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# Guideline

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### Note:

Revised March 2009 as a result of the coming into force of *An Act to amend the law governing financial institutions and to provide for related and consequential amendments*, S.C. 2007, c. 6

## Introduction

Financial institutions outsource business activities, functions and processes to meet the challenges of technological innovation, increased specialization, cost control, and heightened competition. However, outsourcing can increase an institution's dependence on third parties, which may increase its risk profile. Many financial sector regulators have responded by introducing guidance related to the management of outsourcing risks.

This Guideline sets out OSFI's expectations for federally regulated entities (FREs) that outsource, or contemplate outsourcing, one or more of their business activities to a service provider. These expectations should be considered prudent practices, procedures or standards that should be applied according to the characteristics of the outsourcing arrangement and the circumstances of the FRE.

FREs have the flexibility to configure their operations in the way most suited to achieving their corporate objectives. However, this Guideline operates on the premise that **FREs retain ultimate accountability for all outsourced activities**. Furthermore, OSFI's supervisory powers should not be constrained, irrespective of whether an activity is conducted in-house, outsourced, or otherwise obtained from a third party.

Under this Guideline, FREs are expected to:

- evaluate the risks associated with all existing and proposed outsourcing arrangements;
- develop a process for determining the materiality of arrangements;
- implement a program for managing and monitoring risks, commensurate with the materiality of the arrangements;
- ensure that senior management or branch management receives information sufficient to enable them to discharge their duties under this Guideline; and
- refrain from outsourcing certain business activities to the external auditor (see Section 4.3).

OSFI's specific expectations may vary, depending on the nature of the outsourcing arrangement being contemplated and the relationship between the FRE and the service provider. As outlined in its *Supervisory Framework*, OSFI applies a risk-based approach to assessing an FRE's safety and soundness on a consolidated basis. Resources are focused on areas of higher risk and information from other regulators is used as appropriate. For each activity that OSFI identifies as significant<sup>1</sup>, OSFI assesses the level of risk, including regulatory risk, and considers the impact of risk mitigation by evaluating the quality of risk management. Institutions that are well managed relative to their risks will require less supervision. Therefore, as part of OSFI's risk- focused supervisory process, an institution's policies and procedures for assessing the materiality of outsourcing arrangements and managing the risks associated with outsourcing arrangements, may be evaluated against the expectations of this Guideline. In addition, individual outsourcing arrangements may be subject to supervisory review.

## 2. Transition Period

- All arrangements signed on or after December 15, 2004, are expected to comply with all applicable Sections of the Guideline.

- All arrangements entered into prior to December 15, 2004 are expected to comply with the following Sections at the first opportunity, such as the time the outsourcing contract, agreement or statement of work (where applicable) is substantially amended, renewed or extended:
  - Section 7.1 (Due Diligence Process),
  - Section 7.2.1 (Contract for Services),
  - Section 7.3.2 (Monitoring the Outsourcing Arrangement), and
  - Section 7.3.3 (Monitoring the Service Provider)
- All arrangements entered into prior to December 15, 2004 are expected to comply with all other applicable Sections of the Guideline.
- Outsourcing arrangements that an FRE has obtained as a result of an acquisition are expected to comply with the expectations set out in the Guideline at the first opportunity, such as the time the outsourcing contract, agreement or statement of work (where applicable) is substantially amended, renewed or extended.

## 3. Definitions

### 3.1 Outsourcing Arrangement

For the purposes of this Guideline, an outsourcing arrangement is an agreement between an FRE and a service provider, whereby the service provider performs a business activity, function or process<sup>2</sup> that is, or could be, undertaken by the FRE itself. FREs may consult with OSFI when they are uncertain whether a particular arrangement falls within this definition. Examples are provided in Annex 1.

### 3.2 Federally Regulated Entity (FRE)

For the purposes of this Guideline, an FRE is defined as:

1. a bank (listed in Schedule I or II) to which the *Bank Act* applies;
2. a body corporate to which the *Trust and Loan Companies Act* applies;
3. an association to which the *Cooperative Credit Associations Act* applies or a central cooperative credit society for which an order has been made under subsection 473(1) of that Act;

4. an insurance company or a fraternal benefit society incorporated, formed, or continued under the *Insurance Companies Act*;
5. a bank holding company incorporated, formed or continued under Part XV of the *Bank Act*;
6. an insurance holding company incorporated, formed or continued under Part XVII of the *Insurance Companies Act*;
7. the Canadian branch of a foreign bank in respect of which an order under subsection 524(1) of the *Bank Act* has been made [3](#);
8. the Canadian branch of a foreign company in respect of which an order under subsection 574(1) of the *Insurance Companies Act* has been made [4](#).

