



PENSION FUND REGULATORY AND DEVELOPMENT AUTHORITY

Circular

PFRDA/2017/30/PF/4

Date: 09/10/2017

Subject: Guidelines on Outsourcing of Activities by Pension Funds issued under Section 14 (2) (b) of the Pension Fund Regulatory and Development Authority Act read with Regulation 43 and Regulation 12(l) of the PFRDA (Pension Fund) Regulations 2015 effective from 09/10/2017

These guidelines are issued to clarify the core and non-core activities (mentioned under Regulation 12(l) of the Pension fund Regulations) in relation to the activities performed by a pension fund registered by this Authority and shall be effective from 09/10/2017. These guidelines shall be enforced and complied with by the pension funds at all times and any failure/deviation noticed shall be dealt with in accordance with the provisions of the PFRDA Act, 2013 and the PFRDA (Pension Fund) Regulations, 2015.

1. PFRDA (Pension Fund) Regulations, 2015 provide details of role and responsibility of PFs with a view that PFs shall render at all times high standards of service and exercise due diligence and ensure proper care in their operations.
2. In view of the changing business activities and complexities of various financial services being undertaken by the PFs, some of the pension funds have stated to have outsourced some of their activities in order to reduce the costs and increase of efficiencies for strategic reasons.
3. Outsourcing means an arrangement of any form between a PF and a third party service provider by which that service provider undertakes to perform a process, a service or an activity which would otherwise be undertaken by the PF in-house: The objective of the policy is to allow guidance to the pension funds to outsource non-core activities subject, however that no such outsourcing should be detrimental to NPS or the underlying subscribers. Further notwithstanding an outsourcing arrangement which the PF may have with a third party, the same shall be liable to be discontinued upon any direction having been issued to all or any PFs or in terms of any modification/substitution/extinguishment of this policy.

Broadly the activities of the Pension Fund can be divided into investment decision making and execution, fund administration including fund accounting and operational

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management (including middle office). Further, fund administration would include the activities of:

- Calculation of the NAV including the calculation of the fund's income and expense accruals;
- Updation of NAV of the day;
- Preparation of financial statements;
- Maintenance and filing of the fund's financial books and records as the fund accountant, including reconciliation of holdings
- Payment of fund expenses;
- Preparation and filing of regulatory filings/reports;
- Calculation of the total returns and other performance measures of the fund;
- Ensuring investment of funds, strictly in accordance with investment guidelines; and

Middle Office

The middle office serves as the connection point between trade execution and back office functions (such as fund administration). In particular, the middle office is responsible for keeping investment and accounting systems aligned. Functions of the middle office include, but are not limited to, trade confirmation and settlements, corporate action processing, derivative operations and collateral management, cash and position reconciliation and security data maintenance.

4. In order to address the concerns arising from the outsourcing of activities by PFs based on the generally accepted principles advocated by international organisations of repute and the experience of Indian markets, PFRDA proposes the outsourcing guidelines for adherence by Pension Funds.

Key Principles

- (i) Any outsourcing arrangement entered into by the Pension Fund shall be as per the guidelines laid down by PFRDA and principles laid down there under.
- (ii) Core activities, as defined by PFRDA, shall not be outsourced.
- (iii) The decision to outsource an activity by a Pension Fund will vest with the Outsourcing Committee or the risk management committee as laid down herein and in compliance of the Board approved outsourcing policy of the Pension Fund.
- (iv) The selection of the service provider is key to managing outsourcing risk and the risks in outsourcing shall be duly evaluated before a decision to outsourcing is taken.
- (v) The performance of the third party service provider with whom the Pension Fund has entered into an Outsourcing agreement shall be monitored on an ongoing basis, reviewed annually and reported to the Board at least once in a year.



(vi) All Outsourced activities shall be governed by the Risk Management Programme of the Pension Fund.

