



BERMUDA MONETARY AUTHORITY

GUIDANCE NOTES

**OUTSOURCING FOR BANKS, DEPOSIT COMPANIES, THE
BERMUDA STOCK EXCHANGE, CORPORATE SERVICE
PROVIDERS, TRUST COMPANIES, MONEY SERVICE
BUSINESSES, INVESTMENT BUSINESSES, FUND
ADMINISTRATORS AND THE CREDIT UNION**

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I. APPLICATION OF THIS GUIDANCE

1. This guidance is applicable to Banks, Deposit Companies, the Bermuda Stock Exchange, Corporate Service Providers, Trust Companies, Money Service Businesses, Investment Businesses, Fund Administrators and the Credit Union licenced by the Bermuda Monetary Authority. It requires these licenced entities to have in place adequate policies and procedures to manage and monitor existing activities that have been outsourced, as well as to assess the risks arising from outsourcing new activities. An entity falling within the scope of this guidance is defined as a 'Relevant Licenced Entity' (RLE). This guidance replaces the previous guidance on outsourcing for Banks and Deposit Companies the Authority issued in May 2007.
2. This guidance applies to all outsourcing arrangements except those explicitly covered by guidance notes 5.149 to 5.174 inclusive contained in 'Guidance Notes for AML-ATF Regulated Financial Institutions on AML and ATF 2016 (BMA) Notice 2016'.
3. Subject to paragraph 2 above, this guidance is applicable to all outsourcing of activities by RLEs. Specific focus though will be on any material outsourcing undertaken by RLEs.

II. IMPLEMENTATION OF NEW GUIDANCE AND TIMELINE FOR SUBMISSION OF PRIOR APPROVALS / CEO ATTESTATIONS

4. This guidance will come into force from 1 May 2020. Upon reviewing this guidance, should senior management of an RLE identify an existing outsourcing that constitutes a material outsourcing, they will either:
 - Have to seek prior approval for this outsourcing from the Authority prior to implementation of this guidance or
 - The CEO of the RLE can write to the Authority formally attesting the existing material outsourcing complies with all aspects of this new guidance. This attestation will subsequently be verified through the Authority's ongoing supervisory programme post guidance implementation
5. In cases where the prior approval route for an existing outsourcing is followed, the RLE will need to submit a complete application for each outsourcing it deems to constitute a material outsourcing to the Authority for approval from 1 October 2019 to no later than 3 January 2020. The need for RLE submissions to be complete and comprehensive in terms of demonstrating compliance with the guidance cannot be over-emphasised. This is because the Authority will review all submissions when first submitted and if any are deemed to be incomplete, these will be returned to the RLE. At this point, the pre-approval route will no longer be available for that outsourcing and the RLE will need to utilise the CEO attestation route instead.

6. To assist RLEs in delivering complete and comprehensive prior approval submissions, set out below is what the Authority would expect a prior approval submission to include:
 - Name, address and regulatory status of the Service Provider providing the material outsourcing
 - Whether the Service Provider is related to the RLE (part of the same group as the RLE or any other connection)
 - Whether the Service Provider provides other material outsourcing / outsourcing to the RLE. If so, provide details of all activities outsourced to this Service Provider that are deemed material by the RLE. Additionally, how the RLE has addressed/mitigated concentration risk issues arising from using the same service provider for multiple outsourcings
 - Summary of the activity outsourced and why it is considered a material outsourcing by the management of the RLE
 - When the outsourcing arrangement commenced and when it is scheduled to end
 - Reasons for deciding to outsource at the time and whether these reasons still remain valid
 - Having decided to outsource, what Service Provider due diligence was done prior to entering into the agreement
 - What ongoing due diligence of the Service Provider has been undertaken by the RLE since the arrangement was put in place
 - The RLE's contingency plan in the event of Service Provider failure. If the contingency plan would be to immediately bring the activity back within the RLE, has this contingency plan been tested since the outsourcing arrangement was put in place? Alternatively, if the contingency plan is not to bring the activity in-house, provide details of the contingency plan in the event the Service Provider fails to perform the activity; include whether this contingency plan has been tested since the arrangement was put in place
 - Confirmation that a written agreement(s) is in place, which complies with relevant Authority guidance and a copy of the relevant written agreement is provided as part of the submission
 - An explanation of what methods the RLE uses to monitor Service Provider performance in consistently delivering the activity
 - Any material performance or delivery issues with the Service Provider since the arrangement commenced. If so, provide details and what remediation action was taken by Service Provider and did the RLE make any changes to how it monitored the Service Provider post issue identification
 - If applicable, a section where the RLE brings to the Authority's attention any areas where it believes any elements of its existing outsourcing arrangement might diverge or not be in full compliance with relevant Authority guidance so this can be reviewed by the Authority immediately on receipt of the submission
7. Additionally, as these are existing material outsourcings, the Authority will primarily focus when assessing submissions on stages three and four of the outsourcing process

for compliance with the guidance, as well as focusing on the contingency plans in place were the Service Provider to fail to perform the relevant activity.