### 3.2.1 FRE Group

For the purposes of this Guideline, the FRE group of an entity referred to in any of 3.2.a) to f), includes the FRE and any of the following:

1. the entity that controls the FRE if that entity is also an FRE;
2. a subsidiary of the FRE; and
3. a subsidiary of the entity referred to in a).

### 3.2.2 Regulated Financial Institution Parent Group (RFIP Group) - Branches or Subsidiaries with a Regulated Foreign or Provincial Parent

For the purposes of this Guideline, an RFIP group includes:

1. in respect of an entity referred to in 3.2 g), that Canadian branch, head office, and any other branches or agencies of the foreign bank;
2. in respect of an entity referred to in 3.2 h), that Canadian branch, head office, and any other branches or agencies of the foreign company; and
3. in respect of an entity referred to in 3.2 a) to f), the entity that controls the FRE if that entity is regulated by a foreign or provincial financial regulatory body.

## 4. Application of the Guideline

This Guideline applies to all the outsourcing arrangements of an FRE or an FRE group. In addition, in applying this Guideline, the FRE is expected to consider the impact on the FRE and on its consolidated operations, of outsourcing arrangements entered into by all its subsidiaries and business operations, including those located in foreign jurisdictions. OSFI expects the FRE to ensure that its subsidiaries and branches follow the guideline when entering into material outsourcing arrangements.

All outsourcing arrangements should be subjected to the materiality assessment set out in Section 6 of the Guideline. OSFI recognizes that outsourcing arrangements will exhibit varying degrees of materiality and expects that the robustness of an FRE's management of outsourcing risks would be commensurate with the materiality of the arrangement.

With respect to outsourcing arrangements that are deemed material, the FRE is expected to follow the full risk management program detailed in Section 7. However, reduced expectations may be applied, in a manner consistent with Sections 4.1 and 4.2 respectively, where the material outsourcing arrangement is between an FRE and a member of an FRE Group, or between an FRE and a member of an RFIP Group. FREs may consult with OSFI when they are uncertain how to assess a particular combination of intra-group arrangements.

With respect to outsourcing arrangements that are deemed clearly immaterial, the FRE is not expected to follow the risk management program outlined in this Guideline. An FRE should not outsource certain activities to its external auditor (see Section 4.3).

### 4.1 Material FRE Intra-group Outsourcing Arrangements

At a minimum, OSFI expects the following to be addressed when a member of an FRE group enters into a material outsourcing arrangement with another entity that is a member of the same FRE group (Section 3.2.1):

1. an outsourcing agreement that details, among other things, the scope of the arrangement, the services to be supplied, the nature of the relationship between the FRE and the service provider, and procedures governing the subcontracting of services;

2. an appropriate business continuity plan;
3. a process for monitoring and oversight; and
4. legislative requirements relating to location of records (Section 7.2.2).

As appropriate, a parent FRE may address these expectations within enterprise-wide processes or plans, so long as any specific risks to each subsidiary are addressed. As well, a parent FRE may establish the program, approve the policies, and develop and maintain the reporting on behalf of its FRE subsidiaries.

Consistent with the risk-based *Supervisory Framework*, OSFI may have additional expectations for FRE Group arrangements, depending on the risks related to the outsourcing arrangement and the conclusions of OSFI's supervisory review.

## 4.2 Material RFIP Intra-group Outsourcing Arrangements

At a minimum, OSFI expects the following to be addressed when a Canadian branch or a Canadian subsidiary enters into a material outsourcing arrangement with a member of its RFIP group (Section 3.2.2):

1. a due diligence process that addresses the qualitative aspects of the arrangement, particularly those pertaining to the unique operational requirements of the FRE;
2. an outsourcing agreement that details, among other things, the scope of the arrangement, the services to be supplied, the nature of the relationship between the FRE and the service provider (e.g., roles, responsibilities and expectations), and that addresses the items set out in Section 7.2.1, as appropriate;
3. procedures governing the subcontracting of services;
4. an appropriate business continuity plan;
5. a process for monitoring and oversight; and
6. legislative requirements relating to location of records (Section 7.2.2).

