

Risk Management of Critical Outsourcing

Vendors and Other Third Parties

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15 February 2019

- Pressures to reduce costs
- New strategic idea of focussing on key competences
- Later, risk-based considerations – not take on risks we are not expert in.

To offset concerns:

- can set a performance specification
- in case of under-performance, claim on warranties and indemnities
- the Whitehall defence

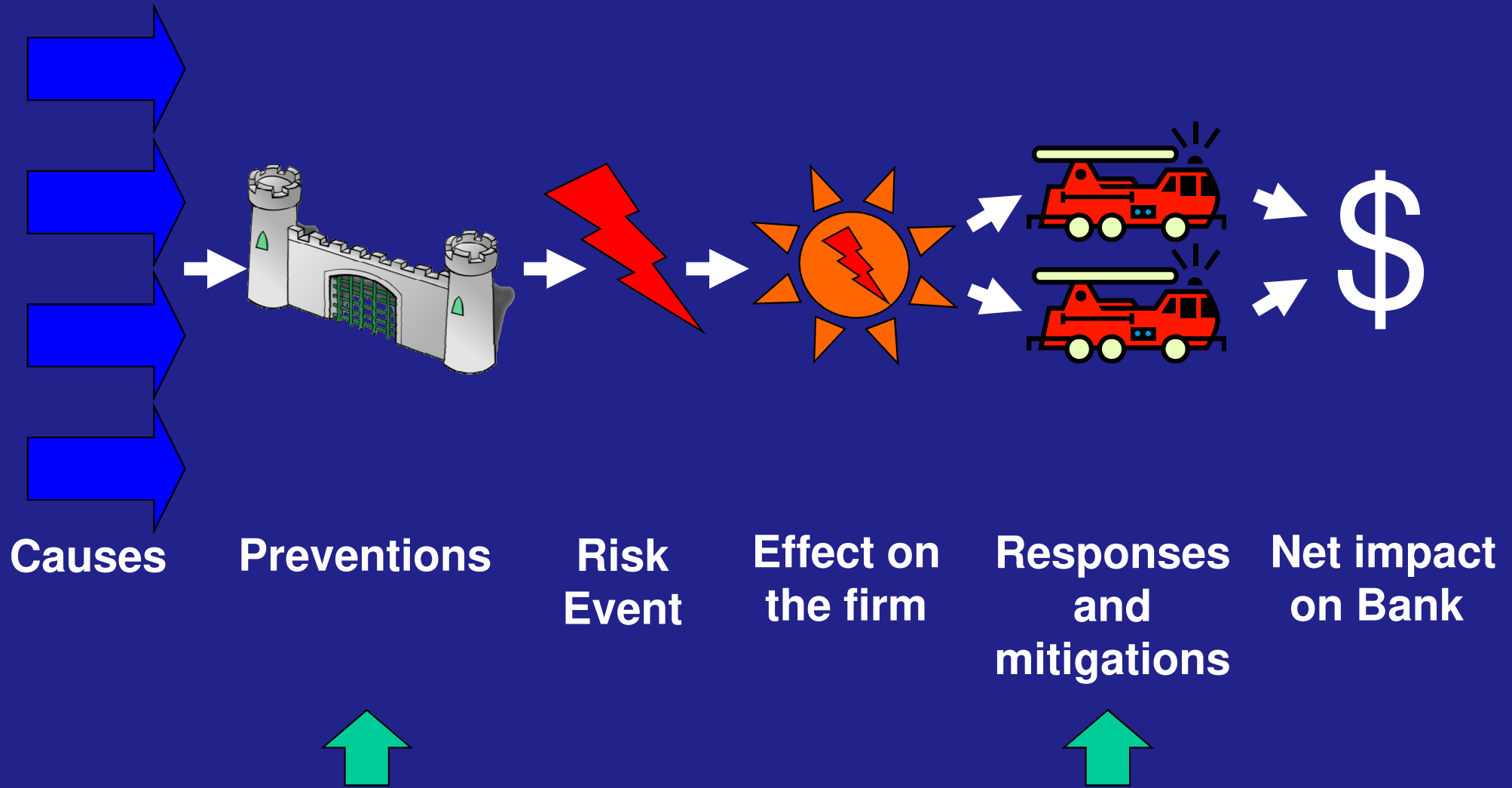
Where Are We Now?

