



Suruhanjaya Sekuriti
Securities Commission

GUIDING PRINCIPLES FOR OUTSOURCING OF BACK OFFICE FUNCTIONS FOR CAPITAL MARKET INTERMEDIARIES

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1.0 DEFINITION

1.01 In these guidelines:

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| books | shall have the same meaning as provided in the <i>Securities Industry Act 1983</i> (SIA), <i>Securities Commission Act 1993</i> (SCA) and <i>Futures Industry Act 1993</i> (FIA). |
| Exchange | shall include Bursa Malaysia Berhad, Bursa Malaysia Securities Berhad, Bursa Malaysia Derivatives Berhad, and any of Bursa Malaysia Berhad's subsidiaries not specifically mentioned herein, either collectively or individually, as the context shall require. |
| external party | shall have the same meaning as assigned to that expression in the <i>Guidelines on the Performance of Supervisory Functions at Group Level for Capital Market Intermediaries</i> . |
| investment bank | shall mean the entity that is licensed both as a dealer pursuant to section 12 of the SIA and a merchant bank pursuant to section 5 of the <i>Banking and Financial Institutions Act 1989</i> , and duly established pursuant to the <i>Guidelines on Investment Banks</i> jointly issued by Bank Negara Malaysia and the Securities Commission (SC). |
| market intermediary | shall mean– (a) a dealer who is licensed pursuant to the SIA and a participating organisation, as defined in the rules of Bursa Malaysia Securities Berhad; (b) a futures broker who is licensed pursuant to the FIA, and a trading participant, as defined in the business rules of Bursa Malaysia Derivatives Berhad; |

- (c) a fund manager who is licensed under the SIA;
- (d) a futures fund manager who is licensed pursuant to the FIA;
- (e) a futures trading adviser who is licensed pursuant to the FIA;
- (f) an investment adviser who is licensed under the SIA; and/or
- (g) a unit trust management company or a “management company” as defined in the SCA and approved by the SC.

rules shall have the same meaning as provided in the SIA and the same meaning assigned to the expression “business rules” in the FIA.

securities laws shall have the same meaning as provided in the SCA.

service level agreement shall mean a legal agreement or contract between the market intermediary and the service provider.

service provider shall mean an independent company or a company within the group of companies to which the market intermediary belongs, to whom the back office functions are outsourced by the market intermediary. The said service provider shall be located in Malaysia.

2.0 INTERPRETATION

2.01 Any words, expressions and phrases used herein importing the singular meaning where the context so permits shall also include the plural meaning and vice versa.

- 2.02 All words expressions and phrases used herein importing the masculine gender shall also include the feminine and neuter gender.
- 2.03 A reference herein to—
- (a) a statute or statutory provision shall be deemed to include all modifications, re-enactments or consolidation thereof, and regulations, rules or other statutory instruments made pursuant thereto; and
 - (b) a rule, directive or guidelines of the Exchange or such other relevant party shall be deemed to include all modifications, variations, amendments, supplements thereto or substitutions therefore.
- 2.04 Where a word or phrase is given a defined meaning herein, any other grammatical form in respect of such word or phrase has a corresponding meaning.
- 2.05 All headings and sub-headings employed herein are inserted for convenience of reference only and shall not affect the interpretation and construction of the relevant provision.

3.0 GENERAL PROVISION

- 3.01 A market intermediary may be permitted to outsource its back office functions to a service provider, in the manner stipulated herein, whose functions are otherwise undertaken by the internal staff of the market intermediary.
- 3.02 A market intermediary may outsource the said back office functions in order to achieve greater efficiency, reduce their administrative burden and operate in a cost efficient manner.
- 3.03 The primary obligation, accountability and responsibility with regards to any regulatory requirements shall remain at all times with the market intermediary despite any back office function being outsourced to a service provider.
- 3.04 Outsourcing shall be limited from a market intermediary to a service provider which shall not further assign or sub-contract these functions to another party.

