

# Prudential Standard

## APS 231 – Outsourcing

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### Related Guidance Note

#### AGN 231.1 – Managing Outsourcing Arrangements

# Prudential Standard

## APS 231 - Outsourcing

### Objective

*This standard aims to ensure that any outsourcing arrangements entered into by an ADI are subject to appropriate due diligence, approval and on-going monitoring. All risks arising from outsourcing should be appropriately managed to ensure that the ADI is able to meet both its financial and service obligations to its depositors and other creditors.*

*This standard should be read in conjunction with [AGN 231.1 – Managing Outsourcing Arrangements](#).*

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### Principles

#### Definition

1. For the purpose of this standard, outsourcing involves an ADI entering into an agreement with another party (including a related company) to perform a business activity which currently is, or could be, undertaken by the ADI itself.

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#### Accountability

2. While outsourcing may result in day-to-day managerial responsibility moving to the service provider, accountability for the business activity remains with the ADI. It is important for ADIs to recognise that outsourcing a business activity does not transfer all of the risks associated with that activity to the service provider. It remains the responsibility of the ADI to ensure that all risks associated with the business activity are addressed to the same extent as they would be if the activity was performed “in-house”. While outsourcing can be of significant benefit to an ADI, and may in fact reduce some risks, it may also give rise to other

risks, which the ADI needs to assess and manage appropriately. The ADI should have policies and processes in place to address the additional risks arising from outsourcing a business activity. Such policies and processes can be captured within existing risk management policies and procedures of the ADI.

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### **Application**

3. This standard applies to all ADIs. In large conglomerates, outsourcing may be through specific subsidiaries set up to provide specialist services to the rest of the group. In other cases, ADIs may be involved in joint ventures, strategic alliances or partnering arrangements that perform the outsourced activities. This standard applies regardless of whether activities are outsourced to related or third party entities. However, APRA has discretion to apply the standard in a flexible manner if the outsourcing is to another regulated entity within the group.

The standard also applies to arrangements where the service provider is located outside Australia – or the functions are performed outside Australia.

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### **Materiality**

4. This standard is only applicable in those situations where the outsourcing arrangement involves business activities that are material in nature. However, in the normal course, APRA would expect ADIs to apply the practices set out in the Standard and [Guidance Note](#) to all outsourcing arrangements.
5. The assessment of what constitutes a material business activity is often a subjective one and depends on the circumstances faced by individual ADIs. Generally, a material business activity is defined as one that has the potential, if disrupted, to impact significantly on the ADI's business operations, reputation or profitability. Factors to be considered when making this assessment would include:
  - (a) the financial and reputational impact of a failure of the service provider to perform over a given period of time (depending on the importance of the business activity, this may be measured in hours);
  - (b) the cost of the outsourcing arrangement as a share of total costs;

- (c) the degree of difficulty, including the time taken, in finding an alternative service provider or bringing the business activity “in-house”; and
- (d) the ability of the ADI to meet regulatory requirements if there were problems with the service provider.

As a guide, a material business activity may include a significant part of the ADI’s information technology function, investment management, internal audit, loan processing, custodial or administration arrangements.

It is not envisaged that a material business activity would include contractor type relationships, where there are numerous providers in the marketplace, the contract is relatively short term and the cost and inconvenience of switching between providers is low. Examples include utility services (such as mail and telephone services), legal services, printing services and software licensing arrangements.

ADIs should consult with APRA where they are uncertain as to whether a business activity that is to be outsourced would be regarded as material for the purposes of this standard.

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### **Notification Requirements**

- 6. ADIs must notify APRA as soon as possible after entering into any agreements to outsource a material business activity (and in any event no later than 30 days after execution). The ADI should outline to APRA the key risks involved in the outsourcing arrangement and the risk mitigation strategies put in place to address these risks. APRA may request additional material where it considers it necessary to do so in order to understand and assess the impact of the outsourcing arrangement on the ADI’s risk profile. In the normal course, however, APRA would seek to obtain all the necessary information directly from the ADI.

