Policy: Managing Risk for Outsourcing of Financial Services

Version - 6.0

Document Management Information

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1. Objective :-

In pursuit of growth, effectiveness, operational excellence & resourceful competences, it is imperative for an organization that certain functions are outsourced, which can be well performed by organised, specialised & established agencies and that too at a cost effective manner. This document lays down a comprehensive policy/code of conduct on "outsourcing", as a pointer for third party service provider to perform certain activities on continuing basis that would normally be undertaken by NBFC itself, currently or in future along with a holistic frame work / direction(s) on managing risks.

In line with RBI guide line & mandate, a self-assessment directive(s) on third Party service provider selection through outsourcing arrangements is documented in a comprehensive manner to build robust notion on 'Outsourcing Policy' with assurance that the NBFC concern & Reserve bank of India have access to all relevant books, record and information available with service provider, timely continuous review & grievance Redressal mechanism.

2. Outsourcing – Definition and Criteria :-

Definition:

As per RBI guidelines on managing risks and code of conduct in outsourcing of financial services by NBFCs vide RBI circular no. DNBR.PD.CC.No.090/03.10.001/2017-18, dated 9th Nov, 2017 "Outsourcing means, using the services of a third party to perform activities on a continuous basis that would have normally been undertaken by an NBFC itself, currently or in the future and refers to outsourcing of financial services".

"Continuing basis" would include agreements for a specified period. For purpose of this policy, Outsourcing financial services can include applications processing, document processing, supervision of loans, data processing and back office related activities etc. However, this shall not include the activities which are ceremonial like usage of courier services, catering of staff, housekeeping and janitorial services, movement & archiving of records and security of the premises etc.

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3. Criteria for determining an outsourcing activity:-

An activity would be termed as outsourcing activity, if responses to any of the following questions is affirmative:

i) Financial services activity normally undertaken by an NBFC is carried out by a third party (including group companies, subsidiaries) i.e. FI Agency, Credit Processing Agency, and Record Management etc.

ii) Non-financial services activity normally undertaken by an NBFC and material to the operations of the NBFC carried out by a third party (including group companies, subsidiaries)

3.1 Clarifications:-

The below mentioned activities shall be kept outside the purview of RBI directions on Outsourcing:

i) Activities requiring specialist's expertise which are the activities typically not carried out by an NBFC,

ii) Activity where the service provider is only providing manpower,

iii) Activities which are not directly supervised by the company on a day-to-day basis.

3.2 Activities not to be outsourced:-

As per RBI directive core management functions including internal audit, compliance function and decision-making functions like determining compliance with Know your customer norms, Sanctioning for loans and management of investment portfolio would be carried out by the company employees and would not be outsourced. Further, while internal audit function itself is a management process, the internal auditors can be on contractual basis.

In the initial phase, Officials in the payroll of Parent Company are conducting the internal audit. The process of audit is being monitored by Head of Finance & Compliance and the final oversight is being done by board of the company.

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4. Role of the Board and Senior Management:-

The Outsourcing of any activity (vies) by NBFC concern does not diminish of its obligation. The Board and senior management are ultimately responsible for outsourcing operations and for managing risks inherent in such outsourcing activities. As mentioned in the Risk Management Framework, the Board has oversight on all risks assumed by the Company. As a structure approach "Risk Management Committee" is constituted to facilitate the focused oversight on various risks including the Outsourcing risks.

4.1. Role of "Risk Management Committee":-

i) Approving a Materialistic framework to evaluate the risk(s) or riders ascribed to outsourcing and the policies that apply to such arrangements.

ii) Laying down appropriate approval authorities for outsourcing depending on risks and materiality.

iii) Undertaking regular review of outsourcing strategies and arrangements for their continued relevance, safety and soundness.

iv) Deciding on business activities of a material nature to be outsourced and approving such arrangements.

4.2 Role of Senior Management:-

Considering the quantum of operations and perceived business risk, Directors shall have the authority to approve outsourcing arrangements based on the recommendations from requisite function, which will use the outsourcing services and review of the recommendation by Chief Operating Officer.

The senior management would inter-alia, have the following responsibilities:

1. Developing and implementing sound and prudent outsourcing policies and procedure.
2. Assuring & ensuring materialistic approach towards third party selection keeping in view compliance risk, operational risk, reputation risk, access risk, exit strategy risk and concentration & systemic risk.

