

Foreword

Outsourcing has become a critical component of financial institutions' management of their business operations and control of their costs.

Many business owners shy away from outsourcing but countless others depend on it. Regardless of which view you take, it is important to know that outsourcing is here to stay.

Outsourcing promotes consistency, allows the Financial Institutions (FIs)

to focus on strategic tasks and may introduce cost savings. If there is one rule about outsourcing, it is that you should not outsource and forget. FIs should outsource, review and monitor; and work with your outsource provider as a partner, exploring what is needed to be more successful.

In September 2014, the Monetary Authority of Singapore issued consultation papers on outsourcing requirements to ensure that FIs have sound risk management practices for outsourcing arrangements. This set of proposed notice and guidelines on

outsourcing should also enhance the service levels to be provided by the service providers.

In this issue, we offer you our thoughts on outsourcing in financial services and key recommendations for FIs to comply with the new outsourcing requirements.

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Are FIs safe when outsourcing their business needs?

By: Daryl Pereira

Outsourcing has become a critical component of FIs management of their business operations and control of their costs.

Leveraging the expertise of others who live beyond our four walls provides a number of advantages for FIs. Hiring service providers helps to handle a FI's non-core tasks and allows the FIs to focus on its strategic proficiencies.

FIs should outsource and review; outsource and monitor; and work with the outsource provider as a partner, exploring what should be outsourced next and what is needed to be more successful.

How did these bring a change to outsourcing regulations in Singapore?

The Monetary Authority of Singapore (MAS) noted that FIs across the world have been facing an increasing number

and varieties of cyber threats coupled with significant service disruptions due to outsourced operations. FIs outsource various functions or services to third-party vendors. Some FIs have even hired external programmers or IT architects to build or manage IT programs and systems.

To safeguard the interests of customers and the Banking and Financial Sector hub in Singapore, the regulations governing outsourcing are set to become more complex, with the MAS releasing two consultation papers on outsourcing in September 2014.

MAS Consultation Papers on Notice and Guidelines on Outsourcing (Sept 2014)

The proposed MAS Notice on outsourcing states mandatory requirements which will be legally enforced. It is expected that a FI will govern and oversee its outsourced

arrangements in a similar way to those operations conducted internally by the organisation itself. The proposed notice and guidelines on outsourcing highlight the FI's duty towards effective due diligence, oversight and management of outsourcing.

Amongst the main changes are those that relate to risk management with the consultation paper stipulating that companies adopt an "Outsourcing Risk Management Framework" that specifically identifies, quantifies and mitigates operational/technology risks inherent in the outsourced arrangement. In particular, the FI will be held accountable for the behaviour of the organisations they have outsourced to. This was in part a reaction to the loss of governance and management oversight that comes from outsourcing. Weak arrangements increase the possibility of lax controls, security breaches or service disruptions.

Although previously mainly focused on banks and insurance companies, MAS proposes to extend the applicability of the new outsourcing regulations to other FIs, including licensed insurers, registered or regulated insurance intermediaries, licensed financial advisers, recognised market operators, licensed trade repositories, trustee-managers of registered business trusts and licensed trust companies.

What should you expect in the future?

- Greater oversight by the board and senior management over outsourcing decisions, as well as assuming responsibility for effective internal controls and risk management.
- The definition of “material outsourcing arrangement” has been changed to include all arrangements concerning or involving customer data. This will cover a wider spectrum of outsourcing arrangements that were previously classified “non-material”. FIs will have to revise their methods of assessing outsourcing arrangements in light of the new definition.
- Need to establish “new” material outsourcing management due diligence process; and revise outsourcing approval limits based on the nature, value and extent of the outsourcing.
- Embed requirements to ensure service providers have the right systems and checks in place to protect customer data. These standards are to be commensurate with the banks’ own internal IT security policies as well as the minimum expectations set out in MAS’ Technology Risk Management Notice & Guidelines (2013).

