



*Growing Asia's Markets*



# Proposed Leading Principles for Regulation of Outsourcing

July 2018

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**ASIFMA** is an independent, regional trade association with over 100 member firms comprising a diverse range of leading financial institutions from both the buy and sell side including banks, asset managers, law firms and market infrastructure service providers. Together, **we harness the shared interests of the financial industry to promote the development of liquid, deep and broad capital markets in Asia.** ASIFMA advocates stable, innovative and competitive Asian capital markets that are necessary to support the region's economic growth. We drive **consensus, advocate solutions and effect change around key issues through the collective strength and clarity of one industry voice.** Our many initiatives include consultations with regulators and exchanges, development of uniform industry standards, advocacy for enhanced markets through policy papers, and lowering the cost of doing business in the region. Through the GFMA alliance with SIFMA in the US and AFME in Europe, ASIFMA also provides insights on **global best practices and standards to benefit the region.**

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## 1. Executive Summary

ASIFMA is an independent, regional trade association with over 100 member firms comprising a diverse range of leading financial institutions from both the buy and sell side, including banks, asset managers, law firms and market infrastructure service providers.

This ASIFMA report outlines proposed leading principles for regulation of outsourcing for regulated securities, futures and banking intermediaries in the Asia-Pacific region, based on research on existing securities, futures and banking regulations in several key Asia-Pacific jurisdictions (Australia, Hong Kong, Japan and Singapore) and two leading international jurisdictions (the UK and US) for comparison. This initiative is the result of ASIFMA members expressing the challenges they currently face with regulatory fragmentation, i.e. complying with varying outsourcing regulations across different Asia-Pacific jurisdictions, and mixed regulatory recognition across the Asia-Pacific jurisdiction of the reduced risk of intra-group outsourcing and the reliance across the group on centralized group functions and centers of excellence within regional and multinational firms. ASIFMA recognizes that there is a growing need regionally for an aligned approach for the regulation of outsourcing to better serve consumers and markets without compromising the core regulatory objectives of protecting consumers and systemic stability. The leading principles set out to achieve this through facilitating the dialogue between financial institutions and policy makers.

The report was prepared by the member firm EY, based on feedback from ASIFMA members regarding their key concerns on various facets of outsourcing regulation and their practical experience of implementing outsourcing globally and within the Asia-Pacific region. The report is structured to propose nine leading principles for regulation of outsourcing, which have been agreed with members and are the focus of this research. Those principles cover nine key issues relating to outsourcing: (1) Prohibition of outsourcing, (2) Definition of outsourcing, (3) Materiality, (4) Intra-group outsourcing, (5) Regulatory approvals and notification, (6) Inventory of outsourcing, (7) Audit requirements, (8) Governance and accountability, and (9) Incident notification. Some issues will be of relevance to more than one principle or there may be some degree of taxonomical debate as to which principle an issue is discussed under. We have sought to highlight this where relevant.

The report was the result of: first, conducting research on relevant regulatory approaches and requirements across jurisdictions surveyed (Hong Kong, Singapore, Japan, Australia, UK and the USA) and, secondly, collecting the practical experience of members seeking to conduct outsourcing on a global or regional basis and trying to comply with disparate regulation in multiple Asia-Pacific jurisdictions.

It is worth noting that the term 'outsourcing' in this report refers to both intra-group outsourcing arrangements and third party outsourcing. By intra-group outsourcing we mean services provided by individual entities or group members that benefit the group as a whole. By contrast, third party outsourcing refers to services being performed on behalf of the group by an external provider. Some members have queried whether outsourcing by one branch of a legal entity to another branch of the same legal entity should be regarded as outsourcing at all as the same legal entity is performing the services.

We discuss these issues under Principle 4 on Intra-group Outsourcing.

The outsourcing of information technology is outside the scope of this report as it raises specific issues compared with outsourcing of other functions and services and is covered by ASIFMA separately. ASIFMA and its members will launch in late 2018 a regulatory briefing note on the use of the cloud in the financial services industry.

Outsourcing has become a key part of regulated financial firms' operating model and brings various benefits such as economies of scale, being able to access lower costs, allowing firms to concentrate on their core business and to benefit from specialization in the provision of services resources. However, it would benefit regulated financial firms if the outsourcing regime in the Asia-Pacific region was further aligned across jurisdictions in order to better allow regulated firms to achieve operational efficiencies, particularly for global and regional regulated firms. We acknowledge that regulated firms should retain ultimate accountability for outsourced functions and that appropriate risk management and governance processes ought to be in place so that the risks of outsourcing are managed prudently and core regulatory objectives for the protection of customers, systemic stability and markets are not jeopardised. The leading principles we propose are aimed to secure these objectives while not disproportionately impeding the benefits firms, their customers and markets can realise from firms pursuing prudent outsourcing.

In February 2005, the Joint Forum released a report on Outsourcing in Financial Services focusing on the potential risks that outsourcing activities can pose to financial sector firms, while recognizing the substantial benefits that outsourcing can provide. To assist firms and regulators in considering their outsourcing activities, the report presented a set of principles outlining issues that should be taken into account in the process.

In developing the outsourcing principles, the Joint Forum worked closely with the International Organization of Securities Commissions (IOSCO), which also released guidance on outsourcing at the same time. The principles are high-level and aimed collectively at the banking, insurance and securities sectors.

The Joint Forum and IOSCO principles form the basis of the proposed leading principles outlined in this report in that we have sought to ensure the leading principles comply with them. Refer to Appendices III and IV.

The nine outsourcing principles are:

### **Principle 1 – Prohibition of outsourcing**

Outsourcing should not be prohibited given the various benefits it brings to the financial services industry through economies of scale, specialization and realization of costs benefits from comparative advantage. However, appropriate due diligence should be carried out when selecting service providers and the firm should monitor performance on an ongoing basis. In addition, firms should adopt risk management proportional to the nature, scale and complexity of the outsourcing arrangements and remain accountable for the outsourced activities.