Consistent with the risk-based *Supervisory Framework*, OSFI may have additional expectations for RFIP Group arrangements, depending on the risks related to the outsourcing arrangement and the conclusions of OSFI's supervisory review.

## 4.3 Outsourcing Arrangements with the External Auditor

Prior to obtaining non-audit services from its external auditor, the FRE should assure itself that, for the services to be performed by the external auditor for that particular FRE, its external auditor would be in compliance with the relevant auditor independence standards of the Canadian accounting profession, as well as any other applicable auditor independence requirements.

In addition, the FRE should not outsource the following activities to its external auditor:

- Any actuarial service, unless it is reasonable to conclude that the results of the service will not be subject to audit procedures during an audit of the FRE's financial statements. For this purpose, actuarial services relates to the determination of an amount to be recorded in the financial statements of the FRE or work normally undertaken by its appointed actuary<sup>5</sup>, and does not include services that involve assisting the FRE in understanding the methods, models, assumptions and inputs used, and advising management on the appropriate actuarial methods and assumptions that will be used. Consistent with Guideline E-15 (Appointed Actuary: Legal Requirements, Qualifications and External Review), the FRE may use an actuary working in the company's external auditor firm for the external review of the appointed actuary's work and reports.
- Any internal audit service related to the internal accounting controls, financial systems, or financial statements of the FRE, unless it is reasonable to conclude that the results of the service will not be subject to audit procedures during an audit of the FRE's financial statements. This does not prohibit the external auditor from providing a non-recurring service to evaluate a discrete item or program, if the service is not, in substance, the outsourcing of an internal audit function.

## 5. Accountability and Control

### 5.1 FRE Senior Management Responsibilities

A FRE should have appropriate risk management policies and practices that are regularly reviewed. In terms of the specific risks arising from outsourcing, it is expected that, in carrying out this duty, senior management would periodically:



- approve or reaffirm the policies that apply to outsourcing arrangements (e.g., risk philosophy, materiality criteria, risk management program and approval limits); and
- review a list of all the FRE's material outsourcing arrangements (see Section 7.3.1) and other relevant reports, when appropriate.

Please refer to OSFI's *Corporate Governance Guideline* for OSFI's expectations of FRE Boards of Directors in regards to operational, business, risk and crisis management policies.

## 5.2 FRE Operational Management Responsibilities

Operational management is responsible for:

- developing outsourcing policies for approval by senior management;
- implementing the policies and any associated procedures;
- periodically reviewing their effectiveness; and
- communicating information pertaining to significant outsourcing risks to senior management in a timely manner.

The policies and procedures are expected to include:

- 1) An outsourcing risk philosophy

The FRE's outsourcing risk philosophy would generally comprise a statement of principles, the basis for decision making, and the parameters for controlling outsourcing risks. Outsourcing risk philosophies will vary between FREs, but should address the following:

- Integration of outsourcing arrangements, both individually and in aggregate, with overall business and strategic objectives. This could include an identification of any functions that, for strategic or internal control reasons, the FRE would not contemplate outsourcing.
- Importance and adequacy of internal expertise and management frameworks to oversee and manage the outsourced activity and the relationship with the service provider.

- Business case for outsourcing a significant business activity. The business case should consider the short- and long-term cost implications and all relevant prudential matters. When the service is being supplied from a foreign jurisdiction, the FRE should identify the issues that may arise as a result of the differing and potentially conflicting requirements among jurisdictions. The business case should also consider the cumulative impacts of all outsourcing arrangements on the overall safety and soundness of the FRE.

- 2) A materiality assessment for outsourcing arrangements

This assessment is expected to identify both the processes for determining the materiality of individual outsourcing arrangements and the underlying materiality factors such as those set out in Section 6.

- 3) An outsourcing risk management program that, at a minimum, includes the expectations contained in Section 7 and is applied consistently throughout the FRE, including operations located in foreign jurisdictions. OSFI expects management to pay particular attention to business continuity planning on an enterprise-wide basis.
- 4) Limits regarding the level or authority that enables the FRE's officers to approve outsourcing arrangements of varying magnitudes, either individually or in aggregate. This system should be consistent with the outsourcing risk philosophy and materiality criteria.