- New requirements to notify MAS as soon as possible of any adverse development or breach of legal and regulatory requirements by the FI itself as well as by the service provider or service provider’s sub-contractors.
- Need to ensure that service provider’s employees and their sub-contractors have been assessed to be fit and proper, consistent with the criteria applied to the FI’s own employees.
- FI’s to perform independent audits and/or expert assessments of all its outsourcing arrangements on a risk-based approach, provided an audit is done at least once in three years.
- FIs must also indemnify the MAS for any losses to the service provider arising out of any action taken to access and inspect the service provider.
- Create and maintain an updated register of outsourcing arrangements.

Key recommendations for FIs to comply with the new outsourcing requirements:

1. All affected parties must update their outsourcing framework, policies and procedures to be in line with the new MAS definition of “material outsourcing”. Their outsourced portfolio also needs to be reviewed against the new materiality definition.
2. The FIs new “Outsourcing Risk Management Framework” will also require revision of the Service Level Agreements (SLAs) established with each Outsourced Service Provider (OSP). In addition to the usual ‘key performance indicators’, the SLAs should also prescribe ‘key risk indicators’ and how these are to be monitored and

- reported on to senior management.
3. FIs should identify potential ‘adverse development scenarios’ and prepare an action plan. They must establish a new notification process to inform the MAS about adverse developments within the appropriate notification timeframe.
4. FIs should extend existing fit and proper criteria to outsourced service providers and sub-contractors through the SLAs. For existing arrangements, they should determine if fit and proper assessments have been performed or need to be applied respectively.
5. It is advised that FIs tier their outsourcing arrangements on the basis of risk to the FI should an incident or event occur. The independent audit frequency can be based on these risk levels, provided an audit is completed once every three years or less.
6. The Association of Banks in Singapore (ABS) recently published ‘Guidelines on Control Objectives and Procedures for Outsourced Service Providers’ for the banking industry in June 2015. The recommendations prescribe a baseline for service providers and their sub-contractors to adhere to. Banks should ensure that the scope of independent audits meet the ABS Guidelines on Outsourcing, and an Outsourced Service Provider Audit Report (OSPAR) is completed by each of their outsourced service providers.
7. FIs should review existing outsourcing register and incorporate MAS prescribed fields. They need to establish documentation repository to ensure appropriate documentation is in place to demonstrate effective management of outsourcing.

Next Step

The proposed MAS outsourcing regulations will have widespread impact on the practices, management and outsourcing arrangements of global and regional FIs with operations in Singapore, as well as service providers and their subcontracting in Singapore and abroad.

When the new outsourcing notice is issued, all affected parties will have a six month transitional period from the date of issuance to ensure compliance before the notice comes into effect. Existing contracts do not need to be updated in accordance with the obligations, but any outsourcing agreements entered into or renewed

on or after this six month transitional period will need to comply with the applicable provisions of the notice.

When outsourcing is conducted appropriately, an organisation can find itself free of time-consuming operational functions and be able to focus on more strategic and forward-looking aspects of its business. This can help enhance revenues and possibly cut costs by limiting the addition of specialised staff.

However, the strategic mix of outsourcing versus in-house operations will need to be re-visited by FIs in light of the more challenging requirements prescribed in the proposed MAS

Outsourcing regulations. Some FIs may find they will need to unwind selected outsourced arrangements that are no longer feasible financially or operationally due to the increased regulatory expectations.

At the same time the OSPs/Vendor may also go through a phase of consolidation as the smaller players or those unwilling to address the new regulatory mandates withdraw from the market. OSPs/Vendors establishing an early response to the MAS Outsourcing regulations can gain a competitive edge in the market by ensuring their ability to continue servicing FI clients.