### **Principle 2 – Definition of outsourcing**

Outsourcing is defined as provision of service in which a regulated firm contracts with or otherwise engages a service provider for the performance of any aspect of the outsourcing firm's regulated or unregulated functions that could otherwise be undertaken by the entity itself on an ongoing basis. It is valuable to provide an inclusive express list of examples of outsourced services and exceptions to what is considered outsourcing. Regulators should seek to align what they define as outsourcing, otherwise the same practice in different jurisdictions is regulated inconsistently which makes adopting a group and region wide approach to outsourcing difficult.

### **Principle 3 – Materiality**

Regulation of outsourcing arrangements should be predicated on a threshold that the arrangement is material. A pragmatic approach should be applied when determining if outsourcing arrangements are material and, if so, trigger additional outsourcing regulatory requirements.

### **Principle 4 – Intra-group outsourcing**

A reduced assessment is considered sufficient for intra-group outsourcing arrangements. For example, appropriate consideration should be given in a self-assessment by the outsourcing regulated firm of the financial soundness, compatibility of corporate culture and strategies, etc. in the case of outsourcing to parent companies or affiliates, that are wholly or more than 50% owned/controlled by the same ultimate parent company, recognizing that outsourcing to such an entity with shared culture, organisational frameworks and control/risk management functions should help lower the risks associated with intra-group outsourcing. Additionally, one branch or head office of a legal entity performing services for another branch of the same legal entity should not be considered outsourcing, as the two branches, or head office and branches, are effectively the same legal entity, and the same global corporate governance, risk management and compliance policies apply.

### **Principle 5 - Regulatory approvals/notifications**

Regulators should not require pre-notification or approval for material outsourcing arrangements. Rather, a regulated entity that commences a material outsourcing arrangement should keep an inventory of the

arrangement, as discussed in principle 6, that should be available to the regulator upon request. If regulators are not content with this proposal, a regulated entity that commences a material outsourcing arrangement should notify its regulator of the commencement of the arrangement as soon as possible thereafter.

#### **Principle 6 – Inventory of outsourcing arrangements**

A complete and accurate inventory or centralized list of material outsourcing arrangements should be maintained by a regulated firm, together with any outsourcing agreements and the firm should review that inventory on a regular basis to ensure it is accurate and up to date. The regulator should provide some minimal guidance on the contents of the inventory. There should be some flexibility as to whether such an inventory is kept at a group or local level, as long as it is available to the regulator upon request. International standard setters should seek agreement among regulators on the contents of such inventories.

#### **Principle 7 – Audit requirements**

A regulated firm's internal audit function must periodically review the risk management controls over material outsourcing arrangements and report to the Board, Board audit committee or relevant risk management or governance organ of the firm, as appropriate. A firm can choose to use external auditors if they wish.

#### **Principle 8 – Governance and accountability**

The Board and senior management of the regulated firm should retain full accountability for discharging all of its responsibilities in relation to any material outsourcing arrangement. The Board and senior management cannot delegate responsibility to the service provider. Risk assurance proportional to the nature, scale and complexity of the outsourcing arrangement should be carried out.

#### **Principle 9 – Incident notification and business continuity planning**

Regulated firms should promptly notify the regulator of any material issues or changes that have the potential to materially affect a material outsourcing arrangement and, as a consequence, materially affect the business operations, customers, profitability or reputation of the regulated firm. This should be done under general incident notification requirements if they exist, rather than replicating it in a separate incident notification requirement specific to outsourcing.

Within a group, while the management of a regulated firm cannot delegate responsibility for outsourcing services, a service providing intra-group company should be able to rely to a proportionate degree upon the business continuity plan of the outsourcing group company rather than having to have a separate business continuity plan.



## 2. Outsourcing Principles

### **Principle 1 – Prohibition of outsourcing**

**Principle:** *Outsourcing should not be prohibited given the various benefits it brings to the financial services industry through economies of scale, specialization and realization of costs benefits from comparative advantage. However, appropriate due diligence should be carried out when selecting service providers and the firm should monitor performance on an ongoing basis. In addition, firms should adopt risk management proportional to the nature, scale and complexity of the outsourcing arrangements and remain accountable for the outsourced activities.*

No jurisdiction that we surveyed prohibited outsourcing, though they subjected it to varying degrees of regulation which we analyze in the following principles. Members have identified that some regional regulators not surveyed do prohibit the outsourcing of certain functions or impose certain restrictions on outsourcing outside the jurisdiction. For example, one regional regulator prohibits the outsourcing of strategic and core management and internal audit. Another requires that data centres and disaster recovery centres for electronic systems for public services be kept within the country. Another member identified that one regional regulator had disallowed it outsourcing certain functions even though the outsourcing was intra-group and the firm had to rely on stretched internal resources or second resources from a wholly owned entity to perform those services.

Members agree with the current state of regulation in the jurisdictions benchmarked in this report. Members believe outsourcing should not be prohibited as it would impede global business, deny regulated firms organizational flexibility, and stop them from realizing cost benefits through economies of scale, competitive advantage and specialization. In turn, this would deny customers and markets cheaper and possibly better services. However, a regulated firm must adopt appropriate and proportional risk management and continue to assume responsibility for its outsourced functions. Regulators should be able to access information necessary to discharge its supervision of the outsourced function.

Similarly, members also consider that no specific type of service should necessarily be prohibited from being outsourced subject to proper risk management and supervision being in place.

## **Principle 2 – Definition of outsourcing**

***Principle:** Outsourcing is defined as provision of service in which a regulated firm contracts with or otherwise engages a service provider for the performance of any aspect of the outsourcing firm's regulated or unregulated functions that could otherwise be undertaken by the entity itself, on an ongoing basis. It is valuable to provide an inclusive express list of examples of outsourced services and exceptions to what is considered outsourcing.<sup>1</sup> Regulators should seek to align what they define as outsourcing, otherwise the same practice in different jurisdictions is regulated inconsistently which makes adopting a group and region wide approach to outsourcing difficult.*

In most jurisdictions, outsourcing refers to an arrangement under which another party undertakes to provide to a financial institution an ongoing service that was previously, currently is or could potentially be carried out by the institution itself, on an ongoing basis. In Singapore, the Monetary Authority of Singapore (MAS) has defined outsourcing as an arrangement in which a service provider provides the institution with a service that may currently or potentially be performed by the institution itself, and where the institution is dependent on the service on an ongoing basis and the service is integral to the provision of a financial service by the institution or the service is provided to the market by the service provider in the name of the institution. This definition is caveated with specific exceptions (see Appendix II to this paper). The Hong Kong Securities and Futures Commission (SFC) and the US Office of the Comptroller of the Currency (OCC) do not have specific definitions of outsourcing. However, the Hong Kong SFC seems to have endorsed the IOSCO guidance while the US OCC has general guidelines around third-party relationships. Outsourcing is not restricted to regulated activities.