IT Operations
Customer Handling (not just
'phones!)
IT Planning &
Implementation

HR Administration & Payroll
Credit/debit Card Admin
Internal Audit
Risk Management
.....

- *Failures, sometimes major, even catastrophic*
- *Key activities no longer under supervision or control*
- *Loss of expertise – reinforced by use of consultants for planning and executing new initiatives*

Impact on Risk Control



- 1. Outsourcing does not eliminate risks**
- 2. Makes the risk harder to monitor and influence**
- 3. Commitment of many years.
Expensive/Challenging to leave**

A photograph of several spotlights on a stage, with beams of light shining down. The scene is dark, and the spotlights are the primary source of light, creating a dramatic effect.

From:

- risks we have assessed ourselves
- have means of control
- are best able to monitor

A photograph of a road or path that is completely obscured by thick fog or mist. The visibility is very low, and the overall atmosphere is grey and hazy.

To:

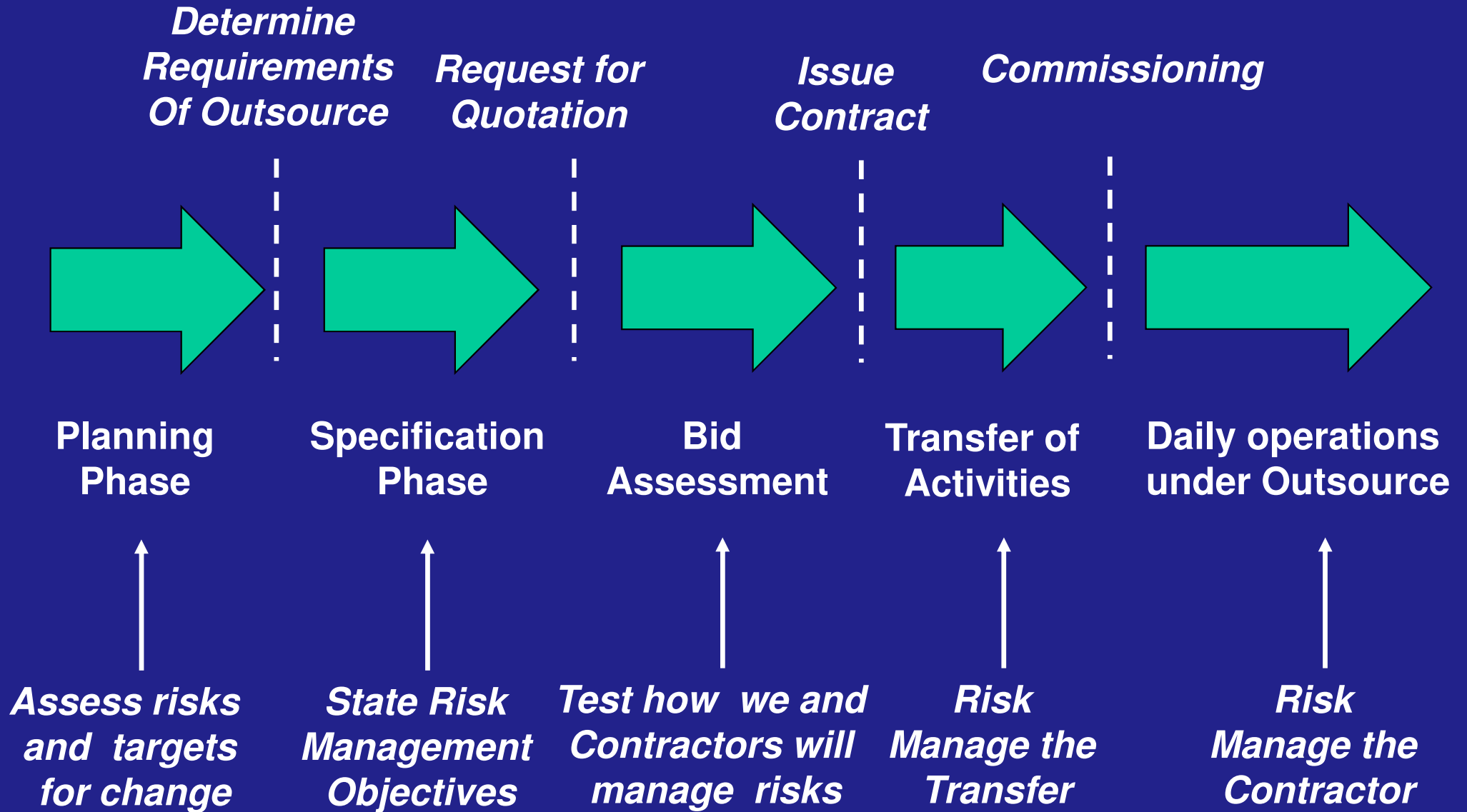
- risks - cannot identify and assess
- no direct control
- poor and slow monitoring

