澳 門 金 融 管 理 局
AUTORIDADE MONETÁRIA DE MACAU

Circular No. 032/B/2009-DSB/AMCM
(Date: 14/8/2009)

Guideline on Outsourcing

The Monetary Authority of Macao (AMCM), under the powers conferred by Article 9 of the Charter approved by Decree-Law No.14/96/M of 11th March and by Article 6 of the Financial System Act of Macao (FSAM) approved by Decree-Law No. 32/93/M of 5th July, establishes the following:

Introduction

1. Under the FSAM, the AMCM is responsible for promoting the general stability and proper functioning of the financial system. Consistent with this responsibility and in recognition that outsourcing has become increasingly common in Macao, the AMCM would seek to ensure that all outsourcing arrangements, in particular those involving material business activities / functions, entered into by all credit institutions are subject to appropriate due diligence, approval and on-going monitoring.

2. Accordingly, this Guideline outlines the AMCM's supervisory approach on outsourcing arrangements of credit institutions and the major prudential issues to be considered by credit institutions when entering into outsourcing arrangements.

Applicability

3. This Guideline applies to outsourcing arrangements entered into on or after 14 August 2009. For outsourcing arrangements entered into before such date, the institution concerned should:

   (a) advise the AMCM those outsourcing arrangements that involve material business activities / functions;

   (b) discuss with the AMCM before renewal of such outsourcing arrangements involving material business activities / functions; and

   (c) make endeavour to comply with the provisions of this Guideline as soon as possible and within 12 months, unless otherwise agreed with the AMCM.

4. In respect of outsourcing arrangements involving part or all of the electronic banking operations of a credit institution, reference on specific risk management controls and requirements should be made to the AMCM's

"Guideline on Risk Management of Electronic Banking".

5. This Guideline applies to all credit institutions incorporated in Macao and the Macao branches of credit institutions incorporated overseas. Where applicable, this Guideline also applies to other financial institutions (excluding institutions that transact insurance activities and/or manage private pension funds) that are under the supervision of the AMCM.

Interpretation

6. "Outsourcing" occurs when a credit institution enters into an arrangement to transfer, generally for a fixed period, the day-to-day running of some part of its business to another party (including a related entity). The activity / function outsourced can be either a part of the credit institution's existing business or operations or an entirely new venture or operations system for which the credit institution wishes to use outside expertise. A credit institution's decision to outsource functions may be based on a number of factors, such as to achieve economies of scale or to improve the quality of services to customers. Whatever is the reason, the AMCM is concerned if the outsourcing arrangement is likely to reduce the protection available to customers (including depositors) or other concerned persons or, is used as a way of avoiding complying with regulatory requirements.

7. A "material" business activity / function is one that is part of or fundamental to the conduct of the concerned institution's business, for which the authorization is required. For example, banking related business area (including back office activities) in the case of a bank. Material business activity / function also includes the activity / function that has the potential, if disrupted, to have a significant impact on the credit institution's business operations or its ability to manage risk effectively. For the purpose of this Guideline, internal audit function[1] is regarded as a material business activity / function. If in doubt as to whether an activity / a function would be regarded as "material", credit institutions should seek advice from the Banking Supervision Department of the AMCM.

Legal provisions and supervisory approach

8. Article 74 of the FSAM requires credit institutions to maintain their own properly organized accounting records, a sound administrative structure and an adequate internal control system. To comply with this requirement, credit institutions should not enter into or continue any outsourcing arrangement if

[1] In the case of a credit institution incorporated outside Macao, an institutional-wide arrangement for internal audit function to be carried out by its head office or another overseas branch can be treated as not an outsourcing arrangement.

this would result in their internal control system or business conduct being compromised or weakened after the activity / function has been outsourced. The same would apply to those credit institutions that are providing services to run activities / functions of other institutions.

9. On the other hand, Article 6 of the FSAM provides that the AMCM may issue criteria to be observed by credit institutions in the accounting system and the procedures for internal control. In this connection, the AMCM expects credit institutions to:

   (a) have a policy relating to outsourcing of business activities / functions;

   (b) have sufficient monitoring processes in place to manage the outsourcing of material business activities / functions;

   (c) for all outsourcing of material business activities / functions with third parties, have a legally binding agreement[2] in place;

   (d) consult with the AMCM prior to entering into agreements to outsource material business activities / functions;

   (e) notify the AMCM after entering into agreements to outsource material business activities / functions;

   (f) manage and monitor outsourcing risks at all times; and

   (g) perform other procedures as they consider necessary and/or as the AMCM may recommend.