- 3.05 The market intermediary shall establish and implement effective policies, operational procedures and controls in relation to the company's day-to-day business operations and in order to protect the interests of clients and to ensure proper management of risk.
- 3.06 A market intermediary that enters into an outsourcing arrangement shall put in place procedures to monitor and maintain overall control of the outsourcing arrangement in accordance with the board of director's approved policy and performance of the market intermediary's primary obligation for the functions that are outsourced.
- 3.07 The SC or the Exchange may at any time require or direct the relevant market intermediary to assume the outsourced back office functions internally in the event the SC or the Exchange is not satisfied for any reason whatsoever with the performance of the service provider or the arrangement between the relevant market intermediary and the service provider, without any compensation whatsoever due to the market intermediary or the service provider.
- 3.08 The market intermediary shall have in place a contingency plan which shall be approved by its board of directors, in order to mitigate any adverse impact arising from the discontinuity and disruption to the outsourced back office functions in the event the service level agreement or part thereof is terminated, or the function cannot be performed by the service provider for any reason whatsoever.
- 3.09 These guiding principles shall not apply to investment banks, unless otherwise stipulated in any guidelines as may be amended or issued from time to time by the SC or any other relevant regulatory authority.

4.0 SCOPE OF OUTSOURCING OF BACK OFFICE FUNCTIONS

- 4.01 Scope of back office function is deemed as regulated or unregulated administrative and/or operational activities that–
- (a) in the case of a dealer, do not fall under the definition of “dealing in securities”, as stipulated in the SIA;
 - (b) in the case of a fund manager, do not fall under management of portfolio of securities for the purpose of investment, as stipulated in the SIA;

- (c) in the case of an investment adviser, do not fall under the activities that may be carried out by such person, as stipulated in the SIA;
 - (d) in the case of a futures broker, do not fall under “futures broking business”, as stipulated in the FIA;
 - (e) in the case of a futures fund manager, do not fall under “futures fund management business”, as stipulated in the FIA;
 - (f) in the case of a futures trading adviser, do not fall under “futures advice business”, as stipulated in the FIA.
- 4.02 The back office functions that are outsourced shall at all times **exclude** the decision making functions of the market intermediary, any interaction or physical contact with the clients of the market intermediary, and middle office functions, such as compliance, risk management and internal audit.
- 4.03 The performance of the middle office functions, such as compliance, risk management and internal audit shall be subject to the *Guidelines on Performance of Supervisory Functions at Group Level for Capital Market Intermediaries*, and any other relevant guidelines and rules as may be issued or be amended from time to time by SC or the Exchange.

5.0 OUTSOURCING PRINCIPLES

The market intermediary shall comply with the following principles prior to outsourcing its back office functions:

A. Due Diligence Exercise and Selection of Service Provider

- 5.01 The relevant market intermediary shall conduct due diligence exercise or review the capabilities and expertise of the service provider which shall *inter alia*, include the assessment of–
- (a) the ability of the service provider to adhere to high standard of care in performing the service;
 - (b) the ability of the service provider to comply with its obligations under the outsourcing service level agreement;

- (c) qualitative and quantitative financial and operational factors;
 - (d) reputation factors;
 - (e) insurance coverage by the service provider;
 - (f) potential conflict of interest especially where the service provider operates within the same industry; and
 - (g) the adequacy of resources and ability of the service provider to efficiently undertake the functions, especially in instances where the service provider performs outsourcing services for multiple entities.
- 5.02 The market intermediary shall ensure that its internal audit department or the external party, as the case may be, shall conduct regular review of the functions performed by the service provider to ensure the continuous quality and integrity of the outsourced back office functions, and adherence by the service provider to the aforementioned criteria. In addition, the market intermediary shall ensure that the regular review conducted by the internal audit department or the external party, as the case may be, shall also identify new material outsourcing risks as they arise or which may arise.
- 5.03 Upon conducting its review, the internal audit department or the external party, as the case may be, shall prepare the necessary report pertaining to, *inter alia*, the quality of the performance of the outsourced functions by the service provider, adherence by the service provider to the criteria mentioned in clause 5.01 hereinabove and identification of risks and strategies for managing such risks. The said report shall be made available to SC and/or the Exchange as and when requested.
- 5.04 To ensure the independence of reviews conducted and reports prepared by the internal audit department or the external party, as stipulated in clauses 5.02 and 5.03 hereinabove, the market intermediary shall ensure that the service provider and the external party are not the same party.
- 5.05 Notwithstanding the same and for the avoidance of doubt, where the back office function is undertaken by the service provider, and internal audit function is undertaken by the entity (as defined in the *Guidelines on Performance of Supervisory Functions at Group Level for Capital*

Market Intermediaries), the said service provider and entity may be the same party.