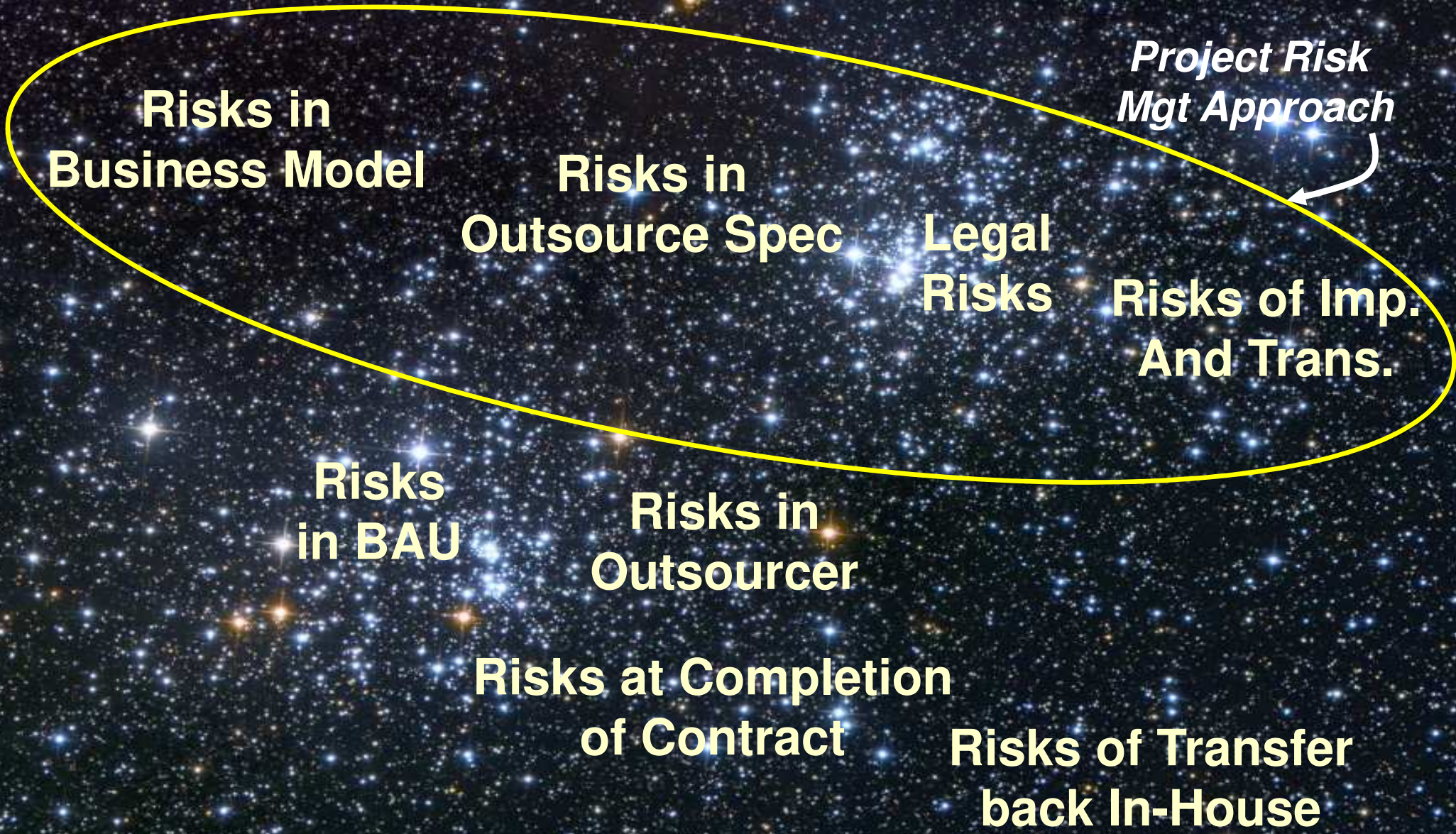
Still have the largest exposures!