ASIFMA members agree with the IOSCO definition of outsourcing, however they consider that a preferable approach would be to add concrete examples and exceptions to provide some greater guidance on the application of the general principles definition of outsourcing. Members favour the lists of examples and exceptions that the MAS provides as providing clarity and suggest other regulators emulate this. Members believe that this would provide the industry with further guidance and clarity regarding what is considered to be an outsourcing arrangement for the purpose of regulation and what is not. There should also be consistency amongst regulators on what is considered an outsourcing agreement so that outsourcing is more easily pursued consistently on a group and regional, if not global, basis. For, example, the co-location of data centres is treated inconsistently in the region, with most leading international jurisdictions not defining it as outsourcing. Regulators should, via international standard setting bodies, seek to align the definition of outsourcing.

Current definitions of outsourcing across regional jurisdictions include intra-group outsourced activities and largely subject it to the same regulation as third party outsourcing. However, members believe that the provision of services by an entity within the same legal entity (as with banks where they operate with

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<sup>1</sup> IOSCO Principles on Outsourcing of Financial Services for Market Intermediaries 2005

a branch structure across different jurisdictions) should not be considered as intra-group (or third party) outsourcing and is hence an exception. We further consider the treatment of forms of intra-group outsourcing under Principle 4.

Members also recommend that there should be a clearer view on whether arrangements to have entities perform on behalf of a regulated entity activities that do not involve matters critical to the regulated entity's regulated activities and/or involve the handling of sensitive customer data should be defined as outsourcing. Examples that might fall within this category include the handling of payroll processing, or the storage and use of employee data. In particular, in relation to employee data, as opposed to customer data, members expressed a view that this was more a matter for data privacy regulation than financial regulation

### **Principle 3 – Materiality**

***Principle:** Regulation of outsourcing arrangements should be predicated on a threshold that the arrangement is material. A pragmatic approach should be applied when determining if outsourcing arrangements are material and if so trigger additional outsourcing regulatory requirements.*

The regulators of all jurisdictions that we surveyed impose additional regulatory requirements specific to material outsourcing arrangements. Most jurisdictions surveyed define material outsourcing as outsourcing of critical functions which, if disrupted or weakened, would heavily impact the company operations and customers and potentially its ability to comply with some regulations. In Singapore (MAS) and Hong Kong (HKMA), materiality is judged by both financial and non-financial criteria.

MAS defines material outsourcing as an arrangement which, in the event of a service failure or security breach, has the potential to either materially impact an institution's business operations, reputation or profitability, or ability to manage risk and comply with applicable laws and regulations, or which involves customer information and, in the event of any unauthorized access or disclosure, loss or theft of customer information, may have a material impact on an institution's customers. Examples of what MAS regards as material are detailed in Appendix V of this paper.

Members recommend that regulators take a pragmatic approach when assessing whether an outsourcing arrangement is considered material. Members generally agreed with an approach of considering materiality in light of the impact of a disruption in the provision of the outsourced services on:

- the services the firm is licensed to provide
- the financial position on the outsourcing firm
- the firm's customers and
- the outsourcing firm's ability to meet its legal and regulatory obligations.

Members suggest that a regulator should consider what a material outsourcing arrangement is against this test based on the nature of the service, its location, the involvement of confidential data.

In light of that, we draw attention to the comments under Principle 2 about the definition of outsourcing and the request that regulators gives examples of matters that are considered material outsourcing and matters that are clearly regarded as exceptions. International and, if that is not possible, regional consistency on what is considered material is important to ensure that firms can pursue outsourcing on a group and internationally, or at the very least regionally, consistent basis.

Members overwhelmingly consider that outsourcing regulation should not apply if an outsourcing arrangement is regarded as immaterial. However, if a regulator still applies outsourcing specific regulatory

requirements, albeit reduced ones, to immaterial outsourcing, members recommend the regulatory requirements should be significantly lighter for immaterial outsourcing arrangements.

Members also proposed that a more pragmatic approach be taken and regulatory guidance be provided for notification obligations in relation to changes in material outsourcing arrangements

For example, members suggest that a change relating to internal reorganization (e.g. moving of internal employees between services providers which are affiliates without changing their responsibilities) should not be viewed as a material change even if the original outsourcing arrangement is considered material. Members further suggest that the need for an independent assessment and pre-approval by or notification to the regulators should be waived in the case of immaterial changes to outsourcing arrangements that are themselves considered material.

#### **Principle 4 – Intra-group outsourcing**

***Principle:** A reduced assessment is considered sufficient for intra-group outsourcing arrangements. For example, appropriate consideration should be given in a self-assessment by the outsourcing regulated firm of the financial soundness, compatibility of corporate culture and strategies, etc. in the case of outsourcing to parent companies or to affiliates, that are wholly or more than 50% owned/controlled by the same ultimate parent company, recognizing that outsourcing to such an entity with shared culture, organisational frameworks and control/risk management functions would should help manage the risks associated with outsourcing. Additionally, one branch or head office of a legal entity performing services for another branch of the same legal entity should not be considered outsourcing, as the two branches, or head office and branches, are effectively the same legal entity and the same global corporate governance, risk management and compliance policies apply.*

Intra-group outsourcing can be defined as an arrangement in which one company provides services for another company within the same group on an ongoing basis. Most regulators do not specifically differentiate between intra-group outsourcing and third party outsourcing except for the HKMA, MAS and two Australian regulators (the Australian Prudential Regulatory Authority (APRA) and the Australian Stock Exchange (ASX)). HKMA recognizes that the risk of intra-group outsourcing may be commensurately lower and excludes arrangements between banks' overseas branches as outsourcing for the purposes of regulation in the sense it is considered in this report. MAS considers that expectations in its Guidelines may be addressed within group-wide risk management policies and procedures for intra-group outsourcing. APRA allows that reduced assessment may be sufficient for intra-group outsourcing and that such an arrangement with a related body corporate need not be documented in a legally binding contract. ASX does not consider arrangements between wholly owned group entities to be outsourcing but may consider it to be "off-shoring", if it occurs cross-border, which is still regulated but not as stringently as "outsourcing".

