



**Guidelines**  
**No. 6/2014**  
**on outsourcing by supervised entities**

**Issued with reference to the second paragraph of Art. 8 of Act No. 87/1998  
on Official Supervision of Financial Activities.**

**8 January 2015**

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## **Introduction**

These Guidelines are intended to explain and illustrate those aspects and arrangements which supervised entities, as referred to in Art. 2 of Act No. 87/1998, on Official Supervision of Financial Activities, are to consider in outsourcing of their activities.

In drafting the Guidelines, regard was had for guidelines of the Committee of European Banking Supervisors (CEBS), now the European Banking Authority (EBA), of 14 December 2006 and preparatory guidelines of the European Insurance and Occupational Pensions Authority (EIOPA) in connection with the introduction of the Solvency II Directive.

Provisions on outsourcing of individual activities by supervised entities exist in numerous Guidelines of the Icelandic Financial Supervisory Authority (FME), although financial market legislation is rather limited in this area. These Guidelines represent an attempt to specify the main principles which FME considers desirable for supervised entities to follow in concluding outsourcing agreements and in their outsourcing arrangements in other respects.

It should be kept in mind that many of the Guidelines issued by FME on specific aspects of supervised entities' activities already include provisions on outsourcing. Although these Guidelines lay down the main principles in connection with outsourcing, FME considers it appropriate that provisions of Guidelines dealing specifically with outsourcing of certain aspects of activities should continue to apply, with these Guidelines serving as a supplement to them.

## 1. Scope

- 1.1. These Guidelines shall apply to outsourcing by all supervised entities as referred to in the first paragraph of Art. 2 of Act No. 87/1998 on Official Supervision of Financial Activities.
- 1.2. The provisions of these Guidelines shall serve to supplement other Guidelines dealing with outsourcing of specific aspects of the activities of supervised entities, e.g. operation of information systems.

## 2. Definitions

In these Guidelines, the following meanings shall apply:

- 2.1. *Outsourcing*: an agreement between a supervised entity and a third party (the outsourcing service provider) for the outsourcing service provider to perform an activity or service that would normally be included in the activities of the supervised entity.
- 2.2. *Outsourcing service provider*: a party providing services or facilities or carrying out activities on behalf of a supervised entity.
- 2.3. *Material activities/key functions*:
  - i The key activities of the undertaking, i.e. risk management, internal audit, compliance and actuarial work in the case of an insurance company;
  - ii Other activities of such nature that any weakness or error in the provision of these activities could have serious consequences for the supervised entity's ability to meet its obligations as provided for in Acts, Regulations, Rules or other criteria which apply to its activities and/or the ability of the supervised entity to continue in business;
  - iii Other activities requiring a operating licence from FME;
  - iv Activities which have a significant impact on the supervised entity's risk management.
- 2.4. *Chain outsourcing*: a situation where an outsourcing service provider sub-contracts the service, entirely or partially, to third parties.

## 3. On outsourcing in general

- 3.1. Outsourcing shall be arranged so that it complies with the Acts, Regulations, Rules and other criteria which apply to the activities of the supervised entity in question, including provisions on sound and proper business practices on the market concerned promoting trust, credibility and security.
- 3.2. Supervised entities should ensure that they always have sufficient in-house oversight and expertise to enable them to supervise their outsourcing and to assume the carrying out of outsourced activities or outsource them to another party if necessary.
- 3.3. Supervised entities must ensure that FME's access to their data and information in the custody of an outsourcing service provider is the same as if this data and information were in their own custody.
- 3.4. Before taking a decision on outsourcing, FME expects supervised entities will ensure that:
  - i The outsourcing does not prevent good corporate governance by the supervised entity as provided for in recognised instructions and guidelines on corporate governance;
  - ii The outsourcing does not damage the supervised entity's reputation;
  - iii The outsourcing does not pose unnecessary risks to the operations of the

- supervised entity;
- iv The supervised entity's possibilities of monitoring and managing outsourced activities or services is neither impaired nor complicated;
- v The possibilities for internal quality control, including with respect to the role of the Board of Directors and Audit Committee, are neither impaired nor complicated;
- vi FME's supervisory possibilities are neither impaired nor complicated; and
- vii Continuous and satisfactory service to customers is not negatively affected.

