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Statement of Guidance: Outsourcing All Regulated Entities

1. STATEMENT OF OBJECTIVES

- 1.1. This Statement of Guidance ('Guidance') is intended to provide guidance to regulated entities on the establishment of outsourcing arrangements (including sub-outsourcing) and the outsourcing of material functions or activities.
- 1.2. This Guidance is not intended to be prescriptive or exhaustive; rather this Guidance sets out the Cayman Islands Monetary Authority's ("the Authority") minimum expectations on the outsourcing of material functions or activities and outsourcing arrangements.
- 1.3. This Guidance is provided on the basis that regulated entities, including their Governing Body and Senior Management, remain ultimately responsible for all outsourced functions or activities, regulatory requirements and any other requirements of the Authority.
- 1.4. The Authority expects that regulated entities would not generally outsource material functions; however, where material functions are outsourced, regulated entities should follow this Guidance.

2. SCOPE OF APPLICATION

- 2.1 This Statement of Guidance applies to all entities regulated by the Authority (except for regulated mutual funds as defined in the Mutual Funds Law). For the purpose of this Guidance, a regulated entity is an entity that is regulated under the:
 - a) Banks and Trust Companies Law
 - b) Insurance Law
 - c) Mutual Funds Law
 - d) Securities Investment Business Law
 - e) Building Societies Law
 - f) Cooperative Societies Law



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- g) Development Bank Law
- h) Money Services Law
- i) Companies Management Law

- 2.2 This Guidance applies regardless of whether the outsourcing arrangement established by a regulated entity is with a related or unrelated entity.
- 2.3 This Guidance should be applied to sub-contractors, where applicable.
- 2.4 In instances where the requirements of this Guidance apply or can be applied with respect to the delegation or sub-delegation of functions or activities, a regulated entity should do so.
- 2.5 This Guidance should not preclude the need for all functions and activities (whether material or not) to be subject to adequate risk management and sound internal controls.

3. DEFINITIONS

- 3.1 For the purpose of this Guidance, the below definitions are provided.
 - a) **Outsourcing:** a regulated entity's use of a third party (either an affiliated entity within a group or an entity that is external to the corporate group) to perform functions or activities on a continuing basis that would normally be undertaken by the regulated entity, now or in the future.
 - b) **Outsourcing agreement:** a written agreement outlining the contractual terms and conditions governing relationships, functions, obligations, responsibilities, rights and expectations of the contracting parties.
 - c) **Material function or activity:** a function or activity that, if disrupted (e.g. service failure or security breach), could



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potentially impact an institution's business operations, reputation or profitability in a significant way (e.g. prolonged failure of information technology system impacting customers' ability to conduct transactions) or could adversely affect an institution's ability to manage risk and comply with applicable laws and regulations.

- d) **Related Party:** a natural person or a group of entities related financially or by common ownership, management or any combination thereof.
- e) **Sub-contracting:** an arrangement where a service provider, which has a legally binding outsourcing agreement with a regulated entity, further outsources the service or part of the service that it was contracted to provide.
- f) **Governing Body:** in the case of a company, the Board of Directors. In the case of a branch or of an entity incorporated or established outside of the Cayman Islands, a management committee or body (beyond local management) empowered with oversight and supervision responsibilities for the entity in the Cayman Islands.
- g) **Service Provider:** a third party (whether related or unrelated) that supplies goods, services or facilities pursuant to an outsourcing arrangement.

4. MATERIALITY ASSESSMENT OF OUTSOURCING ARRANGEMENTS

- 4.1 A regulated entity should assess the materiality of its outsourcing arrangements, and without limiting the scope of its assessments, should consider:
 - a) the impact of the outsourcing arrangement on its finances, reputation and operations, or a significant business line,



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- particularly if the service provider, or group of affiliated service providers, should fail to perform over a given period of time;
- b) its ability to maintain appropriate internal controls and meet regulatory requirements, particularly if the service provider were to experience problems;
 - c) the cost of the outsourcing arrangement; and
 - d) the degree of difficulty and time required to find an alternative service provider or to bring the business activity 'in-house'.

5. GENERAL GUIDANCE

- 5.1 The Authority expects that regulated entities will outsource a function or activity for various reasons, including to take advantage of economies of scale or expertise. The Authority expects the rationale for outsourcing of any material function or activity to be sound and in keeping with the entity's business strategy.
- 5.2 The Authority's supervisory functions and legal obligations should not be hindered by the outsourcing of any function or activity by a regulated entity.
- 5.3 The Authority may, on a case-by-case basis, impose additional requirements on a regulated entity depending on the potential impact of the outsourcing threat to the entity or its investors/clients.
- 5.4 A regulated entity should maintain the same level of oversight and accountability with respect to the outsourcing of any material function or activity as it would apply to its non-outsourced material functions or activities.
- 5.5 Outsourcing all or substantially all of a management oversight function¹ should always be considered material, except in circumstances where the

¹ Management oversight function includes financial analysis; compliance and Anti Money Laundering/Countering the Financing of Terrorism oversight; internal audit services related to the internal accounting controls, financial systems, or financial statements; senior management responsibilities; and risk management.



