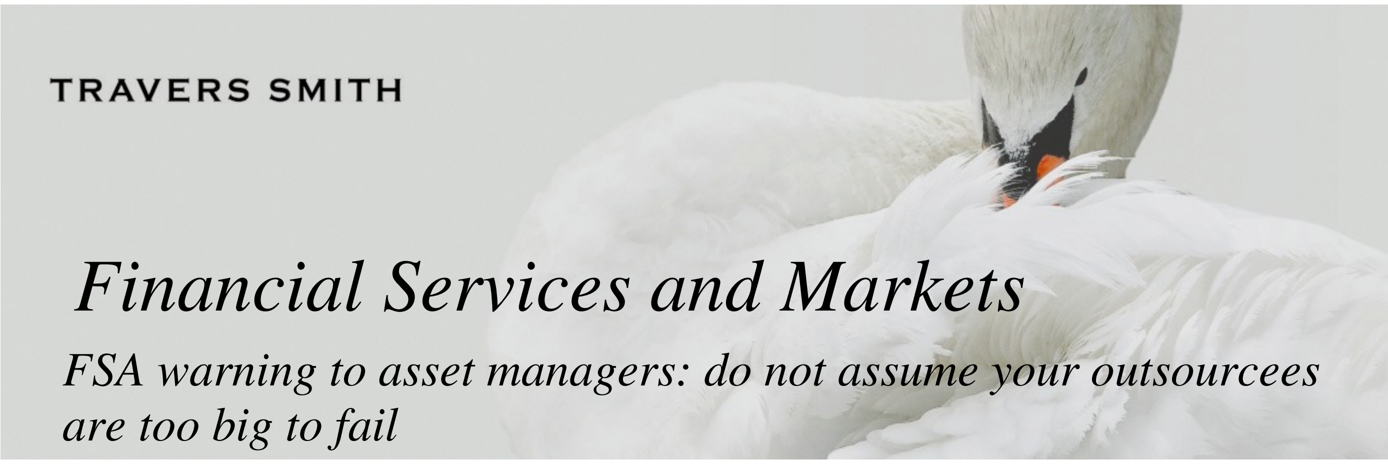

TRAVERS SMITH

Financial Services and Markets

FSA warning to asset managers: do not assume your outsourcees are too big to fail

On 11 December 2012 the FSA published a short Dear CEO letter to asset managers asking them to review their existing outsourcing arrangements and their recovery and resolution plans in relation to such arrangements. The FSA is concerned that current contingency plans across the asset management sector are inadequate and place undue reliance on the size and nature of their outsourced service providers or on their ability to put in place alternative arrangements should such providers fail. While no specific deadline is mentioned for conducting the review, it is clear that this is a high priority issue for the FSA which firms and their senior management should take seriously.

The discussions which the FSA has been having with asset management firms have given rise to a number of concerns (although it is not clear how representative of the sector as a whole the FSA's sample was). In summary, these concerns (which might be grouped under a general heading of "complacency") are that there is:

- an apparent and mistaken assumption amongst some firms that large outsourced service providers (the FSA notes that a small number of providers are usually part of a large and complex international banking groups) are "too big to fail" and would be rescued in the event of their failure;
- an unrealistic reliance upon being able to take the outsourced activities back in-house quickly – the FSA is concerned that firms underestimate the amount of time and resources that would be required to transfer activities;
- an unrealistic reliance upon being able to transfer the outsourced activities to a third party provider; and
- an overly optimistic reliance upon the enforceability and practical use of the rights they have under their outsourcing contracts to intervene in the arrangements in the event that the provider gets into difficulties.

The Dear CEO letter stresses that it is the responsibility of firms' Boards to have adequate contingency and resilience plans which are "viable, robust and realistic" and set out a "clearly defined exit strategy" in the event that an outsourced service provider fails, including where that failure occurs during market turmoil.

While no specific timeline is mentioned in terms of how quickly firms should review their contingency plans in the light of the concerns raised in the letter and the requirements in SYSC 8 on outsourcing of "critical or important" functions, there is a sense of urgency. The FSA encourages "immediate" feedback and intends to host an industry event in "early 2013" in order to facilitate an exchange of views. Firms should take this opportunity to raise any concerns about the FSA's letter with their industry representative body.

For further information on how we can help you with questions arising out of the FSA letter and the structuring your contingency plans, please contact one of the partners in our Financial Services and Markets Department or your usual contact at Travers Smith.

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