B. Access to Books, Records and Documents by the SC and Exchange

- 5.06 The market intermediary shall ensure that the SC and the Exchange shall at all times–
- (a) have access to the books, records and documents of the service provider relating to the outsourced activities;
 - (b) be able to obtain copies of any books, records and documents; and
 - (c) be able to obtain promptly any other information concerning activities that are relevant for the performance of their regulatory oversight or supervisory functions.
- 5.07 The market intermediary shall ensure that appropriate measures are in place to ensure that the SC and/or the Exchange–
- (a) may conduct examination and/or inspection at the premises of the service provider, whether by its internal or external auditors, or by its agents and to obtain copies of any report and finding made on the service provider in conjunction with the service performed for the market intermediary; and
 - (b) shall have access to both the service provider and the market intermediary to obtain records and documents, data of or information on transactions, and any other information of the market intermediary given to, stored at or processed by the service provider, and the right to access any report and finding made on the service provider.
- 5.08 The market intermediary shall procure a written undertaking from the service provider to the effect that the SC and/or the Exchange shall, without any hindrance, reserve the right to conduct examination or inspection at the service provider's premises, including examining books and documents and having access to and obtain copies of the relevant books, records and documents as and when required.

- 5.09 The market intermediary shall ensure that the service provider and the market intermediary maintain their relevant books, records and documents for the time period stipulated in the law, rules and guidelines.

C. Legal and Regulatory Obligations

- 5.10 Outsourcing shall not diminish the obligations of the market intermediary, and those of its board of directors and management, to comply with and fulfil the requirements of securities laws, regulations, guidelines and the rules.
- 5.11 The market intermediary shall be liable for any action for non-compliance with or breach of any requirements of the securities laws, regulations, guidelines and rules arising from the outsourcing arrangement, committed by the service provider.
- 5.12 The market intermediary shall ensure that outsourcing of the back office functions shall not in any way interfere with the ability of the market intermediary to fulfil its legal and regulatory obligations, and effectively and efficiently perform any of its activities.
- 5.13 The market intermediary shall establish internal policies and procedures to ensure compliance with all relevant securities laws, regulations, guidelines, licensing conditions and rules.
- 5.14 The market intermediary shall ensure that the SC's and the Exchange's supervisory and oversight powers over the relevant market intermediary and their ability to carry out market supervision functions shall not in any way be hindered by the outsourcing of the back office functions.
- 5.15 The market intermediary shall ensure that the service provider assumes the outsourced functions in the manner stipulated in the securities laws, regulations, guidelines and rules, including submitting such regular or ad-hoc reports as may be required by the SC and/or the Exchange.

D. Confidentiality of Clients' Information

- 5.16 The market intermediary shall procure from the service provider a written undertaking to maintain the secrecy and confidentiality of the documents and information of clients that the service provider shall

have access to, from any intentional or inadvertent disclosure to unauthorised person(s).

- 5.17 Dealers shall ensure that the requirements stipulated by sections 43 and 45 of the *Securities Industry (Central Depositories) Act 1991* in relation to the outsourcing of back office functions are duly observed.
- 5.18 The market intermediary shall ensure that any requirements pertaining to the confidentiality of clients' information appearing in the relevant laws, rules, regulations and guidelines are adhered to at all times.
- 5.19 The market intermediary shall ensure that the service provider's security policies, procedures and controls enable the protection of confidentiality and security of clients' information.

E. Risk Management

- 5.20 The board of directors and management of the market intermediary shall retain ultimate responsibility for the effective management of risks arising from outsourcing which shall, *inter alia*, include—
 - (a) periodic reviews of its outsourcing arrangements and identification of new material outsourcing risks as they arise or which may arise;
 - (b) ensuring that the outsourcing is consistent with the overall business strategy and objectives of the market intermediary;
 - (c) comprehensive due diligence on the nature, scope and complexity of the outsourcing to identify the key risks and risk mitigation strategies;
 - (d) analysis of the impact of the arrangement on the overall risk profile of the market intermediary, and whether there are adequate internal expertise and resources to mitigate the risks identified; and
 - (e) analysis of the potential benefits of outsourcing against the weaknesses that may arise, including the impact of disruption or unexpected termination of the outsourcing services.