8. The Authority will endeavour to give decisions within 60 calendar days of a complete and comprehensive submission being made.
9. Where the attestation route is utilised, an attestation for each outsourcing deemed to be material by the management of the RLE will need to be provided to the Authority no later than 30 April 2020. In cases where an RLE does not have a CEO, a Board nominated senior executive may attest instead.
10. The CEO attestation can take the form of a short statement that says, for example, *“I attest that as of this date the material outsourcing listed below that the RLE entered into on XX XX XXXX is in full compliance with all aspects of the Authority’s new Outsourcing guidance. Where the RLE has a number of material outsourcings the CEO attestation can take the form of statement that says, “I attest that as of this date the material outsourcings listed below that the RLE entered in to on the various dates listed below are all in full compliance with all aspects of the Authority’s new Outsourcing guidance.”*

III. DEFINITIONS FOR THE PURPOSE OF THIS GUIDANCE

11. For the purposes of this guidance, the following is meant by:

Relevant Licenced Entity (RLE): a Bank, Credit Union, Trust Company, Corporate Service Provider, Bermuda Stock Exchange, Money Services Business, Investment Business or Fund Administrator licenced by the Bermuda Monetary Authority.

Outsourcing: an arrangement in which the RLE uses a third-party (the outsourcing service provider) to perform activities on an ongoing basis that are integral to the provision of services by the RLE itself that would otherwise be undertaken by that licenced entity.

Activities: a general term covering individual activities, an entire service or a complete function that has been outsourced.

Purchased services not deemed to be outsourcing: Purchased services deemed not to be outsourcing are:

- 1) The provision to the RLE of services which do not form part of the services and activities provided by that RLE itself. This would include but is not limited to:
 - the supply of external advisory services to the RLE that do not form part of the services and activities of the RLE

- provision of external legal advice to the RLE
- the provision of external training of staff
- the external security, management and maintenance of an RLE's premises and personnel

With regard to (1) if a trust company acting as trustee arranges the supply of investment management services to a trust, this could fall within this definition depending on individual circumstances. This activity would generally not be deemed to be outsourcing by a trust company acting as an individual trustee except in cases where the trust company held itself out as providing investment management services as part of its individual trustee service. However, if the ongoing monitoring of the performance of the investment management company providing these services to the trust is outsourced by the trust company acting as trustee to another third-party provider, this would constitute an outsourcing.

- 2) The provision of standardised services such as office equipment, stationery or photocopying servicing.

Outsourcing service provider: a third-party legal entity that provides a service to the RLE. This third-party entity may be licenced or not and may be an affiliated entity within the RLE's own corporate group or an entity external to the RLE's group.

Sub-contracting/sub-outsourcing/chain outsourcing: an arrangement where an outsourcing service provider which has an outsourcing arrangement with a RLE to perform an activity, then sub-contracts the provision of all or part of that activity to other service providers.

Outsourcing agreement: a written agreement setting out the contractual terms and conditions governing relationships, obligations, responsibilities, rights and expectations of the contracting parties in an outsourcing arrangement. This term would also cover performance agreements set out in Service Level Agreements (SLAs) between the contracting parties.

Material outsourcing: an outsourcing arrangement where a critical activity as determined by senior management of the RLE has been outsourced to a third party.

For the purposes of the material outsourcing definition above, an activity should generally be regarded as a critical activity by an RLE if a defect or failure in the provision or performance of that activity would materially impact the RLEs. For example:

- Business operations, reputation or financial performance
- Ability to manage risk
- Compliance with applicable Bermuda laws and regulations

