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Saudi Arabian Monetary Agency

Banking Supervision Dept.

34720/B.C.S: 424

20 July 2008

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From : Saudi Arabian Monetary Agency

To : All Banks

Attention : Managing Directors, Chief Executive Officers and General Managers

Subject : **Rules on Outsourcing**

We refer you to our letter # BCS 822 dated 14 November 2007, which enclosed a consultative draft of SAMA's proposed Rules on Outsourcing wherein banks were required to review and provide comments on the draft rules to SAMA. Following a review of the comments received from the banks, the Rules were accordingly revised where appropriate.

We now enclose herewith SAMA's Rules on Outsourcing that provide a framework for all aspects of outsourcing activities by the Saudi Banking Sector and these are in effect immediately. The Banks should review the Rules in relation with their existing arrangement; and by end of September 2008, submit a plan of full compliance to be achieved by 30 June 2009.

If you need any further information on the Rules, please contact Mr. Mehdi Hassan (Tel. No. 01-463-3000 ext. 5808) or Mr. Tariq Javed (Tel. No. 01-466-2532).

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Encl.: a/s

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SAUDI ARABIAN MONETARY AGENCY

RULES ON OUTSOURCING

BANKING SUPERVISION DEPARTMENT
JULY 2008

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I. INTRODUCTION:

Banks are increasingly using third party services to carry out activities, functions and processes as Outsourcing arrangements to meet new challenges like innovation in technology, increasing competition, economies of scale and improvement in quality of service to clients (i.e., customers, depositors or investors). While outsourcing can bring down cost and provide other benefits, it may increase the risk profile of an institution such as strategic, reputation, compliance and operational risks arising from failure of a service provider in providing the service, breaches in security, or inability to comply with legal and regulatory requirements by the institution. A Bank can also be exposed to country risk when a service provider is located overseas and systemic risk when there is lack of control by a group of Banks over a common service provider. It is therefore important that a Bank adopts a sound and responsive risk management framework in outsourcing.

Banks, while deciding to outsource any function, should ensure that outsourcing should not reduce the protection available to depositors or investors nor be used as a way of avoiding compliance with regulatory requirements. It is the responsibility of Banks to continue to satisfy all regulatory and legal requirements issued to them from time to time, while entering into any outsourcing arrangement.

SAMA has been following the growth of Outsourcing within Saudi Arabia and has decided to formulate the appended rules to ensure that Banks are provided clarity on the Agency's position on all aspects of Outsourcing that are relevant to their licensing obligations.

II. APPLICATION OF RULES:

2.1. The rules are applicable to all Outsourcing arrangements entered into by all authorized banks licensed under Banking Control Law promulgated by Royal Decree No. M/5 dated 22/2/1386 H, including all their branches and subsidiaries located in Saudi Arabia, as well as the Saudi Arabian branches of foreign banks (hereinafter referred exclusively as "**Banks**").

2.1.1. Banks are required to ensure that their branches and subsidiaries located overseas are aware of these rules.

2.2. These rules enumerate SAMA's expectations of Banks that have entered or are planning to enter into Outsourcing arrangements. These rules are applicable on all Outsourcing arrangements with domestic as well as foreign Service Providers.

2.3. SAMA requires Banks to:

2.3.1. Seek its no objection prior to undertaking any Material Outsourcing.

2.3.2. Review their existing Outsourcing contracts against these rules and seek post facto no objection for contracts assessed as Material Outsourcing within 180 days from the date of issuance of these rules.

2.3.3. Rectify and remove deficiencies and deviations (as identified under 2.3.2) from the existing contracts within 365 days from the date of issuance of these rules or on renewal date of the contract whichever comes earlier.

2.3.4. Notify SAMA in the event of any breach of legal or regulatory requirements in their Outsourcing arrangements.

2.4. Banks are not allowed Outsourcing any functions relating to the transmission, processing and or retention of Customer Data to a Service Provider, with the exception of functions such as credit card processing and remittances utilizing international payments systems where Banks are required to seek SAMA's prior no objection.