5. Key Risks in Outsourcing Contracts

The risks associated with outsourcing may be strategic risk, reputational risk, Compliance Risk, operational risk, exit-strategy risk, contractual risk, information risk, concentration and systemic risk, legal risk and counter party risk. The outsourcing committee (constituted under section 8 of these Guidelines) of the Pension Fund shall evaluate all the key risks associated with any material outsourcing contract, including, but not limited to, the following risks:

(a) Strategic Risk:

- Activities carried out by outsourcing service provider on its own behalf that are inconsistent with the overall strategic goals of the Pension Fund:
- Failure to implement appropriate oversight of outsourcing service provider
- Inadequate expertise to oversee outsourcing service provider
- Outsourcing service provider may be engaged in similar activities or may have same interest

(b) Reputation Risk: Poor service by outsourcing service provider:

- Customer interaction that is inconsistent with Pension Fund's standards
- Unethical practices of outsourcing service provider
- Termination of services without concurrence of PFs during the contract period

(c) Compliance Risk: Prudential and market conduct guidelines not complied with:

- Breach of obligation to preserve customer data confidentiality
- Changes in guidelines not communicated to outsourcing service provider in a timely manner
- Outsourcing services without ensuring the compliance by the service providers and not including the compliance part in the agreement by PFs.

(d) Operational Risk:

- Technology failure
- Inadequate financial capacity of outsourcing service provider to fulfil obligations or provide remedies/restitution
- Fraud or error
- Failure of Pension Funds to undertake inspections of outsourcing service provider (e.g. due to practical difficulty or cost considerations)
- Inadequate infrastructure and underqualified manpower of the service provider.
- Non-adherence of TAT or service standards as required in the operations of such outsourced activity.



-No direct access of PFs system by service provider.

(e) Exit strategy Risk:

- Over-reliance on one outsourcing service provider
- Loss of relevant skills or resources in the Pension Fund, preventing it from bringing an outsourced activity back in-house
- Contracts which make a speedy exit prohibitively expensive

(f) Contractual Risk:

- Inability to enforce contract

(g) Information Risk:

- Reliance on information by outsourcing service provider that may be materially inaccurate
- Delay in providing timely data and information to Pension Fund or regulator.
- Confidentiality of commercially sensitive/customer information may be compromised

(h) Concentration Risk:

- Reliance on one outsourcing service provider for multiple activities.

6. Activities that shall not be outsourced

The Pension Funds are prohibited from outsourcing any of their core activities and which includes the following:

- i. Investment and related functions
- ii. Fund Management including NAV calculations

All integral components of the above activities shall be treated as Core Activities

The Pension Funds desirous of outsourcing any of their activities shall not outsource their core and compliance functions. The core functions are those functions which:

- (i) Functions/Activities of such importance that any weakness or failure in the provision of these activities could have a significant effect on the pension funds ability to meet its regulatory responsibilities and/or to continue in business;
- (ii) any activities having a significant impact on its risk management; and
- (iii) the management of risks related to these activities.
- (iv) any other activities requiring an approval from the authority;

Any other function which is not a core activity of the pension fund (non-core activities) may be outsourced by the pension fund subject to compliance of clause 9 given below. Further the non-core activities are those like:

- the provision to the of advisory services, and other services which do not form part of the investment business of the firm, including legal advice for the firm, training, billing services and security;
- the purchase of standardised services, including market information services and price feeds; and
- Information technology support system (only software development and hardware)
- Safekeeping of the records with respect to record retention policy of the entity

PFs shall refer to the Annexure I of this circular for indicative list of core and non-core activities.

Policy Summary:

A. Pension Fund shall comply with Guidelines issued by Pension Fund Regulatory and Development Authority (PFRDA) with respect to outsourcing.

B. These guidelines shall be effective from 09/10/2017 and all Pension Funds shall be required to report compliance of these guidelines within six months from such effective date, if already not adhering to.