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regulated entity receives such services from a related entity. Outsourcing should not affect independence, effectiveness or objectivity of the oversight function.

- 5.6 A regulated entity's relationship and obligations towards its clients must not be altered as a result of the outsourcing of any function or activity.
- 5.7 A regulated entity's level of net risk should not materially increase as a result of outsourcing compared to if it carried out the function or activity itself.
- 5.8 When a regulated entity is required to have sufficient staff and to maintain books and records in the Cayman Islands, the outsourcing of functions or activities should not cause a regulated entity to be a 'shell' or 'letter-box' entity².
- 5.9 A regulated entity should ensure that all books and records pertaining to the activities of the regulated entity, including any record of transaction activities for clients are readily accessible to the Authority.
- 5.10 Regulated entities should consider this Guidance at the first opportunity, either at the time of the initial outsourcing agreement or contract or at such time that the agreement or contract is substantially amended, renewed or extended, whichever is earliest.
- 5.11 Regulated entities should give due consideration to all relevant laws, regulations and measures issued by the Authority when assessing an outsourcing arrangement.

6. RISK MANAGEMENT

²**Shell entity:** means an entity that has no physical presence in the country in which it is incorporated and licensed, and which is unaffiliated with a regulated financial group that is subject to effective consolidated supervision.

Letter-box entity: an entity that no longer retains the necessary expertise and resources to supervise the delegated tasks and to manage the risks associated with the delegation.



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- 6.1 A regulated entity should, at a minimum:
- a) implement a policy on outsourcing;
 - b) have proper procedures in place to identify all material outsourcing arrangements;
 - c) establish and document an adequate risk management framework, systems, policies and processes to assess, control and monitor its material outsourcing arrangements;
 - d) establish clear responsibility in-house for monitoring the conduct of the service provider and outsourced functions or activities and for delivering respective reports to the Governing Body;
 - e) establish feasible contingency planning in the event that the outsourcing fails; and
 - f) establish proper approving authorities and limits for material outsourcing arrangements.
- 6.2 A regulated entity should thoroughly assess the risk attached to the outsourcing of any material functions or activities including, but not limited, to the following risks:
- Strategic Risk
 - Reputation Risk
 - Compliance Risk
 - Operational Risk
 - Exit Strategy Risk
 - Counterparty Risk
 - Country Risk
 - Contractual Risk
 - Access Risk
 - Concentration and Systemic Risk
- 6.3 A regulated entity's risk assessment should be completed prior to initiation of the outsourcing arrangement and regularly thereafter; frequency to be determined by level of associated risk and materiality of the outsourcing arrangement.



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- 6.4 A regulated entity should conduct a risk assessment with respect to the jurisdiction in which a service provider is located, if outside the Cayman Islands, and appropriately mitigate any identified risks, as necessary, in accordance with the entity's risk management policy.

7. ASSESSING SERVICE PROVIDERS

- 7.1 A regulated entity should perform in writing and maintain as part of its records a due diligence assessment of a service provider before entering into the initial outsourcing agreement and on a regular basis thereafter (at least annually) in order to ensure that the service provider is fit and proper and can effectively perform the outsourced function or activity and to ensure high ethical and professional standards.
- 7.2 A regulated entity's due diligence process should include, but not be limited to, the assessment of the service provider's:
- a) human, financial and technical resources (including information technology systems) to effectively undertake the outsourced tasks;
 - b) ability, capacity and any authorisation required by law to perform the outsourced functions or activities in a reliable and professional manner;
 - c) ability to safeguard the confidentiality, integrity and availability of information entrusted;
 - d) corporate governance, risk management, security, internal controls, reporting and monitoring processes;
 - e) reputation, complaints or pending litigation;
 - f) business continuity arrangements and contingency plans;
 - g) reliance on and success in dealing with sub-contractors;
 - h) policies in general, business culture and how they align with the regulated entity's own policies and culture; and
 - i) knowledge of the Cayman Islands' legal framework, where appropriate.



