Statement of Guidance

Outsourcing Regulated Entities

April 2023

Statement of Guidance: Outsourcing Regulated Entities

1. Statement Of Objectives/ Statutory Authority

Statement of Objectives

1.1 This Statement of Guidance ('Guidance') is intended to provide guidance to regulated entities on the establishment of outsourcing arrangements (including sub-outsourcing) and the outsourcing of material functions or activities.

1.2 This Guidance is not intended to be prescriptive or exhaustive; rather this Guidance sets out the Cayman Islands Monetary Authority's ("the Authority") minimum expectations on the outsourcing of material functions or activities and outsourcing arrangements.

1.3 This Guidance is provided on the basis that regulated entities, including their Governing Body and Senior Management, remain ultimately responsible for all outsourced material functions or activities, regulatory requirements and any other requirements of the Authority.

1.4 The Authority expects that regulated entities would not generally outsource material functions; however, where material functions are outsourced, regulated entities should follow this Guidance.

Statutory Authority

1.5 Section 34 of the MAA provides that the Authority may issue rules, statements of principles or guidance:

> *(1) After private sector consultation and consultation with the Minister charged with responsibility for Financial Services, the Authority may–*
>
> (a) *issue or amend rules or statements of principle or guidance concerning the conduct of licensees and their officers and employees and any other persons to whom and to the extent that the regulatory laws may apply;…*

1.6 This Guidance should be read in conjunction, with other regulatory instruments issued by the Authority from time to time, where applicable.

2. Scope of Application

2.1 This Statement of Guidance applies to all entities regulated by the Authority[1]

[1] Exceptions are a) Regulated mutual funds as defined in the Mutual Funds Act (as amended); b) Private Trust Companies as defined in the Private Trust Companies Regulations (as amended); and c) Private Funds as defined in the Private Funds Act (as amended).

including controlled subsidiaries as defined in the Banks and Trust Companies Act (as amended). For the purpose of this Guidance, a regulated entity is an entity that is regulated by the Authority in accordance with the regulatory Acts, as defined in the Monetary Authority Act (as amended).

2.2 This Guidance applies regardless of whether the outsourcing arrangement established by a regulated entity is with a related or unrelated entity.

2.3 This Guidance should not preclude the need for all functions and activities (whether material or not) to be subject to adequate risk management and sound internal controls.

3. Definitions

3.1 For the purpose of this Guidance, the below definitions are provided.

3.1.1 **Outsourcing:** a regulated entity's use of a third party (either an affiliated entity within a group or an entity that is external to the corporate group) to perform functions or activities on a continuing basis that would normally be undertaken by the regulated entity, now or in the future. Outsourcing does not include purchasing contracts[2].

3.1.2 **Outsourcing agreement:** a written agreement outlining the contractual terms and conditions governing the outsourcing relationship, functions, obligations, responsibilities, rights and expectations of the contracting parties.

3.1.3 **Material function or activity:** a function or activity that, if disrupted (e.g. service failure or security breach), could impact an institution's business operations, reputation or profitability in a significant way (e.g. prolonged failure of information technology system impacting customers' ability to conduct transactions); or could adversely affect an institution's ability to manage risk; or comply with applicable Acts and regulations.

3.1.4 **Related Party:** an entity under common ownership directly (i.e. at the parent level) or indirectly (i.e. ultimate parent to the regulated entity).

3.1.5 **Sub-contracting:** an arrangement where a Service Provider, which has a legally binding outsourcing agreement with a regulated entity, further outsources the service or part of the service that it was contracted to provide.

3.1.6 **Governing Body:** the Board of Directors where the entity is a

[2] Purchasing is defined, among other things, as the acquisition from a vendor of services, goods or facilities (but not an associated process) without the transfer of the purchasing firm's non-public proprietary information pertaining to its customers or other information connected with its business activities.

corporation, the General Partner where the entity is a partnership, the manager (or equivalent) where the entity is a Limited Liability Company, and the Board of Trustees where the entity is a trust business.

