

Fund Administration Outsourcing and the Emerging Alternatives

Taking a closer look at the Central Bank of Ireland's
"Dear CEO" letter and the alternatives to Outsourcing

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Introduction

Outsourcing remains a key priority for The Central Bank of Ireland (“CBI”). This can be seen from recent CBI speeches and publications.

Most note-worthy of these is the recently issued “Dear CEO” letter to all Irish regulated Fund Administrators detailing observations and recommendations for Fund Administrators who outsource fund administration activities. These recommendations are the result of an Outsourcing Review which was conducted by the CBI in 2016.

The observations and recommendations made in this letter span the first, second and third lines of defence with the aim of providing examples of good practice and promoting consistency in practice.

The key message that is being delivered from the CBI is that whilst certain activity may be outsourced, responsibility for it may not.

The CBI acknowledges that Outsourcing is growing and that it is a key element to the strategy of many businesses.

Outsourcing can create efficiencies and cost savings but firms need to ensure that they can satisfy the CBI that effective oversight and governance arrangements are in place which reflect the associated risks.

In this paper, Deloitte sets out what the CBI expects when it comes to outsourcing by Fund Administrators in Ireland.

Dear CEO Letter observations

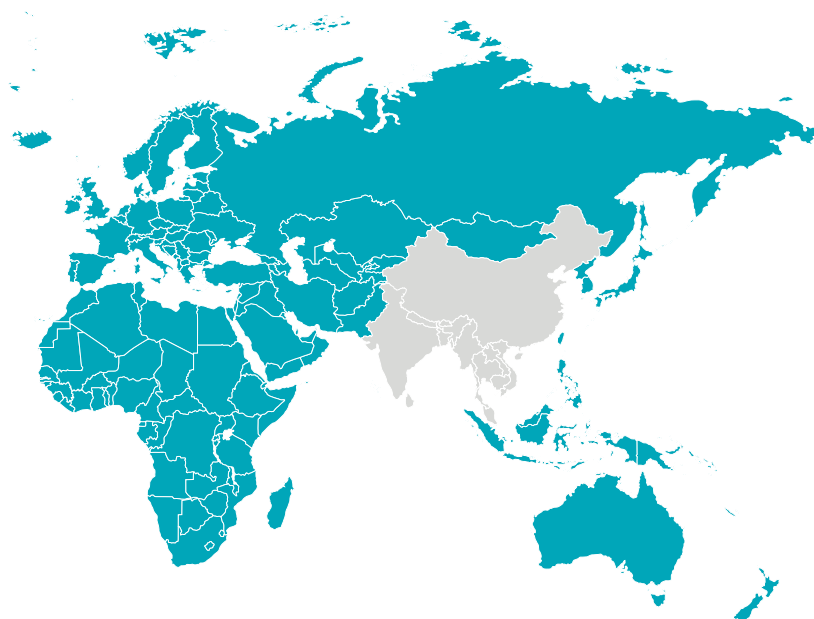
Current Scale of Outsourcing

Extensive level of outsourcing amongst certain Irish Fund Administrators.

Out of Five Firms Reviewed;

- Levels of between **48%-61%** of activities were carried out by Full Time Equivalents;
- Outsourcing to on average **10 Locations**;
- Outsourcing primarily to other **group entities**; and
- Concentration exposure to one or multiple locations.

“The Central Bank’s view is that the level of outsourcing observed.. is likely to be at or close to the outer limit of what is appropriate for this industry”



Governance and Oversight

With...

- Increased **efficiencies**
- **Cost** reduction

Brings...

- Challenges regarding **responsibility**
- **Compliance** with Outsourcing Requirements

CBI Key Observations



Comprehensive outsourcing records are not maintained by all firms.



In most cases, the Outsourced Service Provider (“OSP”) is not regulated at all or is not regulated to the same extent as the Fund Administrator.



No tolerance level set regarding the amount of outsourcing permitted for a specific activity.

“Outsourcing is a key area.. and is now integral to the business model of.. Irish Fund administrators... It is imperative.. to concentrate on having strong controls .. around the governance and oversight of all outsourcing arrangements”

So, you've decided to Outsource

What does the Central Bank of Ireland expect?