In addition to the current regulations and guidelines, a reduced assessment approach for the outsourcing of the intra-group arrangements is welcomed by members. Members support a streamlined risk assessment and due diligence approach for intra-group outsourcing recognizing that appropriate consideration should be given in a self-assessment by the outsourcing regulated firm of the financial soundness, compatibility of corporate culture and strategies, etc. in the case of outsourcing to parent companies or affiliates, that are wholly or more than 50% owned/controlled by the same ultimate parent company, recognizing that outsourcing to such an entity with shared culture, organisational frameworks and control/risk management functions would should help reduce the risks associated with outsourcing.

In addition, for some intra group activities, for example group audit or risk management activities performed on a regional office or head office level, the regulator could consider allowing greater flexibility on the application of requirements.

For example, members considered that notification to the regulator and audit of the outsourcing arrangement should not be required in recognition of the common policies and systems that would enable intra-group outsourcing to be better risk-managed.

Members therefore considered a light assessment approach should be adopted for intra-group outsourcing and the regulators could provide more examples of areas where a reduced assessment can be applied.

Additionally, members also considered that one branch or head office of a legal entity performing services for another branch of the same legal entity should not be considered outsourcing, as the two branches, or head office and branches, are effectively a single entity and the same internal corporate governance, risk management and compliance policies apply.

## **Principle 5 – Regulatory approvals/notifications**

***Principle:** Regulators should not require pre-notification or approval for material outsourcing arrangements. Rather, a regulated entity that commences a material outsourcing arrangement should keep an inventory of the arrangement, as discussed in Principle 6, that should be available to the regulator upon request. If regulators are not content with this proposal, a regulated entity that commences a material outsourcing arrangement should notify its regulator of the arrangement as soon as possible thereafter.*

Unlike the Singapore, Japanese and US regulators, the HKMA, Australian (APRA and ASX at least) and UK regulators require to be notified when entering into a material outsourcing agreement. APRA asks for a summary of key risks and risk mitigation strategies while the UK requires notification for critical operational functions only. ASX expects notification of the start and termination of outsourcing arrangements. It is not clear what ASIC and the Hong Kong SFC's position is. The Japanese FSA requires informal consultation on large scale outsourcing arrangements. It is necessary to unofficially convince the Japanese FSA that there are sufficient risk management measures in place before such large scale outsourcing proceeds.

It is unclear whether formal consent is required in the US and UK. However, banks have to receive acknowledgment of pre-notification from the HKMA in Hong Kong (the position of the Hong Kong SFC is unclear) before proceeding with their outsourcing arrangements. This appears to be a form of “negative consent” – i.e. the regulator is unofficially indicating that it does not object through an acknowledgement which says nothing more. But, in theory, the regulator may object to or express concerns about some proposed arrangements from a supervisory perspective through a communication of the supervisory concerns that a proposed outsourcing arrangement raises. ASX requires that firms obtain and maintain necessary regulatory approvals from relevant governmental agencies or regulatory authorities in Australia or elsewhere in respect of overseas activity.

Regulatory notification or approval for insourcing (i.e. a regulated firm in the jurisdiction in question performing a service for another firm, perhaps but not necessarily, outside the jurisdiction) is not required in any jurisdiction.

Pre-notification is required on material outsourcing by some regulators. However, such a requirement is not required in other countries in the region. In countries where it is required, it has increased the time required for implementation of outsourcing in that country compared to others, and, in certain cases, affected the global implementation of the services where it is not feasible to proceed with implementation only for certain countries/entities.



In some jurisdictions, it is not clear whether an acknowledgement should be obtained before the outsourcing activities start. However, as market practice, in those jurisdictions, members would wait for the regulator to give consent before any implementation.

As global firms seek to develop global outsourcing policies and to implement them globally, not jurisdiction by jurisdiction, jurisdictions that require pre-notification or approval can significantly delay roll out of outsourcing arrangements and realization of their cost reduction, specialization and other benefits.

Members consider that keeping an inventory of material outsourcing arrangements that is made available to the regulator upon request should be sufficient. If this is not acceptable, they consider that post-notification of the commencement of an outsourcing arrangement as soon as possible after commencing a material outsourcing arrangement is preferable to pre-notification and would enable regulators to adequately monitor outsourcing and its risks.

## **Principle 6 – Inventory of outsourcing arrangements**

***Principle:** A complete and accurate inventory or centralized list of material outsourcing arrangements should be maintained by a regulated firm, together with any outsourcing agreements and the firm should review that inventory on a regular basis to ensure it is accurate and up to date. The regulator should provide some minimal guidance on the contents of the inventory. There should be some flexibility as to whether such an inventory is kept at a group or local level, as long as it is available to the regulator upon request. International standard setters should seek agreement among regulators on the contents of such inventories.*

The HKMA, MAS and ASX require firms to have an inventory of outsourcing arrangements. MAS requires a firm to maintain a register of all outsourcing arrangements and ensure that the register is readily accessible for review by the board and senior management of the regulated firm and accessible to the MAS upon request. MAS has provided a template for the information to be included.

It is not clear what the rule is for other regulators. However it may be wise for a regulated outsourcing firm to keep such an inventory for its own purposes and in order to manage its risks and to better manage its relations with regulators, for example, for it to respond more easily to a request for a list of outsourcing arrangements during a regulatory compliance inspection.