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3. Gauging potential impact of the outsourcing on company on various parameters such as earnings, solvency, liquidity & profile Risk.
4. Assessment of Significant impact on customer service & protection.
5. Ensuring contingency plans are in place and tested.
6. Ensuring that there is independent review and audit of compliances set forth for channelization of outsourcing policy.

5. Materiality of outsourcing

The risk and materiality of any outsourcing arrangement shall be identified and evaluated prior to entering into any Outsourcing arrangement by the company. The extent and degree to which this Policy is implemented is expected to be commensurate with the materiality of the outsourcing. The company shall without limitation consider the following factors while assessing materiality of any outsourcing arrangement:

i) Impact on Reputation & Brand value of the company.
ii) Aggregate exposure on third party service provider.
iii) Cost of Outsourcing in correlation to total operating cost.

6. Evaluation of risks:-

The key risks in outsourcing that need to be evaluated by the company are:

i) **Strategic risk –** The service provider may conduct business on its own behalf, which is inconsistent with the overall strategic goals of the company.
ii) **Reputation risk –** Poor service from the service provider, its customer interaction not being consistent with the overall standards of the company.
iii) **Compliance risk –** Privacy, consumer and prudential laws not adequately complied with.
iv) **Operation risk –** Arising due to technology failure, **access risk,** fraud, error, inadequate financial strength to fulfil obligations and/or provide remedies.

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v) **Legal risk** – includes but is not limited to exposure to fines, penalties, or punitive damages resulting from supervisory actions, as well as private settlements due to omissions and commissions of the service provider.

vi) **Exit strategy risk** – This could arise from over-reliance on one firm, the loss of relevant skills in the company itself preventing it from bringing the activity back in-house and contracts executed wherein speedy exits would be prohibitively expensive.

vii) **Counter party risk** – Where there is inappropriate underwriting or credit assessments.

viii) **Contractual risk** – Arising from whether or not company has the ability to enforce the contract.

ix) **Concentration and systemic risk** – Where the overall industry has considerable exposure to one service provider and hence the company may lack control over the service provider.

x) **Country risk** – Due to the political, social or legal climate creating added risk.

7. Evaluation of the service providers:-

7.1. Pre-outsourcing evaluation

Proper selection/renewal of third party service provider will be ensured through due diligence on the basis of:

i) Competence – qualitative and quantitative.

ii) Financial strength/business strategy and strength including operational, reputational and external factors.

iii) Market report/feedback on track record from users / clients.

iv) Infrastructure facilities.

v) Compliance with regulatory/statutory requirements.

vi) Security and internal control, audit coverage, reporting and monitoring environment, Business continuity management.

vii) Due-diligence of its employees by the service providers.

viii) Outsourcing costs.

ix) Ability to service commitments under adverse conditions.

x) Ability of the service provider to perform activities as per the Service Level Agreement (SLA) wherever the activity is further sub-contracted.

xi) Outsourcing on potential litigation.

xii) Insurance coverage.

xiii) Past defaults/complaints.

xiv) Compliance with the approved External Agency specific 'Selection Criteria'.

xv) Reference check on the service provider.

7.2. Post outsourcing evaluation

An annual review should also be conducted by the concern department to re-assess the capabilities of the service provider on the basis of past breaches of performance standards, confidentiality and security and business continuity preparedness, if any

Explicitly on recommendation from requisite function, which will use the outsourcing services, post review & recommendation by Head Of Operations to Chief Operating Officer , necessary amendments in the Pre-as well as Post outsourcing evaluation shall be carried out and brought to knowledge of the board at decided interval.

8. Documentation

The company shall maintain proper documentary records of the control processes and procedures. The department using the services shall be responsible for maintaining these documents. The list of documents to be maintained is as under:

i) **Approval/review notes:** The concern department shall maintain copies of all approval notes/mails for outsourcing arrangements along with the details of the risk assessment and evaluation framework adopted for the same.

ii) **List of service providers and review dates:** A list of all outsourcing service providers along with updated contact details and review dates shall be maintained.

iii) **Service Level Agreements (SLA):** A copy of all SLAs signed between the department concern and the service providers shall be kept for record by the department. Copies of any modifications/amendments shall be kept along with such SLAs.

iv) **Audit reports:** The department shall maintain copies of reports provided by internal or external audit teams if any, related to the Service Provider.

These documents shall be retained as per the record maintenance norms as mentioned in the Board approved policy on 'AML & KYC norms'.

9. Agreement covering legal obligations

The decision on outsourcing and selection of service provider shall be followed by execution of standard service level agreements (SLA) drafted and vetted by legal team of the company for this purpose.