2.5. Banks are not allowed to outsource Financial Data to a Service Provider except with prior no objection of SAMA.

2.6. In the event of a reported failure and or breach of a Material Outsourcing arrangement, SAMA may require the affected Banks to modify or cancel the arrangement, or re-integrate an outsourced function into the institution.

2.7. Insourcing contracts utilizing 3rd party personnel under the direct supervision, control and management of Banks are exempt from the purview of these Outsourcing Rules.

III. <u>OBLIGATIONS AND ACCOUNTABILITY</u>:

3.1. The Board of Directors and Management of Banks retain the ultimate responsibility for all of their Outsourcing arrangements, including compliance with all relevant legal and regulatory laws.

3.2. Banks' Board of Directors should ensure that appropriate policies are developed and implemented within the proper risk management framework for Outsourcing arrangements.

3.3. Banks are required to ensure that for Material Outsourcing, SAMA and its auditors must have effective access to data related to the Outsourcing, as well as to the business premises of the Service Providers; and SAMA and the Banks' auditors must be able to exercise those rights of access.

3.4. Banks are required to ensure that the process of awarding of Outsourcing contracts is free from any conflict of interest.

IV. OUTSOURCING POLICY:

4.1. Banks are required to develop and put in place a policy on Outsourcing duly approved by their Board of Directors within 180 days from the date of issuance of these rules.

4.2. The outsourcing policy should provide for the development, implementation and update of detailed procedures for managing Outsourcing arrangements. These procedures should incorporate the roles and responsibilities of the Board of Directors and Management, risk identification criteria and risk mitigation measures, and systems for monitoring and control of these Outsourcing activities as well as eligibility and qualification criteria for selection of Service Providers. The procedures should also incorporate all the requirements as laid down in these rules.

V. RISK MANAGEMENT:

5.1. Risk Assessment

5.1.1. The Board of Directors and Management of Banks should ensure the existence of relevant policies and procedures whereby all existing and proposed Material Outsourcing arrangements have been subject to a comprehensive risk review process. All existing and proposed Non-material Outsourcing arrangements are also required to be reviewed and subject to suitable risk evaluation. The risk review process should identify and evaluate each proposal for key risk factors namely Operational, Legal, Reputation and Regulatory risks and risk mitigation strategies.

5.1.2. (i) Banks should conduct a comprehensive risk evaluation of the Material Outsourcing at inception and for all subsequent renewals.

(ii) Non-Material Outsourcing is to be subject to appropriate risk evaluation at inception and then reviewed at renewal only in case of a change in scope or occurrence of operational errors etc.

5.1.3. Before entering into an Outsourcing arrangement, Banks are required to analyze the business case, the suitability of the Service Provider including conducting due diligence on the Service Provider's financial, technical and ethical capabilities, the impact of the Outsourcing on the overall risk profile and its impact on systems and controls within the bank. The level and extent of due diligence will depend on the nature of Outsourcing arrangement i.e. Material outsourcing will entail a more comprehensive exercise.

5.1.4. The Banks should ensure that the Service Provider has the ability, capacity and authorization to perform the outsourced function reliably and professionally.

5.1.5. The Banks must establish a method for periodically assessing the Service Provider.

5.1.6. The Banks must retain the necessary expertise to supervise the outsourced functions effectively.

5.2. Contractual Agreements

5.2.1. Banks should document their Outsourcing arrangements through a written, legally binding agreement. As a minimum, the contract should incorporate the following:

a. Scope of the Contract;
b. Service levels and performance requirements;
c. Audit and monitoring procedures;
d. Business continuity plans;
e. Default arrangements and termination provisions;
f. Pricing and fee structure;
g. Dispute resolution mechanisms;
h. Liability and indemnity;
i. Confidentiality, privacy and security of information;
j. For Material Outsourcing, ensuring access to SAMA and the Bank's internal and external auditors;
k. Compliance with all applicable regulatory and legal requirements;
l. Contractual obligations of the Service Provider in case of subcontracting all or part of the Outsourcing;
m. Mechanisms for reporting and escalation;
n. Commitment of the service provider to report to the bank any control weaknesses or adverse developments in its financial performance;
o. Commitment of foreign Service Provider that there are no regulatory impediments to the data and record access as per 5.6.

