have robust exit planning in place.
- **Idea 7:** Asset manager to have robust exit planning in place.
- **Idea 8:** Industry working towards improving portability and increased industry standardisation.
- **Idea 9:** Encourage the Insolvency Practitioner to “keep the lights on.”
- **Idea 10:** Consider the extent to which a service provider has a robust and viable approach to emergency exit planning.
- **Idea 11:** Standard industry approach for capital requirements and financial “health checks” at service providers.

Next steps

Many in the industry recognise the serious nature of the regulator's concerns in its Dear CEO Letter, and that this is part of a broader change agenda to deal with the too big to fail problem. It is also recognised that the regulator has allowed the asset management industry some time and space to consider its concerns.

A number of asset managers have already started to review and action some of the key points highlighted in this paper, but the industry also awaits the outcome of the FCA's analysis and work in this area. It is hoped this will contain a clear statement of the regulator's expectations as to specific next steps it wishes for both individual firms and the industry generally to take.

As highlighted in the ideas outlined earlier, the IMA working group do not see the publication of this paper as being the final step, but as a catalyst to further work on mitigating risks of service provider failure. There are plans for a small representative group of asset managers to work with the service providers to consider in particular Ideas 8, 9 and 11. This group will take forward the concepts of standardisation, continuation of services (keeping the lights on) and health checks in conjunction with the service providers and continue to update the wider asset management industry via the IMA.

There will also be some further work to look at whether there may be some possibility of FCA rule waivers, should a service provider fail. This would allow a continuation of service to underlying investors until alternative arrangements could be made with another provider.

Finally, some investigation is required to consider cost analysis of this work and a determination of which functions are 'critical' during the failure of a service provider.

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No responsibility can be accepted by the Association for action taken which is a result of information contained in this paper. Readers should take specific advice when dealing with specific situations.

What is outsourcing?

In this white paper, the term outsourcing refers to the ordinary and commonly understood meaning of that word - i.e. a firm discharges or conducts a particular function or activity and, for commercial, risk management or indeed any other reason, the firm decides to appoint a third party to stand in its shoes and do so on its behalf. Another way to consider this in the context of asset management is that outsourcing takes the contractual chain of client to asset manager, and extends it by a further step: asset manager to service provider.

However, in high level terms, a firm is only engaged in outsourcing from a strict legal perspective if it is required to discharge or conduct the relevant function itself, or is otherwise responsible for it.

As to what should be considered in versus out for this purpose, it may be helpful to consider some scenarios:

- It is not generally an outsourced activity where an investment manager deposits client money with a bank under the FCA's Client Assets Sourcebook. First, in the typical scenario, this is not part of the service that the investment manager is offering or agreeing to provide to the client (i.e. from a commercial and contractual perspective). Secondly, an investment manager is only permitted to outsource something it can otherwise lawfully conduct itself, and most investment managers will not have FCA authorisation to act as a bank or deposit taker.
- Similarly, where a manager of a collective investment scheme or fund falling within (say) the UCITS Directive appoints a depositary, strictly speaking, this is not an outsourced arrangement. This is because applicable regulatory requirements do not permit the manager to discharge this function itself.
- On the other hand, an asset manager may conduct portfolio management for high net worth retail clients (i.e. on a segregated mandate basis). If the asset manager has an FCA permission to do so, it may contractually agree with its retail clients to also act as the custodian of their relevant assets. It may then decide, for various reasons, to engage a third party custodian to do this on its behalf, in which case the arrangement would constitute an outsourcing within the meaning of this paper.
- Another example, in high level terms, concerns a manager of a retail fund falling with the UCITS Directive which has a regulatory obligation to accept orders for the subscription or redemption of shares in the relevant fund. It may conduct this function itself i.e. from its own business premises using its own internal team, IT facilities etc. and certainly some firms do so. Alternatively, it may appoint a third party known as a transfer agent to discharge this function. This would constitute an outsourcing as the manager has a regulatory obligation to discharge the function itself, even though it may choose not to do so in practice for commercial, risk management or other reasons.

In terms of the scope of this paper, however, there are two further points to note:

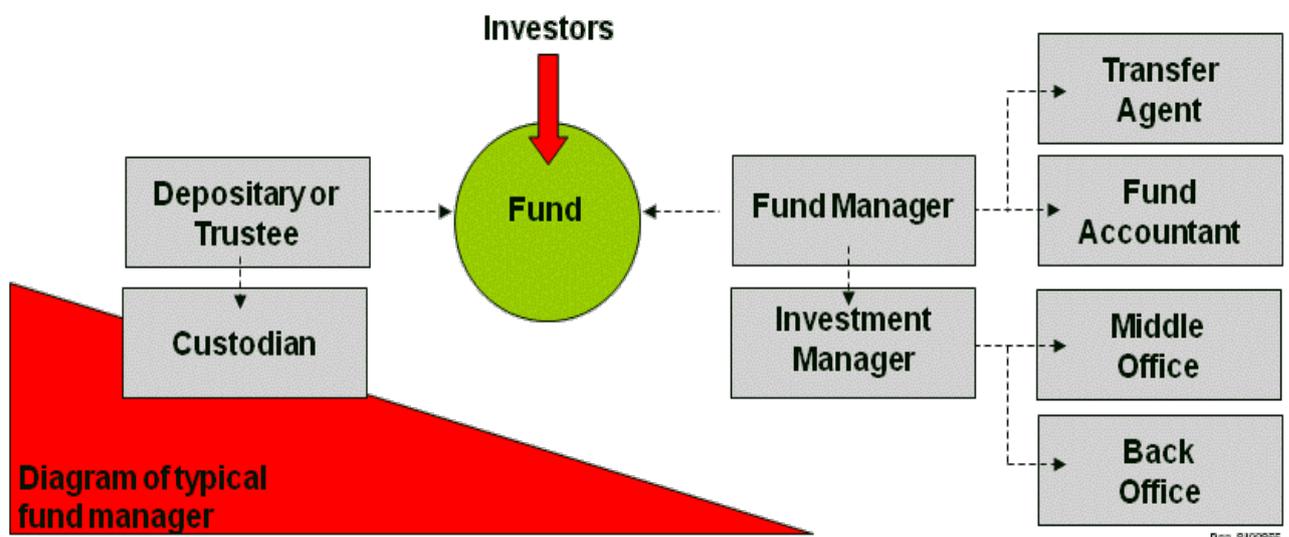
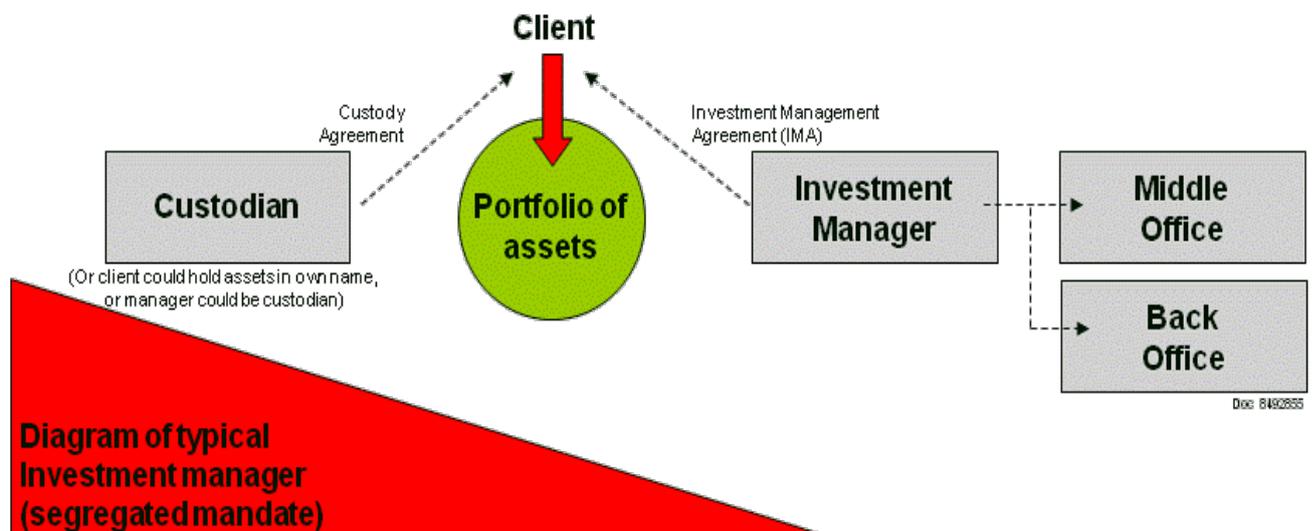
- Strictly speaking, an outsourced arrangement requires an asset manager to consider what is done on an entity by entity, or firm by firm basis. It therefore covers any intragroup outsourcing – i.e. circumstances where a firm appoints

another firm in its group to discharge a particular function on its behalf. However, to ensure that we focused on the most important issues that arise in practice, in this paper, we have only dealt with genuine third party outsourced arrangements – i.e. where a firm outsources to an entity outside its group.

- In this paper, we have only dealt with outsourcing of operational functions that can sensibly be regarded as critical or important, within the meaning of the FCA's rules on outsourcings, consistent with the focus of the FCA's Dear CEO letter. As described in the Next Steps section of this paper, further work will be carried out to determine the definitions of critical.

