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TECHNOLOGY OUTSOURCING BY NATIONAL SECURITIES EXCHANGES AND REGISTERED CLEARING AGENCIES

Outsourcing of technology systems plays an important role for national securities exchanges and registered clearing agencies, but raises securities law compliance issues. After providing a regulatory framework for outsourcing, the author discusses compliance considerations when national securities exchanges and registered clearing agencies decide to outsource their technology systems, including compliance obligations under Regulation SCI. In this context, she discusses the importance of risk assessment of the outsourcing decision, due diligence on the prospective third party, and management of the third-party relationship, to ensure regulatory compliance, through contractual terms, ongoing monitoring, and oversight, among other means. She closes with considerations for the third-party service provider.

By Wenchi Hu *

Outsourcing — the use of third-party service providers to perform certain activities, functions, processes, or services in place of producing such internally — is widely utilized and, in many instances necessary, for an operating entity to perform its activities and functions. As technology develops and advances, outsourcing may not only be used for resource management and cost savings, but also to leverage new technology and third-party expertise that enables the business to operate in a way that would not otherwise be possible.

Unique issues and challenges arise when a regulated entity contemplates outsourcing any of its activities and

functions to a third party. Questions to be answered include: Can the regulated entity outsource the particular activity or function? If so, to whom can it be outsourced? Who is legally responsible for regulatory compliance after outsourcing, and how should it comply with regulatory requirements in the outsourcing arrangements? It would typically be prudent to answer these questions before heavy investments are made and binding contractual outsourcing arrangements are entered into. Given that the operation of many regulated entities rely heavily on technology systems and leverage third parties' technological expertise, technology

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INSIDE THIS ISSUE

- CLE QUESTIONS, Page 271
- RECENT LAW FIRM PUBLICATIONS, Page 272