Members therefore do not object to a requirement for the maintenance of a centralized list of material outsourcing activities and related agreements or arrangements governing those outsourcing arrangements. Members considered the regulator could provide some guidance on the minimal expected information required in the inventory. It would be desirable for regulators to standardize the content of such inventories through international standard setting bodies as ideally a single inventory should be able to serve the need of all regulators as long as it is readily available to each of them upon request.

Members also consider that some flexibility is desirable as to whether such an inventory is kept at a group or local level, as long as it is accessible to local regulators upon request.

## **Principle 7 – Audit requirements**

**Principle:** *A regulated firm's internal audit function must periodically review the risk management controls over material outsourcing arrangements and report to the Board, Board audit committee or relevant risk management or governance organ of the firm, as appropriate. A firm can choose to use external auditors if they wish.*

While it is unclear what the audit related requirements are for several regulators, it appears that the HKMA, MAS and APRA and the US banking regulators require audit over the risk management controls of outsourcing arrangements on a regular basis determined on a risk based approach. However, ASX does not consider it an obligation and refers to the right of the regulated outsourcing firm to audit performance of services provided by the service provider. Those regulators who require it allow it to be performed by internal or external auditors.

As long as the outsourcing rules include a proper periodic audit by internal audit or a reputable external auditor, then the regulator should leave that to the institution to comply with and execute. There should not be a need to submit audit reports to the regulator and, if so, it should again differentiate between intra-group outsourcing, which will have an integrated governance model with internal audit standards and policies, and third party outsourcing. This appears to be in line with the majority of regulators surveyed.

## **Principle 8 – Governance and accountability**

***Principle:** The Board and senior management of the regulated firm should retain full accountability for discharging all of its responsibilities in relation to any material outsourcing arrangement. The Board and senior management cannot delegate responsibility to the service provider. Risk assurance proportional to the nature, scale and complexity of the outsourcing arrangement should be carried out.*

All jurisdictions require regulated firms to retain ultimate responsibility for oversight of any outsourced business or operations.

Members agree with the current regulation regarding governance and that the Board and senior management of the regulated firm should remain fully accountable for the outsourced activities.

## **Principle 9 – Incident notification and business continuity planning**

***Principle:** Regulated firms should promptly notify the regulator of any material issues or changes that have the potential to materially affect a material outsourcing arrangement and, as a consequence, materially affect the business operations, customers, profitability or reputation of the regulated firm. This should be done under general incident notification requirements if they exist, rather than replicating it in a separate incident notification requirement specific to outsourcing.*

*Within a group, while the management of a regulated firm cannot delegate responsibility for outsourcing services, a service providing intra-group company should be able to rely to a proportionate degree upon the business continuity plan of the outsourcing group company rather than having to have a separate business continuity plan.*

Most jurisdictions formally or informally require regulated firms to notify their regulators of material incidents in relation to outsourcing arrangements.

Members considered that any material issues or changes that would materially affect the business operations, profitability or reputation of the regulated firm, whether it is material outsourcing arrangement or not, are reported to the regulator under the current incident notification process. While they did not dispute that the requirement should apply to outsourcing, they thought it more appropriate that a specific/separate outsourcing incident notification requirement not be created. This would cause unnecessary duplicate reporting under the general and outsourcing specific incident notification requirements.

### 3. Conclusion and Next Steps

ASIFMA and its members hope that these high-level principles will be a reference point for regulators within the Asia-Pacific region as well as regional and global forums when they consider reforming outsourcing regulations/guidelines and hope that these principles will further drive harmonization of outsourcing regulations.

Appendix I – Regulatory survey

	SG (MAS)	HK (HKMA)	HK (SFC)	AUS (APRA, ASX, ASIC)	UK (FCA and PRA)	US (OCC and FRB)	JP (JFSA)
<b>Prohibition of outsourcing</b>	No.	No.	No.	No.	No. Even outsourcing of important operational functions as long as it does not impair materially the quality of internal control and the ability of the FCA to monitor the firm's compliance with obligation under regulatory system.	No.	No. Outsourcing includes entrusting operations necessary for banks to conduct its businesses including cases where no outsourcing contracts are executed but the reality is considered as equivalent to outsourcing and cases where outsourced businesses/operations are conducted/operated offshore.
<b>Definition of outsourcing (including exceptions)</b>	Outsourcing arrangement refers to an arrangement in which a service provider provides the institution with a service that may currently or potentially be performed by the institution itself and which the institution is dependent on the service on an ongoing basis; and the service is integral to the provision of a financial service. Exceptions include: (1) Arrangements in which certain industry characteristics require the use of third-party providers (2) Introducer arrangements and arrangements that pertain to principal-agent relationships (3) Arrangements that the institution is not legally or administratively able to provide. (Further information is provided in the Annex)	Outsourcing refers to an arrangement under which another party (i.e. the service provider) undertakes to provide to an AI a service previously carried out by the AI itself or a new service to be launched by the AI.	Not defined in regulatory requirements. But, as appears to have endorsed IOSCO guidance - "outsourcing" is defined as an event in which a regulated outsourcing firm contracts with a service provider for the performance of any aspect of the outsourcing firm's regulated or unregulated functions that could otherwise be undertaken by the entity itself. According to this definition, outsourcing would not cover purchasing contracts.	'Outsourcing' involves an APRA-regulated institution, or an institution within a group that is not an APRA-regulated institution, entering into an arrangement with another party (including a related body corporate) to perform, on a continuing basis, a business activity that currently is, or could be, undertaken by the institution itself.  For ASX, "Outsourcing" occurs when a participant enters into an arrangement with another party to perform, on a continuing basis, a business activity that currently is, or could be undertaken by the participant itself. That other party could be a related body corporate or an unrelated third party.  ASIC provides examples of outsourcing in their guidance rather than a given definition.	Outsourcing refers to the arrangement of any form between a firm and a service provider by which that service provider performs a process, a service or an activity which would otherwise be undertaken by the firm itself.	OCC does not have specific definition over outsourcing but on a broader level - third-party relationship in general, which is defined as any business arrangement between a bank and another entity, by contract or otherwise. Third-party relationships include activities that involve outsourced products and services.	Outsourcing refers to banks entrust business operation to third-party entities, which also includes entrustment of administrative operations necessary for operating business. Cases where a business operation is deemed to be virtually outsourced without the signing of an outsourcing contract, and cases where the outsourced business operation is conducted abroad, are also included.
<b>Definition - Restricted to regulated activities</b>	No. Includes other matters that are integral to the provision of regulated activities or provided to the market by the service provider in the name of the firm and the firm is dependent on the service on an ongoing basis.	No. Includes other matters that are integral to the provision of regulated activities or provided to the market by the service provider in the name of the firm and the firm is dependent on the service on an ongoing basis.	Not expressed.	No. Includes other matters such as internal audit function and risk management function as material business activities. (APRA).  Not expressed for ASX or ASIC.	PRA: No. Includes (1) activities that constitute dealing in investments as principal, disregarding the exclusion in article 15 of Regulated Activities Order; (2) ancillary activities; (3) in relation to MiFID business, ancillary services; and (4) unregulated activities in a prudential context.	No. Includes bank functions, information technology and customer impact activities.	No.