Information about the asset management sector and its approach to outsourcing

The following diagrams provide a high level summary of how asset management firms can often structure their relationships, taking as examples a typical investment manager providing portfolio management on a segregated mandate basis of a typical sort of institutional client, and a typical fund manager. These show some of the key outsourcing relationships that asset managers can have. It is important to note, however, that there is considerable variation in the industry and a number of other equally valid business models and structures exist.



Client relationships

One of the drivers underlying the FCA's concerns around outsourcings is a concern around continuity of service by FCA authorised firms to their clients, and a desire to ensure they do not suffer detriment. It may therefore be useful to confirm who a typical asset manager's clients are, in the context of the diagrams and scenarios referred to above:

- Where an asset manager is responsible for managing a particular portfolio of investments, the owner of the investments is of course generally the client.¹
- With a fund manager, the position may be more complex. For example, in the second diagram above, assuming the fund is an FCA regulated retail fund the fund manager will have two client relationships (in general terms):
 - As the operator of a fund, the fund itself is obviously a client of a fund manager. The fund manager has various regulatory obligations and responsibilities to the fund, including those arising under the FCA's Collective Investment Schemes Sourcebook and Conduct of Business Rules.
 - Fund managers are also in a client relationship with direct investors in the fund, as they conduct the FCA regulated business of arranging deals in relation to those clients when accepting orders from them to subscribe for or redeem shares. Where a fund manager provides an ISA wrapper for retail investors in a fund, the fund manager will also have an on-going relationship with relevant clients, providing dealing services (when they wish to subscribe for or redeem shares) and custody services (the safeguarding and administration of shares in the fund manager's fund).

Typical types of service providers that can be used by asset managers

As shown in the diagrams above, asset managers can have various types of outsourcing relationships. Some of the key possible relationships identified in discussions with the IMA working group on this project include the following:²

For a fund manager

**Transfer agent
or TA**



This type of service provider will tend to conduct a number of key regulatory and operational functions in relation to the relevant fund and its investors, on behalf of the fund manager, including:

- dealing – i.e. receiving orders for the subscription and redemption of shares in the fund by investors/potential investors, receiving subscription proceeds and paying out redemption proceeds, issuing contract notes to investors
- maintaining the fund's register of shareholders
- shareholder servicing
- intermediary servicing – e.g. calculation and payment of any relevant commission or rebates

¹ In some cases, however, a third party may engage the asset manager on the underlying client's behalf and may be treated as the asset manager's client under the agent as client rule in the FCA's Conduct of Business Rules.

² This summary is provided in very high level terms and does not cover all possible business models and possible outsourcing arrangements, as there is considerable variation in the industry.

- paying out fund distributions to investors
- box management and fulfilment
- call centre function
- in specie transfers

Fund accountant



This type of service provider is generally used in relation to a fund where the fund manager has an obligation to calculate the fund's net asset value at certain intervals. This is the basis on which the fund manager calculates the price at which investors can subscribe for or redeem shares in the fund from time to time

It will also:

- publish the fund's price
- maintain the legal books and records of the fund
- publish interim and final accounts for the fund

Investment manager



One of the key functions of a typical fund manager is, of course, to manage the assets of the relevant fund. At its most basic level, this means making the day to day decisions as to what the fund's portfolio of assets should comprise, including decisions as to what to buy and sell

A fund manager may choose to discharge this function itself, or may delegate or outsource it to another firm. For larger groups, this may be another company in the fund manager's group. Alternatively, it may be a third party

Where the fund manager does not delegate or outsource this function, it will by necessity conduct investment management itself and will therefore tend to have direct relationships with the sorts of service providers mentioned below as relevant to investment management

For an investment manager³

Middle office



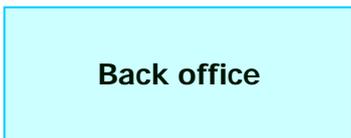
An investment manager may wish to conduct its own middle office function, or may outsource this to another entity (whether alone or together with back office functions)

A service provider of middle office functions may take responsibility for the following, although the suite of relevant services and the way they are described internally can vary considerably in practice:

³ Where a fund manager that does not outsource investment management to another firm, it will often have a direct relationship with service providers.

- trade processing – i.e. trade matching/confirmation with the broker, and provision of trade instructions to the custodian
- portfolio accounting – i.e. maintenance of investment books and records⁴
- pricing and valuation⁵
- corporate actions and proxy voting*
- derivatives servicing*
- collateral management*
- data management – e.g. setting up static data such as approved brokers, client data such as the relevant base currency, details of the relevant custodian, restrictions on the client's account, etc.
- client reporting – e.g. performance measurement, risk analytics, investment reporting (i.e. admin packs) and value add reporting (e.g. graphics, colour charts, lists of top 10 holdings etc.)

* Or these can be done by the back office



Similarly, an investment manager may wish to conduct its own back office functions, or may outsource this to another entity (whether alone or together with middle office functions)

A service provider of back office functions may take responsibility for the following, although the suite of relevant services and the way they are described internally can vary considerably in practice:

- settlement management (including investigating failed trades)⁶
- reconciliations
- corporate actions and proxy voting*
- corporate actions and proxy voting*
- derivatives servicing*
- income and tax reclaim collection

* Or these can be done by the middle office

Common drivers for outsourcing in the asset management industry

Based on discussions with the IMA member firms that joined the working group on this project, the key drivers for the types of outsourcings in the asset management industry mentioned above can often include the following:⁷

⁴ Note that the portfolio managers in the front office will have their own position tracking systems and technology, separate to this.

⁵ For an investment manager of a segregated mandate, this is used in client reporting, but where the underlying client is a fund, it is used more for internal purposes.

⁶ Actual settlement is done by the custodian, who has or (after the relevant transaction) will have legal title to the relevant assets, as well as any cash required to make payments, and therefore engages directly with the relevant counterparty to effect settlement.

Scalability



A fundamental concern is often scalability – an asset manager wishes to ensure it has the ability to discharge key regulatory and operational functions as its business grows, and will often select a service provider that is considered to have a platform that can handle a growing amount of work in a capable manner

Risk management



A fundamental concern is risk management – a service provider may be viewed as having the critical mass to hire and retain staff with the appropriate expertise, and to develop and deploy IT and other systems and processes, that ensure an optimum level of service is provided to the fund manager's underlying clients, as well as an optimum level of risk management

Investment in IT and infrastructure



Another fundamental concern relates to the pace of commercial and regulatory change in the industry, and, beyond this, the resources required to be expended in maintaining and conducting any necessary development work in relation to a firm's IT systems and other infrastructure

A service provider may again be viewed as having a sufficient critical mass so as to sustain this sort of spend, whereas this may be more difficult for a stand-alone asset manager

Other drivers



Beyond the fundamental drivers set out above, other common drivers can include the following:

- Cost management: This has two strands. A service provider may be able to manage a function at a lower overall cost than the asset manager. More importantly, a service provider can spread across its entire client base the cost of making any necessary changes to accommodate regulatory reforms (e.g. the Retail Distribution Review) etc.), commercial developments (e.g. the increased use of derivatives), or generic system development, upgrades etc.
- Key-man risk – A firm may use a service provider to help them to manage this type of risk
- Core competencies – A firm may wish to outsource certain functions to industry specialists to enable a greater focus by the firm's management on its core competencies and the areas in which it can add value to clients

⁷ See also the information summarised in Appendix 2 (Survey results on outsourcing activities) and Appendix 3 (Survey results on transfers).

Part A: Severe operational disruption within a service provider - key risks and issues

The Dear CEO Letter raised concerns about a severe operational disruption to the activities of a key service provider. In particular, the regulator stated as follows:

“Our concern is that if an outsource provider were to face ... severe operational disruption, UK asset managers would not be able to perform critical and important regulated activities, thereby causing detriment to customers.

Based on our findings so far we are not confident that across the industry, effective recovery and resolution plans are in place for the asset management sector as a whole. ...”

This area has been the focus of a great deal of debate and analysis in the industry for some time, but it may be useful to provide a high level summary of some of the key risks and issues that arise for asset managers on this front.

Loss of capacity to conduct essential activities for clients



The asset manager may be unable to conduct certain essential functions. For example:

- an asset manager's middle office service provider suffers a severe operational disruption and is therefore unable to process a decision by the asset manager to sell a particular asset on behalf of a client (e.g. shares in a particular company) where the market is falling rapidly, or to process a corporate action before a relevant deadline
- a fund manager's fund accountant suffers a severe operational disruption and is therefore unable to calculate a relevant fund's net asset value on a regular basis as per the fund manager's regulatory and contractual obligations

