**FINANCIAL SUPERVISORY COMMISSION
OF THE
COOK ISLANDS**

Banking Prudential Statement

BPS12

<u>Outsourcing</u>

Objectives and key requirements of this Prudential Statement

This Prudential Statement requires that all outsourcing arrangements involving material business activities entered into by a bank be subject to appropriate due diligence, approval and ongoing monitoring. All risks arising from outsourcing material business activities must be appropriately managed to ensure that the bank protects the interest of the institution and ultimately its depositors.

The key requirements of this Prudential Statement are that a bank must:

- have effective policies and procedures in place to manage the outsourcing of material business activities; and

- notify FSC after entering into agreements to outsource material business activities.

Contents

Authority

1. This Prudential Statement is issued by the Financial Supervisory Commission (FSC) in accordance with section 65 of the Banking Act 2011 (the Act).

Application

2. This Prudential Statement is applicable to all financial institutions licensed under the Banking Act 2011.

Definitions

3. This Prudential Statement has used the following terms, which unless otherwise indicated, have the meanings specified below:

    3.1. **Bank** – an entity licensed under the Banking Act 2011.

    3.2. **Material Business Activity** - one that has the potential, if disrupted, to have a significant impact on the bank's business operations or its ability to manage risks effectively.

    3.3. **Outsourcing** - entering into an arrangement with another party (including a related entity) to perform, on a continuing basis, a material business activity that currently is, or could be, undertaken by the institution itself.

    3.4. **Offshoring** - means the outsourcing of a material business activity where the outsourced activity is to be conducted outside the Cook Islands. Offshoring includes arrangements where the service provider is incorporated in the Cook Islands, but the physical location of the outsourced activity is outside the Cook Islands. Offshoring does not include arrangements where the physical location of an outsourced activity is within the Cook Islands but the service provider is not incorporated in the Cook Islands.

    3.5. **Related Bodies Corporate -** where a body corporate is: (a) a holding company of another body corporate; or (b) a subsidiary of another body corporate; or (c) a subsidiary of a holding company of another body corporate; or where two bodies corporate have (i) significant common purposes and substantial common membership or (ii) directly or indirectly substantial common direction or control.

Materiality

4. This Prudential Statement only applies to the outsourcing of a material business activity as defined in this Prudential Statement.

5. For the purposes of this Prudential Statement, the internal audit function is a material business activity.

Restrictions

6. A bank should not outsource the following functions:

   6.1. Compliance or a core management function;

   6.2. Any activity where the outsourcing of that activity would;

      6.2.1. impair the FSC's ability to supervise the licensee; or

      6.2.2. affect the rights of a customer/client against the licensee, including the right to obtain legal redress.

7. In this prudential statement, core management functions are considered to be:

   7.1. the setting and approval of the licensee's risk management and other strategies;

   7.2. the oversight of the licensee's policies, systems and controls; and

   7.3. the responsibility of the delivery of services to the licensee's customers/client.

Board and Senior Management Responsibilities

8. A bank must identify, measure, monitor and control risks associated with outsourcing to meet the institution's obligations to its depositors.

9. The Board is ultimately responsible for oversight of any outsourcing arrangement.

10. The Board must approve the institution's outsourcing policy.

11. The Board must ensure that outsourcing risks and controls are taken into account as part of the institution's risk management strategy and when completing a risk management declaration required to be provided to FSC[1].

12. The Board and senior management must provide all information relating to any outsourced material business activity to the FSC upon request.

13. For branches of foreign banks, the Senior Overseas Officer is ultimately responsible for the oversight of the Cook Islands branch outsourcing arrangements.

[1] Refer to *Prudential Statement on Governance and Risk Management*

Outsourcing Policy

14. The senior management is responsible for developing and implementing an outsourcing policy that sets out the approach to outsourcing of material business activities, including a detailed framework for managing all such outsourcing arrangements.

15. The outsourcing policy must set out specific requirements in relation to outsourcing to related bodies corporate and outsourcing to service providers conducting the material business activity outside the Cook Islands.

16. A bank must have procedures to ensure that all the institution's relevant business units are aware of the outsourcing policy, and have processes and controls for monitoring compliance with the policy.

Assessment of Outsourcing Options

17. A bank must be able to demonstrate to the FSC that, in assessing the options for outsourcing, it has:

    17.1. prepared a business case for outsourcing the material business activity;

    17.2. undertaken due diligence on the chosen service provider, including the ability of the service provider to conduct the business activity on an ongoing basis;

    17.3. involved the Board or Senior Overseas Officer in approving the agreement;

    17.4. considered all the matters outlined in paragraph 20, that must, at a minimum, be included in the outsourcing agreement itself;

    17.5. established procedures for assessing performance under the outsourcing agreement on a continuing basis;

    17.6. addressed the renewal process for outsourcing agreements and how the renewal will be conducted; and

    17.7. developed contingency plans that would enable the outsourced business activity to be provided by an alternative service provider or brought in-house if required.