The “Dear CEO” letter highlighted the key areas of focus for the CBI from a first, second and third line perspective which is set out below.

First Line of Defence

Dedicated Outsourcing Team

- Actively involved in the oversight of outsourced arrangements.
- Conduct onsite testing.
- Dedicated Oversight Role

Outsourcing Governance Forum

- Initial approval of arrangements;
- Ongoing oversight;
- Representatives from the Board, Risk, Compliance and Operations

Concentration Exposure & Risk

- Carry out regular assessments of Concentration Risk

Formal Outsourcing Policy

- Reviewed Annually
- Governance Forum

Record Keeping

- Comprehensive and up-to-date records.
- Centralised log of all arrangements.
- CBI access to log upon request.

Take Back Testing

- Ensure undue reliance not being place on OSP's expertise and controls
- Ensure oversight of activities
- Demonstrate take back testing on activities and ability to manage risks

Training

- Formalised annual training for OSP staff
- Attendance records

Operational Oversight

- Conduct Due diligence review at least annually to assess;
 - Resources;
 - Experience of staff;
 - Regulatory status;
 - Information handling;
 - Risk Mgt. & Controls;
 - Conduct of business;
 - Business culture; and
 - BCP

Disaster Recovery/ Business Continuity Planning (“BCP”)

- Assess adequacy of OSP BCP
- Develop incident response plan to OSP's BCP
- Testing OSP's BCP
- Document prioritisation of critical activities
- Maintain an exit strategy

Considerations when assessing or entering into an Outsourcing Arrangement

01. All risks- including country and concentration;
02. Strategic purpose of arrangement;
03. Financial benefits (vs. the risks) of the arrangement;
04. Impact on firms overall strategy;
05. Impact on employees;
06. Nature of interaction with Service Provider;

07. Information security requirements;
08. Relevant regulations/ legislation;
09. Any group policy requirements;
10. Oversight of arrangements ;
11. Customer service impacts; and
12. Scale of outsourcing already conducted.

So, you've decided to Outsource

What does the Central Bank of Ireland expect?

2nd Line of Defence

Role of the Risk & Compliance Functions

Firms should ensure that; Compliance monitoring evaluates compliance with obligations and the controls are effective and appropriate The Board are furnished with necessary information where regulatory concerns arise regarding the operation of outsourced operations.

12 Month Compliance Reports

The extent of the 12 month review should take into account and reflect the scale, complexity and nature of the outsourced activity.

Presence of Control Function in the OSP

Firms should ensure that there are sufficient compliance resources onsite or in the location of the OSP to ensure effective oversight. The onsite presence should be commensurate with the operations carried out in each OSP.

Format of 12 Month Report

Sufficient detail should be provided in the report covering the following;

- Details and activities provided by the OSP
- CBI clearance date
- Commencement date
- Report date, preparer and approver.

3rd Line of Defence

Internal Audit Reviews should assess the adequacy of the firms process for;

- Ensuring OSP relationships align to firms strategy
- Identifying, assessing, managing and reporting on all risks
- Responding to breaches/ service disruptions
- Ensuring appropriate staffing and expertise is in place to perform Due Diligence and On-going monitoring/ management of OSP's
- Identifying and managing concentration risks.

Client Notification records should be sufficient to evidence that clients have been notified of the outsourcing arrangement and should be available for inspection where required.

Regulated Status of OSP / Group Relationship

Ensuring activity is performed to the regulatory standard even if the OSP itself is not regulated.

So, you've decided to Outsource

What does the Central Bank of Ireland expect?



Governance

- Board and Senior management should retain ultimate responsibility for all outsourced arrangements;
- Strong governance and proper challenge from the Board; and
- Appropriate risk information and assessment of robustness of arrangements.



Oversight

- Monitoring- key performance indicators and monitoring tools should be embedded in the Risk Monitoring Framework;
- Reporting- sufficient level of detail in the reports;
- Appraisal- conducting initial and on-going appraisals of all OSP's including on-site inspections;
- Business Continuity- testing of action plans and determine whether replacements can be found in time frame required;
- Outsourcing Policy- expectation of increased granularity regardless of the nature and the scale of the outsourcing arrangement;
- Ownership- a dedicated person assigned with the ownership of each outsourcing arrangement; and
- Contract.