3.1.7 **Service Provider:** a third party (whether related or unrelated) that supplies services or facilities (excluding lease of business premises) pursuant to an outsourcing arrangement.

4. Materiality Assessment of Outsourcing Arrangements

4.1 A regulated entity should assess the materiality of its outsourcing arrangements, and without limiting the scope of its assessments, should consider:

a) the impact of the outsourcing arrangement on its finances, reputation and operations, or a significant business line, particularly if the Service Provider, or group of affiliated Service Providers, should fail to perform over a given period of time depending on the nature of the outsourced function/service;
b) its ability to maintain appropriate internal controls and meet regulatory requirements, particularly if the Service Provider were to experience problems;
c) the cost of the outsourcing arrangement;
d) the risk of potential loss, temporarily or permanently, of access to important data; and
e) the degree of difficulty and time required to find an alternative Service Provider or to bring the business activity 'in-house'.

4.2 Outsourcing all or substantially all of a management oversight function or activity[3] should always be considered material. Where a regulated entity outsources such a function or activity to a related party, the regulated entity may assess the materiality of the arrangement to determine whether it is material given the circumstances. Outsourcing should not affect independence, effectiveness or objectivity of the oversight function or activity.

5. General Guidance

5.1 The Authority expects that regulated entities will outsource a material function or activity for various reasons, including to take advantage of economies of scale or expertise. The Authority expects the rationale for outsourcing of any material function or activity to be sound and in keeping with the entity's business strategy.

[3] Management oversight function or activity includes financial analysis; compliance and anti-money laundering/countering the financing of terrorism oversight; internal audit services related to the internal accounting controls, financial systems, or financial statements; senior management responsibilities; and risk management.

5.2 A regulated entity should implement this Guidance commensurate with the size, complexity, structure, nature of business and risk profile of its operations, following an appropriate risk assessment of the outsourcing arrangement.

5.3 The Authority's supervisory functions and legal obligations should not be hindered by the outsourcing of any material function or activity by a regulated entity.

5.4 The Authority may, on a case-by-case basis, impose additional requirements on a regulated entity depending on its assessment of the potential negative impact of the outsourcing arrangement on the entity or its investors/clients.

5.5 A regulated entity should maintain the same level of oversight and accountability with respect to the outsourcing of any material function or activity as it would apply to its non-outsourced material functions or activities.

5.6 A regulated entity's relationship and obligations towards its clients must not be altered as a result of the outsourcing of any material function or activity.

5.7 A regulated entity's level of net risk should not materially increase as a result of outsourcing compared to if it carried out the material function or activity itself.

5.8 When a regulated entity is required to have sufficient staff and to maintain books and records in the Cayman Islands, the outsourcing of material functions or activities should not cause a regulated entity to be a 'shell' or 'letter-box' entity[4].

5.9 A regulated entity should ensure that all books and records pertaining to its outsourced material functions or activities, including any record of transaction activities for clients, are readily accessible to the Authority.

5.10 Regulated entities are expected to use this Guidance to evaluate the risks associated with all existing and proposed outsourcing arrangements.

5.11 Regulated entities should assess their outsourcing risk management framework and address any deficiencies as appropriate.

5.12 Where a regulated entity has identified deficiencies relating to an existing outsourcing agreement, such deficiencies can be addressed when the agreement or contract is amended, renewed or extended, whichever is earliest. Nevertheless, if a deficiency identified is significant, the Authority expects a

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[4]**Shell entity:** means an entity that has no physical presence in the country in which it is incorporated and licensed, and which is unaffiliated with a regulated financial group that is subject to effective consolidated supervision.

Letter-box entity: an entity that no longer retains the necessary expertise and resources to supervise the outsourced tasks and to manage the risks associated with the outsourcing arrangement.

regulated entity to have appropriate measures in place to mitigate the risks in the interim.