C. The Board of the pension fund shall have the responsibility for the outsourcing policy and related overall responsibility for activities undertaken under that policy. Internal selection of activities that may be outsourced, after careful examination of suitability, need, risk associated with such outsourcing the risk mitigation/management processes proposed in accordance with such policy on outsourcing approved by the Board.

D. Proper due diligence process in selection of the vendor/service provider

E. Comprehensive Service Level Agreements (SLAs) commensurate with the activity outsourced to ensure that:

i. the service provider employs the same standards in performing the services as would be employed by the Pension Fund if the activities were conducted in-house.

ii. the ability of the Pension Fund to fulfill its obligations to the Authority or obligations of Pension Fund under regulations notified by the Authority is not diminished.

iii. effective supervision by PFRDA is not impeded.

iv. the Company retains the control over the outsourced activity and in case of any breach by the service provider it can terminate the arrangement and take charge.

F. Review of the arrangement periodically.



Pension Funds shall remain responsible to the Authority even if the activity is performed by a third-party.

7. RESPONSIBILITIES OF THE BOARD OF DIRECTORS

A pension fund seeking to outsource activities shall have in place a comprehensive policy to guide the assessment of whether and how those activities can be appropriately outsourced. The Board of the pension fund shall have the responsibility for the outsourcing policy and related overall responsibility for activities undertaken under that policy. The Board of Directors shall approve and put in place an Outsourcing Policy.

i. The policy shall cover activities or the nature of activities that can be outsourced, the authorities who can approve outsourcing of such activities, and the selection of third party to whom it can be outsourced. For example, an activity shall not be outsourced if it would impair the supervisory authority's right to assess, or its ability to supervise the business of the pension fund. The policy shall be based on an evaluation of risk concentrations, limits on the acceptable overall level of outsourced activities, risks arising from outsourcing multiple activities to the same entity, etc.

ii. The Board shall mandate a regular review of outsourcing policy for such activities in the wake of changing business environment. There shall be at least one review annually of the outsourced activities of the Pension Fund and changes if required shall be incorporated in the policy. It shall also have overall responsibility for ensuring that all ongoing outsourcing decisions taken by the pension fund and the activities undertaken by the third-party, are in keeping with its outsourcing policy.

iii. Such a policy shall have framework for assessment of risks involved in outsourcing including the confidentiality of data, quality of services rendered under outsourcing contracts

iv. While there shall not be any prohibition on a group entity / associate of the pension fund to act as the third party, systems shall be put in place to have an arm's length distance between the pension fund and the third party in terms of infrastructure, manpower, decision-making, record keeping, etc. for avoidance of potential conflict of interests. Necessary disclosures in this regard shall be made as part of the contractual agreement. It shall be kept in mind that the risk management practices expected to be adopted by a pension fund while outsourcing to a related party or an associate would be identical to those followed while outsourcing to an unrelated party.

v. Notwithstanding such outsourcing of non-core activities by the Pension Fund, it is the pension fund and its officers, which shall be held solely responsible in case



of any deviations, discrepancies, wrongdoings, violations or any shortcomings and shall be liable to be proceeded with as provided under law including the provisions of the PFRDA Act, 2013 and the relevant regulations. The Pension Fund under no circumstances shall be allowed to shift its responsibility either wholly or partly on any third party service provider/facilitator of services, notwithstanding the interse arrangement with such party.

8. Outsourcing committee

The Board of Directors of the PF shall constitute an Outsourcing Committee or nominate any existing committee like risk management committee comprising of key management persons of the PF to implement the outsourcing policy decided by the Board of the Pension Fund. The outsourcing committee shall inter-alia be responsible for:

- i. Effective implementation of the Outsourcing policy as approved by the Board of Directors;
- ii. Validating the need to perform the activities proposed for outsourcing. Evaluation of key risks associated with outsourcing contracts;
- iii. Coverage of the scope of services within the objects' clause of the Deed of constitution of the outsourcing service provider;
- iv. Ensuring that the decision to outsource a material activity is supported by a sound business case taking into account the cost and the potential benefits of outsourcing against risks that may arise, having regard to all relevant prudential matters as well as short-term (e.g. temporary service disruptions) and long-term (e.g. impact on business continuity) implications.
- v. Ensuring that the approval to the outsourcing arrangements entered into/proposed to be entered into by the PF is as per the Outsourcing Policy approved by the Board of Directors.
- vi Annual performance evaluation of each of the outsourcing service providers and reporting exceptions to the Board of Directors.
- vii. Communicating information pertaining to risks associated with material activities to the Board of Directors in a timely manner.