Delay in service being restored

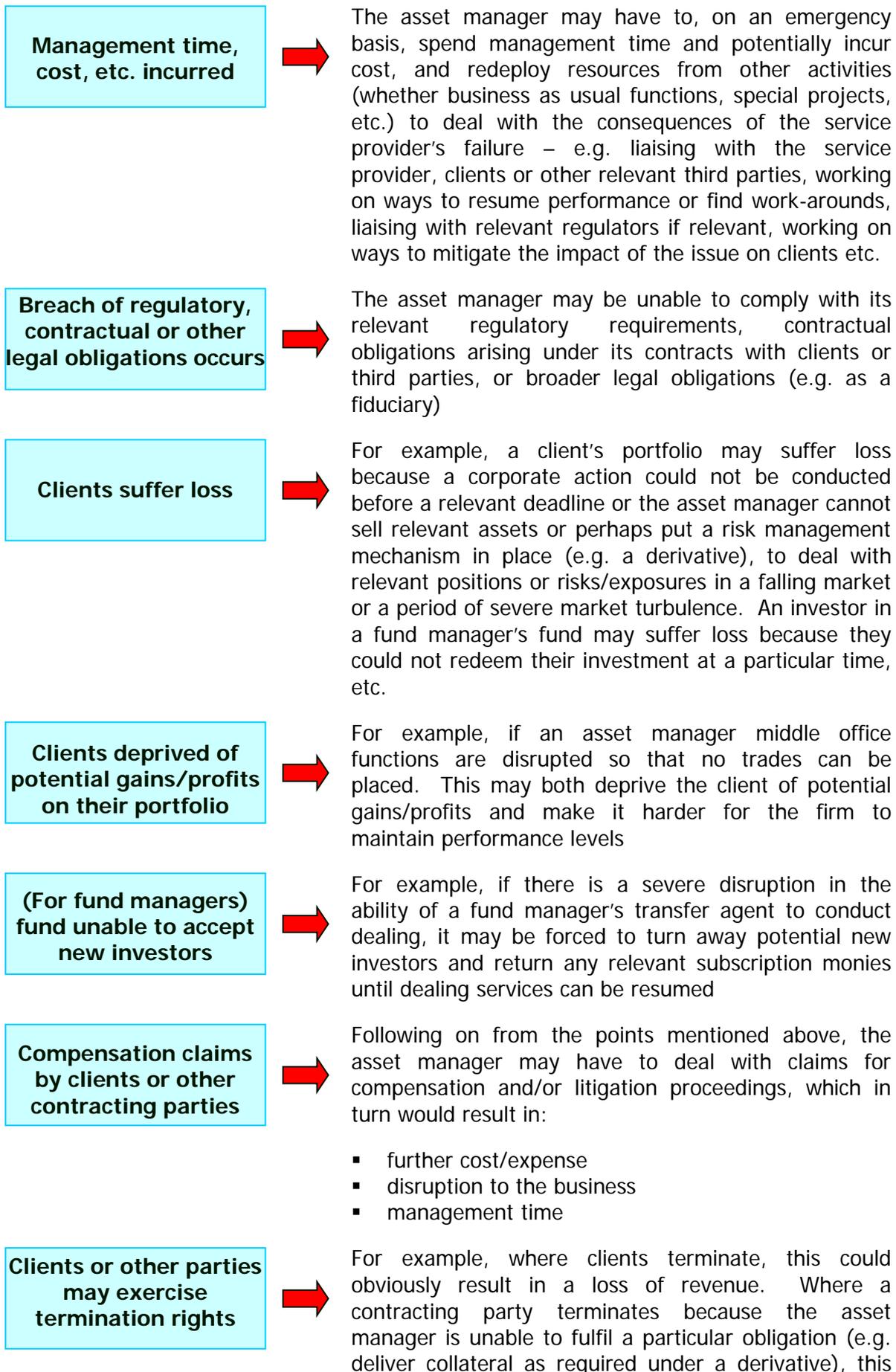


Following on from the previous point, it may take some time for the service provider to resume performance, for alternative means to be found by which key functions can be conducted, or for relevant issues to be mitigated

Possible suspended fund and (in extreme scenario) wind up



Where service could not be restored (at all or within an acceptable period of time), the fund may have to be suspended. In an extreme scenario, the fund may also have to be wound up and the relevant monies returned to investors



could cause loss to the asset manager's underlying client and therefore trigger a compensation claim

Enforcement action or supervisory attention from regulators



Following on from the points mentioned above:

- a regulator may commence enforcement action against the firm leading to fines, censure etc.
- a regulator may apply additional supervisory mechanisms
- a regulator may commission a skilled person report under the Financial Services and Markets Act

Each of these would in turn involve:

- further cost/expense
- disruption to the business
- management time

Reputational damage suffered



This follows on from a number of the risks/issues mentioned above

Any claim on its insurance may drive premiums up



The asset manager could have relevant insurance arrangements in place to cover some or all of the costs or losses mentioned above. But any claim on this may result in the asset manager suffering higher premiums in subsequent years

Potential strain on financial position



The need to throw cash at the relevant problem or pay compensation may place a strain on the asset manager's financial position

Deters new clients and/or disrupts business development



It may harm the asset manager's prospects in any RfPs or tenders that it may be participating in at the relevant time or wish to submit. It may also disrupt usual marketing or business development activity

Part B: Financial distress suffered by a service provider - key risks and issues

The Dear CEO Letter raised concerns about a key service provider experiencing financial distress. In particular, the regulator stated as follows:

“Our concern is that if an outsource provider were to face financial distress ... UK asset managers would not be able to perform critical and important regulated activities, thereby causing detriment to customers.

Based on our findings so far we are not confident that across the industry, effective recovery and resolution plans are in place for the asset management sector as a whole. ...”

In terms of the key risks and issues that arise for asset managers on this front, many of the points identified in Part A above apply equally in this scenario, where the service provider’s financial distress is sufficiently serious as to endanger the service provider’s ability to continue to operate.

For example, the loss of capacity to conduct certain essential activities for clients if an insolvency practitioner is appointed that shuts down all business activities within the service provider and commences an immediate winding up (i.e. disclaiming leases on relevant business premises, preventing staff from entering the building, turning off the electricity etc., so no further costs/liabilities are incurred).

However, the following additional risks and issues may also arise.

Liquidator may wish to continue business for very short period



If an insolvency practitioner has been appointed, they may agree to continue the service provider’s business but only for a relatively short period of time before ceasing all activity in advance of a winding up

More difficult issues if service provider has a more complex operating model



It may be more difficult for an asset management client of a service provider to solve practical problems arising from the service provider’s actual insolvency, and/or to find ideas to mitigate issues arising from the risk of insolvency, if the service provider has a complex operating model. For example:

- If the service provider is a large company with a variety of business lines and activities, with its services to asset managers being only a small part, in the event of the service provider’s insolvency, there may be bigger issues for its insolvency practitioner or management to solve on an emergency basis, compared to the position of its UK based asset management clients
- If the service provider is domiciled outside the UK (or in certain other scenarios), it may be subject to

the insolvency laws of a jurisdiction other than the UK

- A service provider which is a member of a broader group, may have intertwined or centralised systems, IT centres, call centres etc. within its group. Its asset management clients may therefore be dependent on the other parts of its group continuing to be up and running

Concentration risk may make it hard to find alternative providers



It may not be easy for an asset manager to find an alternative service provider for a particular type of service where there is significant concentration in the industry

Service provider may not be able to fund transfer activities



It may not be possible for the service provider to solve any issues that arise in trying to conduct an expeditious transfer off of its clients to alternative service providers, by attempting to throw money at the problem – e.g. by hiring external resource. It may also struggle to fund any transfer projects per se

May not be possible to conduct a transfer & BAU at the same time



If an insolvency practitioner has been appointed, they may agree to conduct any necessary transfer off work but may not be prepared to – or may not feel there is adequate resource to – conduct business as usual activities at the same time

Transfer harder if legacy IT or systems highly bespoke



This may make the transfer process more complex, lengthy or protracted, and/or make an alternative service provider harder to find

Financial distress may lead to key staff being demotivated or leaving



Key staff within the service provider, concerned about job security, may be de-motivated or may find other employment, which may lead to an erosion of service levels and/or a difficulty in achieving transfers per se

Part C: Ideas

This section considers ideas that may be used by an asset manager to attempt to address the concerns set out in the Dear CEO Letter.

Preliminary comments

- There is considerable variation in the industry in terms of business models, the scale and nature of any individual firm's activity, and the use and nature of service providers. In terms of the issues identified by the FCA, there will therefore not be a "one size fits all" approach, and the ideas set out below should be viewed only as a starting point for discussion.
- A number of the ideas mentioned below dealing with the risk that a service provider may suffer financial distress:
 - are intended to operate as a suite, with some being relevant or viable only if implemented in conjunction with others; and
 - may only be viable in practice if they result in the development of relevant industry standards or protocols - in particular, to address the situation of a smaller asset manager with little bargaining power in negotiations.
- In terms of timing for potential implementation or delivery, the ideas mentioned below tend to fall within three categories, by their very nature:
 - **short to medium term** – those that could possibly be actioned by asset managers and their service providers in a short to medium term time frame;
 - **medium term** – those that constitute broader industry initiatives, or require extensive work and analysis within service providers (working in conjunction with their asset manager clients); and
 - **longer term** – those that can realistically only be implemented in a longer term time frame, such as ideas around the next generation of IT development within asset managers and their service providers.
- As a final point relevant to timing, it is also important to recognise that in some cases, an asset manager that appoints a new service provider will not bear the service provider's costs for conducting the transfer in process, but these costs may be considerable. As a result, the service provider may have negotiated a minimum initial period for the term of its agreement with the asset manager, the commercial intention being to enable it to recover its set up costs. During this period, the asset manager may have limited freedom to require or mandate the implementation of some of the sorts of ideas set out below. It may therefore have to wait until the end of this initial period to negotiate their inclusion in the parties' commercial deal.