#### **4. Responsibility for outsourcing**

- 4.1. The ultimate responsibility for all outsourced activities and any risks associated with them always lies with the supervised entity. Such responsibility cannot be outsourced.

#### **5. Restrictions on outsourcing of tasks of the Board of Directors**

- 5.1. Activities involving core management functions in the operations of a supervised entity cannot, in FME's assessment, be outsourced to third parties.
- 5.2. Core management functions in the operations of a supervised entity include, inter alia, determining risk strategy, risk appetite and risk-bearing capacity. Having regard to the above, in FME's assessment management functions such as the setting of strategies and policies with respect to the supervised entity's risk profile and control, the oversight role of the Board of Directors and the final responsibility towards customers and supervisors cannot be outsourced.
- 5.3. Supervised entities may not outsource activities requiring a licence from FME unless the outsourcing service provider has an authorisation equivalent to that of the supervised entity to provide the service or carry out the activities.
- 5.4. Supervised entities should take adequate measures to ensure that the outsourcing does not result in activities or services being of poorer quality than if they had not been outsourced.

#### **6. Outsourcing of material activities**

- 6.1. Supervised entities should exercise particular care in outsourcing material activities. Supervised entities must also ensure that decisions on outsourcing of material activities are based on business premises and not on management contacts or other possible conflicts of interest.
- 6.2. With reference to the first paragraph of Art. 9 of Act No. 87/1998, on Official Supervision of Financial Activities, FME requests to be informed with sufficient notice of the outsourcing of material activities and any changes to such outsourcing.
- 6.3. It is important that in an outsourcing agreement with an outsourcing service provider the supervised entity specify the responsible party within the undertaking who is responsible for supervision of the outsourced activities and that the outsourcing service provider satisfies the requirements made of the supervised entity in connection with the activities. Furthermore, that the outsourcing contract specify the responsible party in the outsourcing service provider with sufficient experience and expertise to perform the activities.
  - i. In specifying a responsible party, both in the supervised entity and the outsourcing service provider, FME considers it sufficient to specify the working

title or position of the employee within the undertaking concerned, i.e. naming a specific individual is not necessary.

- 6.4. FME may examine whether outsourcing of material activities is consistent with the statutory provisions which apply to the activities of the supervised entity, including the first paragraph of Art. 8 of the Act on Official Supervision of Financial Activities, which provides for the activities of supervised entities to accord with Acts, Regulations, Rules or the company statutes governing such activities, and that they are in other respects consistent with sound and proper business practices.

In such an examination FME would have regard, for instance, to the following factors:

- i the type and scope of the supervised entity's activities;
- ii the nature of the activities or services which are outsourced;
- iii special circumstances concerning the outsourcing service provider and its market position;
- iv the duration of the outsourcing contract;
- v potential conflicts of interest which may arise in connection with the outsourcing;
- vi the possibilities of the outsourcing service provider to influence decisions by the supervised entity;
- vii geographical location of the outsourcing service provider.

## **7. Eligibility of an outsourcing service provider for outsourcing of material activities**

- 7.1. FME expects that supervised entities ensure that outsourcing service providers who undertake material activities and their employees who carry out these activities do so with integrity and possess the professional qualifications, knowledge and experience to be able to perform the activities satisfactorily.