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### **Transition Arrangements**

- 7. At the time this standard comes into effect, ADIs should notify APRA of all existing outsourcing agreements involving material business activities. However, these agreements do not need to be covered by the requirements of this standard (as set out below and in the attached [Guidance Note](#)) until such time as the agreement is due for renewal. ADIs should contact

APRA to agree an acceptable timeframe for providing this information. ADIs should consult with APRA where they are uncertain as to transition arrangements.

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**Board and Management Responsibility**

8. The Board and senior management of an ADI should ensure that the risk management policies of the ADI include a formal policy covering outsourcing arrangements.
9. The Board or responsible Committee should be actively involved in assessing the processes involved in outsourcing all material business activities. This includes involvement in the decision to outsource, the due diligence process, the evaluation and selection of potential service providers, transition arrangements, and ensuring that appropriate exit strategies are in place. The Board or responsible Committee should also be kept informed on a regular basis on the performance of the service provider (including any significant issues that may arise).
10. The responsibility of setting up and managing the outsourcing arrangement may be delegated to senior management.

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**Policy**

11. ADIs should develop a policy document that sets out its approach to outsourcing, including a detailed framework for managing outsourcing arrangements. Ideally, this should be captured within existing risk management policies.
12. Procedures should be in place to ensure that all business units are fully aware of, and comply with, the outsourcing policy.

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**Risk Management Framework for Outsourcing**

13. At a minimum, the risk management framework for outsourcing should cover:
  - (a) the preparation of a business case for outsourcing a business activity;

- (b) the tender process;
- (c) the role of the Board or responsible Committee in approving the agreement;
- (d) factors to be included in the agreement itself;
- (e) procedures for monitoring performance under the agreement; and
- (f) any other factors viewed as relevant.

It should also deal with renewal arrangements and how these will be conducted to ensure that the ADI has appropriately managed the risks surrounding renewal of outsourcing agreements.

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### **The Outsourcing Agreement**

14. Outsourcing arrangements should be undertaken using a written, legally binding agreement. At a minimum, the contract should address the following issues:
- (a) service levels and performance requirements;
  - (b) audit and monitoring procedures;
  - (c) business continuity plans;
  - (d) default arrangements and termination provisions;
  - (e) pricing and fee structure;
  - (f) dispute resolution arrangements;
  - (g) liability and indemnity; and
  - (h) confidentiality, privacy and security of information.

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## **APRA Access to Service Provider**

15. The outsourcing agreement should include a clause giving APRA access to documentation related to the outsourcing arrangement and the right to conduct on-site visits to the service provider if APRA considers this necessary in its role as prudential supervisor of the regulated institution(s). In the normal course, APRA would seek to obtain whatever information it requires through the ADI itself. Where APRA intends to undertake an on-site visit to a service provider, it will normally inform the ADI of its intention to do so.

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## **Monitoring the Relationship and Reporting to Management and the Board**

16. The ADI should devote sufficient resources to managing and monitoring the outsourcing relationship. The type and extent of resources required would depend on the materiality of the contract. At a minimum, this would include:
  - (a) maintaining appropriate levels of regular contact with the service provider. This would range from daily operational contact, to senior management involvement where appropriate;
  - (b) a process for regular monitoring of performance under the agreement, including meeting criteria set out in the service level agreements; and
  - (c) dealing with issues as they arise and elevating them to senior management - or the Board - as appropriate.
17. The ADI should advise APRA of any significant problems that are being encountered which have the potential to materially affect the outsourcing arrangement. Before terminating the outsourcing arrangement, the ADI should provide reasonable notice to APRA, together with a report on the impact of termination, including transition strategies.

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## **External Audit**

18. Where considered appropriate, APRA may request the external auditor of the ADI or an appropriate external expert to provide an assessment of the risk management processes in place with respect to the outsourcing arrangement. This could cover areas such as IT systems, data security,

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internal control frameworks and business continuity plans. Such reports will be paid for by the ADI and would be made available to APRA.

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