5.13 Regulated entities should give due consideration to all relevant Acts, regulations and measures issued by the Authority and any other jurisdiction, where applicable when assessing an outsourcing arrangement.

6. Intra-Group Arrangements

6.1 The Authority recognizes that an outsourcing arrangement with a related entity may, in certain cases, present fewer risks for a regulated entity than outsourcing with an unrelated entity. Nevertheless, given that outsourcing arrangements with related parties still may present risks, the Authority, in respect of intra-group outsourcing arrangements relating to material functions, expects, at a minimum, the following:

a) a written outsourcing agreement that details, among other things, the scope of the arrangement, the services to be supplied, the nature of the relationship between the regulated entity and the Service Provider, and procedures governing the subcontracting of services;
b) an appropriate business continuity plan that is designed to handle foreseeable risks;
c) an appropriate process for monitoring, reporting and oversight;
d) an exit strategy from the outsourcing arrangement and ability to choose another outsourcing provider if risk is deemed too high by the Governing Body;
e) location of books and records that will meet legal requirements and be available for review by the Authority (see 5.8 and 5.9);
f) be subject to appropriate internal and external audit and risk control measures which are substantially equivalent to those applicable to the regulated entity; and
g) the regulated entity will follow any additional expectations the Authority may have depending on the risks related to the outsourcing arrangement and the conclusion of any supervisory review conducted by the Authority.

6.2 The Authority recognizes that the oversight of outsourcing arrangements in relation to regulated entities that are branches may differ from arrangements in other regulated entities given the different legal structure of a branch. A branch may be covered by outsourcing arrangements entered into by its head office. When that is the case, the regulated entity should assess the applicability of the various elements of this Guidance bearing in mind the risks posed to its operations and clients by the outsourcing arrangement.

6.3 Where a regulated entity that is a branch is covered by outsourcing arrangements concluded by its head office, it should receive written confirmation of certain details regarding the outsourcing arrangement, including, at a minimum:

a) the material function(s) or activities being outsourced;
b) the name of the Service Provider;
c) the location of the Service Provider;
d) the expiration of the outsourcing agreement(s);
e) a confirmation that an appropriate outsourcing agreement is in place and that proper due diligence has been completed;
f) that books and records of the regulated entity's clients are accessible to the Authority; and
g) a declaration that the head office has implemented an appropriate risk management framework in respect of outsourcing that considers and mitigates any related risks to the branch.

6.4 Notwithstanding 6.2 and 6.3, a regulated entity that is a branch should maintain a log that confirms outsourcing arrangements of material functions or services that apply to its operations and clients and should satisfy itself that outsourcing arrangements that affect its operations and clients are properly assessed and monitored and that all relevant risks are managed or mitigated.

6.5 With respect to regulated entities that are a part of a group structure, the expectations in 6.1 may be addressed within group-wide processes, policies or plans, provided that any specific risks to the regulated entity are dealt with, and the Governing Body is able to fulfill its accountabilities under section 12 of this Guidance and to its clients.

7. Risk Management

7.1 A regulated entity should, at a minimum:

a) implement a policy on outsourcing duly approved by its governing body;
b) have proper procedures in place to identify all material outsourcing arrangements;
c) establish and document an adequate risk management framework, systems, policies and processes to assess, control and monitor its material outsourcing arrangements;
d) establish clear responsibility in-house for monitoring the conduct of the Service Provider and outsourced material functions or activities and for delivering respective reports to the Governing Body;
e) establish feasible contingency plans in the event that the outsourcing fails; and
f) ensure that any limits regarding the level or authority that enables the approval of the outsourcing of material functions or activities is governed by appropriate policies and procedures (as approved by the regulated entity's Governing Body) giving regard to the level of risk surrounding the outsourcing arrangement.