5.2.2. The contract should allow for renewal, renegotiation, default termination and early exit so as to enable the bank to retain control over the outsourced activity and should include provisions that prohibit sub contracting of the Material Outsourcing under the contract without the prior approval of the Bank and no objection from SAMA.

5.2.3. For Material Outsourcing, the contract should also incorporate a clause for providing SAMA access to documentation and accounting records in relation to the Outsourcing. The contract should require the Service Provider to cooperate with SAMA.

5.2.4. The contract should preferably include Saudi Arabia as the legal jurisdiction of the contract.

5.2.5. Banks should institute a defined internal mechanism for receipt and resolution of any customer complaints regarding their outsourced services and the Outsourcing contract should include appropriate clauses to ensure that the service provider will facilitate the resolution mechanism.

5.3. Data Confidentiality and Security

5.3.1. Banks are not allowed Outsourcing any functions relating to the transmission, processing and or retention of Customer Data to a Service Provider with the exception of functions such as credit card processing and remittances utilizing international payments systems where SAMA's prior no objection is required.

5.3.2. Banks are not allowed to outsource Financial Data to a Service Provider except with prior no objection of SAMA.

5.3.3. Banks should make certain that before providing Customer Data and Financial Data to a Service Provider, the proposed outsourcing arrangement complies with the relevant statutory requirements related to confidentiality of its customers, specifically the provision of Article #19 of the Banking Control Law dated 22/2/1386 H, regulations and instructions issued by SAMA from time to time and other relevant local laws.

5.3.4. Banks should establish proper safeguards, as appropriate to protect the integrity and confidentiality of Customer Data and Financial Data including obtaining undertaking and or Non Disclosure agreements, only providing Customer Data and Financial Data to a Service Provider on a need-to-know basis, requiring service providers to ring fence and segregate its data from their other data pools .

5.3.5. Upon termination of the outsourcing arrangement and contract for whatever reason, Banks should ensure that all Customer Data is either retrieved from the Service Provider or destroyed with all exceptions to be reported to SAMA.

5.4. Business Continuity Management

5.4.1. Banks should ensure that their business continuity is not compromised by any Outsourcing arrangements. For all Material Outsourcing, Banks should have a contingency plan which outlines the procedures to be followed in the event that the arrangement is suddenly terminated or the Service Provider is unable to fulfill its obligations under the Outsourcing agreement for any reason.

5.4.2. Banks should document within their Business Continuity Plans, the availability of alternate service providers or the procedures for brining the outsourced function in-house for each of their Material Outsourcing contracts.

5.5. Control and Monitoring of Outsourcing

5.5.1. Banks should put in place an internal structure to manage and control all of their Outsourcing activities. The nature and scope of this structure will vary within banks, depending on the level and complexity of Outsourcing activities, with different risk review processes for Material and non Material Outsourcing as per 5.1.2. However, the primary function of this structure should be to effectively control, monitor and manage all Outsourcing activities and to provide timely reports to senior management.

5.6. Access to Outsourced Data

5.6.1. Banks should ensure that SAMA has unrestricted and timely access to up to date and accurate records pertaining to the Outsourcing as per Article # 17 and 18 of the Banking Control Law dated 22/2/1386 H (11/6/1966).

5.6.2. Banks should ensure that data pertaining to Outsourcing as retrieved from their Service Providers is accurate and if required Banks' internal and external auditors and SAMA have unrestricted access to data pertaining to the Outsourcing if located at the premises of the Service Provider.

5.7. Material Outsourcing

5.7.1. There are a number of mission critical systems and processes within banks that are critical to their ongoing operation. These are designated as "Material" functions and they require continued, ongoing hands-on oversight by the Banks' management.

5.7.2. Generally Banks are not allowed to outsource their Material Functions, with exceptions to be assessed by SAMA on a case by case basis.