Specific ideas

Idea 1	Asset manager has strong internal knowledge base with regards to its outsourcing arrangements
Idea 2	Robust business continuity arrangements are in place at service providers
Idea 3	A robust internal approach exists within the asset management firm for business continuity planning
Idea 4	There is regular testing and follow up to rectify any issues identified
Idea 5	Service providers to have a strong user group discipline in place, to provide active oversight on issues set out in this white paper
Idea 6	Service providers to have robust exit planning in place
Idea 7	Asset manager to have robust exit planning in place
Idea 8	Industry working towards improving portability and increased industry standardisation
Idea 9	Encourage the Insolvency Practitioner to keep the lights on
Idea 10	Consider the extent to which a service provider has a robust and viable approach to emergency exit planning
Idea 11	Standard industry approach for capital requirements and financial health checks at service providers

Idea 1



Strong internal knowledge base with regards to outsourcing arrangements

- What, how and who - An asset manager's ability to understand and manage risks and emergencies within its service provider(s) will obviously be greater if it has:
 - a strong understanding of **what** the service provider does in practice for the asset manager and how that fits together with its own processes/procedures;
 - a strong understanding of **how** the service provider conducts its functions in practice (i.e. what IT systems it uses, how they work, what processes/procedures are in place, how they work etc.);
 - a strong understanding of **who** does what within the service provider as relevant to the services it provides the asset manager; and
 - beyond this, strong relationships with key relevant individuals within the service provider's organisation.
- Internal bench strength:
 - Similarly, an asset manager's ability to understand and manage risks and emergencies within its service provider will obviously be enhanced if it has suitability experienced and skilled staff of its own, with a lead role taken by someone with a sufficient level of seniority within the business.
 - Those personnel within the asset management firm responsible for putting in place the manager's outsourcing arrangements, monitoring key service providers, and owning the

asset manager's own business continuity planning, could similarly be robust and experienced.

- The team would ideally have sufficient resource and support (e.g. headcount, IT, access to/resource from other relevant departments where required etc.).

Idea 2



Require robust business continuity arrangements within all service providers

- An asset manager will often contractually require all of its service providers to have a business continuity plan (BCP).
- This could be required to comply with industry recognised principles and practices, and could also specifically refer to applicable UK or international standards (e.g. those published by the British Standards Institute and/or the International Organization for Standardization).
- The service provider's plan could be required to be comprehensive and robust, to comply with any applicable FCA or other regulatory requirements applicable to the asset manager, and to also cover certain agreed subjects.
- Internal ownership – The asset manager may contractually require ownership of the plan and related processes/procedures to reside with a sufficiently senior individual within the service provider's firm.
- Communications plan – The plan could include a communications strategy, with a cascade approach to communications and updates, so that the service provider's asset management clients can attempt to be proactive with its clients, key stakeholders and (where relevant) the media, with appropriate internal communications and reporting to regulators.

Idea 3



Robust internal approach to planning and risk management on business continuity

An asset manager could separately maintain its own business continuity plan or BCP:

- This would reflect/coordinate with its service providers' individual plans, but contain a plan of action, mitigation strategies etc. from the asset manager's own perspective.
- This could be required to be comprehensive and robust, comply with any applicable FCA or other regulatory requirements, and be consistent with good industry practice.
- It could be regularly assessed and updated. Reassessment and updates could also be required where the asset manager commences any new business activities or makes material changes to existing activities.
- Internal ownership – Responsibility for the plan could reside with a suitably senior person within the firm, with clarification as to the role of other key functions (e.g. IT, ops, compliance etc.).
- Governance – Processes and procedures could be in place and documented to ensure appropriate governance – e.g. oversight by the asset manager's board or senior management team, escalation of relevant issues, etc.
- Training – The key people within the asset manager (i.e. those who would be involved in deploying its business continuity plan where a relevant emergency occurs within the service provider) would ideally be trained on a regular basis.
- Communications plan – The asset manager could have a communications strategy in place for dealing with relevant emergencies, so that the asset manager can attempt to be proactive with clients, key stakeholders and (where relevant) the media, with appropriate internal communications and reporting to regulators.

- The asset manager could have a robust approach in place, more generally, to monitor the service provider's conduct on BCP issues.
- It could ensure it incorporates these issues in its compliance monitoring, risk management and internal audit programmes, using a joined-up approach.
- ICAAP and regulatory capital - Similarly, the points mentioned above could be picked up in the asset manager's ICAAP analysis and regulatory capital calculations.

Idea 4



Regular testing, with follow up and rectification of any issues identified

- An asset manager could require all of its service providers to:
 - periodically test the measures set out in their business continuity plans (with one full exercise at least annually);
 - report back to the asset manager in agreed terms; and
 - deal with any issues identified in its testing in an agreed way (e.g. gaps or areas of deficiency identified).
- The service provider could put processes and procedures in place to ensure it follows up on these issues with appropriate monitoring to ensure they are adequately resolved.
- Separate to this, the asset manager could test its own BCP arrangements (at least annually), to ensure they are fit for purpose and understood within the business.

Idea 5



Require service providers to have strong user group discipline in place

This is the basis for a number of other ideas below, and may be explained as follows:

- An asset manager could have an internal policy that, except in exceptional circumstances,⁸ it will use service providers that have a user group in place within their client base. This could be a key element of any RfP, tender or due diligence process conducted for the purpose of any new outsourcing or outsourcing renewal.
- An asset manager could have internal policies and procedures as to:
 - what such user groups should cover;
 - how they should work;
 - how they should interact with the relevant service provider; and
 - the asset manager's own participation and contribution.

The goal is to ensure a user group forum works effectively, has an appropriate scope and operating model, and is properly resourced.

- An asset manager could incorporate its approach to user groups in its compliance monitoring, risk management and internal audit programmes. There could also be an agreed reporting and governance structure in place to ensure there is discipline around the asset manager's use of and contribution to the user group forum, and an agreed approach to remedying any issues or deficiencies that arise.
- An asset manager could include various requirements as to the user group forum in its agreement with a service provider, so that they "have teeth" from the asset manager's perspective.
- The points mentioned above could be developed into an industry standard protocol for asset managers. This would promote a shared understanding of the commitment required by all

⁸ For example, if a new entrant to the service provider market is commencing its new business with a single cornerstone client.

clients of individual service providers to make a user group forum a robust and effective control mechanism for the benefit of all relevant firms. An asset manager could also require compliance with this protocol in its agreement with the service provider.

Idea 6



Require robust exit planning within all service providers

This is analogous to robust business continuity plans being required to be in place within all service providers:

- An asset manager could require its service providers to have a robust and viable exit planning approach in place, and could have an internal process to regularly check that this has been done and that it reasonable believes the approach adequate – i.e. **using a trust but verify approach**.
- This could involve a service providing having an exit plan in place to deal with each of the following three scenarios:

Standard Single Exit



A standard transfer or exit scenario for a single client – e.g. a party terminates for convenience. The plan could cover subjects including the following:

- a detailed approach for dealing with any data transfer or other IT related issues
- an agreed approach to cost, resource, periodic reporting etc.

Standard Multiple Exit



A standard transfer or exit scenario where two or three clients wish to transfer out at the same time. This would otherwise cover the same sorts of subjects mentioned above.

Emergency Multiple Exit



A plan by which the service provider could conduct an unplanned or emergency exit of all of its clients to alternative service providers.

This would effectively constitute a sort of **living will or resolution plan** for the part of the service provider's business that services the UK asset management sector (and in fact, some service providers may already have such measures in place as part of their **Recovery and Resolution Plans (RRPs)**).⁹

In particular, this should be based on the scenario that:

- the service provider is in severe financial distress at the relevant time; and
- the entire business cannot be the subject of a trade

⁹ It should be recognised that, for some service providers, this may not constitute the entirety of their business, and that a service provider may have clients in other jurisdictions or be domiciled outside the UK.

sale or management buy-out – e.g. the debt markets may be depressed, or potential buyers may not be in a position to conduct a rescue type corporate acquisition because they or the group of which they are a part are also financially stretched or are distracted by other financial issues within the group.

In addition:

- The emphasis of the plan should be on **achieving the transfer or exit of clients as quickly as possible**. This is fundamental as it should **not** be assumed that an insolvency officeholder appointed over the service provider will be **in a position to cause the provider to trade for a protracted period**.
 - It should be drafted with the specialist input of an insolvency expert, to ensure it reflects relevant insolvency law issues and requirements, as well as the practical considerations concerning administrators and how they operate.
-
- The exit plans could be required to be updated and reconfirmed annually with an agreed certification procedure.

Timing

- It may obviously take time for a service provider to do the necessary analysis and planning to develop these plans:
 - The asset manager could therefore commercially agree a specified period within which the service provider will build up its competency and internal know how and resource on this front.
 - A staggered approach could be used – e.g. the Standard Single Exit Plan could be required to be developed first by an agreed deadline, then the Standard Multiple Exit Plan, with the development of the overall Emergency Multiple Exit Plan to follow.
- This is the first driver for suggesting service providers develop three types of plans, dealing with scenarios that have an escalating level of gravity. The second driver is to enable the industry to gradually develop more know-how and practical tools to deal with transfer or exit scenarios involving an escalating level of difficulty.

Monitoring and periodic testing and assessment

- The asset manager's user group¹⁰ with the service provider could monitor the development of the three exit plans over time, to ensure they are delivered within the agreed time scales and have the required content.
- The asset manager's user group could engage an auditor or third party consultant to periodically assess any exit plan (once it is developed/launched), using a deep-dive approach as follows:
 - This would provide periodic comfort for both the asset managers and their regulator(s) that the plan is robust and viable and caters for all material points.

¹⁰ This is obviously only relevant where it is possible for a service provider to put a user group in place – e.g. where it has more than one client.