IV. GENERAL GUIDANCE

Management responsibilities

12. An RLE's management should have in place policies and procedures for the management of outsourcing that includes:
 - a. The risk appetite for outsourcing activities and what activities constitute outsourcing at the RLE
 - b. Criteria for determining what constitutes a material outsourcing at the RLE
 - c. The evaluation process as to whether and how an activity should be outsourced
 - d. The due diligence to be undertaken in selecting an appropriate service provider
 - e. The structure and content of the outsourcing arrangement between RLE and service provider. Outsourcing relationships should be governed by written agreements that clearly detail all material elements of that arrangement
 - f. The ongoing management and monitoring of outsourcing arrangements post-implementation
13. With regard to 12 above, management of the RLE are reminded that while activities can be outsourced, responsibility for those outsourcing activities remains with management. RLE management should always ensure that an outsourcing arrangement in no way impedes the RLE's obligations to customers and regulators.
14. With regard to 12 a. and b. above, defining what constitutes outsourcing and then material outsourcing by management in each RLE will be essential in developing a credible risk-based approach to managing outsourcing risk. Not all activities outsourced will be critical activities; therefore, management will need to determine the factors that should be used when determining what activities are critical and what are not. For example, if the delivery of an activity that has been outsourced is time critical, then defining criticality on the basis of how long a service is not available before it damages reputation, causes a regulatory breach or material financial loss could be the appropriate metric for determining the criticality in this case. Whatever metrics are used to determine materiality, these will need to be formalised, and be clearly articulated in the RLE's policy and procedures with senior management able to explain why these specific metrics were chosen.
15. With regard to 12 e. above in the case of both intra-group material and non-material outsourcing, any written outsourcing agreement between the RLE and the group service provider may be supplemented with other group documents (including but not limited to group policy and procedure documents, Performance Level Agreements and/or Service Level Agreements) in complying with the provisions set out in paragraph 24. This is provided the RLE can demonstrate to the Authority, if requested to do so, that the provisions contained in the supplemental group

documents are sufficiently robust and can be relied on by the RLE to deliver the relevant protection / action if required to do so.

16. With regard to 12 e. and f. above, where the activity being outsourced is deemed by management of the RLE not to be a critical activity, implementation of the guidance can be applied proportionally to the risk that a failure in the delivery of that outsourced service would pose to the RLE from a financial, regulatory and reputational perspective. The RLE will need to be able to explain the rationale behind why it is appropriate and proportionate not to fully apply all the guidelines.
17. With regard to sub-contracting/sub-outsourcing/chain outsourcing, all sub-contracting arrangements should be detailed in the outsourcing agreement. If the outsourcing agreement allows the Service Provider to sub-contract any of the activities to be outsourced, any sub-contractor should be subject to the same levels of due diligence by the RLE as the primary Service Provider. Additionally, any sub-contractor should be required to adhere to all aspects of the outsourcing agreement. The RLE should also approve in writing any changes to existing sub-contracting arrangements before they commence.

Provision of innovative technologies for outsourcing service providers

18. Senior management will also need to consider whether the provision of innovative technology supporting its business (including but not limited to Artificial Intelligence, Distributed Ledger Technology or cloud services) by a third-party constitutes an outsourcing and, if so, whether that constitutes a material outsourcing. The risks arising from the provision of such innovative technologies by a third-party to the RLE will be similar to other types of outsourcing. Where senior management does consider the supply of these innovative technologies to constitute outsourcing, then these guidelines apply.
19. Set out below is proposed guidance relating to each stage of the outsourcing process, starting with risk evaluation prior to outsourcing.

Risk evaluation

20. The Authority will expect to see clear evidence of a risk evaluation process having been undertaken by the RLE prior to entering into an outsourcing arrangement clearly articulating the rationale as to why the outsourcing option was/is being pursued. This evaluation will need to set out the benefits of the outsourcing and how any risks arising from it are to be mitigated/managed. There will be specific focus on this risk evaluation by the Authority in cases where:
 - A material outsourcing is being contemplated or re-negotiated
 - Multiple activities are to be/have been outsourced to a single service provider due to the heightened concentration risk this exposes the RLE to

