OUTSOURCING REGULATIONS IN THE BANKING AND INSURANCE INDUSTRIES IN ASIA PACIFIC
Welcome

- You are on mute
- A link to a recording of the webinar will be available
- We can take questions by using the chat function, we will respond to your questions by email after the webinar
Speakers

Scott Thiel  
Partner, Hong Kong

Louise Crawford  
Legal Officer, Hong Kong
Some of the key regulations

- **Hong Kong**
  - HKMA Outsourcing Guidelines (applicable to banks)
  - Insurance Authority Guidance Note on Outsourcing (applicable to insurance companies)

- **Singapore**
  - MAS Guidelines on Outsourcing (applicable to banks and insurance companies)

- **Australia**
  - Prudential Practice Guide on Outsourcing (applicable to banks)
  - Prudential Standard on Outsourcing (applicable to insurance companies)

- **China**
  - CBRC Guidelines for the Supervision of Information Technology Outsourcing Risks of Banking Institutions
  - Guidelines for Commercial Banks on Management of Information Technology Risks
Regulations define "Outsourcing" but a common definition is:

*an arrangement under which the service provider undertakes to perform a service (including a business activity, function or process) which would otherwise be undertaken by the institution itself.*

Usually includes:

- services which are being outsourced from the institution to a service provider, and
- new services being launched.
Why outsource?

Key drivers for outsourcing:

- Access to specialist and world-class capabilities
- Cost savings
- Time-to-market
- Using multiple delivery locations to mitigate risks
- Direct resources to core functions
- Managing technology and other risks
- Availability of increasingly high quality service providers

Why outsource?

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Scott Thiel
Partner

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Why regulate outsourcing?

Just as it is necessary to regulate certain industries, for the same reasons some regulators consider it necessary to regulate outsourcing within those industries.

The key purpose of regulations is to protect customer interests (e.g. depositers, policy-holders).

Regulations also fulfill the following purposes:

- To ensure that regulators maintain control over regulated institutions
- To protect shareholders and others who fund the organisation
- To protect suppliers themselves
What are the risks?

- Loss of control over services
- Culture change and loss of "personal touch"
- Service provider failure
- Turnover of personnel
- Loss of business knowledge \(\rightarrow\) may be difficult to bring services back
- Data security and protection
- Lack of expertise within industry

Scott Thiel
Partner

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It's a matter of common sense...

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**Louise Crawford**
Legal Officer

Outsourcing deal

- proper planning
- thorough risk assessment
- due diligence
- negotiated contracts

Good services

- poor planning
- inadequate negotiations
- insufficient DD

Risks to institution and its customers

Regulations operate with a view to preventing "bad" outsourcing deals.
Examples of activities which are normally considered "outsourcing"

- Application processing and client onboarding processes
- Customer service centres
- Policy and account administration (e.g. invoicing and statements, policy renewals)
- IT systems, data processing software, data centres, disaster recovery centres
- IT security software
- IT support (e.g. application and desktop support)
- HR management and payroll processing
- Marketing and research
Impact on all stages of the outsourcing process

Should this type of service be outsourced?
- is it a core function?
- confidentiality risks?
- control over services?
- benefits of outsourcing?

How will the risks be managed?
- What is the institution's BCP?
- What is the service provider's BCP?
- Who will monitor the services?

Who is the service provider?
- Capabilities and resources?
- Reputation?
- Financial stability?

Is the contract acceptable?
- are there reporting obligations
- is there a team assigned to monitor reports and deal with breaches?

Louise Crawford
Legal Officer

Scott Thiel
Partner

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1. **Threshold on "materiality" of outsourcing** - some regulations apply only to outsourcings which are deemed material.

2. **Definition of "service provider"** – typically includes group companies.

3. **Prohibited outsourcing.** Certain regimes prohibit outsourcing of "core" activities.

4. **Due diligence** to be undertaken on all service providers.