7.2 A regulated entity should thoroughly assess the risk attached to the outsourcing of any material functions or activities including, but not limited, to the following risks, as applicable:

- Strategic Risk
- Reputation Risk
- Compliance Risk
- Operational Risk
- Exit Strategy Risk
- Counterparty Risk
- Country Risk
- Contractual Risk
- Access Risk
- Concentration and Systemic Risk

7.3 A regulated entity's risk assessment should be completed prior to initiation of the outsourcing arrangement and regularly thereafter. The frequency of the risk assessment should be done at least annually or as determined given the level of associated risk and materiality of the outsourcing arrangement.

7.4 A regulated entity should conduct a risk assessment with respect to the jurisdiction in which a Service Provider is located, if outside the Cayman Islands, and appropriately mitigate any identified risks, as necessary, in accordance with the regulated entity's risk management policy.

7.5 A regulated entity should regularly assess its aggregate exposure to Service Providers to which it outsources its material functions or activities and effectively mitigate and manage any vulnerabilities and related risks, including operational and concentration risks as a result of the outsourcing of material functions or activities.

7.6 A regulated entity should maintain a centralized log of all its material outsourcing arrangements, which should be updated on an ongoing basis. The Authority should have access to the log at any time upon request.

8. Assessing Service Providers

8.1 A regulated entity should perform in writing and maintain as part of its records a due diligence assessment of a Service Provider before entering into the initial outsourcing agreement and on a regular basis thereafter (at least annually or in keeping with the level of the perceived risk) in order to ensure that the Service Provider is fit and proper and can effectively perform the outsourced material function or activity, and to ensure high ethical and professional standards.

8.2 A regulated entity's due diligence process should include, but not be limited to, the assessment of the Service Provider's:

a) human, financial and technical resources (including information technology systems) to effectively undertake the outsourced tasks;
b) ability, capacity and any authorisation required by law to perform the outsourced material functions or activities in a reliable and professional manner;
c) ability to safeguard the confidentiality, integrity and availability of information entrusted;
d) corporate governance, risk management, security, internal controls, reporting and monitoring processes;
e) reputation, complaints or pending litigation;
f) business continuity arrangements and contingency plans;
g) reliance on and success in dealing with sub-contractors;
h) policies in general, business culture and how they align with the regulated entity's own policies and culture; and
i) knowledge of the Cayman Islands' legal framework, where appropriate.

8.3 A regulated entity should satisfy itself that the Service Provider has in place and maintains during the course of the outsourcing arrangement comprehensive insurance coverage.

8.4 A regulated entity should satisfy itself that the Service Provider is carrying out its functions in compliance with applicable Acts, regulations, and relevant regulatory measures, where applicable.

9. Outsourcing Agreement

9.1 A regulated entity should have a detailed, legally binding, written outsourcing agreement or contract in place for all material outsourcing arrangements irrespective of whether such arrangements are with related or unrelated parties.

9.2 An outsourcing agreement should contain a clear allocation of responsibilities between the regulated entity and the Service Provider, as well as all other material information, including details regarding:

a) scope of the arrangement, including but not limited to services to be provided, rights, responsibilities and expectations of all parties, reporting requirements etc.;
b) nature of the relationship;
c) obligation of the Service Provider to identify, disclose, monitor and manage conflicts of interest;
d) remuneration terms under the agreement;
e) contingency plans and business continuity plans;
f) obligation of the Service Provider to maintain appropriate insurance coverage;
g) dispute and remedy process, including choice-of-law and choice of jurisdiction clauses in the event of any dispute;
h) obligation to notify the regulated entity in respect of any breach in data/information security; and

i) procedures governing the sub-contracting of service(s).

9.3 A regulated entity should ensure that the outsourcing arrangement does not diminish its ultimate responsibility for effectively overseeing and supervising its activities and affairs and for ensuring that it can meet its legal and regulatory obligations.

9.4 Outsourcing agreements should ensure that outsourcing arrangements are subject to regular reviews and reporting to the regulated entity in keeping with the level of risks and the nature of the outsourced activity.