### 5.3 Responsibilities of Branch Management

OSFI's expectations of branch management are set out in Guideline E-4 *Foreign Entities Operating in Canada on a Branch Basis*. OSFI expects branch management to take on the corporate governance role normally assumed by senior management. Branch management remains accountable for the business in Canada, regardless of whether a particular business activity takes place in Canada or has been outsourced.

OSFI expects branch management to ensure that the branch has risk management policies for outsourcing and that the expectations set out in Section 5.2 of this Guideline are met. In particular, branch management would be expected to:

- ensure that materiality assessment criteria are developed and applied;
- ensure that the risk management program is applied; and
- within a reasonable time advise its OSFI relationship manager (either formally or informally) about any events that are likely to have a significant negative impact on the delivery of the service provided for by a material outsourcing arrangement.

## 6. Materiality Assessment for Outsourcing Arrangements

As outlined in Section 4, OSFI recognizes that the outsourcing arrangements undertaken by an FRE will have differing degrees of materiality and may not be readily classified as either material or immaterial. In general, OSFI expects that an FRE will design a risk management program that applies to all its outsourcing arrangements, except those that are clearly immaterial, and that the risk mitigants employed under this program will be appropriate to the particular outsourcing arrangement. As such, the risk management program could be scaled to apply different requirements depending on the type of outsourcing arrangement. Those arrangements deemed material should be subject to the full expectations set out in Section 7, unless it is reasonable to conclude that a particular expectation is not appropriate for the outsourcing arrangement in question. OSFI may review an FRE's materiality assessment on a case-by-case basis as part of the supervisory review process.

The materiality of an outsourcing arrangement will depend on the extent to which it has the potential to have an important influence – whether quantitative or qualitative – on a significant line of business of the consolidated operations of the FRE or the Canadian operations of a foreign branch or subsidiary.

The assessment of the materiality of an outsourcing arrangement is often subjective and depends on the circumstances faced by an individual FRE. Without limiting the scope of the materiality assessment, factors that the FRE should consider include:

1. the impact of the outsourcing arrangement on the finances, reputation and operations of the FRE, 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;

2. the ability of the FRE to maintain appropriate internal controls and meet regulatory requirements, particularly if the service provider were to experience problems;
3. the cost of the outsourcing arrangement;
4. the degree of difficulty and time required to find an alternative service provider or to bring the business activity 'in-house'; and
5. the potential that multiple outsourcing arrangements provided by the same service provider can have an important influence – in aggregate – on the FRE.

Specific questions an FRE might consider in assessing the materiality of outsourcing arrangements are set out in Annex 2.

Outsourcing all or substantially all of a management oversight function should always be considered material, except in circumstances where the FRE receives such services from another member of the FRE Group. For the purpose of this Guideline, management oversight functions include:

- financial analysis;
- compliance;
- any internal audit services related to the internal accounting controls, financial systems, or financial statements;
- senior management; and
- risk management.

For example, a material arrangement could relate to the outsourcing of a significant part of the FRE's information technology function, investment management, or loan processing. Arrangements that likely do not represent material outsourcing include those where there are numerous similar providers in the marketplace and the cost and inconvenience of switching between providers is low.

Significant changes in the volume or the nature of business conducted should cause the FRE to reassess an outsourcing arrangement's materiality. In cases where an arrangement is reassessed as material, it should come into compliance with all aspects of this Guideline at the first opportunity, such as when the outsourcing contract, agreement or statement of work (where applicable) is substantively amended, renewed or extended.

## 7. Risk Management Program for Material Outsourcing Arrangements

In general, OSFI expects that an FRE will design a risk management program that applies to all outsourcing arrangements of the FRE group, except those that are clearly immaterial, and that the risk mitigants employed will be commensurate with the FRE's assessment of the risks associated with the particular outsourcing arrangement.

### 7.1 Due Diligence Processes

OSFI expects an FRE to conduct an internal due diligence to determine the nature and scope of the business activity to be outsourced, its relationship to the rest of the FRE's activities, and how the activity is managed.

In selecting a service provider, or substantially amending or renewing a contract or outsourcing agreement, FREs are expected to undertake a due diligence process that fully assesses the risks associated with the outsourcing arrangement, and addresses all relevant aspects of the service provider, including qualitative (i.e., operational) and quantitative (i.e., financial) factors (see Annex 3 for a list of factors that could be included when performing due diligence of a service provider). When out-of-Canada outsourcing is being contemplated, the FRE should pay particular attention to the legal requirements of that jurisdiction, as well as the potential foreign political, economic and social conditions, and events that may conspire to reduce the foreign service provider's ability to provide the service, as well as any additional risk factors that may require adjustment to the risk management program.