5. **Outsourcing agreement** to be signed with the service provider. Most regimes prescribe the types of clauses which need to be included.
5. **Regulators' access to information** should not be impeded. The institution must normally ensure that regulators will readily be able to access information if requested.

6. **Client confidentiality** to be maintained.

7. **Risk assessment** to be undertaken, and generally the business should be satisfied that the outsourcing will not increase the institution's overall risk profile.

8. **Notification requirements.** Some regimes require notification and/or approval of proposed outsourcing before commencing.

9. **IT outsourcing.** Some regimes impose additional requirements on the outsourcing of IT.
Typically regulations require outsourcing contracts to:

- set out clear description of the services
- provide robust service levels
- enable termination in the event of breach and also where circumstances might otherwise affect the services (e.g. insolvency, change of control)
- require the service provider to protect confidentiality
- contain business continuity provisions
- reporting obligations and ongoing right to inspect records, documents etc.
- include change control provisions
- restrict sub-contracting
- contain a governing law clause – should normally be laws of institution's jurisdiction
What do banks and insurance companies need to do?

1. Adopt a board approved outsourcing policy and an approval process for all proposed outsourcing
2. Framework for assessing materiality
3. Comprehensive risk assessment of proposed outsourcing arrangements
4. Due diligence in respect of all proposed service providers
5. Periodic review of ability of selected service providers
6. Written outsourcing agreement – revise templates and policies on negotiation as regulations may prescribe the clauses required in the contract

7. Safeguards to protect the integrity and confidentiality of data

8. Sufficient resources to monitor and control outsourcing arrangements

9. Contingency plan to protect against business disruptions
### Outsourcing Contract Dashboard

<table>
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<tr>
<th>Scope of Services</th>
<th>Service Levels</th>
<th>Charging Structure</th>
<th>Cost Control</th>
<th>Delivery Incentives</th>
<th>Staff Provisions</th>
<th>IPR</th>
<th>Liability Provisions</th>
<th>Termination Assistance</th>
<th>Termination Rights</th>
<th>Governance and Audit</th>
<th>Overall Weighted Score</th>
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- **Comprehensiveness**: Detailed, output-based services description includes those which are more...  
- **Rates/Charges**: Set out at reasonable, balanced levels. Only increased pursuant to a reasonable, more...  
- **Supplier**: Has very limited cost increase provisions. Cost decrease commitments linked to productivity, more...  
- **Supplier’s Payment**: Morally contingent upon meeting objective criteria related to milestones, more...  
- **Customer’s Liability**: Owner of all new IP and widest possible licence to embedded/supplied More...  
- **Termination Assistance**: To be provided by the Supplier for as long as the customer requires, with a reasonable, more...  
- **Customer’s Rights**: Has the right to terminate at will, but upon reasonable notice and payment of all reasonable, more...  

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Checklist

Review your existing outsourcing arrangements and identifying areas for change

Review your outsourcing practices and policies and identifying areas of risk

Advice in all aspects of outsourcing transactions including regulatory compliance

Manage outsourcing projects – small, medium and large scale

Respond to regulatory requests or sanctions

Scott Thiel
Partner

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Scott Thiel
Foreign Legal Consultant/Head of Intellectual Property and Technology, Hong Kong
scott.thiel@dlapiper.com

- Scott is an outsourcing specialist with a particular focus on regulated outsourcing activities in the financial services and insurance sector.
- Experience includes advice to banks in Hong Kong on their compliance with the HKMA’s Outsourcing Guidelines and to a range of financial services clients in relation to the FSA’s MiFID regulations and Material Outsourcing Guidelines.

Louise Crawford
Legal Officer, Intellectual Property and Technology, Hong Kong
louise.crawford@dlapiper.com

- Louise is an IT, data protection and commercial lawyer.
- Louise has worked with a number of clients from the financial services industry such as UBS, HSBC, Credit Suisse, Barclays, National Australia Group, AXA and Aon, and has also worked in-house at a global bank advising on outsourcing regulatory work in Hong Kong.