9.5 Outsourcing agreements should make provisions for the Service Provider to disclose to the regulated entity any developments that may have a material impact on its ability to carry out the outsourced material function or activity effectively and in compliance with applicable legal and regulatory requirements.

9.6 A regulated entity should include a stipulation in its outsourcing agreement that the Service Provider cooperates with respect to access to relevant systems (and documents) maintained by the Service Provider relating to the outsourced material function or activity.

9.7 Outsourcing agreements should allow the regulated entity to conduct audits on the Service Provider and its sub-contractors with respect to the material outsourced activity, whether by its internal and external auditors or by agents appointed by it.

9.8 Outsourcing agreements should allow for ready access to data that relates to the outsourced material function or activity, as well as to the Service Provider's business premise to allow for onsite inspections by the Authority.[5]

9.9 The sub-contracting of a material function or activity should not hinder the Authority's ability to execute its supervisory functions including its ability to effectively conduct inspections and access to information or data at any given time.

9.10 Outsourcing agreements should outline a clearly defined metric that measures performance and indicates the level of service required from the Service Provider.

9.11 Outsourcing agreements should require the approval of the regulated entity for any sub-contracting of an outsourced service unless standing consent is given in advance.

[5] The Authority may seek reimbursement for reasonable out-of-pocket expenses and related matters with respect to any on-site inspections outside the Cayman Islands.

10. Confidentiality

10.1 A regulated entity should be satisfied that a Service Provider has in place policies, procedures and physical and technological measures to protect information that a customer of a regulated entity might reasonably expect to be confidential.

10.2 A regulated entity should be satisfied that the Service Provider has proper safeguards in place for the collection, storage and processing of customers' confidential information and to prevent unauthorized access, misuse or misappropriation.

10.3 A Service Provider should not use a regulated entity's proprietary information or its customers' information unless it is a necessary part of providing the contracted service and then only for the provision of such service.

10.4 Any disclosure to a sub-contracted provider by the contracted Service Provider should only be with the prior consent of the regulated entity and subject to applicable Act. Standing consent may be given in advance.

10.5 A regulated entity should consider whether it is appropriate to notify customers regarding how it maintains effective control and oversight of the outsourced material function or activity.

10.6 When a regulated entity decides to outsource a material function or activity, it should provide prior notification to customers that data or information pertaining to them is to be transmitted to a Service Provider or a sub-contracted provider, unless terms and conditions of the agreement between the client and regulated entity allow for outsourcing and disclosure to a third party.

10.7 Where a Service Provider or its sub-contractor is required by law (including by legal or judicial authorities) to disclose customer information, it should notify the regulated entity as soon as practicable prior to disclosure, provided notification is allowed in accordance with the laws of the jurisdiction to which the function is outsourced.

11. Conflicts of Interest

11.1 A regulated entity should properly assess the Service Provider to identify conflicts of interest and ensure that preventative measures are taken to manage any such conflicts.

11.2 A regulated entity should ensure that the Service Provider periodically reviews, identifies, discloses, monitors and manages all its conflicts of interest with respect to the outsourced activity it is charged with carrying out.

11.3 Where a regulated entity outsources a material function to its auditor, the regulated entity must obtain written confirmation that the auditor has satisfied

all independence requirements issued by the International Federation of Accountants (IFAC) and/or any other relevant accounting standard setters.

12. Accountability

12.1 The Governing Body and Senior Management of the regulated entity are ultimately responsible for the effective management of risks arising from the outsourcing of material functions or activities.