Regulatory Updates



Regulatory Updates

FIs

Public Consultation on Market Conduct Rules for Marketing and Distribution Arrangements of FIs at Retailers and Public Places

In July 2015, MAS issued a consultation paper on Market Conduct Rules for Marketing and Distribution Arrangements of FIs at Retailers and Public Places. This was, in response to increasing interest amongst FIs to market and distribute financial products and services at retailers and public places. These Market Conduct Rules would mitigate the potential market conduct risks posed to consumers arising from such arrangements.

The proposed measures require FIs to:

- Comply with a set of Market Conduct Guidelines setting out controls and safeguards that FIs should put in place when conducting marketing and distribution activities at retailers and public places; and
- Provide prior notification to MAS of their plans to conduct marketing and distribution activities at retailers and public places, as well as information on the actual activities conducted.

Consultation Paper on Proposed Enhancements to Resolution Regime for FIs in Singapore

In June 2015, MAS proposed to strengthen the resolution regime for FIs in Singapore. The key proposals include but are not limited to:

Recovery and Resolution Planning

- Require FIs that have been notified by MAS to formulate Recovery and Resolution Plans ("RRPs"), adopt measures to address deficiencies in the RRP and to remove impediments to the implementation of the RRP;
- Responsibility for the development and maintenance of RRP lie with the board and executive officers of the FIs, and a failure to discharge such responsibilities will constitute an offence;

Temporary Stays and Suspensions

- Introducing statutory powers to temporarily stay early termination rights of counterparties to financial contracts entered into with a FI over which MAS may exercise its resolution powers.
- MAS could request a stay up to two business days, or until the completion of a transfer of business, shares or restructuring of the institution, or, if earlier, the receipt of a written notice from MAS that contract will not form part of the business that is being transferred. MAS also proposes being able to extend this stay if necessary;

Statutory Bail-in Powers

- MAS proposes to introduce statutory powers to carry out the bail-in of liabilities under the MAS Act. Such powers will be applied to Singapore-incorporated banks and

bank holding companies, MAS may consider extending the bail-in regime for non-bank financial sectors that may be systematically important for Singapore;

- Bail-in regime is intended to be applied to unsecured subordinated debt and unsecured subordinated loans, issued or contracted after the effective date of the relevant legislative amendments implementing the statutory bail-in regime;
- Introducing statutory powers to either convert into equity or write down contingent convertible instruments and contractual bail-in instruments whose terms had not been triggered prior to entry into resolution;

Creditor Safeguards

- Establishing a framework to compensate creditors who will be worse off under resolution than in liquidation. This would be decided by an independent valuation agent, and creditors would have the rights to appeal against their determined compensation eligibility or entitlement;

Resolution Funding

- Resolution funding arrangements will be used to cover the costs incurred in implementing resolution measures. Such arrangements may also be used to address any creditor compensation claims.

Merchant Banks

Consultation Paper on Proposed Notice on Liquidity Coverage Ratio ("LCR") and Minimum Liquid Assets ("MLA") Requirements for Merchant Banks

MAS had previously issued two consultation papers on local

implementation of Basel III Liquidity Rules in August 2013 and August 2014. The responses to the consultation feedback described revisions to the liquidity regulatory framework in Singapore, including the implementation of the LCR rules in Singapore and a revision of the MLA rules. Another key revision to the framework was the expansion of the scope of liquidity requirements, which means that Merchant banks will be subjected to the same liquidity requirements as banks from 1 January 2016.

Banks

Consultation Paper on Removing the DBU-ACU Divide – Implementation Issues

In June 2015, MAS announced that it will remove the requirements for banks in Singapore to maintain two separate accounting units- the Domestic Banking Unit (“DBU”) and the Asian Currency Unit (“ACU”). On 31 August 2015, MAS issued a consultation paper to outline the proposed consequential amendments to current regulatory requirements following the removal of the DBU-ACU divide.

MAS proposes to give banks two years, from the time the revised regulatory requirements are issued, to implement the proposed changes.