10. Credit institutions should discuss with the AMCM in advance their proposals for outsourcing material business activities / functions and satisfy the AMCM that all the **prudential issues** set out in paragraphs 15 to 34 below are properly addressed. Credit institutions should not outsource their business activities / functions if the relevant arrangements would have the effect to defeat the purposes of the FSAM, which requires certain operations to be carried out exclusively by credit institutions. Before submitting proposals to the AMCM, the decisions of credit institutions to outsource material activities / functions should be approved at the board[3] level.

11. The proposals to be submitted to the AMCM should normally include (i) details of the activities / functions to be outsourced; (ii) the rationale for the

---

[2] Where the service provider is a part of the same entity (e.g. the head office of the credit institution or an overseas branch), a memorandum of understanding or a service level agreement signed and dated by all relevant parties would be acceptable.

[3] In the case of branches of overseas incorporated credit institutions, the reference to the "board of directors / the board" in this Guideline refers to, depending on the circumstances, either the branches' local management or, the management at the head office responsible for the operations of the branches.

outsourcing; (iii) details relating to the service provider; and (iv) a description of the methods that the credit institution would employ to ensure that it retains its ability to control and monitor the outsourced activities / functions. Where necessary, the AMCM may request additional information from the credit institution.

12. When considering the outsourcing proposals, the AMCM would take into account the adequacy of management control over the activities / functions and the ability of internal compliance and internal audit functions, as well as external audit, to monitor and perform the necessary checks on the activities / functions. If in the AMCM's view the outsourcing arrangement involves risk that the credit institution is not managing properly, the AMCM may require the credit institution to make other arrangements.

13. After having consulted with the AMCM, a credit institution may enter into the agreement to outsource a material business activity / function and it should notify the AMCM of the execution of such agreement within 30 days. Throughout the outsourcing period, the credit institution is expected to review on a continuing basis the effectiveness and adequacy of its controls in monitoring the performance of the service provider and managing the risk associated with the outsourced activity / function. Where any deficiencies are identified, the credit institution should take appropriate action to rectify them.

14. In the course of its on-site examinations and offsite reviews, the AMCM would ascertain if credit institutions have rectified deficiencies arising from outsourcing arrangements, if any, and have adequately addressed the prudential issues mentioned in this Guideline.

Prudential issues

Outsourcing policy and procedures

15. A credit institution that proposes to outsource its activities / functions is expected to have an outsourcing policy that sets out its approach to outsourcing of business activities / functions, including a detailed framework for managing all such outsourcing arrangements. The policy should be approved by the board of the credit institution, which should ensure that all relevant business units are fully aware of and comply with such outsourcing policy.

Accountability

16. In any outsourcing arrangement, the board and the institution's management should retain ultimate accountability for the outsourced activities / functions.

Credit institutions should recognize that outsourcing a business activity / function does not transfer all of the risks associated with the activity / function to the service provider. It remains the responsibility of the credit institution to ensure that all risks associated with the business activity / function are addressed to the same extent as they would be if the activity / function were performed "in house". The credit institution should also ensure that the additional risks (e.g. operational, legal and reputation risks) arising from outsourcing are adequately assessed and managed appropriately.

Due diligence

17. Under normal circumstances, proposals to outsource material business activities / functions to other group entities of the credit institution or to another credit institution in Macao would be acceptable to the AMCM. Where the proposal is to outsource activities / functions to an external party, the AMCM would expect the credit institution to conduct detailed due diligence on the entity to ensure that it is fit and proper and can fulfill the task in a responsible, professional and suitable manner. The due diligence process should always be undertaken prior to the decision to outsource a material business activity / function and it should address all material factors that would impact the potential service provider's ability to perform the outsourced activity / function.

18. The due diligence process should, as a minimum, assess the financial ability, technical ability and capacity of the service provider to deliver the required services. The evaluation process would include an assessment of the service provider's control framework, performance standards, policies, procedures, compliance, reporting and monitoring processes. The due diligence should also address other issues, such as potential conflict of interests where the service provider is related to the credit institution, or where it provides services to competitors.

Confidentiality

19. Credit institutions should ensure that the proposed outsourcing arrangement complies with the relevant statutory requirements related to customer confidentiality (e.g. the FSAM and the Law on Protection of Personal Data "個人資料保護法"). In this regard, credit institutions should have controls in place to ensure that the requirements of customer data confidentiality are observed and proper safeguards are established to protect the integrity and confidentiality of customer information.

Outsourcing agreement

20. The type and level of services to be provided and the contractual liability and

obligations of the service provider should be clearly set out and evidenced by a written, legally binding agreement, which should be executed before the outsourcing arrangement commences. At a minimum, the agreement should address the following matters:

(a) the scope of the arrangement and services to be supplied;

(b) commencement and end dates;

(c) provisions for conducting reviews;

(d) pricing and fee structure;

(e) service levels and performance requirements;

(f) audit and monitoring procedures;

(g) business continuity management;

(h) disclosure of information / confidentiality, privacy and security of information[4];

(i) default arrangements and termination provisions;

(j) dispute resolution arrangements;

(k) liability and indemnity;

(l) subcontracting;

(m) insurance; and

(n) other relevant issues (see also paragraphs 21 and 22).