- 5.21 In order to ensure that the business conduct, integrity and internal controls of the market intermediary are not compromised or weakened, the board of directors and management shall be fully aware of and understand the risks involved in an outsourcing exercise and the possible impact it may have on the market intermediary, and shall accordingly design risk management and risk mitigation strategies.

F. Board and Management Responsibility

- 5.22 Prior approval of the board of directors of the market intermediary shall be obtained before the market intermediary proceeds to outsource its back office functions to a service provider.
- 5.23 The primary responsibility of back office functions that are outsourced shall remain with the board of directors and management of the relevant market intermediary.
- 5.24 The responsibilities for effective due diligence and oversight of outsourcing and accountability for all outsourcing decisions shall continue to rest with the board of directors and management of the market intermediary.

G. Service Level Agreement

- 5.25 The relevant market intermediary shall enter into a written and binding service level agreement with the service provider in order to formalise the outsourcing arrangement, which shall explicitly and carefully define the roles, responsibilities and obligations of the service provider.
- 5.26 The service level agreement shall as far as possible capture all the nature and materiality of the outsourcing arrangement and shall document all components of the outsourcing arrangement between the parties and the terms and conditions governing the relationship.
- 5.27 The market intermediary shall ensure that the service level agreement stipulates provisions for proper reporting and monitoring mechanisms from the service provider to the market intermediary, including also the market intermediary's right and access to prompt information and records.
- 5.28 The service level agreement shall include provisions relating to termination of the contract and appropriate exit strategies.

- 5.29 The market intermediary shall ensure that the SC's and the Exchange's access to books, records and documents, and rights of examination and inspection are duly stipulated in the service level agreement.
- 5.30 The service level agreement shall include provisions relating to the maintenance of books, records and documents for the time period stipulated in the law, rules and guidelines.
- 5.31 It is recommended that the service level agreement is prepared and/or duly reviewed by a competent legal counsel with regards to its legal effect and enforceability.

H. Business Continuity

- 5.32 The market intermediary shall ensure that its business continuity plan is not compromised or impaired by the outsourcing exercise.
- 5.33 The market intermediary shall adopt sound practices and standards to ensure its business continuity as stipulated in the rules and/or guidelines for an effective business continuity plan on an ongoing basis.

I. Readiness Audit by the SC or the Exchange

- 5.34 Pursuant to receiving a written application from the market intermediary to outsource its back office functions in the manner stipulated herein, and prior to the commencement of the outsourcing arrangement between the market intermediary and service provider, the SC or the Exchange, as the case may be, shall reserve the right to conduct a readiness audit on the service provider which may, *inter alia*, cover the service provider's readiness to assume such functions in terms of the infrastructure and sufficiency of resources.

J. Application for Outsourcing of Back Office Functions

- 5.35 Where a market intermediary intends to outsource its back office functions, the said market intermediary shall submit a written application in the following manner:
 - (a) Dealers and futures brokers shall submit their application to the Exchange, who shall review such application in consultation with the SC; and

- (b) A market intermediary that is licensed or approved as a fund manager, futures fund manager, unit trust management company, investment adviser and futures trading adviser is required to submit a written application directly to:

The Director
Market Supervision Division
Securities Commission
3 Persiaran Bukit Kiara
Bukit Kiara
50490 Kuala Lumpur.

5.36 The said application shall, *inter alia*–

- (a) state the objectives for outsourcing the back office functions;
- (b) provide details on the scope of activities that are being outsourced and the detailed arrangement between the market intermediary and the service provider;
- (c) provide details on the selection criteria of the service provider and the manner in which the market intermediary shall monitor the performance of the functions by the service provider;
- (d) expressly state that the arrangement between the market intermediary and service provider is in compliance with all relevant securities laws, regulations, guidelines, licensing conditions and rules, and that measures are in place to ensure compliance on a continuous basis;
- (e) provide details on the evaluation of risks; and
- (f) include a copy of the duly executed service level agreement.

5.37 The SC and/or the Exchange may request for any further information and/or documents, and impose any conditions deemed fit in granting their approval for such application.

5.38 Dealers and futures brokers shall notify the Exchange, while fund managers, futures fund managers, unit trust management companies, investment advisers and futures trading advisers shall notify the SC, of any changes to the particulars of the service

provider, and any changes, variations, additions or amendments to the service level agreement or the arrangement between the market intermediary and the service provider.