9. Risk Management programme for the outsourced activities



The Pension Fund shall establish a comprehensive outsourcing risk management programme to address the outsourced activities and the relationship with the third party including:

- a. The impact of failure of a third party to adequately perform the activity on the financial, reputational and operational performance of the intermediary and on the investors / clients;
- b. Ability of the intermediary to cope up with the work, in case of non-performance or failure by a third party by having suitable back-up arrangements;
- c. Regulatory status of the third party, including its fitness and probity status;
- d. Situations involving conflict of interest between the intermediary and the third party and the measures put in place by the intermediary to address such potential conflicts, etc.
- e. PFs should ensure that failure of service provider should not affect the functioning of the schemes or the system.

10. Due Diligence of Outsourcing Service Providers

It is important that the pension fund exercises due care, skill, and diligence in the selection of the third party to ensure that the third party has the ability and capacity to undertake the provision of the service effectively. The due diligence undertaken by a pension fund shall include assessment of

- a. third party's resources and capabilities, including financial soundness, to perform the outsourcing work within the timelines fixed;
- b. compatibility of the practices and systems of the third party with the pension fund's requirements and objectives;
- c. market feedback of the prospective third party's business reputation and track record of their services rendered in the past;
- d. level of concentration of the outsourced arrangements with a single third party.
- e. third party should keep these operations out of its main business and maintain secrecy of the information data .

11. Outsourcing Agreements

Outsourcing arrangements shall be governed by a clearly defined and legally binding written contract between the pension fund and each of the third parties, the nature and detail of which shall be appropriate to the materiality of the outsourced activity in relation to the ongoing business of the pension fund.

Care shall be taken to ensure that the outsourcing contract:



- a. clearly defines what activities are going to be outsourced, including appropriate service and performance levels;
- b. The terms of such contract shall be in consonance with and be not in derogation of any provisions of the PFRDA Act, rules, regulations, guidelines and directions issued by the Authority.
- c. provides for mutual rights, obligations and responsibilities of the pension fund and the third party, including indemnity by the parties;
- d. provides for the liability of the third party to the pension fund for unsatisfactory performance/other breach of the contract
- e. provides for the continuous monitoring and assessment by the pension fund of the third party so that any necessary corrective measures can be taken up immediately, i.e., the contract shall enable the pension fund to retain an appropriate level of control over the outsourcing and the right to intervene with appropriate measures to meet legal and regulatory obligations;
- f. has unambiguous confidentiality clauses to ensure protection of proprietary and customer data during the tenure of the contract and also after the expiry of the contract;
- g. specifies the responsibilities of the third party with respect to the IT security and contingency plans, insurance cover, business continuity and disaster recovery plans, force majeure clause, etc.;
- h. provides for preservation of the documents and data by third party ;
- i. provides for the mechanisms to resolve disputes arising from implementation of the outsourcing contract;
- j. provides for termination of the contract, termination rights, transfer of information and exit strategies including clauses that such contract shall be brought to an end upon a direction received either from the Authority or NPS Trust, as the case may be;
- k. addresses additional issues arising from country risks and potential obstacles in exercising oversight and management of the arrangements when pension fund outsources its activities to foreign third party. For example, the contract shall include choice-of-law provisions and agreement covenants and jurisdictional covenants that provide for adjudication of disputes between the parties under the laws of a specific jurisdiction;
- l. neither prevents nor impedes the pension fund from meeting its respective regulatory obligations, nor the regulator from exercising its regulatory powers; and
- m. Provides for the pension fund and /or the regulator or the persons authorized by it to have the ability to inspect, access all books, records and information relevant to the outsourced activity with the third party.
- n. Under no circumstances any data or documents pertaining to NPS shall lie with the third party post extinguishment of contract, in any manner.