12.2 The Governing Body is, at a minimum, responsible for:

a) approving and regularly reviewing outsourcing policies and periodically:

i. approving, or reaffirming the policies that apply to outsourcing arrangements; and

ii. reviewing a log of all of the regulated entity's material outsourcing arrangements and other relevant reports.

b) providing clear guidance in the outsourcing policy to Senior Management on contractual risks and other relevant risks as well as appropriate limits regarding the level or authority that enables the approval of outsourcing material functions or activities, and the number of functions or activities that can be outsourced to a single Service Provider. This guidance should result in the implementation of policies that detail an appropriate internal review process and required approvals for the outsourcing of material functions or activities.

c) approving a framework for reporting to the Governing Body and Senior Management on matters relating to outsourced activities including incident reports and testing results among other things.

d) assessing, along with Senior Management, how the regulated entity's risk profile will be impacted by the outsourcing of any material function or activity.

e) approving the outsourcing of any material function or activity, including:

i. verifying, before approving, that there was an appropriate assessment of the risks related to the outsourcing;

ii. regularly reviewing reports provided by Senior Management and the Service Provider with respect to the outsourced material functions or activities, including relating to the performance of Service Providers;

iii. ensuring that roles and responsibilities are clearly defined within the signed outsourcing agreements;

f) verifying that an assessment of Service Providers is conducted as per section 8 of this Guidance.

g) taking or authorizing appropriate action if it appears that the Service Provider may not be carrying out or cannot carry out the outsourced material functions or activities effectively or in compliance with applicable legal and regulatory requirements.

h) determining the frequency of expected comprehensive assessments including the establishment of realistic thresholds for success, performance or substandard performance.

i) the terms of the outsourcing agreement(s) and any changes made.

12.3 Senior Management is, at a minimum, responsible for:

a) evaluating the risks and materiality of all existing and prospective outsourcing arrangements based on the framework approved by the Governing Body;

b) developing and implementing sound and prudent outsourcing policies, procedures and effective controls commensurate with the nature, scope and complexity of the outsourcing arrangement to ensure investor/client protection and adequate management of associated risks;

c) periodically reviewing the effectiveness of outsourcing policies and procedures and material outsourcing arrangements;

d) ensuring that clear communication procedures (regular calls, meetings or written communications) are in place between the regulated entity and the Service Provider;

e) communicating information pertaining to risks, the expertise and experience of the Service Provider and any other pertinent information relating to or affecting the outsourcing arrangement to the Governing Body in a timely manner;

f) ensuring contingency plans, based on realistic and probable scenarios, are in place and properly tested; and

g) ensuring that there are independent reviews or audits for compliance with set policies.

13. Termination and Exit Strategy

13.1 A regulated entity should ensure that there is a termination and/or exit strategy in the event that the outsourced material function or activity can no longer be effectively carried out by the Service Provider, a breach of the contract occurs or if the nature of the agreement has changed (e.g. liquidation, change of ownership, poor performance, etc.).

13.2 Outsourcing agreements should confirm when an outsourcing arrangement can be terminated, the termination process and strategies for managing the transfer of the activity back to the regulated entity or to another Service Provider.

14. Relations with the Authority

14.1 A regulated entity should notify the Authority in writing, within a reasonable timeframe, of any new outsourcing agreement being signed or terminated, when a material function or activity is being outsourced. The notification of a signed outsourcing agreement should contain pertinent details including, at a minimum:

a) Function or service that is being outsourced;
b) Name of the Service Provider (indicating whether this firm is part of the regulated entity's group and its regulatory status, if any);
c) Location where the outsourced activity will be carried out whether in the Cayman Islands or outside of the Cayman Islands;
d) Date of commencement and expiration of outsourcing agreement; and
e) Main reason(s) for outsourcing the specific function or activity.

14.2 A notification to the Authority of the termination of an outsourcing agreement should, at a minimum, include the name of the Service Provider, date of termination, reason for termination and how the outsourced function or activity will be performed.

14.3 Where the regulated entity is uncertain whether a function or activity is deemed material, it should be prudent to communicate with the Authority.

14.4 The regulated entity should be transparent with respect to its outsourcing arrangements and always disclose to the Authority any matter which could materially and adversely affect the financial soundness of the regulated entity.

SIX, Cricket Square
PO Box 10052
Grand Cayman KY1 - 1001
CAYMAN ISLANDS

General Office: 345-949-7089

www.cima.ky