- Activities are to be/have been outsourced and post-outsourcing, there is/will be little or no realistic ability to transfer those activities back so they can be delivered by the licenced entity itself in a reasonable time period. The Authority accepts that in some cases it may not be commercially or operationally possible to transfer an outsourcing back to the RLE in a reasonable time period and to do so may actually increase operational risk not reduce it. Where this is the case, the complete reliance for the provision of this activity on the service provider poses a significant extra risk to the RLE. In these cases the Authority will:
 - Expect the RLE's risk evaluation assessment to clearly articulate why the benefits still outweigh the risks of pursuing this outsourcing option
 - Focus on the due diligence undertaken by the RLE as to the robustness and resilience of the service provider's Business Continuity Plans and Disaster Recovery Plans
 - Require more regular testing of these contingency plans at the service provider than for outsourcing where the service can be easily transferred back to the RLE. This increased frequency of testing is to be explicitly included in the written agreement
 - Require more intense monitoring of the performance of the service provider by the RLE than for outsourcing where the service can be easily transferred back to the RLE. This increased monitoring is to be explicitly included in the written agreement
 - Require, as part of the written agreement, the service provider to immediately disclose to the RLE at the point when it first becomes aware of any legal, operational, technological, financial, resource or regulatory adverse development that may affect the service provider's ability to provide the outsourced activity
 - Require the development by the RLE of more detailed contingency plans that could be utilised in the event that the service provider is unable to provide the outsourced activity. In this case, the contingency plan would relate to the ability to transfer the activity to other service providers in the same jurisdiction in a timely manner
- Activities are outsourced to service providers outside Bermuda due to the increased cross-border and timing risks these pose
- Or all of the above are present

21. Once the risk evaluation process has determined that outsourcing is the preferred option for an activity, the next stage will be due diligence on the service provider.

Due diligence on the service provider

22. An RLE considering an outsourcing arrangement should undertake due diligence on the service provider under consideration. This due diligence should include, but not be limited to, evaluating that the service provider:

- Has the quantity and quality of staff with the requisite skills and experience to effectively deliver the outsourced activities, as well as having any authorisations

- required by law to perform the outsourced activity reliably and professionally throughout the life of the outsourcing
- Has the relevant technology, cyber security, operational infrastructure, and financial capacity to undertake the outsourcing arrangement effectively and efficiently
 - Has appropriate information and data security to protect any and all confidential information relating to the RLE and its clients
 - Has an appropriate risk management framework and controls to ensure that the carrying out of the outsourced activity is properly supervised and any risks associated with the outsourcing are effectively managed
 - Has appropriate Business Continuity Plans (BCP) and Disaster Recovery Plans (DRP) and can demonstrate to the RLE a successful track record of BCP and Disaster Recovery testing
 - Will provide access to all documents and data relating to the outsourced activity to the RLE, its auditors and its competent authority, as well as access to the business premises of the outsourcing service provider

Contingency plan(s) should be considered in the event the service provider is unable to provide the outsourced activity for any reason.

The outsourcing agreement

23. The RLE and the outsourcing service provider should execute a legally binding written agreement setting out the contractual terms and conditions governing relationships, obligations, responsibilities, rights and expectations of the contracting parties in the outsourcing arrangement.
24. The content of this written agreement should explicitly address any issues identified in the RLE's risk evaluation and due diligence of the service provider. While it will depend on the activity being outsourced, the Authority would expect the written agreement to:
 - Specify the activities to be outsourced and laws/regulations applicable to the agreement
 - Specify the responsibilities of the RLE and service provider in the agreement
 - Specify the policies, procedures and controls to ensure the ongoing security and confidentiality of information provided by the RLE to the service provider
 - Impose an obligation on the service provider to comply with all relevant data protection, and data privacy rules and regulations
 - Impose an obligation on the service provider to maintain appropriate risk management standards and internal controls through the life of the outsourcing
 - Impose an obligation on the service provider to provide regular updates on its financial soundness, and that it retains the human expertise, and technological and operational capacity to provide the contracted activities through the life of the outsourcing

- Impose an adverse disclosure obligation on the service provider to immediately disclose to the RLE any legal, operational, technological, financial, resource or regulatory adverse development that may affect the service provider's ability to provide the outsourced activity on an ongoing basis
- Specify agreed quantitative and qualitative service level standards, and performance targets to be met by the service provider in performing this activity, and set out the method and frequency by which these quality standards and performance metrics will be monitored by the RLE through the life of the outsourcing
- Specify the reporting and escalation process where performance standards are not met, and the dispute escalation and resolution process agreed by both parties
- Impose an obligation on the service provider to:
 - Regularly update the RLE on the adequateness of its Business Continuity Plans (BCP) and Disaster Recovery Plans (DRP)
 - Update the RLE on any material changes in its BCP/DRP that would affect the provision of the RLE's activity
 - Undertake regular testing of its BCP/DRP (in conjunction with the RLE if requested) and to disclose the results of these tests to the RLE
- Specify whether sub-contracting is allowed in the agreement, and the conditions and liabilities imposed on the service provider and the sub-contractor where this is allowed
- Specify the triggers that would allow either party to terminate or exit early from the agreement
- Impose an obligation on the service provider to provide access to all documents and data relating to the outsourced activity to the RLE, its auditors and its competent authority, as well as provide access to the business premises of the outsourcing service provider for these parties if required

Ongoing monitoring of the outsourcing

25. Post-contract signing, the Authority will expect the RLE to be able to demonstrate that it is monitoring all its outsourcing arrangements through the use of management information, calls, meetings and visits to the service provider. The level of monitoring for each outsourcing activity should be proportionate to the risks to the RLE from that arrangement.

