



28 June 2019

Dear Stakeholders

Response to industry feedback on 5 November 2018 Outsourcing Consultation Paper

This letter sets out the Bermuda Monetary Authority's (the Authority or BMA) response to industry feedback on the New Outsourcing Guidance for Banks, Credit Unions, Trust Companies, Bermuda Stock Exchange, Corporate Service Providers, Money Service Businesses, Investment Firms & Fund Administrators Consultation Paper (Consultation Paper or guidance) issued by the Authority in November 2018.

The Authority received over a dozen responses to the Consultation Paper from both individual licensed entities and trade bodies representing various sectors on the island. The Authority thanks respondents for taking the time to provide their feedback.

Overall, industry respondents are supportive of the introduction of the guidance. However, responses highlighted two general areas of concern: 1.) implementing a 60-day prior approval approach for material outsourcings after 1 January 2020; and 2.) the treatment of intra-group outsourcing. Additionally, clarification was sought on a number of other issues.

Prior approval of material outsourcings

Some respondents questioned whether a prior approval approach is appropriate while others are concerned about the overall length of the process. It is felt a 60-day process is too long, and could negatively influence competitiveness and client service.

The Authority is still of the view it is essential to have the opportunity to review and object, if necessary, to material outsourcing arrangements prior to a Relevant Licenced Entity (RLE) actually entering in to them.

The Authority has listened to industry feedback on the timing issue and developed a mechanism to provide faster decision making while still providing the Authority with the opportunity to object to a proposed material outsourcing arrangement, if necessary.

Therefore, the proposed 60-day prior approval approach will be replaced with an objection-based prior notification approach. This means the Authority will have 20

working days to object following a submission of an RLE's prior notification. The approach is similar to but less onerous on the RLE than what is presently used by a fellow peer jurisdiction that recently updated its outsourcing guidance. In addition, it is based on the approach the Authority uses in relation to material outsourcing undertaken by institutions subject to the Insurance Act 1978. The expectation is that decisions resulting in the Authority's no objection to a material outsourcing by an RLE could be made sooner than the end of the 20 working day period if RLEs engage early with the Authority and discuss proposed outsourcing with the Authority in advance of their notification submission.

Additionally, and again in response to industry feedback, the Authority intends to make the prior notification submission process more 'user friendly' by setting out in the guidance what should be included in the notification letter, as well as in a submission for prior approval to the Authority prior to 3 January 2020. A suggested form of words is also included in the guidance for use by RLEs, making an attestation if they decide to pursue this route.

Intra-group outsourcing

A number of respondents are of the view that intra-group outsourcing is generally less risky than outsourcing to external third parties and should be reflected in the guidance. Other respondents, while acknowledging that intra-group outsourcing may pose more or less risk than outsourcing to external third parties, are of the view that the Authority should allow greater flexibility in the documentation an RLE could use to evidence compliance with the provisions in paragraph 18 beyond just a written agreement.

On the first point, the Authority's view remains that RLEs should be cautious in assuming intra-group outsourcing, whether material or not, is less risky than outsourcing to external third parties without any verification. While intra-group outsourcing might allow the RLE to exert more influence over the management of the intra-group service provider, the opposite may also be the case. In addition, it may raise group specific risks such as conflicts of interest in the event of a group-wide problem. For example, group priorities may conflict with or override the best interests of the RLE in maintaining its own continuous provision of services. The Authority believes the way the guidance is presently structured means that the ultimate determination of the level of risk posed by a particular intra-group outsourcing (and thus whether it is material or not) rightly sits with the management of each RLE.

On the second point, the Authority will amend the guidance to allow RLEs to use other written documents (including but not limited to group policy and procedure documents, Performance Level Agreements and /or Service Level Agreements) to supplement (but not fully replace) a legally enforceable written contract to evidence compliance with some or all of the provisions set out in the relevant guidance. This is provided the RLE can demonstrate to the Authority, if requested to do so, that the provisions contained in

these group documents are sufficiently robust to be relied on by the RLE to deliver the relevant provision if required to do so.

Definition of material outsourcing

A number of respondents asked for further clarity on the definitions, and interaction between material outsourcing and critical activities.

In response to this feedback, the Authority subsumed the previously separately defined term ‘critical activities’ into the material outsourcing definition to which it related, and has narrowed the scope of this in relation to applicable laws and regulations.

Attestation where RLE does not have a CEO

A number of respondents asked for further clarity on who can attest where an RLE does not have a CEO.

The Authority amended the guidance in cases where an RLE does not have a CEO to allow for a senior executive nominated by its Board to make the compliance attestation in such circumstances.

Sub-outsourcing

A number of respondents asked for further clarity on the use of sub-outsourcing/sub-contracting /chain outsourcing in the guidance.

The Authority has therefore expanded the present guidance on sub-outsourcing to mirror the present Anti-Money Laundering guidance on this issue.

Impact of new Economic Substance legislation

A number of Investment Business sector respondents are of the view that implementation of the new Economic Substance legislation would lead to a significant increase in on-island outsourcing. They asked whether the guidance should be delayed to enable the Authority to evaluate whether this change warrants any revision to the guidance.

The November 2018 guidance is focused on ensuring the appropriate management of outsourcing arrangements by RLEs. The Authority does not see the need to delay or change the guidance based on either a potential increase in the quantum of outsourcing arrangements done on-island or a movement in outsourcing from off-island to on-island. In fact, quite the opposite. Based on the Authority’s understanding of the timeline for Economic Substance legislation implementation, any changes in existing outsourcing arrangements will likely need to have occurred before the final date for the submission of prior approval and attestation submissions in the Authority’s guidance. This means with the guidance available to RLEs, they can use it as a template if and when implementing any new outsourcing arrangements triggered by the Economic Substance legislation.

Guidance based on inadequate data review

A number of Investment Business sector respondents were of the view that the guidance was based on inadequate data review in that it did not include the outcomes of a thematic review of outsourcing in their sector undertaken between March and May 2018 by the Authority.

With regard to the points made by these respondents, the Authority's response is:

- The present policy of the Authority is not to publish the outcome of these thematic pieces of work. This type of thematic work is used primarily as an internal tool to inform our regulatory strategy and future areas of focus
- The Authority can confirm the outcomes from this survey were reviewed and given appropriate consideration in developing this guidance

The Authority thanks all stakeholders again for their participation in this consultation process. Final, revised outsourcing guidance for RLEs will be published shortly on our website.