- ORM ensures the risks of outsourcing are identified
 - to Whole-Firm extent
 - inc. Worst Cases
- ORM's requirements are part of the Performance Spec. in the ITT
- ORM has expertise and resources to monitor and provide in-house reports on the risk profile and risk experience of the outsourcer

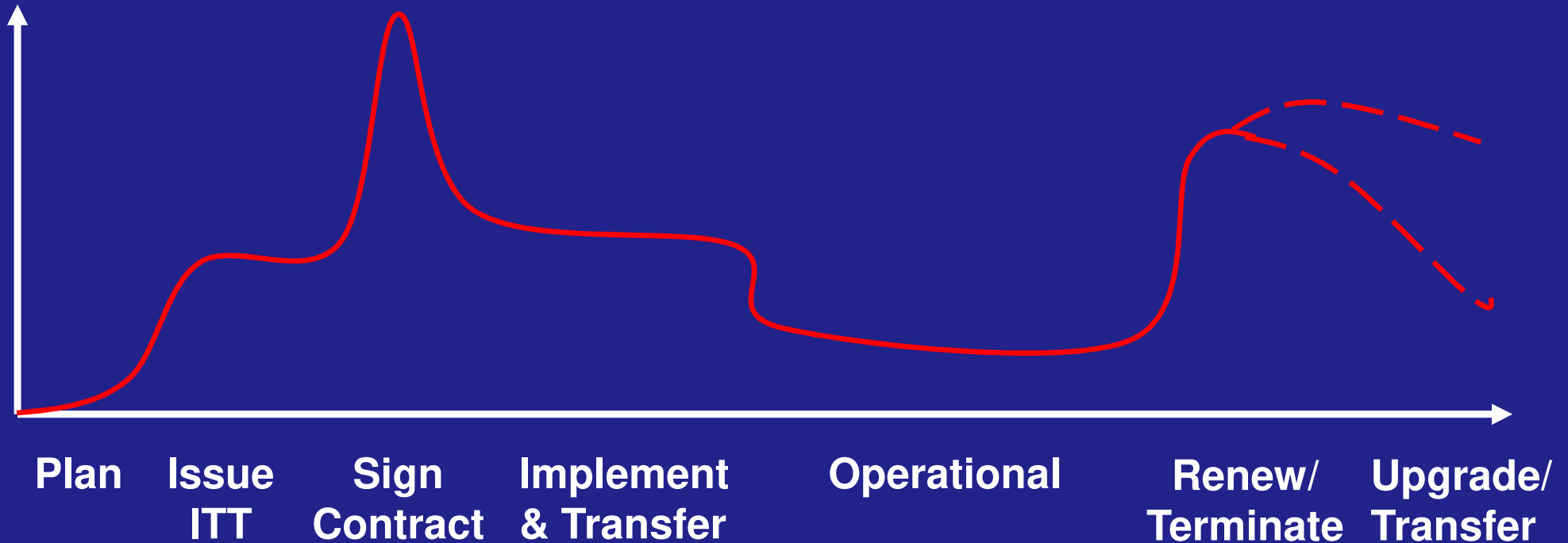
Outsourcing/Major Project Timeline





Level of Risk Exposure under Active Mgt.