- It could be done in accordance with an agreed approach and protocol, documented in individual asset manager's contracts with the service provider.
- The use of a third party auditor or consultant would help address confidentiality concerns that the service provider may have as regards detailed financial information or planning.
- It should be a more efficient approach for the service provider, rather than having to deal with individual audit and information requests.
- It may support or help build relevant expertise within audit or consulting firms, in the nature of that which has developed over time as regards business continuity planning.

Other points

- An asset manager could include various requirements on the above matters in its agreement with a service provider, so that they have teeth from the asset manager's perspective.
- Beyond this, the points mentioned above could be develop into an industry standard protocol for asset managers, with individual asset managers requiring compliance with this protocol in their agreements with service providers.

Idea 7



Robust internal approach to planning and risk management on emergency exit planning

This is analogous to a robust internal approach being in place to deal with business continuity issues:

- An asset manager could have an emergency exit plan, dealing with a scenario where a service provider is so financially distressed that it is necessary to conduct an emergency transfer or lift out from that provider to an alternative:
- This would reflect/coordinate with the relevant service providers' individual plans, but contain a plan of action, mitigation strategies etc. from the asset manager's own perspective.
- This could be required to be comprehensive and robust, comply with any applicable regulatory requirements, and be consistent with good industry practice.
- The plan could in particular include **the asset manager's approach to "triage"** - i.e. a detailed and thorough analysis of:
 - what functions the service provider performs;
 - how these should or could be prioritised in the sort of scenario mentioned above to mitigate the risk of severe customer detriment;
 - which (if any) could be taken back by the asset manager or otherwise covered on an emergency basis.
- The asset manager's planning could also consider what budget may be required to deal with relevant costs, both for itself, for the service provider in distress, and for any service provider to whom an emergency transfer or lift out would be conducted.

Other key points to address in Emergency Exit Plan

- Beyond the points mentioned above, the plan may cover subjects such as the following:
- Overall responsibility for the emergency exit plan.
- The core project team that would be pulled together if the plan was activated (i.e. representatives from key internal functions such as IT, ops, compliance etc.).
- What governance process would be put in place – e.g. escalation of issues, reporting, sign offs required, oversight, etc.
- What emergency project management and other key resources would be deployed.
- What steps would be taken on an emergency basis to identify and decide on an alternative service provider.

- A communications strategy, so that the asset manager can attempt to be proactive with clients, key stakeholders and (where relevant) the media, with appropriate internal communications and reporting to regulators.
- A high level assessment of the commercial and key legal terms that could be requested from relevant alternative service providers, recognising that the asset manager would have limited leverage in an emergency scenario.

Alternative service providers

- The asset manager could conduct periodic assessments of alternative service providers, including the following:
 - It could ensure that it maintains relationships with potential alternative service providers.
 - It could attempt to ensure it has contracts in place with a range of service providers at any given time (even if some are for relatively minor functions). The idea would be to always have a variety of warm relationships with key firms, with experience of their business and functional regular contact. This is suggested because a to a service provider with whom there is an existing warm relationship is generally considered easier in practice than a transfer or lift out to an entirely new relationship.
- It could periodically collect detailed information on potential alternative service providers and conduct high level due diligence, ensuring it knows what they could/could not do on an emergency basis and what their appetite and capacity is for both taking on new clients and conducting transfers or lift outs.

Other points

- Responsibility for the plan could reside with a suitably senior person within the firm, with clarification as to the role of other key functions.
- The plan could be regularly assessed and updated. Reassessment and updates could also be required where the asset manager commences any new business activities or makes material changes to existing activities.
- The asset manager could periodically test the measures set out in its plan (with one full exercise at least annually), and have a process in place for dealing with any issues (e.g. gaps or areas of deficiency identified) and ensuring they are appropriately resolved.
- The key people within the asset manager that would be involved in deploying the plan could be trained on a regular basis.
- The asset manager could incorporate its approach to emergency exit planning in its compliance monitoring, risk management and internal audit programmes. There could also be an agreed reporting and governance structure in place to ensure there is discipline around the planning process, and an agreed approach to remedying any issues or deficiencies that arise.
- Similarly, the points mentioned above could be picked up in the asset manager's ICAAP analysis and regulatory capital calculations.

Idea 8**Work towards improving portability – i.e. improved efficiency/reduced time, cost and risk in transfers**

There are two key strands to this idea:

(1) Industry initiative on improved portability

- Asset managers could conduct an industry initiative to improve the efficiency and reduce the time, cost and risk involved in conducting a service provider to service provider transfer or lift out, with the overall goal of working towards improved portability of service arrangements.
- Within the short term, this industry project may identify some quick wins as to what may be done to improve matters – e.g. by exploring some of the problems that can arise in practice in transfers and what initiatives could be suggested to address these.
- Standardisation etc. - In the longer term, it may identify broader industry initiatives and proposals – for example:
 - Recommendations as to how common service functions can be done on a more standardised basis, so that they can more easily be transferred.
 - Ideas around standardised electronic messaging.
 - Longer term recommendations, such as how asset managers (in partnership with software vendors) could attempt to ensure the next generation of IT development in the asset management or service industry could assist in resolving issues or improving portability – e.g. by ensuring new IT systems are more easily able to talk to or accept data from old ones.
- Another possible long term initiative that could be explored is the idea of the industry developing a data utility:
 - Each asset manager and service provider could use an agreed data storage provider to keep its back-ups for business continuity purposes.
- If each individual service provider in the industry developed its internal systems and infrastructure so that it could receive data from, and transfer data to, the central storage utility, this central hub could be used to improve the ability of service providers to transfer data to one another in the transfer of a function to another provider.

(2) Bilateral or multilateral transfer agreements between providers

- An asset manager could have an internal policy preference for using service providers that have bilateral agreements in place with each other relevant service provider in the industry (e.g. middle office service provider to middle office service provider, fund accountant to fund accountant etc.), as to how transfers will be conducted in practice.
- Such an agreement would include detailed transfer protocols, a detailed approach for dealing with data transfer and other IT related issues, full costings, and periodic testing (perhaps annually) on an agreed basis.
- It may be prudent for these agreements to include provisions on each service provider's Emergency Multiple Exit Plans, so that both sides of the equation are captured – i.e. the service provider in financial distress that has activated its plan, and the service provider or providers who will do a transfer in or lift out in respect of the service provider's ex-clients on an emergency basis.

Monitoring and periodic testing and assessment

- The agreements could be updated and reconfirmed annually with an agreed certification procedure.

- The asset manager's user group¹¹ with a particular service provider could engage an auditor or third party consultant to periodically assess the service provider's bilateral agreements (once they are developed/launched), using a deep-dive approach:
- This could provide periodic comfort for both the asset managers and their regulator(s) that agreements are robust and viable, and cater for all material points.
- It could be done in accordance with an agreed approach and protocol, documented in individual asset manager's contracts with the service provider.
- It should be a more efficient approach for the service provider, rather than having to deal with individual audit and information requests.
- Importantly, it should also help facilitate the development of expertise within relevant audit or consulting firms, in the nature of that which has developed over time as regards business continuity planning.

Timing

- It may obviously take time for service providers to do the necessary analysis and planning to develop such an approach, and to negotiate and put relevant agreements in place:
 - The asset manager could therefore commercially agree a specified period within which the service provider will build up its competency and internal know how and resource on this front.
 - A staggered approach could also be used – e.g. the first agreement within an agreed deadline, the second agreement within a further period etc.
- The asset manager's user group with the service provider could monitor the development of the relevant agreements over time, to ensure they are delivered within the agreed time scales and have the required content.

Other points

- An asset manager could include various requirements on the above matters in its agreement with a service provider, so that they have teeth from the asset manager's perspective.
- Beyond this, the points mentioned above could be develop into an industry standard protocol for asset managers, with individual asset managers requiring compliance with this protocol in their agreements with service providers.
- The bilateral approach could ultimately evolve into a multilateral approach across all relevant service providers for a particular function (e.g. all fund accountants). This may make the process more transparent, and achieve efficiencies in terms of maintenance, assessment and testing for the benefit of service providers, asset managers and regulators.

¹¹ This is obviously only relevant where it is possible for a service provider to put a user group in place – e.g. where it has more than one client.

Idea 9



User group forum used to mitigate risk of insolvency practitioner shutting down service provider business

- Even if a service provider has a robust Emergency Multiple Exit Plan in place, a problem may arise if that plan cannot be fully implemented before the commencement of insolvency proceedings in relation to the service provider.
- It cannot simply be assumed that an insolvency officeholder appointed over the service provider would put the Emergency Multiple Exit Plan into effect (or complete a process already started prior to their appointment). The action taken by an officeholder in such circumstances will depend on numerous factors, including the funding available to the insolvent estate of the provider, the position of creditors, the possible termination of contracts to which the service provider was a party and, most importantly, the officeholder's view of those actions which will benefit the service provider's creditors as a whole.

Ideas for keeping the lights on

- It may be possible for a user group forum to be used to mitigate these risks – e.g. to fund the service provider's continued trading during the implementation of the plan, to agree how the user group might collectively conduct a form of lift out or acquisition etc.
- These ideas could be considered further through an industry project, conducted with the support of insolvency specialists (to verify that any relevant ideas are as workable as possible and identify and help address any possible practical issues that may arise).