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- 7.3 A regulated entity should satisfy itself that the service provider has in place and maintains during the course of the outsourcing arrangement comprehensive insurance coverage.
- 7.4 A regulated entity should satisfy itself that the service provider is carrying out its functions in compliance with its strategic goals, applicable laws, regulations, and relevant regulatory measures, where applicable.
- 7.5 A regulated entity should regularly assess its aggregate exposure to service providers to which it outsources its functions or activities and effectively mitigate and manage any vulnerabilities and related risks including operational and concentration risks as a result of the outsourcing of material functions or activities.
- 7.6 A regulated entity should maintain a centralized log of all its material outsourcing arrangements, which log should be updated on an ongoing basis. The Authority should have access to the log at any time upon request.
- 7.7 Bearing in mind the size, scope and nature of a regulated entity's business and a risk based approach to business and supervision, any outsourced functions or activities to unrelated parties should cause a regulated entity to consider:
- a) enhanced due diligence process;
 - b) enhanced monitoring; and
 - c) enhanced processes and procedures that mitigate risks associated with a material outsourcing arrangement.

8. OUTSOURCING AGREEMENT

- 8.1 A regulated entity should have a detailed, legally binding, written outsourcing agreement or contract in place for all material outsourcing arrangements irrespective of whether such arrangements are with related or unrelated parties.



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- 8.2 An outsourcing agreement should contain a clear allocation of responsibilities between the regulated entity and the service provider, as well as all other material information, including details regarding:
- a) scope of the arrangement;
 - b) services to be supplied;
 - c) rights, responsibilities and expectations of all parties;
 - d) remuneration terms under the agreement, ensuring consistency with the regulated entity's remuneration policy;
 - e) contingency plans and business continuity plans;
 - f) insurance coverage to be maintained by the service provider;
 - g) choice-of-law and choice of jurisdiction clauses in the event of any dispute;
 - h) notification of any changes with the service provider's business including, at a minimum, the size or volume of business and its capacity that may adversely impact the service provider's ability to effectively perform the outsourced function or activity;
 - i) nature of the relationship; and
 - j) procedures governing the sub-contracting of service(s).
- 8.3 A regulated entity should ensure that the outsourcing arrangement does not diminish its ultimate responsibility for effectively overseeing and supervising its activities and affairs and for ensuring that it can meet its legal and regulatory obligations, thus minimizing any outsourcing related risks to its clients.
- 8.4 Outsourcing agreements should ensure that outsourcing arrangements are subject to regular reviews and reporting to the regulated entity in keeping with the level of risks and the nature of the outsourced activity.
- 8.5 Outsourcing agreements should make provisions for the service provider to disclose to the regulated entity any developments that may have a material impact on its ability to carry out the outsourced function or activity effectively and in compliance with applicable legal and regulatory requirements.



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- 8.6 A regulated entity should include a stipulation in its outsourcing agreement that the service provider cooperates with respect to access to relevant systems (and documents) maintained by the service provider relating to the outsourced function or activity.
- 8.7 Outsourcing agreements should allow the regulated entity to conduct audits on the service provider and its sub-contractors with respect to the material outsourced function or activity, whether by its internal and external auditors or by agents appointed by it.
- 8.8 Outsourcing agreements should allow for ready access to data that relates to the outsourced function or activity, as well as to the service provider's business premise to allow for onsite inspections by the Authority.³
- 8.9 The sub-contracting of a material function or activity should not hinder the Authority's ability to execute its supervisory functions including its ability to effectively conduct inspections and access to information or data at any given time.
- 8.10 Outsourcing agreements should outline a clearly defined metric that measures performance and indicates the level of service required from the service provider.
- 8.11 Outsourcing agreements should require the approval of the regulated entity for any sub-contracting of an outsourced service.

9. CONFIDENTIALITY

- 9.1A regulated entity should be satisfied that a service provider has in place policies, procedures and physical and technological measures to protect

³ The Authority may seek reimbursement for reasonable out-of-pocket expenses and related matters with respect to any on-site inspections outside the Cayman Islands.



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information that a customer of a regulated entity might reasonably expect to be confidential.

9.2A regulated entity should be satisfied that the service provider has proper safeguards in place for the collection, storage and processing of customers' confidential information and to prevent unauthorized access, misuse or misappropriation.

9.3A service provider should not use a regulated entity's proprietary information or its customers' information unless it is a necessary part of providing the contracted service and then only for the provision of such service.

9.4 Any disclosure to a sub-contracted provider by the contracted service provider should only be with the prior consent of the regulated entity.

9.5A regulated entity should consider whether it is appropriate to notify customers regarding the details of its controls, ownership and oversight of the outsourced function or activity.

9.6 When a regulated entity decides to outsource a material function or activity, it should provide prior notification to customers that data or information pertaining to them is to be transmitted to a service provider or a sub-contracted provider.