- o. None of the members/officers/trustees of either the Authority or NPS Trust, shall be liable to any third party in relation to any conduct or action on the part of Pension Fund affecting the rights interse the PF and such third party.

Further, the Pension Fund shall ensure that the outsourcing service provider shall not sub-contract the whole or a substantial portion of the Outsourced activity. Where sub-contracting is allowed partially it should be with the prior consent of the Pension Fund and the additional risk which flows due to subcontracting shall be factored in at the time of due diligence.

12. CONFIDENTIALITY AND SECURITY

- i. The Pension Fund shall satisfy itself that the outsourcing service provider's security policies, procedures and controls will enable the Pension Fund to protect confidentiality and security of policyholders' information even after the contract terminates.
- ii. It shall be the responsibility of the Pension Fund to ensure that the data or information parted to any outsourcing service provider under the outsourcing agreements remains confidential.
- iii. A Pension Fund shall take into account any legal or contractual obligations on the part of the outsourcing service provider to disclose the outsourcing arrangement and circumstances under which Pension Fund's customer data may be disclosed. In the event of termination of the outsourcing agreement, the Pension Fund should ensure that the customer data is retrieved from the service provider and ensure there is no further use of customer data by the service provider.

13. INSPECTION AND AUDIT BY THE PENSION FUND

The Pension Fund shall conduct periodic inspection or audit on the outsourcing service providers either by internal auditors or by Chartered Accountant firms appointed by the Pension Fund to examine the compliance of the outsourcing agreement while carrying out the activities outsourced.

The outsourcing committee of the Pension Fund may decide on the periodicity and service providers to be inspected taking into account the risks associated with the activity outsourced. Pension Fund shall ensure that enabling provisions for the Inspection by the Pension Fund shall be included in the Agreement with outsourcing service provider. Measures shall be taken to arrest the deficiencies noticed if any in the inspection or audit report. PF should submit such audit reports along other audit reports to NPS Trust.

14. LEGAL AND REGULATORY OBLIGATIONS

- i. Pension Funds shall ensure that outsourcing arrangements do not,



- a) diminish their ability to fulfill their obligations to NPS Trust and the PFRDA
- b) impede effective supervision by the PFRDA
- c) result in their internal control, business conduct or reputation being compromised or weakened

ii. The Guidelines apply irrespective of whether the outsourcing arrangements are entered into with an affiliated entity within the same group as the Pension Fund, or an outsourcing service Provider external to the group or the one who has been given sub-contract

iii. Outsourcing shall not diminish the obligations of a Pension Fund and those of its Board and Senior Management to comply with the relevant law/s and guidelines. The Pension Fund is ultimately accountable for all acts of commission and omission of the outsourcing service Providers. The Pension Fund's liability shall not in any way be restricted or limited by way of outsourcing.

iv. All the outsourcing service providers engaged by Pension Funds are subject to the provisions of the PFRDA Act, 2013, Rules, PF regulations 2015, Guidelines and any other orders issued there under.

15. CONTINGENCY PLANS

i. Pension Funds shall establish and maintain adequate contingency plans where the outsourced activity is material. These include disaster recovery plans and backup facilities to support the continuation of an outsourced activity with minimal business disruption in the event of reasonably foreseeable events that affect the ability of an outsourcing service provider to continue providing the service.

ii. The contingency plans should be appropriate to the potential consequences of a business disruption resulting from problems at the outsourcing service provider and should consider contingency plans maintained by the outsourcing service provider and their coordination with the Pension Fund's own contingency arrangements. In particular, contingency plans should ensure that the Pension Fund can readily access all the records necessary to allow it to sustain business operations, meet statutory obligations, and provide any information relating to the outsourced activity as may be required by the PFRDA.

iii. Contingency plans should also be regularly reviewed and tested to ensure that they remain robust, particularly under changing operating conditions.