Ideas only viable as a suite

- It is critical to recognise that any insolvency practitioner appointed in the type of scenario mentioned above may be unwilling – or even unable - to carry on a particular firm's business for a long and/or indefinite period.
- Accordingly, it may be that any idea along the lines mentioned above is only workable and viable in practice if implemented in tandem with some of the other ideas we have proposed, for example:
 - an asset manager having a strong internal knowledge base to deal with emergencies, and its own robust emergency exit planning;
 - the service provider having a robust and viable Emergency Multiple Exit Plan in place that is regularly tested/assessed by its user group;
 - bilateral or possibly multilateral agreements being in place that cover (among other things) emergency exits for both sides of the equation – i.e. the service provider in financial distress that has activated its Emergency Multiple Exit Plan, and the service provider or providers who will do a transfer in or lift out in respect of the service provider's ex-clients on an emergency basis; and
 - longer term work within the industry to try to resolve some of the issues in conducting transfers and improve portability.

Idea 10



Approach to emergency exit planning key factor in asset manager's choice of service provider

- A service provider's approach to emergency exit planning in the event it suffers severe financial distress, could be a key factor for an asset manager to consider when conducting any RFP, tender or due diligence process for a new outsourcing arrangement or renewal.
- In turn, however, this gives rise to a practical point, which is that the different operating models of different service providers give rise to different risks and levels of complexity:

Model 1



It may be more challenging to structure and develop a viable approach where:

- the service provider is a large company with a variety of business lines and activities, of which services to asset managers is only a small part; and/or
- the service provider has intertwined or centralised systems, IT centres, call centres etc. within its group, so that it is dependent on the other parts of its groups continuing to be up and running – this may be difficult to guarantee in a potential insolvency scenario where all or key parts of the group are in distress; and/or
- the service provider is not UK domiciled, such that the law of another country may govern its insolvency; and/or
- the service provider is part of a large international group, with a non-UK lead financial services regulator; and/or
- there is some other analogous element of complexity in the service provider's business or operating model.

Model 2 (UK Model)



It may be simpler to structure and develop a viable approach where the service provider:

- is a stand-alone UK entity with only one business line (e.g. servicing asset managers); and
- is self-sufficient in terms of IT, systems etc.

- For Model 1, the regulator could give the industry time to consider whether it is possible for service providers who have a more complex model to develop a viable and robust approach to emergency exit planning in the event of their severe financial distress.
 - This may be developed along the lines suggested above, with the use of a viable Emergency Multiple Exit Plan, etc.
 - Alternatively, a particular service provider may have other ideas it can use to provide comfort – certainly, there is no one size fits all approach. For example, for regulatory reasons, the service provider may have a **living will** supervised by a regulator. It is possible that this could deal with the provision of services to asset managers in a way acceptable to the FCA, with periodic assessment by the service provider's user group etc.

- A fall-back approach would involve a firm transitioning from first Model to a Ring-fenced (UK) Model:
 - Initially at least, this could involve a separate entity within the service provider's group being used to enter into service contracts with UK asset managers and deliver relevant services. This could be appropriately capitalised, with no cross guarantees, to limit contagion risk. (See also idea 11 below.)
 - It could have a degree of operational separation for key functions, with thought given and a cost/benefit analysis conducted to consider what else could be done to ensure it could achieve continuity of service for UK asset managers if the rest of its group failed. One idea that could be explored, for example, is whether in such an occurrence, it could take ownership of relevant BCP facilities and back up operating sites, switching to these to provide continued service on a stand-alone basis.
 - Finally, the asset manager could receive a performance and/or financial guarantee from a parent company in the group, or another large operating entity or other relevant entity in the group. This is proposed so that a move to the Ring-fenced Model would not result in the asset manager exchanging a benefit on one front (comfort on emergency planning for a financial distress scenario) for a downside on another (having a contract with a potentially less well capitalised entity, whose capital and liquidity levels are not subject to regulatory scrutiny).

There is no right or wrong, as different models may clearly have different benefits as well as risks, but some alternatives are as follows:

- Some service providers with a complex international operating model may have a living will or resolution plan that is supervised by a regulator. If this deals with the provision of services to asset managers in a way acceptable to its asset management clients and the FCA, with periodic assessment by the service provider's user group etc., this could prove sufficient.
- An alternative or fall back approach would involve a service provider setting up its business in such a way as to make it easier, from a legal and operational perspective, to find a way to keep the lights on if the rest of the service provider's group failed.
- One option here is to explore is the use of a ring-fenced model - i.e. a separate entity within the service provider's group being used to enter into service contracts with UK asset managers and deliver relevant services. This could be appropriately capitalised, with no cross guarantees, to limit contagion risk. It could also have a degree of operational separation for key functions, with thought given and a cost/benefit analysis conducted to consider what else could be done to ensure it could achieve continuity of service for UK asset managers if the rest of its group failed. To ensure this model does not result in increased credit risk for relevant asset management clients, the client could receive a performance and/or financial guarantee from a parent or large operating entity in the group.

[The key point within Ideas 9 and 10 is that asset managers need to have or develop legal and operational mechanisms to enable them to protect their underlying clients in the event of a service provider's financial failure, in view of the realities of an insolvency situation.]

Idea 11**Industry standard approach for capital requirements and financial health checks at service providers**

As a final point, the other ideas mentioned above have been directed at improving an asset manager's ability in practice to deal with a particular scenario, if it occurs. On the basis that prevention is better than cure, however, we would wish to suggest a further idea:

- An industry standard protocol could be developed in relation to service providers as to:
 - agreed levels of capital and liquidity, risk management processes, the conduct of an ICAAP etc. where a service provider and/or its relevant business activities are not regulated, as may be the case;¹²
 - agreed levels of recordkeeping to evidence compliance with the matters set out above; and
 - regular financial health checks within service providers.
- Individual asset managers could require compliance with this protocol in their relevant agreements so they have teeth from the asset manager's perspective.
- The asset manager's user group¹³ with the service provider could engage an auditor or third party consultant to conduct each health check at agreed intervals, using a deep-dive approach:
 - This could provide periodic comfort for both the asset managers and their regulator/s, and therefore act as another useful risk mitigation tool.
 - The use of a third party auditor or consultant would help address confidentiality concerns that the service provider may have, as regards detailed financial information.
 - It should be a more efficient approach for the service provider, rather than having to deal with individual audit and information requests.

Broader recommendations or ideas for regulatory change

Since the issue of the Dear CEO Letter, the FCA has welcomed a debate within the industry on relevant issues, holding a number of meetings with industry bodies, asset managers, service providers and others. It has also welcomed any broader comments or ideas that the industry may have as to regulatory changes or other initiatives that may be helpful in addressing the issues it identified. On this front, the following comments may be helpful.

- Although views differ on this point, some firms have suggested that the provision of certain key services to UK asset managers could be the subject of direct regulation by the UK's financial services regulators. At minimum, it may be useful to conduct an industry consultation on this issue – i.e. to consider the costs and benefits of such an approach, and if it was taken forward, how this might best be done. This could be done as a joint project between UK asset managers and relevant service providers, or alternatively, could be led by the FCA/PRA.
- Since the Dear CEO Letter was issued, the FSA has of course been separated into:
 - the FCA - responsible for conduct regulation, and the prudential regulation of most UK asset managers; and
 - the PRA - responsible for the prudential regulation of most UK authorised banks.

It is hoped the FCA and PRA can work together to ensure a joined up approach on relevant issues in this paper, including in particular, on the subject of recovery and resolution planning.

¹² For example, the service provider may be required to comply with certain relevant rules of the FCA as if they applied.

¹³ This is obviously only relevant where it is possible for a service provider to put a user group in place – e.g. where it has more than one client.

- Following on from this, certain service providers in the industry are of course banks or members of banking groups that are required to put in place Recovery and Resolution Plans (RRPs):
 - It is suggested that the UK regulatory regime expressly require a bank's recovery and resolution planning to cover certain key services provided to other UK financial services firms, including in particular, UK asset managers.
 - It is suggested that UK regulators and the industry should work together to agree how banks can disclose relevant aspects of their recovery and resolution planning, in particular, to clients who are regulated in their own right, providing comfort to both these clients and their respective regulators. As regards UK asset managers in particular, this is consistent with the regulatory and commercial drivers for them to adopt a trust but verify approach.
 - Where a particular service provider or its group has a lead regulator outside the UK, it is suggested that the FCA and PRA attempt to work with this lead regulator to cover the points mentioned above.

- A broader debate is currently being held in banking and political circles as to what banks should be allowed to do going forward and how.
 - For example, the Report of the Independent Commission on Banking headed by Sir John Vickers (the Vickers Report) has looked at potential solutions to the too big to fail issue within the UK banking industry, among other matters. One of the report's key recommendations was to create a ring-fence, separating retail utility-type banking activities, from other sorts of commercial activities that a bank may wish to conduct – e.g. investment banking, corporate finance etc.
 - Similar debates have been conducted elsewhere, including the High-level Expert Group on reforming the structure of the EU banking sector, chaired by Erkki Liikanen, Governor of the Bank of Finland.

This gives rise to at least three further thoughts:

- First, the position of a UK asset manager's underlying clients, and the UK retail funds industry generally, should not be lost within this broader debate. The FCA would ideally champion a joined up approach, so that the issues flagged in its Dear CEO Letter are kept in mind as work on other regulatory issues and initiatives progress.
- Secondly, it is assumed that the provision of services to asset managers will fall outside any ring-fence introduced here, if the UK government stays its present course. This would mean that an asset manager would not be contracting with a bank backed by a retail banking balance sheet, but rather, could be facing an entity with quite a risk profile, business model and overall approach.
- Thirdly, the types of regulatory initiatives mentioned above are likely to be a catalyst for significant change within the international banking sector, both from a strict legal perspective as relevant banking groups restructure their activities to comply with the new rules, as well as from a commercial perspective.