New material outsourcings - prior notification submission

26. Post-implementation of this guidance on 1 May 2020, a new prior notification submission will be required to be made by RLEs wanting to enter in to new material outsourcings. This submission will be reviewed by the Authority who then has 20 working days to object if deemed appropriate. As a transitional measure if an RLE post 4 January 2020 (closure of the window for prior approval submissions to be made to the Authority) and 1 May 2020 wishes to enter in to a new material outsourcing the RLE may use either the attestation route or may utilize the prior

notification process set out below ahead of 1 May 2020 implementation of this guidance.

Prior notification process

27. In the event an RLE wishes to pursue a new material outsourcing, the RLE will need to provide a prior notification letter to the Authority signed by the CEO or Board-nominated senior executive in cases where the RLE does not have a CEO. The letter will notify the Authority that the RLE intends to enter into a material outsourcing subject to no objection being received from the Authority following the 20 working day notification period.
28. The contents of the prior notification letter should contain:
 - Name, address and regulatory status of the Service Provider that the RLE is proposing to use to provide the material outsourcing
 - Whether the service provider is related to the RLE (subsidiary of the same group as the RLE or other connection)
 - Whether the service provider provides other material outsourcing/outsourcing to the RLE. If so, provide details of all activities outsourced to the service provider, and which are deemed material by the RLE and how the RLE is proposing to address any concentration risk issues
 - Summary of the activity to be outsourced and why it is considered a material outsourcing by the management of the RLE
 - Reasons for outsourcing and whether the contingency plan would be to immediately bring the activity back within the RLE in the event of Service Provider failure. If not, provide details of the contingency plans in the event the Service Provider fails to perform the activity
 - RLE senior management confirmation that risk assessment and service provider due diligence has been undertaken complying with all relevant Authority guidance
 - What risks were identified during the risk assessment and Service Provider due diligence process, and how does the RLE propose to mitigate/ manage these
 - RLE senior management confirmation that upon entering into the arrangement, a written agreement(s) will be signed that complies with relevant Authority guidance. If the activity to be outsourced is a regulated activity, provide a copy of the proposed draft outsourcing arrangement
 - An explanation of how the RLE proposes to monitor the performance of the material outsourcing post-contract signing including the tools that the RLE will use to achieve this
 - If applicable, a section where the RLE brings to the Authority's attention areas where it believes any elements of its outsourcing arrangement might diverge or not be in full compliance with relevant Authority guidance so this can be reviewed by the Authority immediately on receipt of the notification

Starting the 20 working day clock

29. If the letter with all the above information is received by 5 p.m. on any working day by the Authority, the Authority will check the submission and will provide the RLE with an e-mail receipt the next day. It will contain confirmation that it has received the RLE's prior notification letter and the 20 working day clock commences from the start of the day of receipt. If the letter is received and in the opinion of the Authority it is not complete, it will be returned to the RLE highlighting those areas that are deficient.

Actions that can be taken by the Authority during the 20 working day period

30. During the 20 working days after the day of receipt of the RLE's prior notification letter, the Authority may take a number of actions. These can be summarised as:
- Requesting further information / clarification from the RLE on aspects of the material outsourcing as set out in the RLE's letter. The 20 working day clock will stop until this information / clarification is furnished to the Authority
 - Formally objecting to the material outsourcing, with the objection detailing why the Authority reached this decision and what remediation action would be needed to reverse this decision
 - Increasing the speed of response where the Authority has determined it has no objection, it may provide a no objection confirmation to the RLE within this 20 day period, first verbally and then formally in writing. This action is likely to occur where there has been ongoing dialogue between the RLE and the Authority prior to letter submission. The Authority would encourage all RLEs to make contact at an early stage when considering entering into a new material outsourcing. This would also be the process used by the Authority in an emergency where rapid action is required by the RLE to transfer material outsourcing activities to other service providers to stop a major operational failure or significant reputational or financial damage occurring at the RLE
 - Remaining silent throughout the 20 working day time period. Post the ending of this 20 working day period this silence can be taken by the RLE to constitute no objection by the Authority to the outsourcing.

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