16. MAINTENANCE OF RECORDS



- i. In respect of all outsourcing arrangements, Pension Funds shall ensure that adequate documentation is maintained to support the Pension Fund's satisfaction of the expectations in these Guidelines.
- ii. Such documentation shall be preserved for five years from the end of the outsourcing contract period by the Pension Funds.

17. REPORTING REQUIREMENTS

(a) Awarding contract first time: It should be reported to NPS Trust within 30 days from the date of finalization of the contract.

(b) Subsequent reporting: All the activities that are outsourced by a Pension Fund shall be reported to the Authority on annual basis (within 45 days from the end of the financial year) in the below given format:(an undertaking may also be taken that the activities outsourced and the vendors to whom outsourced does not in any way is a breach of PFRDA Act/ PF regulations/ agreement with NPST and any other guidelines issued there under)

A. Details of all outsourcing arrangements

SI No	Particulars of activity outsourced (detailed description)	Name and Address of the Vendor/ entity	Contract or agreement period	Audit checks done during the year by Pension fund on the outsourced activity/vendor (Please provide number)

B. Outsourcing with Related Parties or Group entities: If yes, please provide the details in the below table. Otherwise a NIL statement needs to be given.

SI No	Particulars of activity outsourced (detailed description)	Name and Address of the Vendor	Contract or agreement period	Audit checks done during the year by Pension fund on the outsourced activity/vendor (Please provide number)

18. APPLICABILITY TO EXISTING OUTSOURCING CONTRACTS

These Guidelines shall be applicable to all outsourcing arrangements in force on the date of coming into effect of these guidelines. However, any existing outsourcing arrangement to which these guidelines become applicable shall be appropriately amended to bring such arrangement in compliance with these Guidelines within 180 days from the date of coming into effect of these Guidelines. Pension Funds shall ensure that all arrangements that do not comply with these Guidelines within 180 days of the date of the Guidelines coming into effect shall be terminated and Pension Fund shall not avail such services thereafter.

Any activity which is not outsourced but which is shared with the sponsor of the pension fund or a related entity, an approval from the Authority shall be sought for such an activity by giving full details in compliance of Regulation 12 (l) of the PFRDA (Pension Fund) Regulations, 2017 as also these guidelines and giving proper reasoning for allowing such sharing. No pension fund shall have a right to such sharing unless specifically permitted by the Authority. However, an approval for all such existing arrangements shall be sought within 90 days from the date of coming into effect of these Guidelines and the decision of the Authority on such matters shall be final and binding.



09/10/17
(Venkateswarlu Peri)
Chief General Manager

Annexure- I

Indicative list of core and non- core activities

S. No.	Activities	Core/ Non-Core
1	Investment function and compliance	Core
2	Regulatory reporting	Core
3	Fund and Portfolio Management	Core
4	Trade confirmation and settlement	Core
5	Fund Accounting including NAV calculations	Core
6	Proxy - Voting decision making	Core
7	Banking and Treasury	Core
8	Risk Assessment- Any activities having a significant impact on its risk management	Core
9	All investment and fund deployment activities as mentioned in PFRDA (PF) regulation	Core
10	Market Research, Stock selection & recommendation, Deal Execution & Order Placement	Core
11	Broker empanelment & review	Core
12	Public disclosure of information	Core
13	Advisory services (support function)	Non-Core
14	Legal	Non-Core
15	Training	Non-Core
16	Billing services	Non-Core
17	Information technology support system (only software development and hardware)	Non-Core
18	Safekeeping of the records with respect to record retention policy of the entity	Non-Core
19	Administrative support services	Non-Core
20	MIS reporting, financial accounts	Non-Core