Risk Level

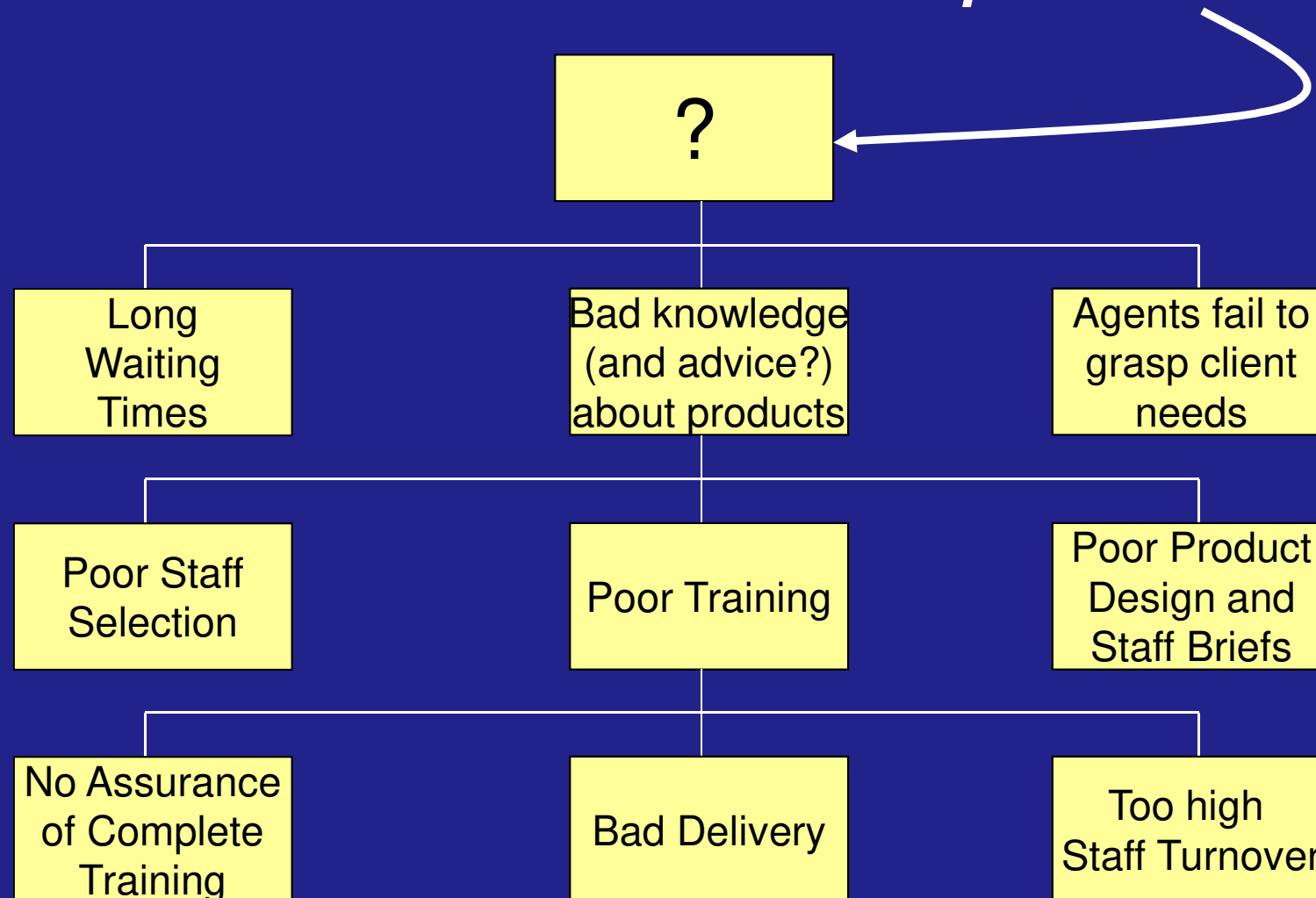


Risk Profile – Risk in absolute or Risk cf in-house?

1. What are the risks of the activity to be outsourced?
Develop the KRIs and require monitoring and reporting.
2. What risks within Outsource company's provision of services, including corporate condition. Develop KRIs
3. What are the risks of the transfer project?
4. Specify risk management framework you want Outsourcer to use internally on the services and the transfer, inc.
 - monitor effectiveness (Assurance)
 - right of Inspection/Internal Audit
5. Ensure Cost Savings > Increased Cost of Risk

Understanding The Risks - Fault Tree

eg how could we become one of the most complained-about for telephone service?



Specific Inclusion in ORM Framework Policies/Procedures including:

- **ORM Director decides if a project is “Outsourcing”**
- **OR manager(s) embedded in outsourcing investigations, planning etc right from the outset**
- **Process and Methodology is key topic in ORM training and briefing – Div. Heads, Line 1, with Line 2 having Outsourcing RM Expert**
- **Content of OR activity in the various stages**

Essential to have high level authority for the Policy and Procedure

- Pre-determined preferences and momentum
- Championed by Director or senior Line 1 Executive
- Under-estimating the challenges to the firm and the issues
- Strain to make the business case – on both sides

Early Stages

- *Risk profile of current operations. Cost of the risks to us*
- *identification of major sensitivities and vulnerabilities for the firm from these activities*
- *foreseeable changes in business environment and business model – challenges for the outsource activity*
- *the business objectives in outsourcing*
- *expected risks to these objectives within an outsourcer*
- *data security issues*

Be prepared to challenge pre-decisions

Prepare ITT

Prepare ITT

- *required ORM practice by outsourcer including requirements for information about past experience of risk losses in firm*
- *bidder to provide assessments of risks of implementation, of BAU, of termination. Description of controls and mitigations.*
- *requirements for risk reporting to us, inc. entitlement to undertake audit of ORM performance*

Issue ITT

Bid Evaluation, Selection and Negotiations

- *examine ORM performance of bidders*
- *quality of ORM practice to be part of the formal appraisal of each bidder*
- *establish standards of risk exposure, for when monitoring (Risk Tolerance etc)*