## **8. Outsourcing policy**

- 8.1. The Board of Directors of a supervised entity intending on outsourcing any aspects of its activities should adopt a policy covering the main aspects of outsourcing, including outsourcing of non-material activities, whether the outsourcing is to a party within the same corporate group or not.
- 8.2. The Board of Directors of a supervised entity intending on outsourcing any aspects of its activities should adopt a general policy on outsourcing, including whether outsourcing should be done within or outside of the corporate group if applicable. The outsourcing policy must be reviewed on a regular basis.
- 8.3. An outsourcing policy should include inter alia the following general points:
- i Consideration of the impact of outsourcing on the undertaking's activities and the risks it involves, such as operational risk, reputational risk and concentration risk
  - ii How supervision of outsourced activities shall be arranged;
  - iii Consideration of actions to be taken if uncertainty develops regarding the outsourcing service provider's activities which could have a negative effect on its ability to carry out the outsourced activities
  - iv Consideration of how and under what circumstances the outsourcing contract could be terminated; and
  - v Consideration as to how a decision on outsourcing will be taken

8.4. The outsourcing policy should include the following aspects concerning the outsourcing service provider:

- i Consideration of what demands the supervised entity makes of the outsourcing service provider;
- ii Consideration of who is to evaluate the outsourcing service provider, cf. subparagraph i;
- iii How the outsourcing service provider communicates information on outsourced activities to the undertaking;
- iv Consideration of how possible changes in the organisation and ownership of the outsourcing service provider can be monitored and what representative of the supervised entity is to monitor this; and
- v Contingency plan for response to non-fulfilment by the outsourcing service provider.

## **9. Outsourcing contract**

9.1. FME expects outsourcing contracts be made in writing. The contract should include at least the following:

- i Detailed description of the outsourced activities;
- ii Detailed discussion of the requirements which the outsourcing service provider must meet for the activities to be regarded as carried out satisfactorily. The supervised entity should specify the above-mentioned requirements in both qualitative and quantitative terms, in order to enable effective supervision of the outsourced activities;
- iii Discussion of the role and responsibility of the supervised entity, on the one hand, and the outsourcing service provider, on the other. This should include a discussion of access by the supervised entity to the company's data at the outsourcing service provider and of the supervised entity's ownership of the data and products concerned in the outsourcing contract;
- iv FME's access to the supervised entity's data and information in the outsourcing service provider's custody, together with access to the outsourcing service provider's establishment and employees for the purpose of inspecting the performance of activities carried out for the supervised entity;
- v Discussion of access by the compliance officer and the internal and external auditors of the supervised entity to all data and information concerning the outsourced activities, together with access to the outsourcing service provider's establishment and employees for the purpose of inspecting the performance of activities carried out for the supervised entity;
- vi Provision for the outsourcing service provider to notify the supervised entity or FME of all major changes in its operations which could affect its ability to carry out the outsourced activities;
- vii provision for termination of outsourcing following a pre-determined notice period, together with provisions for termination of the contract without prior notice under exceptional circumstances which result in FME requiring this;
- viii Provision for resolution of a dispute between the contracting parties; and
- ix Provisions on confidentiality and non-disclosure by the outsourcing service provider concerning the activities entrusted to it, cf. provisions on confidentiality in relevant special legislation.

9.2. In addition, FME expects that an outsourcing contract provide specifically for the following concerning chain outsourcing:

- i Whether the outsourcing service provider is authorised to chain outsource and

- ii That the supervised entity will receive comprehensive information as to what parties carry out activities through chain outsourcing.

**10. Chain outsourcing**

- 10.1. A supervised entity should only agree to chain outsourcing if the outsourcer's sub-contractor agrees to fully comply with the conditions of the contract with the outsourcing service provider, as referred to in Art. 9.
- 10.2. A supervised entity should only agree to chain outsourcing if the outsourcer's sub-contractor is equally or more qualified to perform the activities than the outsourcing service provider.
- 10.3. Before agreeing to chain outsourcing a supervised entity should independently evaluate the risks involved in chain outsourcing, including whether chain outsourcing reduces the outsourcing service provider's ability to completely fulfil the outsourcing contract.

*Financial Supervisory Authority, 3 December 2014*

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