	SG (MAS)	HK (HKMA)	HK (SFC)	AUS (APRA, ASX, ASIC)	UK (FCA and PRA)	US (OCC and FRB)	JP (JFSA)
<b>Materiality</b>	Yes. MAS is particularly interested in material outsourcing arrangements and the degree to which a firm implements its regulations should be commensurate with the risks and materiality of the outsourcing arrangement. Materiality judged by financial and non-financial criteria.	Yes. Notification only required for material outsourcing including material changes to existing material outsourcing. Materiality judged by financial and non-financial criteria.	Although materiality is not expressed in the regulatory documents issued by SFC, SFC suggests Licensed Corporations to endorse IOSCO guidance – which states that materiality is judged by financial and non-financial criteria.	Yes. For an APRA-regulated institution must consult with APRA prior to entering into any offshoring agreement involving a material business activity. Materiality judged by financial and non-financial criteria.  ASX has higher expectations around the documentation and supervision of “material” outsourcing arrangements. Outsourcing is considered “material” if in relation to a material business activity, i.e. one that, if disrupted, has material impact on the company. Guidance note 9 provides examples.  Not expressed for ASIC.	Yes. FCA: operational functions which are critical for the performance of regulated activities, listed activities or ancillary services (in this chapter “relevant services and activities”) on a continuous and satisfactory basis.  PRA: Material outsourcing means outsourcing services of such importance that weakness, or failure, of the services would cast serious doubt upon the firm’s continuing satisfaction of the threshold conditions or compliance with the Fundamental Rules.	Yes. “Critical activities” include: (1) significant bank functions (2) significant shared services and (3) activities with significant customer impacts, require significant investment in resources, or significantly impact bank operations if the relationship failed.	Yes. There are additional requirements to the following types of outsourcing: (a) entrusting services concerning receipt or payment of money pertaining to the business of a deposit or loan by using a cash dispenser or an automatic teller machine and (b) entrusting the safety management of information concerning customers, who are individuals and handled by the Bank, the supervision of employees, and handling of said information.
<b>Intragroup outsourcing – need for differentiation</b>	No.	No for most outsourcing requirement, except that they need only notify material outsourcing and risk management measures for such may be commensurate with the lower associated risks. Specific exclusion for outsourcing solely between bank’s overseas branches.	Not expressed in the regulatory requirements but would probably apply IOSCO guidance – i.e. the principles applied to intra-group outsourcing but with modification to account for the different degree of risk.	For APRA, yes. Reduced assessment may be sufficient for outsourcing arrangement intragroup. Outsourcing arrangement with a related body corporate may not be necessarily documented in a legally binding agreement.  For ASX, as long as intra-group activities remain wholly in-house (between wholly owned group entities), ASX does not consider them “outsourcing arrangements”, instead it may consider them “off-shoring” (which still needs to be appropriately documented and managed but not as formally as for an outsourcing arrangement).  Not expressed for ASIC.	No.	No according to the Steady-State Requirements section.	No for most outsourcing requirement, except that the new amendment to the Banking Act introduced a new arrangement where when multiple banks in the same group entrust common operation to affiliate service companies, the holding company is subject to group-wide outsourcing management obligation.
<b>Regulatory approvals/notification</b>	Generally no, but notification is required for any adverse development arising from its outsourcing arrangements that could affect the institution. Such adverse developments include any event that could potentially lead to prolonged service failure or disruption in the outsourcing arrangement, or any breach of security and confidentiality of the institution’s customer information. An institution should also notify MAS of such adverse development encountered within the institution’s group.	Yes. Before implementation of material outsourcing in 1 month.	Not clear.	Yes, APRA also require a summary of key risks involved and the risk mitigation strategies, as soon as possible after entering into an outsourcing agreement, and in any event no later than 20 business days after execution of the outsourcing agreement.  Yes, ASX requires notification when entering into and terminating an outsourcing arrangement.  Not expressed for ASIC.	Yes for operational functions which are critical or important for the performance of relevant services and activities on a continuous and satisfactory basis.	No.	No. However, at least for the drastic or huge-scale business process outsourcing, banks are expected to informally consult with JFSA in prior to implementation of such outsourcing.