"Certain good governance arrangements, where firms were adequately managing risks in relation to outsourcing were observed, but some weaknesses in the oversight of service providers remain... The information provided aims to support the development of consistent industry practices to assist in ensuring compliance by firms with the Outsourcing Requirements."

Michael Hodson, Central Bank of Ireland



Outsourcing of IT systems and services

"The decision to outsource critical IT services is a strategic one and requires full consideration of associated risks. Firms need to have a good understanding of the process flows for their critical operations and where the potential failure points lie in that flow

The Central Bank will be paying closer supervisory attention to the risks associated with outsourcing, including IT outsourcing, in the coming months."

Address by Director of Policy and Risk, Gerry Cross, to ACOI Annual Conference

Implementing, Assessing or Changing your Outsourcing model

How Can Deloitte Assist?

Provide Industry Insights

- Provide insights based on extensive industry experience of what a good outsourcing model looks like and how to get there.
- Provide advised based on knowledge of CBI expectations.

Establishing a New Entity

- Assist with queries related to setting up a new entity in Ireland – the mind and management and the requirement to have a substantive presence in Ireland.
- Prepare the Application Form for authorisation and the outsourcing information required by the CBI.

Risk Based Governance Framework

- Assess existing arrangements in place to determine whether there is sufficient oversight and governance in place to manage the relevant risks.
- Assist in the development of a Risk Based Governance Framework and a Risk Based approach to managing outsourcing risk on an ongoing basis.

Due Diligence

Conduct pre contractual and ongoing due diligence of outsource service providers.

Board Oversight

Implement a Risk Based Oversight Framework to allow the Board to effectively manage risk.

Operating Model

- Assist with the assessment, rationalisation and CBI notification process in advance of a change to the existing operating and/or outsourcing model – ensuring that outsourcing is not hollowing out an important function.

Assess the Alternatives

- Assess if technology can overcome the need to outsource with extensive experience in;
 - Robotic Process Automation ("RPA")
 - Blockchain
 - Cognitive Technology
- Assess whether automation of tasks is possible which would reduce or remove the need for manual activities to be performed. Read more below.

Assessing the Alternatives to Outsourcing

The Future of Asset Servicing...

Deloitte's recently issued report "The future of asset servicing, shaped by three disruptive technologies" details why we believe disruptive technologies offer enormous potential for asset servicers in creating efficiency, reducing risk and improving quality of service to clients. Both Robotic Process Automation ("RPA") and Blockchain could replace many of the repetitive, manual activities carried out in asset servicing today. [The full text of this report can be found here.](#)



How can RPA change the way you operate ?

RPA refers to a set of software tools called robots or "bots" that perform routine or repetitive business processes – the kind that are typically carried out today by shared service centres or transaction processing teams.

- RPA could replace much of the manual work involved in asset servicing to handle post-settlement tasks like trade processing, reconciliation and reporting – both for clients and regulators.
- A license for a software robot is likely to cost less than an onshore or offshore staff member
- The tasks and processes that have been outsourced by global asset servicers to locations such as India are highly manual, high-volume repeat tasks -making them ripe for rapid automation.



How can Blockchain replace manual activities?

One of the most talked about technologies right now, a blockchain is one form of a distributed database for recording transactions where every participant on the network shares a copy of each transaction. By design, blockchain doesn't need a centralized trusted authority to validate transactions.

Blockchain could have large ramifications for some of the key tasks that asset servicers carry out today. Rather than outsourcing these activities, they could be replaced by a blockchain solution.

For instance, the investor register and subscription and redemption activity in a fund could be held on a blockchain. Investor KYC could be maintained on a blockchain. Asset reconciliations could become obsolete if all assets acquired by the fund are held on a blockchain. There are endless opportunities.

"A huge wave of technology disruption is heading towards the asset servicing industry"

Contact Us

Further guidance is expected from the CBI in 2017 with regard to outsourcing. This is a key area of interest for the Regulator and for firms operating or planning to operate in Ireland. If you would like to discuss your proposed or existing outsourcing arrangements and the potential alternatives for your business, please contact us.



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