5.7.3. Any Material Outsourcing requires prior no objection from SAMA.

5.7.4. Proposals for all Material Outsourcing should be submitted for a no objection to SAMA in writing well in advance (at least 30 business days for domestic and 60 days for foreign) of the proposed commencement of the outsourcing arrangement.

5.7.5. It is the responsibility of the Banks to assess whether the function being outsourced is considered Material Outsourcing or not. The Board of Directors must ensure that senior Management has assessed each proposed Outsourcing function against both qualitative and quantitative criteria with the overriding proviso that the function is designated Material Outsourcing if its failure has the potential to significantly impact on the bank's business operations, reputation or profitability and may have wider systemic implications. Banks may seek SAMA's guidance in case of doubt whether an existing or new arrangement is considered material outsourcing or not.

5.7.6. Banks are required to immediately report to SAMA any breach of legal and or regulatory requirements or any adverse developments relating to a Material Outsourcing arrangement that could significantly and adversely affect the institution, along with measures proposed and taken for continuity of the service.

5.7.7. Banks are required to provide their Service Providers with a copy of the SAMA Outsourcing Rules.

5.8. <u>Outsourcing to Service Providers located Overseas</u>

5.8.1. The Outsourcing of activities by banks to Service Providers located overseas exposes them to a number of additional risks including the foreign country's economic, political, regulatory, legal and infrastructure conditions. Furthermore an outsourcing activity involving transmission to and retention of Customer Data and Financial Data by a Service Provider located overseas raises a number of critical risk issues including potential breach of customer confidentiality (as enshrined within Article 19 of the Banking Control Law) by allowing access to Customer Data by foreign regulatory and or judicial authorities, right of access by SAMA to the Service Provider's overseas operations and any restrictions and or delays on timely availability of data to SAMA as required under Article 17 and 18 of the Banking Control Law.

5.8.2. For any proposed Outsourcing arrangements involving transmission, processing and retention of Customer Data and or Financial Data and or Material Outsourcing to a Service Provider located overseas (including Head Offices and or Regional offices and or affiliated entities of banks), banks are required to provide the following information to SAMA accompanying their request:

- Details of the function to be outsourced
- Categorization of the function (Material and Non-Material Outsourcing)
- Rationale for Outsourcing
- Details on the Service Provider located overseas
- Details on the nature and disposal of the data to be transferred (if applicable)
- Legal opinion on compliance with confidentiality legislation
- Confirmation in writing by the Bank supported by a legal opinion confirming SAMA's right of access to the Outsourcing activity at the Service Provider

VI. <u>TIMING AND TRANSITION:</u>

6.1. Banks which have existing Outsourcing arrangements in place or are interested in entering into such arrangements are required to formulate their Outsourcing policy and submit a copy thereof to SAMA duly approved by their Board of Directors within 180 days from the issuance of these rules. If such a policy already exists, Banks should ensure that they are in compliance with these rules and to submit a copy of the policy to SAMA within 90 days from the date of issuance of these rules.

6.2. All new Outsourcing arrangements as well as renewal of existing arrangements should be made in accordance with the terms of the Outsourcing policy prepared in compliance with these rules.

6.3. Banks are required to submit details of all existing Material Outsourcing arrangements to SAMA for its information within 180 days from the date of issuance of these rules.

6.4. Proposals for Material Outsourcing should be submitted for no objection to SAMA in writing well in advance (at least 30 business days for domestic and 60 days for foreign) of the commencement of Outsourcing arrangement. As a minimum the proposals should include the scope of the contract and relevant details of the Service Provider etc.

6.5. Banks are required to immediately report to SAMA any breach of legal and or regulatory requirements or any adverse developments relating to a material outsourcing arrangement that could significantly and adversely affect the institution, along with measures proposed or taken for continuity of the service.

VII. DEFINITIONS:

In these Rules, unless the context otherwise requires:

"**Board**" or "**Board of Directors**" means:

(a) in the case of an institution incorporated in Saudi Arabia, the board of Directors;

(b) in the case of an institution incorporated outside Saudi Arabia, a local board, a management committee or body beyond local management empowered with oversight and supervision responsibilities for the institution in Saudi Arabia.