	SG (MAS)	HK (HKMA)	HK (SFC)	AUS (APRA, ASX, ASIC)	UK (FCA and PRA)	US (OCC and FRB)	JP (JFSA)
<b>Regulatory approvals/notification: Consent needed</b>	Yes as the acknowledgement of pre-notification in industry practice is deemed as approval	Not strictly but should wait for HKMA acknowledgement of pre-notification.	Not clear.	For APRA, in some cases - for all outsourcing of material business activities with third parties, have a legally binding agreement in place, unless otherwise agreed by APRA.  For ASX, obtain and maintain necessary regulatory approvals from relevant governmental agency or regulatory authority in Australia or elsewhere in respect of overseas activity and provide to ASX upon request.  Not expressed for ASIC.	Not clear.	Not clear.	No. However, discussions between banks and JFSA will be held and banks are expected to convince JFSA through demonstrating reasonable risk management measures and capabilities.
<b>Regulatory approvals/notification for insourcing</b>	No.	Not strictly, but if it poses major risks, should tell HKMA.	Not clear but SF (Licensing and Registration) (information) Rules may suggest yes.	For APRA, no.  Not expressed for ASX and ASIC.	No.	No.	No, unless when transitional processes for insourcing will have, or contain risks to have, material impacts on customers.
<b>Inventory</b>	Yes for all material and immaterial outsourcing arrangements.	Yes. For immaterial outsourcing and all insourcing arrangements. May be requested during supervision.	Not clear but may be wise for own purposes and to better manage regulatory relations.	For APRA not clear but may be wise for own purposes and to better manage regulatory relations.  For ASX, refers to record keeping under SLA obligations. Onus on service provider to provide records of outsourced activities.  Not expressed for ASIC. However, refers to "appropriate measures in place for ongoing monitoring".	Not clear but may be wise for own purposes and to better manage regulatory relations.	Not clear but may be wise for own purposes and to better manage regulatory relations.	Not clear but JFSA might request such list on onsite inspections.
<b>Audit requirements – frequency and scope (including both the audit rights of regulators as well as the obligation for institutions to perform internal audits)</b>	Yes. Independent audit or expert assessments of the outsourcing agreements should be conducted. Such audit or assessment may be performed by the institution's internal or external auditors, service provider's external auditors or by agent appointed by the institution. Scope: an assessment of the service providers' and its sub-contractors' security and control environment, incident management process and the institution's observance of these Guidelines in relation to the outsourcing arrangement. Frequency: dependent on the nature and extent of risk and impact. Copies of audit reports should be submitted to MAS.	Yes. Internal audit should review the control procedures over the outsourcing arrangement regularly, which should include the procedures for monitoring the performance of, and managing the relationship with the service provider and risk associated with the outsourced activity. HKMA also states that it may be appropriate to seek an independent opinion on the effectiveness of the service provider.	Not clear.	For APRA, yes. Internal audit function must review any proposed outsourcing of a material business activity and regularly review and report to the Board or Board Audit Committee on compliance with the institution's outsourcing policy. APRA may request the external auditor or an appropriate external expert to provide an assessment of the risk management processes in place with respect to an arrangement to outsource a material business activity.  For ASX, No. Refers to the right of the participant to audit performance of services provided by service provider.  Not clear for ASIC.	Not clear.	Yes. Independent review should be conducted on a regular basis, either by the bank's internal auditor or an independent third party. OCC may use its authority to examine the functions or operations performed by a third party on the bank's behalf which may include safety and soundness risks, the financial and operational viability of the third party to fulfill its contractual obligations, compliance with applicable laws and regulations and whether the third party engages in unfair or deceptive acts or practices in violation of federal or applicable state law.	Not clear. However, FSA states that when a bank is outsourcing business operation, the bank should consider whether the outsourced business operation is subject to audits. It is noted that audit is required when it is requested by the regulator which serve as a reference in connection with the business or financial condition of the Bank or during on-site inspection.

	SG (MAS)	HK (HKMA)	HK (SFC)	AUS (APRA, ASX, ASIC)	UK (FCA and PRA)	US (OCC and FRB)	JP (JFSA)
<b>Governance</b>	Firm, board and senior management retain ultimate responsibility. Firm must ensure outsourcing services managed as if still performed by firm.	Board and management must retain ultimate responsibility. CE or ACE should sign notification.	Not clear, but likely to follow IOSCO principles that require board and senior management to be fully responsible.	For APRA, the Board is ultimately responsible for oversight of any outsourcing of a material business activity undertaken by an APRA-regulated institution.  For ASIC, if firms outsource functions that relate to an AFS license, the license holder remains responsible for complying with its obligations as a licensee. If firms outsource functions that relate to an AFS license, they are expected to: (a) have measures in place to ensure that due skill and care is taken in choosing suitable service providers; (b) monitor the ongoing performance of service providers; and (c) appropriately deal with any actions by service providers that breach service level agreements or obligations as a licensee. OTC derivative brokers may outsource a lot of their operations. Licensees must be transparent about how they conduct their business and deposit money to client accounts within 1 business day.  For ASX, refers to management supervision processes.	Firms retain full accountability for discharging all of their responsibilities under the regulatory system and cannot delegate responsibility to the service provider.	OCC recommends that for critical activity outsourcing, the board assesses the risk, reviews due diligence reports and approves the MSA.  FRB recommends the Board to establish policies governing the use of service provider and senior management is responsible for appropriate execution of the board-approved policies.	Banks remain responsible for their entire businesses and operations to their customers and supervisors even when some of them are outsourced.  JSA also requires banks to have company-wide chief officers responsible for managing outsourcing.
<b>Incident notification</b>	Firm should notify MAS as soon as possible of any adverse development arising from its outsourcing arrangements.	Yes. Of any significant problems and of any related issues that require incident reporting.	Not clear but SF (Licensing and Registration) (information) Rules may suggest yes.	For APRA, yes. Of any significant problems that have the potential to materially affect the outsourcing arrangement and, as a consequence, materially affect the business operations, profitability or reputation of the group.  Yes, ASX requires notification of any material changes in outsourcing arrangements.  For ASIC, states that the participant should appropriately deal with any actions by service providers that breach service level agreements or obligations as a licensee.	Not clear but if it would be a good practice to have ongoing notification.	Yes. OCC suggested prompt notification of financial difficulty and catastrophic events and significant incidents such as info breaches and data loss etc.	Not clear but it is stated that the bank should have a system in place to ensure prompt report to the bank for leakage of customer information.