Securities, Futures and Fund Management

Guidelines on Good Drafting Practices for Prospectuses

On 7 July 2015, MAS issued Guidelines for issuers and their professional advisers on good drafting practices for prospectuses to improve the readability of prospectuses and facilitate investors’ understanding of the key information disclosed in prospectuses.

Issuers and their advisers are also

encouraged to follow these Guidelines’ principles for other types of offer disclosure documents (whether for an offer to retail or non-retail investors), such as offer information statements, product highlights sheets and information memoranda wherever possible.

Notice on Financial Market Infrastructure Standards

In August 2015, MAS issued a Notice for financial market Infrastructures (“FMIs”) which applies to licensed trade repositories and approved clearing houses.

MAS supervises and exercises oversight of these FMIs in accordance with the CPMI-IOSCO Principles for Financial Market Infrastructures (“PFMI”). Some of the principles of the PFMI are set out in the SFA and its subsidiary legislations. This Notice sets out the remaining principles that an FMI should comply with, including risk management and settlement procedures.

This Notice became effective from 31 August 2015.

Consultation Paper on Proposed Amendments to the Securities and Futures Act (SFA)

In February 2015, MAS issued a Consultation Paper on the proposed changes to Part XII of the SFA

with a view to strengthening the effectiveness of MAS’ enforcement regime in deterring market misconduct. Following the feedback received from the February Consultation Paper, this Paper sought comments on the relevant draft legislative amendments to Part XII of the SFA. This consultation also included a proposed amendment to section 324 of the SFA to support market misconduct investigations carried out with powers under the Criminal Procedure Code.

Securities, Futures and Fund Management/Financial Advisers

Consultation Paper on Draft Regulations for Mandatory Clearing of Derivative Contract

In July 2015, MAS issued a consultation paper proposing the Draft Regulations for Mandatory Clearing of Derivative Contracts. The draft Securities and Futures (Clearing of Derivatives Contracts) Regulations (“SF(CDC)R”) sets out the type of OTC derivative contracts to be cleared and circumstances under which clearing is mandatory, persons who are subject to or exempt from clearing obligations, and other implementation details.

MAS intends to issue the SF(CDC)R by the end of 2015 and will provide at least six months’ notice before the clearing obligations take effect.



Global topics



IFRS Newsletter - The Bank Statement Q3 2015 (October 2015)

This publication provide updates on IFRS developments directly impacting banks, considers accounting issues affecting the sector, and discusses the potential accounting implications of regulatory developments.



Basel 4 Revisited: The fog begins to clear – Sept 2015

This publication examines the continuing evolution of Basel 4 and the related parallel tracks, as well as the extent of unfinished business that banks need to take into account.



Approaching the Crossroads of Conduct and Culture: Improving Culture in the Financial Services Industry

This publication highlights the regulatory attention on perceived shortcomings in the prevailing culture of the financial services industry and KPMG's framework to assist organisations evaluate and improve their existing culture.



New Indonesian 'Branchless Banking' and Microfinance Laws - a catalyst for microfinance growth?

A publication looking at the implications of the new Indonesian Branchless Banking regulations and Microfinance Law, intended as catalysts for domestic banks to provide basic financial services to 'unbanked' Indonesians.



Going Beyond the Data - Turning Insights Into Value

A report based on the survey of more than 800 senior executives to identify key themes influencing D&A's value proposition around the world.



Role of Digital Banking – Furthering Financial Inclusion

A publication articulating the importance of digital in driving financial inclusion in India.



Hong Kong Banking Survey 2015

The annual survey of Hong Kong's banking sector which analyses the key performance metrics for the top 10 locally incorporated banks for the year ended 31 December 2014 and outlines the opportunities and challenges facing the sector.



Transforming the Regulatory Agenda: A Strategic Opportunity for the Financial Services Industry

The report looks at the importance of implementing a change management framework that centralises and synthesises current and future regulatory demands.

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If you would like more technical information on any of the issues discussed in this publication, please contact us.

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