In Operation

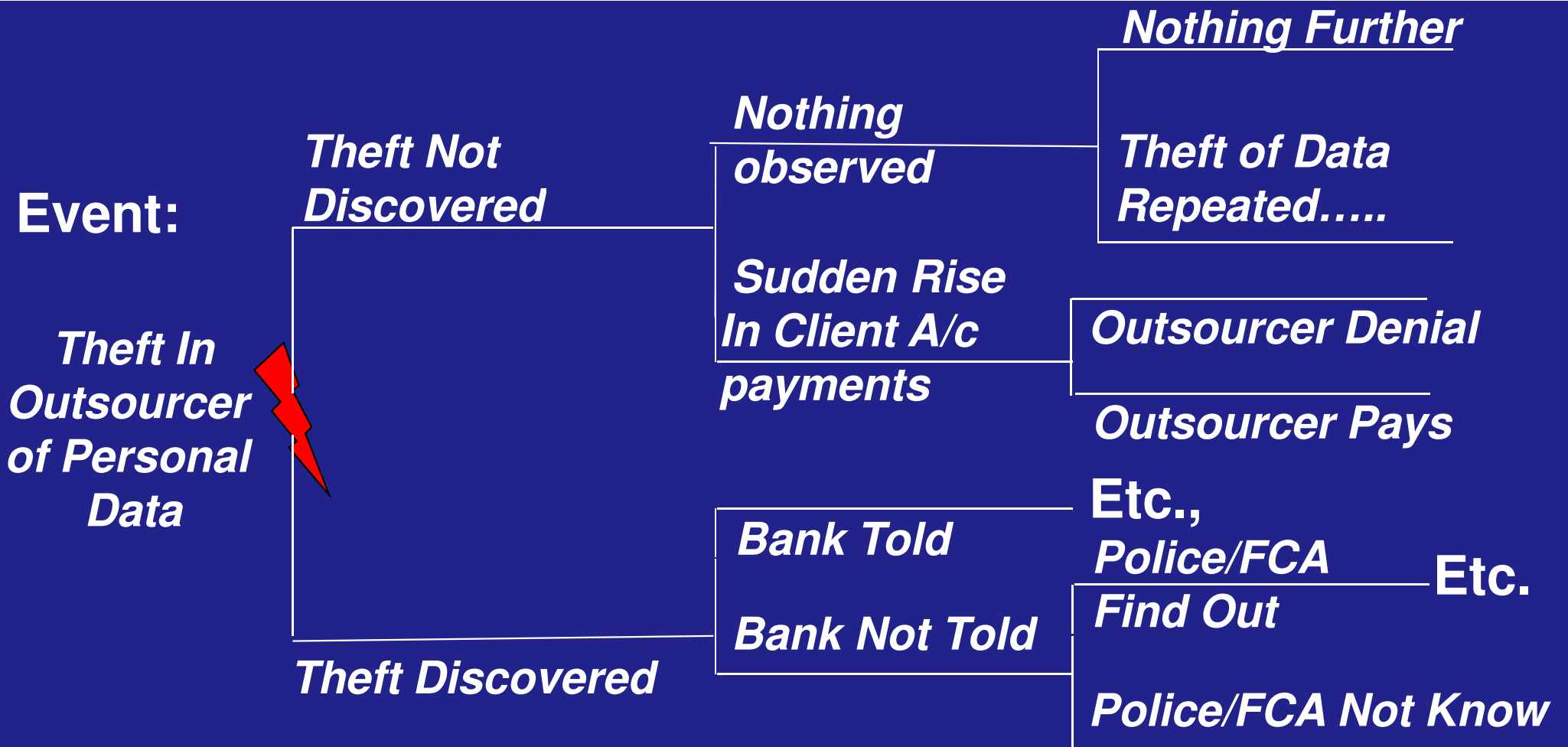
- *regular monitoring of OR reports. Investigate when outside agreed standards (in contract)*
- *maintain monitoring of overall performance and risks of Outsourcer firm*
- *be prepared to deep dive to check.*

Why Should We Worry if the Contract is Right?

Key aims for an Outsourcer

- 1. Win new contracts*
- 2. Make sure rights to payment are keyed to measureable controllable KPIs and potential liabilities are capped*
- 3. Get the costing (including compensations) right and as low as possible for the Performance Spec.*
- 4. Ensure “good” terms for changes*
- 5. In operation – has different culture from bank*
 - drive to reduce costs so long as underperformances do not cause escalation*
 - leads to sub-sub-contracting – invisibility, lack of influence*

Outcomes Analysis – Event Tree



Note: Lack of Transparency

Time Lags are created by the Outsource function
Each Outcome has a probability and potential loss

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