These points may mean that it is an opportune time for the asset management industry to consider the optimum approach as to how a service provider could be structured, from the asset manager's perspective – for example:

- to reduce or manage the risk of a service provider becoming insolvent; and/or
- to reduce or manage any threat to the continuity of service to an asset manager's underlying clients.

In other words, it may be an opportune time for some of the issues set out in this paper to be “thrown into the mix”, as banking groups consider how best to structure themselves going forward to comply with other regulatory changes.

On a more prosaic front, as asset managers and their service providers progress their analysis on exit plans and other matters, it may be useful to discuss with the FCA how certain continuity of service issues would be dealt with if they arose, and whether any regulatory relief could be available to avoid a firm being in breach of the FCA rules. It may also be useful to discuss whether disclosure on relevant issues should be included in client or investor facing disclosure documents, such as a retail fund’s prospectus.

As a final point to suggest, a new approved person category could be introduced within asset managers to make a senior person responsible for the types of issues addressed in this paper – i.e. analogous to the new CF10a function in relation to client assets. This may assist in ensuring a consistent and on-going focus within firms in the delivery of any relevant **short, medium** and **long-term** initiatives discussed in this paper.

Appendix 1: Dear CEO Letter

Financial Services Authority

11 December 2012

To the CEOs of Asset Managers

Review of Outsourcing Arrangements in the Asset Management Sector

The FSA is assessing the risk to our objectives arising from asset management firms outsourcing operational activities to external service providers. Our initial discussions and research have identified that the asset management industry outsources a growing number of activities, and that the small number of outsource providers are usually part of complex international banking groups. At group level, these organisations will have balance sheet exposure to activities other than the provision of outsourcing activities. Our concern is that if a service provider were to face financial distress or severe operational disruption, UK asset managers would not be able to perform critical and important regulated activities, thereby causing detriment to customers.

Based on our findings so far we are not confident that across the industry, effective recovery and resolution plans are in place for the asset management sector as a whole. For the purposes of this letter we are referring to the outsourcing of regulated activities and/or activities that are critical or important in the support of regulated activities as set out in SYSC 8.1.4R.

Our discussions with firms indicate that there are several types of contingency plans in place within the sector which give rise to concerns:

- Some firms appear to rely on the fact that the outsource service provider is a large financial institution which regulators might look to rescue using public funds. We are concerned that this approach lacks prudence and is inconsistent with the FSA's policy of allowing such organisations to fail.
- Some firms rely on taking activities back in house. We are concerned that any transfer would take many months and we do not believe firms would immediately have the capacity and abilities required.
- Some firms rely on being able to transfer outsourced activities to another provider. We are concerned about the considerable operational challenges inherent in a transfer as well as the probability that this could not be implemented swiftly enough to protect customers if a service provider were to fail. A plan to transfer to another provider may not necessarily be a realistic option due to concentration risk in the supply of certain activities.
- Some firms place reliance on being able to exercise step in rights but we are concerned that in a stressed scenario such rights might prove difficult to enforce and that there could be undue delay and/or operational risks arising which would be to the detriment of the service provided to customers.

We believe it is the responsibility of firms' Boards to have considered the implications of outsourcing to an external third party supplier having regard to the regulatory requirements that apply. SYSC 8.1.7R requires that firms should be exercising "due skill and care and diligence" when entering into, managing or terminating any outsource arrangement. We believe this, together with the

additional requirements in SYSC 8.1.8R(5), (7) and (11) includes having adequate contingency plans in place to deal with either an unexpected or expected termination of an outsourcing contract and/or other service interruption with their outsource provider(s). We therefore believe that it is the responsibility of firms' Boards to ensure that they have in place an adequate resilience plan which enables the firm to carry out regulated activity if a service provider fails.

We recognise that there may be more robust contingency plans other than those set out above of which we are not yet aware; but in all cases we expect firms to have devised adequate contingency plans which are viable, robust and realistic and set out a clearly defined exit strategy in the event of a termination of outsourced activity under any circumstances, including stressed market conditions.

We therefore ask you to review your current contingency plans taking into account the observations in this letter to ensure compliance with your obligations under SYSC 8.

Our desired outcome is to ensure that there are effective recovery and resolution plans in place for the asset management industry as a whole, hence we would be interested in any immediate constructive feedback you may have towards achieving this objective which can be communicated to us via the following email address:

FSASupervisionAssetManagementDepartmentTeam4@fsa.gov.uk. We also intend to host an industry event in early 2013 in order to facilitate an exchange of views which should help achieve our outcome.

Yours sincerely

Clive Adamson
Director of Supervision
Conduct Business Unit
Financial Services Authority

Appendix 2: Survey results on outsourcing activities

Members of the IMA Outsourcing Working Group participated in a confidential questionnaire to discover how much activity was outsourced to how many different providers.

19 asset managers (out of 30 on the IMA working group) responded to the questionnaire, which asked for the following information:

1. How many service providers do you delegate an activity to?

Across the responses, there were 45 individual service providers, although some of these were separate entities within the same group. One asset manager had decided to use one service provider to carry out all their delegated activities, stating this would reduce the risk of outsourcing. Another asset manager had 14 separate contracts with service providers, preferring to spread any risk across different outsourcers.

In many cases, there was evidence of bundling contracts, as asset managers gave custody or allowed custody to be given to a service provider and also delegated some of their back office functions at the same time. These were often covered by one contract.

2. Are the service providers you contract with regulated?

According to the responses, 50% of the service providers are regulated. However a number of asset managers were not sure whether such regulation was only at a group or parent company level (i.e. whether the specific entity they were contracting with was regulated in its own right). Therefore the responses to this question were inconclusive.

3. Is your service provider UK or non-UK?

The asset managers responding said that 32% of their service providers were UK, which means that 68% were non-UK, although a number of asset managers had reported that their service provider was both. This may have meant that they were contracting with an international group that had both UK and non-UK entities, but a head office outside the UK.

Those service providers from outside the UK were chiefly from Ireland and Luxembourg.

4. How old is your current contract with your service provider?

Many of the asset managers had not negotiated a new contract for some time, with more than half of all contracts being in place between three and five years. Three contracts were between seven and 10 years old and another claimed its contract was part of a long-established relationship.

5. What is the term of your contract with your service provider?

The reason for this question was to check whether those with long standing contracts were due to renegotiate in the near future. The majority of contracts were renegotiated every three to five years.

The three older contracts were on a three to six month rolling basis, with only one asset manager claiming not to have a fixed term to their contract.

6. Do you have an Exit Plan in the contract with your service provider?

Most asset managers considered themselves to have some form of an Exit Plan, although not one asset manager claimed it was more than a clause to review should the need arise.

Some asset managers, when asked if the Exit Plan was a clause or whether there was more detail, responded with the following:

- Not a full plan, but more of an outline
- Merely an obligation to support
- A framework to deal with an event, with the precise approach being tailored depending on the specific circumstances
- A substantive plan, but not yet complete
- Currently renegotiating contract and will look to add Exit Plan
- Looking to add more content, but will need to pass via Legal Team

Appendix 3: Survey results on transfers

Some members of the IMA Outsourcing Working Group agreed to be interviewed on their experiences associated with transferring to another service provider.

Although a detailed questionnaire had been prepared, the interviews were also an opportunity for asset managers to discuss quite openly their experiences of transferring.

❖ What were the key drivers for transferring to another service provider?

- Unhappy with current provider (end of tether)
- Reduction of number of outsourcers (legacy contracts following M&A)
- Improve technology or specific know how with new provider (to allow more product launches or to enable the expanded use of derivatives, which new provider's platform could facilitate)
- Provider moving out of outsourcer market
- Rationalisation of outsource providers, cost reduction, improve efficiencies
- Seeing the raft of new regulatory requirements coming down the pipeline, each of which would have required significant spend, taking away the firm's capacity for spending cash available for investment on front office capability/systems

❖ How long did the transfer take from first considering to final implementation?

Transfers averaged 12 to 18 months, with one asset manager stating their transfer took longer than this due to some internal (unforeseen) issues.

Many asset managers said the timeframe depended on what delegated activity was being transferred, whether they already had another relationship with that service provider, whether there was a particular driver to complete the transfer within a particular period, and whether there were legacy issues that had to be dealt with as work on the transfer progressed.

Such projects were often passed to specific project managers, rather than being run from within the operations team, but there was a huge amount of involvement and time from operations, compliance, risk and legal teams within the asset management firm.

❖ What were the top risks during the project?

Some of the responses to this question were as follows:

- People risk - e.g.:
 - Designated personnel moving on from their role and leaving the company
 - Change of personnel or management during project (new team need to catch up on details)

- The need for the incoming service provider to build up the necessary understanding of the asset manager's business and relevant activities
- Focus - e.g. a transfer project is only successful if there is a dedicated team on each side focused on the end game
- Lack of understanding as to the profile of the business being transferred and how it interacts with the asset manager's broader business
- Transfer uncovering a myriad of legacy issues each of which had to be fixed before the transfer could proceed
- Project overrunning (need to implement on specific date, particularly if investor permission granted via EGM)
- Unforeseen issues with in-house systems requiring interface with systems at new service provider
- Some areas of project dependent on outcome of due diligence (this can take a long time and not allow other activities to commence)
- A change of certain decisions/parameters during the project
- Disruption of service during the transfer process and deterioration of service levels
- The risk that having to move quick can mean the "wheels come off"

Appendix 4: Key regulatory rules

FCA's Systems and Controls Manual

SYSC 8.1 General outsourcing requirements [Emphasis added]

[**Note:** ESMA has also issued guidelines under article 16(3) of the ESMA Regulation covering certain aspects of the MiFID compliance function requirements. See <http://www.esma.europa.eu/content/Guidelines-certain-aspects-MiFID-compliance-function-requirements>.]