"**Banks**" means any bank licensed by SAMA under the Banking Control Law (Article 3).

"**Material Functions**" means risk management, credit assessment and approval, finance, internal audit, treasury, internal control and compliance functions and primary decision-making processes such as account opening (for a typical list please refer to Annex 1)

"**Customer Data**" means any information or document whatsoever relating to the affairs or account of a customer (whether held physically or electronically and whether held by the Banks themselves or by Service Provider on their behalf)

"**Financial Data**" means all financial data including books of accounts, general and sub-ledger, financial statements and various financial data other than Customer Data.

"**Insourcing**" means an arrangement where a Bank is utilizing personnel provided under a contract with a Service Provider to undertake functions within or outside the Bank's premises under its direct supervision, control and management.

"**Material Outsourcing**" means an outsourcing arrangement which, if disrupted, has the potential to significantly impact an institution's business operations, reputation or profitability (for a typical list please refer to Annex 1);

"**Outsourcing**" means an arrangement under which a third party (i.e. the service provider) undertakes to provide to an authorized institution ("Bank") a service previously carried out by itself or a new service to be launched by it. Outsourcing can be to a Service Provider in Saudi Arabia or overseas and the Service Provider may be a unit of the same Bank (e.g. head office or an overseas branch), an affiliated company of the Bank's group or an independent third party. Insourcing contracts utilizing 3rd party personnel under the direct supervision and control of Banks are exempt from the purview of these Outsourcing Rules.

"**Overseas**" refers to entities located outside of Saudi Arabia and subject to laws and regulations of the jurisdiction in which they are located.

"**Service Provider**", includes a member of the group to which the institution belongs e.g. its Head Office (HO), parent institution, another branch or related company, or an unrelated 3rd party, whether located in Saudi Arabia or elsewhere.

Annex I

1. The following are typical examples of functions and services that, when performed by a third party, would be regarded as Material Outsourcing for the purposes of the Guidelines although they are not exhaustive:

Material Functions

- risk management, credit assessment and approval, treasury, finance, internal control and internal audit and compliance functions and primary decision-making processes such as account opening

Material Outsourcing

- Financial Data;
- Application processing (e.g. opening of customer accounts, know your customers, loan origination, credit card origination and approvals);
- Back office management (e.g. electronic funds transfer, payroll processing);
- Claims administration (e.g. loan processing, collateral management, collection of bad loans except execution of judgments);
- Document processing (e.g. cheques, credit card and bill payments, bank statements, other corporate payments);
- Information system management and maintenance (e.g. data entry and processing, data centers, IT hosting, end-user support, local area networks);
- Treasury Activities (e.g. placements, deposits, foreign exchange, securities trading etc);
- Manpower management (e.g. benefits and compensation administration, staff appointment, training and development);
- Marketing and research (e.g. product development, data warehousing and mining, call centers, marketing and telemarketing of Banking Products and Services); and
- Business continuity and disaster recovery capacity and Capabilities.

Non-Material Outsourcing

2. The following arrangements would generally not be considered Material Outsourcing:

- Utilities such as telephone, electricity;
- Market information services (e.g. Bloomberg, Moody's, Standard & Poor);
- Common network infrastructures (e.g. VISA, Mastercard, AMEX, SWIFT);
- Correspondent banking services;
- External audit and independent audit assessments;
- Advisory services (e.g. legal opinions);
- Independent consulting;
- Mail, courier services;
- Printing services; (Cheque Book/Statement of Accounts etc printing only permitted to be outsourced to local Service Providers)
- Purchase of goods including their after sales or other support services, commercially available software and other commodities;
- Credit and background investigation and information services;
- Employment of contract or temporary personnel; Head Hunting Services, Employee Assessment, Consulting on staff development;
- Physical Security Services;
- Housekeeping, building maintenance, cleaning services etc; and
- Cash Transportation between locations, ATM Cash replenishment etc.