The concerned Director(s) is/are authorised to execute the agreement as per the standard format. Additions/deletion of any clause from the standard agreement, if any, due to business specific reasons, would be carried out in consultation with the consensus of Chief Operating Officer & due vetting by legal team.

The legal team of the company shall ensure that every outsourcing agreement complies the following provisions –

i) Every such agreement shall address the risks and risk mitigation strategies. The agreement shall be sufficiently flexible to allow the company to retain an appropriate level of control over the outsourcing and the right to intervene with appropriate measures to meet legal and regulatory obligations.

ii) The agreement shall also bring out the nature of legal relationship between the parties - i.e. whether agent, principal or otherwise.

iii) The contract shall clearly define what activities are going to be outsourced including appropriate service and performance standards.

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iv) The contract ensure that the company all the time have the access to all books, records and information relevant to the outsourced activity duly maintained or available with the service provider.

v) The contract shall provide for continuous monitoring and assessment by the company so that any necessary corrective measure can be taken immediately.

vi) A termination clause and minimum period to execute a termination provision is included wherever necessary.

vii) The contract incorporates the controls to ensure customer data confidentiality and service providers' liability in case of breach of security and leakage of confidential customer related information.

viii) The contract to include the contingency plans to ensure business continuity (BCP).

ix) The contract shall provide that service provider requires the prior approval/ consent of the company for the use of subcontractors for all or part of an outsourced activity.

x) The contact shall provide the company with the right to conduct audits on the service provider whether by its internal or external auditors, or by agents appointed to act on its behalf and to obtain copies of any audit or review reports and findings made on the service provider in conjunction with the services performed for the company.

xi) The outsourcing agreements shall include clauses to allow the Reserve Bank of India or persons authorised by it to access the company's documents, records of transactions, and other necessary information given to, stored or processed by the service provider within a reasonable time.

xii) The outsourcing agreement shall also provide that confidentiality of customer's information shall be maintained even after the contract expires or gets terminated and

xiii) The contract shall have necessary provisions to ensure that the service provider preserves documents as required by law and take suitable steps to ensure that interest of the company is protected in this regard even post termination of the services

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xiv) The contract to ensure that access to customer information by staff of the service provider shall be on 'need to know' basis i.e., limited to those areas where the information is required in order to perform the outsourced function

xv) The contract shall require the service provider to disclose security breaches, corrective steps taken, internal review by service provider and feedback from company.

10. Responsibilities of the service providers:-

The service providers/employee of the service providers should handle with care and sensitivity, their responsibilities particularly aspects like soliciting customers, hours of calling, privacy of customer information, conveying the correct terms and conditions of the products on offer, avoidance of intimation or harassment of any kind during debt collection efforts. It is essential that they refrain from any action that could damage the integrity and reputation of the company and that they observe strict customer confidentiality. The respective unit would ensure that Fair Practice Code of the company is being adhered by the agents / employees of the Service Provider wherever applicable.

The company shall ensure in evaluation of outsourcing arrangements that the service provider is able to isolate and clearly identify the company's customer information, documents, records and assets to protect the confidentiality of the information and ensure that there is no rapture of information / documents, records and assets.

11. Monitoring and control of outsourced activities:-

i) A central record of all outsourcing arrangements shall be maintained with Head of Operations and shall be placed before the "Risk Management Committee" on the half yearly basis.

ii) The risk management practices adopted in overseeing and managing the outsourcing arrangement are subject to regular audits by internal and external auditors.

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iii) The Department using the services is responsible to conduct an annual review of the service provider and review assess his ability to continue to meet its outsourcing obligations. These due diligence reviews shall highlight any deterioration or breach in performance standards, confidentiality and security, and in business continuity preparedness and a comprehensive report shall be submitted with Head of Operations who in turn will submit the same for review with Chief Operating Officer.

iv) In the event of termination of the outsourcing agreement for any reason in cases where the service provider deals with the customers, the same shall be publicized by displaying at a prominent place in the branch, posting it on website, and informing the customers so as to ensure that the customers do not continue to deal with the service provider.

v) The company would maintain a list of terminated agencies and promoters, which would be made available if required by the Regulator.

12. Grievance redressal mechanism:-

A grievance redressal mechanism is in place to ensure that grievances, if any, on service related issues are addressed. The service providers are informed about the redressal mechanism through standard terms of the SLA wherever applicable.

13. Policy review and approval process:-

The policy will be reviewed by the Board of Directors of the company on a yearly basis or as the need may arise.

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