9.7 Where a service provider or its sub-contractor is required by law (including by legal or judicial authorities) to disclose customer information, it should notify the regulated entity as soon as practicable prior to disclosure.

10. CONFLICTS OF INTEREST

10.1 A regulated entity should properly assess the service provider to identify conflicts of interest and ensure that preventative measures are taken to manage any such conflicts.



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10.2A regulated entity should ensure that the service provider periodically reviews, identifies, discloses, monitors and manages all its conflicts of interest with respect to the outsourced activity it is charged with carrying out.

10.3 Where a regulated entity engages an auditor for non-audit services, it should ensure that there is independence from any audit service, if such service is provided by the same auditor or firm.

11.ACCOUNTABILITY

11.1 The Governing Body and Senior Management of the regulated entity are ultimately responsible for the effective management of risks arising from the outsourcing of material functions or activities.

11.2 The Governing Body is, at a minimum, responsible for:

- a) approving and regularly reviewing outsourcing policies and periodically:
 - (i) approving, or reaffirming the policies that apply to outsourcing arrangements; and
 - (ii) reviewing a log of all of the regulated entity's material outsourcing arrangements and other relevant reports.
- b) providing clear guidance in the outsourcing policy to Senior Management on contractual risks and other relevant risks as well as appropriate limits on the level of outsourced activities, and the number of activities that can be outsourced to a single service provider. The policies should detail an appropriate internal review process and required approvals for the outsourcing of material functions or activities.
- c) approving a framework for reporting to the Governing Body and Senior Management on matters relating to outsourced activities



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- including incident reports and testing results among other things.
- d) assessing, along with Senior Management, how the regulated entity's risk profile will be impacted by the outsourcing of any material function or activity.
- e) approving the outsourcing of any material function or activity, including:
- (i) verifying, before approving, that there was an appropriate assessment of the risks related to the outsourcing;
 - (ii) satisfying itself that the service provider is performing the outsourced function or activity in accordance with the terms of the agreement;
 - (iii) regularly reviewing reports provided by Senior Management and the service provider with respect to the outsourced functions or activities;
 - (iv) satisfying itself, before approving an outsourcing arrangement and on an ongoing basis, regarding the expertise and experience of the service provider;
 - (v) ensuring that roles and responsibilities are clearly defined within the signed outsourcing agreements and that the responsibilities are clearly identified; and
 - (vi) ensuring that clear communications procedures (regular calls, meetings or written communications) are in place to deal with the service provider.
- f) regularly assessing and documenting the suitability and capability of its service providers during the life of the agreement.



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- g) taking or authorizing appropriate action if it appears that the service provider may not be carrying out or cannot carry out the outsourced functions or activities effectively or in compliance with applicable legal and regulatory requirements.
- h) determining the frequency of expected comprehensive assessments including the establishment of realistic thresholds for success, performance or substandard performance.
- i) the terms of the contracts and any changes made to it.

11.3 Senior Management is, at a minimum, responsible for:

- a) evaluating the risks and materiality of all existing and prospective outsourcing arrangements based on the framework approved by the Governing Body;
- b) developing and implementing sound and prudent outsourcing policies, procedures and effective controls commensurate with the nature scope and complexity of the outsourcing arrangement to ensure investor/client protection and adequate management of associated risks;
- c) periodically reviewing the effectiveness of outsourcing policies and procedures and material outsourcing arrangements;
- d) communicating information pertaining to risks, the expertise and experience of the service provider and any other pertinent information relating to or affecting the outsourcing arrangement to the Governing Body in a timely manner;
- e) ensuring contingency plans, based on realistic and probable scenarios, are in place and properly tested; and
- f) ensuring that there are independent reviews and audits for compliance with set policies.



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12. TERMINATION AND EXIT STRATEGY

- 12.1 A regulated entity should ensure that there is a termination and/or exit strategy in the event that the outsourced function or activity can no longer be effectively carried out by the service provider, a breach of the contract occurs or if the nature of the agreement has changed (e.g. liquidation, change of ownership, poor performance, etc.).
- 12.2 Outsourcing agreements should confirm when an outsourcing arrangement can be terminated, the termination process and strategies for managing the transfer of the activity back to the regulated entity or to another service provider.

13. RELATIONS WITH THE AUTHORITY

- 13.1 A regulated entity should notify the Authority when a material function or activity is being outsourced.
- 13.2 Where the regulated entity is uncertain whether a function or activity is deemed material, it should be prudent to communicate with the Authority.
- 13.3 The regulated entity should be transparent with respect to its outsourcing arrangements and always disclose to the Authority any matter which could materially and adversely affect the financial soundness of the regulated entity.