21. An outsourcing agreement should include a clause that allows the AMCM access to documentation related to the outsourcing arrangement. This should also include the right for the AMCM to conduct on-site visits to the service provider as discussed under paragraph 29 below.

22. In light of the implications of subcontracting, the outsourcing agreement should include a provision that the service provider should not further outsource any of the functions to a subcontractor without the credit institution's approval. The agreement should also include an indemnity to the effect that any failure on the part of the subcontractor would be the responsibility of the service provider.

<u>Control over outsourced activities / functions</u>

23. A credit institution should have procedures in place and should ensure that it has sufficient and appropriate resources to manage and monitor the outsourcing relationship at all times. The type and extent of resources

[4] Including non-public customer information to be collected or stored by the service provider.

required would depend on the materiality of the outsourced business activity / function. At a minimum, monitoring should include:

(a) maintaining appropriate levels of regular contact with the service provider. This may range from daily operational contact to senior management involvement; and

(b) a process for regular monitoring of performance under the agreement, including meeting the criteria concerning service levels.

24. The credit institution should advise the AMCM 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 credit institution.

25. Where a credit institution terminates an outsourcing agreement, it should notify the AMCM as soon as practicable and provide a statement as to the transition arrangements and future strategies for carrying out the outsourced material business activity / function.

Anti-money laundering / combating the financing of terrorism

26. Credit institutions should ensure that with the outsourcing arrangements in place, any statutory requirements on anti-money laundering / combating the financing of terrorism or record keeping procedures and practices would continue to be met. Among other materials, references can be made to the AMCM's AML/CFT guidelines.

Contingency planning

27. The credit institution should have a contingency plan that outlines the procedures to be followed in the event that the outsourcing arrangement is suddenly terminated or the service provider is unable to fulfill its obligations for any reason. Among other things, the credit institution should consider the availability of alternative service providers or the possibility of bringing the outsourced activity / function back in-house in an emergency or due to substandard performance of the service provider, and the costs, time and resources that would be involved.

28. The contingency arrangements in respect of daily operational and systems problems should normally be covered in the service provider's own contingency plan. The credit institution should ensure that it has an adequate understanding of the service provider's contingency plan and that such plan is regularly tested by the service provider and, by itself as necessary.

AMCM access to service providers

29. In the normal course, the AMCM would seek to obtain information it requires from the credit institution. The AMCM may however conduct on-site visits to the service provider if it considers this necessary in its role as the credit institution's regulator. The AMCM expects service providers to cooperate with its request for information and assistance. If the AMCM intends to undertake an on-site visit to a service provider, it would normally inform the credit institution in advance of its intention to do so.

30. Where a credit institution enters into an outsourcing arrangement with a related entity, the board of the credit institution should ensure that access by the AMCM to the related entity would not be impeded.

Overseas outsourcing

31. For the outsourcing by a credit institution of its material business activity / function in Macao to a service provider (including a related entity) outside Macao, the AMCM would need to be satisfied that the relevant impact as may arise from the overseas outsourcing has been adequately addressed as part of the credit institution's risk management framework. For example, the credit institution should take into account the differences in legal system, regulatory regime, sophistication of technology or infrastructure etc.

32. In general, the proposal to outsource business activities / functions to an entity outside Macao would be acceptable to the AMCM if the outsourcing is to a regulated entity (e.g. a bank) in a jurisdiction which is adequately regulated. In line with local outsourcing, the credit institution should ensure that the AMCM would have the right of access to the service provider (see paragraphs 21 & 29 above). The credit institution should also notify their customers of the jurisdiction in which the service provider is located and the right of access, if any, available to overseas authorities.

Audit / review arrangements

33. The credit institution's internal audit function should review any proposed outsourcing of a material business activity / function and regularly review and report to the board of directors / audit committee / head office on compliance with this Guideline.

34. The AMCM may require the credit institution to make arrangement for its

external auditor or an appropriate external expert to provide an assessment[5] of the risk management processes in place with respect to an arrangement to outsource a material business activity / function. This may cover areas such as IT systems, data security, internal control frameworks and business continuity plans etc. The reports of assessment should be made available to the AMCM at the time as specified by the AMCM.

5 Such assessment would be required by the AMCM on a case by case basis. If the business activity / function involved is part of or all of the credit institution's electronic banking operations, the credit institution should make reference to the AMCM's "Guideline on Risk Management of Electronic Banking" for a separate arrangement for independent assessment.