SYSC 8.1.1

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;
- (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 *appropriate regulator* 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 13(5) first paragraph of *MiFID*]

SYSC 8.1.1A

Other *firms* should take account of the outsourcing *rule* (SYSC 8.1.1R) as if it were *guidance* (and as if should appeared in that rule instead of must) as explained in SYSC 1 Annex 1.3.3G.

...

SYSC 8.1.3

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, 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 8.1.1R(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.

SYSC 8.1.4

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 *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.

[**Note:** article 13(1) of the *MiFID implementing Directive*]

SYSC 8.1.5

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; [**Note:** article 13(2) of the *MiFID implementing Directive*]
 - (3) the recording and retention of relevant telephone conversations or electronic communications subject to COBS 11.8.

SYSC 8.1.5A

Other *firms* should take account of the critical functions *rules* (SYSC 8.1.4R and SYSC 8.1.5R) as if they were *guidance* (and as if should appeared in those rules instead of must) as explained in SYSC 1 Annex 1.3.3G.

SYSC 8.1.6

If a *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.

[**Note:** article 14(1) of the *MiFID implementing Directive*]

SYSC 8.1.7

A *common platform 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. [**Note:** article 14(2) first paragraph of the *MiFID implementing Directive*]

SYSC 8.1.8

A *common platform 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 *appropriate regulator* and any other relevant *competent authority* in connection with the *outsourced* activities;
- (9) the *firm*, its auditors, the *appropriate regulator* 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 *appropriate regulator* 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*.

[Note: article 14(2) second paragraph of the *MiFID implementing Directive*]

SYSC 8.1.9

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.

[Note: article 14(3) of the *MiFID implementing Directive*]

SYSC 8.1.10

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

[Note: article 14(4) of the *MiFID implementing Directive*]

SYSC 8.1.11

A *common platform firm* must make available on request to the *appropriate regulator* and any other relevant *competent authority* all information necessary to enable the *appropriate regulator* and any other relevant *competent authority* to supervise the compliance of the performance of the *outsourced* activities with the requirements of the *regulatory system*.

[Note: article 14(5) of the *MiFID implementing Directive*]

SYSC 8.1.11A

Other *firms* should take account of the outsourcing of important operational functions *rules* (SYSC 8.1.7R to SYSC 8.1.11R) as if they were *guidance* (and as if should appeared in those rules instead of must) as explained in SYSC 1 Annex 1.3.3G.

SYSC 8.1.12

As SUP 15.3.8G explains, a *firm* should notify the *appropriate regulator* 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 20 of the *MiFID implementing Directive*]

Additional requirements for a management company

SYSC 8.1.13

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*]

SYSC 8.1.14

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

FCA's Collective Investment Schemes Sourcebook

Delegation: guidance

6.6.16(1)

Directors of an ICVC, authorised fund managers and depositaries should also have regard to SYSC 8 (Outsourcing). SYSC 8.1.6R states that a firm remains fully responsible for discharging all of its obligations under the regulatory system if it outsources crucial or important operational functions⁸ or any relevant services and activities. ...

FCA's Principles for Businesses

PRIN 2.1.1 The Principles

...	
2 Skill, care and diligence	A firm must conduct its business with due skill, care and diligence.
3 Management and control	A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.
...	
6 Customers' interests	A firm must pay due regard to the interests of its customers and treat them fairly.
7 Communications with clients	A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading.
...	
11 Relations with regulators	A firm must deal with its regulators in an open and cooperative way, and must disclose to the appropriate regulator appropriately anything relating to the firm of which that regulator would reasonably expect notice.

FCA's Threshold Conditions

COND 1.2.1

COND gives guidance on the threshold conditions. The FCA threshold conditions represent the minimum conditions for which the FCA is responsible, which a firm is required to satisfy, and continue to satisfy, in order to be given and to retain http://media.fshandbook.info/Legislation/2013/FCA_2013_22.pdf Part 4A permission [i.e. to obtain/maintain FCA authorisation to conduct regulated activities in the UK]. ...

COND 2.2 Location of offices

COND 2.2.1A

- (1) ... if A is a body corporate incorporated in the United Kingdom-
 - (a) A's head office, and
 - (b) if A has a registered office, that office,

must be in the United Kingdom. ...

COND 2.3 Effective supervision

COND 2.3.1A

- (1) A must be capable of being effectively supervised by the FCA having regard to all the circumstances including-
 - (a) the nature (including the complexity) of the regulated activities that A carries on or seeks to carry on;
 - (b) the complexity of any products that A provides or will provide in carrying on those activities;
 - (c) the way in which A's business is organised;
 - (d) if A is a member of a group, whether membership of the group is likely to prevent the FCA's effective supervision of A; ...

COND 2.3.3

In assessing the threshold conditions set out in paragraphs 2C ... of Schedule 6 to the Act, factors which the FCA will take into consideration include, among other things, whether:

- (1) it is likely that the FCA will receive adequate information from the firm ... to enable it to determine whether the firm is complying with the requirements and standards under the regulatory system for which the FCA is responsible and to identify and assess the impact on its statutory objectives; this will include consideration of whether the firm is ready, willing and organised to comply with Principle 11 (Relations with regulators and the rules in SUP on the provision of information to the FCA);
- (2) the structure and geographical spread of the firm, [and] the group to which it belongs ..., might hinder the provision of adequate and reliable flows of information to the FCA; ...
- (4) in respect of a firm not carrying on, or seeking to carry on, a PRA-regulated activity, it is possible to assess with confidence the overall financial position of the group at any particular time

COND 2.4 Appropriate resources

COND 2.4.1A [Emphasis added]

- (1) The resources of A must be appropriate in relation to the regulated activities that A carries on or seeks to carry on.
- (2) The matters which are relevant in determining whether A has appropriate resources include-
 - (a) the nature and scale of the business carried on, or to be carried on, by A;
 - (b) the risks to the continuity of the services provided by, or to be provided by, A; and**
 - (c) A's membership of a group and any effect which that membership may have.
- (3) The matters which are relevant in determining whether A has appropriate financial resources include-
 - (a) the provision A makes and, if A is a member of a group, which other members of the group make, in respect of liabilities; and
 - (b) the means by which A manages and, if A is a member of a group, by which other members of the group manage, the incidence of risk in connection with A's business.
- (4) The matters which are relevant in determining whether A has appropriate non-financial resources include-
 - (a) the skills and experience of those who manage A's affairs;
 - (b) whether A's non-financial resources are sufficient to enable A to comply with -
 - (i) requirements imposed or likely to be imposed on A by the FCA in the course of the exercise of its functions;

- (ii) any other requirement in relation to whose contravention the FCA would be the appropriate regulator for the purposes of any provision of Part 14 of this Act. ...

COND 2.7 Business model

COND 2.7.1

- (1) A's business model (that is, A's strategy for doing business) must be suitable for a person carrying on the regulated activities that A carries on or seeks to carry on.
- (2) The matters which are relevant in determining whether A satisfies the condition in subparagraph (1) include-
 - (a) whether the business model is compatible with A's affairs being conducted, and continuing to be conducted, in a sound and prudent manner;
 - (b) the interests of consumers;
 - (c) the integrity of the UK financial system. ...

COND 2.7.8

In deciding how they will satisfy and continue to satisfy the threshold conditions set out in paragraphs 2F ... of Schedule 6 to the Act, firms should consider matters including (but not limited to) the following:

- (1) the assumptions underlying the firm's business model and justification for it;
- (2) the rationale for the business the firm proposes to do or continues to do, its competitive advantage, viability and the longer-term profitability of the business;
- (3) the needs of and risks to consumers;
- (4) the expectations of stakeholders, for example, shareholders and regulators;
- (5) the products and services being offered and product strategy;
- (6) the governance and controls of the firm and of any member of its group (if appropriate);
- (7) the growth strategy and any risks arising from it;
- (8) any diversification strategies; and
- (9) the impact of the external macroeconomic and business environment.

COND 2.7.9

Firms should consider the manner in which they intend to bring their business model into operation. This plan could, for example, include matters such as procurement, outsourcing, and recruitment. ...

Appendix 5: Glossary

In this paper, certain terms have been used as explained below:

Asset manager	Refers to any firm that is conducting or responsible for conducting portfolio or investment management in respect of a particular client's portfolio of assets. It would therefore include a fund manager, as well as the portfolio manager or investment manager of a segregated mandate
Dear CEO Letter	Refers to the letter dated 11 December 2012 issued by the FSA and titled "Review of Outsourcing Arrangements in the Asset Management Sector" (a copy of which is set out in Appendix 1 to this paper)
Fund manager	Refers to the operator of a fund or collective investment scheme and would include (for example) the authorised fund manager of a UK domiciled UCITS, NURS or QIS
Portfolio management or investment management	Refers to the management by a firm of a client's portfolio of assets
Shares	Refers to both shares and units

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