## Appendix II – MAS exceptions regarding outsourcing arrangements

The following arrangements would generally not be considered outsourcing Arrangements:

- I. Arrangements in which certain industry characteristics require the use of third party Providers
  - (i) Maintenance of custody account with specified custodians as required under Regulation 27 of the Securities and Futures (Licensing and Conduct of Business) Regulations;
  - (ii) Telecommunication services and public utilities (e.g., electricity, SMS gateway services);
  - (iii) Postal services;
  - (iv) Market information services (e.g., Bloomberg, Moody's, Standard & Poor's);
  - (v) Common network infrastructure (e.g., Visa, MasterCard, MASNET+);
  - (vi) Clearing and settlement arrangements between clearing houses and settlement institutions and their members, and similar arrangements between members and non-members;
  - (vii) Global financial messaging infrastructure which are subject to oversight by relevant regulators (e.g., SWIFT); and
  - (vii) Correspondent banking services.
  
- II. Introducer arrangements and arrangements that pertain to principal-agent Relationships
  - (i) Sale of insurance policies by agents, and ancillary services relating to those sales;
  - (ii) Acceptance of business by underwriting agents; and
  - (iii) Introducer arrangements (where the institution does not have any contractual relationship with customers)
  
- III. Arrangements that the institution is not legally or administratively able to provide
  - (i) Statutory audit and independent audit assessments;
  - (ii) Discreet advisory services (e.g., legal opinions, independent appraisals, trustees in bankruptcy, loss adjuster); and
  - (iii) Independent consulting (e.g., consultancy services for areas which the institution does not have the internal expertise to conduct)

### Appendix III- IOSCO Principles

- I. An outsourcing firm should conduct suitable due diligence processes in selecting an appropriate third party service provider and in monitoring its ongoing performance.
- II. There should be a legally binding written contract between the outsourcing firm and each third party service provider, the nature and detail of which should be appropriate to the materiality of the outsourced activity to the ongoing business of the outsourcing firm.
- III. The outsourcing firm should take appropriate measures to determine that:
  - Procedures are in place to protect the outsourcing firm's proprietary and customer-related information and software; and
  - Its service providers establish and maintain emergency procedures and a plan for disaster recovery, with periodic testing of backup facilities.
- IV. The outsourcing firm should take appropriate steps to require that service providers protect confidential information regarding the outsourcing firm's proprietary and other information, as well as the outsourcing firm's clients from intentional or inadvertent disclosure to unauthorized individuals.
- V. Regulators should be cognizant of the risks posed where one service provider provides outsourcing services to multiple regulated entities.
- VI. Outsourcing with third party service providers should include contractual provisions relating to termination of the contract and appropriate exit strategies.
- VII. The regulator, the outsourcing firm, and its auditors should have access to the books and records of service providers relating to the outsourced activities and the regulator should be able to obtain promptly, upon request, information concerning activities that are relevant to regulatory oversight.

## Appendix IV – Joint Forum Guiding Principles on Outsourcing in Financial Services

- I. A regulated entity seeking to outsource activities should have in place a comprehensive policy to guide the assessment of whether and how those activities can be appropriately outsourced. The board of directors or equivalent body retains responsibility for the outsourcing policy and related overall responsibility for activities undertaken under that policy.
- II. The regulated entity should establish a comprehensive outsourcing risk management programme to address the outsourced activities and the relationship with the service provider.
- III. The regulated entity should ensure that outsourcing arrangements neither diminish its ability to fulfil its obligations to customers and regulators, nor impede effective supervision by regulators.
- IV. The regulated entity should conduct appropriate due diligence in selecting third-party service providers.
- V. Outsourcing relationships should be governed by written contracts that clearly describe all material aspects of the outsourcing arrangement, including the rights, responsibilities and expectations of all parties.
- VI. The regulated entity and its service providers should establish and maintain contingency plans, including a plan for disaster recovery and periodic testing of backup facilities.
- VII. The regulated entity should take appropriate steps to require that service providers protect confidential information of both the regulated entity and its clients from intentional or inadvertent disclosure to unauthorised persons.
- VIII. Regulators should take into account outsourcing activities as an integral part of their ongoing assessment of the regulated entity. Regulators should assure themselves by appropriate means that any outsourcing arrangements do not hamper the ability of a regulated entity to meet its regulatory requirements.
- IX. Regulators should be aware of the potential risks posed where the outsourced activities of multiple regulated entities are concentrated within a limited number of service providers.

## Appendix V – MAS guidelines on material outsourcing arrangements

1. An institution should assess the materiality in an outsourcing arrangement. In assessing materiality, MAS recognises that qualitative judgment is involved and the circumstances faced by individual institutions may vary. Factors that an institution should consider include:
  - (a) importance of the business activity to be outsourced (e.g., in terms of contribution to income and profit);
  - (b) potential impact of the outsourcing on earnings, solvency, liquidity, funding and capital, and risk profile;
  - (c) impact on the institution's reputation and brand value, and ability to achieve its business objectives, strategy and plans, should the service provider fail to perform the service or encounter a breach of confidentiality or security (e.g., compromise of customer information);
  - (d) impact on the institution's customers, should the service provider fail to perform the service or encounter a breach of confidentiality or security;
  - (e) impact on the institution's counterparties and the Singapore financial market, should the service provider fail to perform the service;
  - (f) cost of the outsourcing as a proportion of total operating costs of the institution;
  - (g) cost of outsourcing failure, which will require the institution to bring the outsourced activity in-house or seek similar service from another service provider, as a proportion of total operating costs of the institution;
  - (h) aggregate exposure to a particular service provider in cases where the institution outsources various functions to the same service provider; and
  - (i) ability to maintain appropriate internal controls and meet regulatory requirements, if the service provider faces operational problems.
  
2. Outsourcing of all or substantially all of its risk management or internal control functions, including compliance, internal audit, financial accounting and actuarial (other than performing certification activities) is to be considered a material outsourcing arrangement.
  
3. An institution should undertake periodic reviews of its outsourcing arrangements to identify new outsourcing risks as they arise. An outsourcing arrangement that was previously not material may subsequently become material from incremental services outsourced to the same service provider or an increase in volume or change in nature of the service outsourced to the service provider. Outsourcing risks may also increase when the service provider sub-contracts the service or makes significant changes to its sub-contracting arrangements.
  
4. An institution should consider materiality at both the institution's level and as a group, i.e., together with the institution's branches and corporations under its control.



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