18. A bank must be able to demonstrate to the FSC that, in assessing the options for outsourcing to related bodies corporate, it has taken into account:

    18.1. the changes to the risk profile of the business activity that arise from outsourcing the activity to a related body corporate and how this changed risk profile is addressed within the institution's risk management framework;

18.2. that the related body corporate has the ability to conduct the business activity on an ongoing basis;

18.3. the required monitoring procedures to ensure that the related body corporate is performing effectively and how potential inadequate performance would be addressed; and

18.4. contingency issues in accordance with Prudential Statement - Business Continuity Management should the outsourced activity need to be brought in-house.

Outsourcing Agreement

19. Each outsourcing arrangement must be a documented legally binding agreement. The agreement must be signed by all parties to it before the outsourcing arrangement commences.

20. At a minimum, the agreement must address the following matters:

20.1. the scope of the arrangement and services to be supplied;

20.2. commencement and end dates;

20.3. review provisions;

20.4. pricing structure;

20.5. service levels and performance requirements;

20.6. the form in which data is to be kept and clear provisions identifying ownership and control of data;

20.7. reporting requirements, including content and frequency of reporting;

20.8. audit and monitoring procedures;

20.9. business continuity management;

20.10. confidentiality, privacy and security of information;

20.11. default arrangements and termination provisions;

20.12. dispute resolution arrangements;

20.13. liability and indemnity;

20.14. sub-contracting;

20.15. insurance; and

20.16. offshoring arrangements (including through subcontracting).

21. A bank that outsources a material business activity must ensure that its outsourcing agreement includes an indemnity to the effect that any sub-contracting by a third-party service provider of the outsourced function will be the responsibility of the third-party service provider, including liability for any failure on the part of the sub-contractor.

FSC Access to Service Providers

22. An outsourcing agreement must include a clause that allows the FSC access to documentation and information related to the outsourcing arrangement. The outsourcing agreement must include the right for the FSC to conduct on-site visits to the service provider if FSC considers this necessary in its role as prudential supervisor.

23. Where a bank enters an outsourcing arrangement with a related body corporate, the bank must ensure that access by the FSC to the related body corporate is not impeded.

Notification Requirement

24. A bank must notify the FSC no later than 15 business days after execution of an outsourcing agreement for a material business activity.

25. When a bank notifies the FSC of a new outsourcing agreement, it must also provide a summary to the FSC of the key risks involved in the outsourcing arrangement and the risk mitigation strategies put in place to address these risks.

Offshoring Arrangements

26. A bank must advise the FSC of any offshoring agreement involving a material business activity.

27. Prior to entering into an offshoring arrangement, the bank must ensure that the impact of the proposed arrangement has been adequately addressed and documented as part of the bank's risk management framework. It must also ensure that it reviews that risk on a periodic basis to ensure it is current and up to date.

Monitoring the Relationship

28. A bank must ensure the institution has sufficient and appropriate resources to manage and monitor each outsourcing relationship. The type and extent of resources required will depend on the materiality of the outsourced business activity. At a minimum, monitoring must include:
    - 28.1. maintaining contact with the service provider; and
    - 28.2. a process for regular monitoring of performance under the agreement, including meeting criteria concerning service levels.

29. A bank must advise the FSC 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 institution.

30. Where an outsourcing agreement is terminated, a bank must notify the FSC as soon as practicable and provide a statement about the transition arrangements and future strategies for carrying out the outsourced material business activity.

Contingency Planning

16. Banks must establish and maintain contingency plans for all material outsourcing arrangements.

17. Plans must address reasonably foreseeable situations (such as system breakdown and natural disaster) where the external service provider fails to continue providing service, and must ensure that should the service provider become unable to provide the service, the licensee possesses (or can readily access) all records necessary to allow it to sustain business operations, meet statutory obligations and provide all information as may be required by FSC to fulfil its supervisory obligations.

18. Banks must ensure the service provider regularly tests its business continuity arrangements relevant to the outsourced activity, notify the licensee of the test results, and address any material deficiencies.

19. Banks must provide a summary of the test results to the FSC upon request. In addition, banks must ensure they are notified in the event that the service provider makes significant changes to its business continuity plans or encounters other circumstances which may have a serious impact on the service.

20. At least annually, banks must review the service provider to ascertain its ability to continue delivering the service in the manner expected. The review should be commensurate with the level of risk involved and include assessing the service provider's technical competence and performance.

Audit Arrangements

21. A bank's internal audit function must review any proposed outsourcing arrangement for compliance with the institution's outsourcing policy and report to the Board or Senior Overseas Officer. To ensure ongoing compliance with the institution's outsourcing policy the review must be conducted on a regular basis and reported to the Board or Senior Overseas Officer.

22. The FSC may request the external auditor of an institution, 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. Such reports will be paid for by the institution and must be made available to the FSC.

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