Due diligence processes will vary depending on the FRE and on the nature of the outsourcing arrangement being contemplated. For example, in the case of renewals where no material change has occurred that would affect the viability of the outsourcing relationship, it may be appropriate to conduct more streamlined due diligence. If the service provider is a member of an RFIP Group, a streamlined due diligence process may be followed that addresses the qualitative aspects of the arrangement, particularly those pertaining to the unique operational (e.g., Canadian) requirements of the FRE.

The FRE may rely on a due diligence review of the service provider that has been performed by an affiliate or home office within the previous 15 months, provided the review addresses the above-noted requirements as well as the risks particular to the FRE.

## 7.2 Policies and Procedures to Manage Risks Associated with Material Outsourcing

### Arrangements

#### 7.2.1 Contract for Services

OSFI expects material outsourcing arrangements to be documented by a written contract that addresses all elements of the arrangement and has been reviewed by the FRE's legal counsel. Some of the items identified below may not be applicable in all circumstances; however, FREs are expected to address all issues relevant to managing the risks associated with each outsourcing arrangement to the extent feasible and reasonable given the circumstances, and having regard to the interests of the FRE. FRE and RFIP intra-group outsourcing arrangements can be documented by an outsourcing agreement that meets the expectations set out in Sections 4.1 and 4.2 respectively.

##### a) Nature and Scope of the Service Being Provided

The contract or outsourcing agreement is expected to specify the scope of the relationship, which may include provisions that address the frequency, content and format of the service being provided. The contract or outsourcing agreement is expected to detail the physical location where the service provider will provide the service.

##### b) Performance Measures

Performance measures should be established that allow each party to determine whether the commitments contained in the contract are being fulfilled.

##### c) Reporting Requirements

The contract or outsourcing agreement is expected to specify the type and frequency of information the FRE receives from the service provider. This would include reports that allow the FRE to assess whether the performance measures are being met and any other information required for the FRE's monitoring program (see Section 7.3). In addition, the contract or outsourcing agreement is expected to include procedures and requirements for the service provider to report events to the FRE that may have the potential to materially affect

the delivery of the service.

#### **d) Resolution of Differences**

OSFI expects the contract or outsourcing agreement to incorporate a protocol for resolving disputes. The contract or outsourcing agreement should specify whether the service provider must continue providing the service during a dispute and the resolution period, as well as the jurisdiction and rules under which the dispute will be settled.

#### **e) Defaults and Termination**

The contract or outsourcing agreement is expected to specify what constitutes a default, identify remedies, and allow for opportunities to cure defaults or terminate the agreement. The FRE is expected to ensure that it can reasonably continue to process information and sustain operations in the event that the outsourcing arrangement is terminated or the service provider is unable to supply the service. Appropriate notice should be required for termination of service and the FRE's assets should be returned in a timely fashion. In particular, data and records relating to data processing outsourcing arrangements should be returned to the FRE in a format that would allow the FRE to sustain business operations without prohibitive expense.

The contract or outsourcing agreement should not contain wording that precludes the service from being continued in situations where the Superintendent takes control of the FRE, or where the FRE is in liquidation.

#### **f) Ownership and Access**

Identification and ownership of all assets (intellectual and physical) related to the outsourcing arrangement should be clearly established, including assets generated or purchased pursuant to the outsourcing arrangement. The contract or outsourcing agreement should state whether and how the service provider has the right to use the FRE's assets (e.g., data, hardware and software, system documentation or intellectual property) and the FRE's right of access to those assets.

#### **g) Contingency Planning**

The contract or outsourcing agreement should outline the service provider's measures for ensuring the continuation of the outsourced business activity in the event of problems and events that may affect the service

provider's operation, including systems breakdown and natural disaster, and other reasonably foreseeable events. The FRE should ensure that the service provider regularly tests its business recovery system as it pertains to the outsourced activity, notifies the FRE of the test results, and addresses any material deficiencies. The FRE is expected to provide a summary of the test results to OSFI upon reasonable notice. In addition, the FRE should be notified in the event that the service provider makes significant changes to its business resumption and contingency plans, or encounters other circumstances that might have a serious impact on the service.

#### h) Audit Rights

The contract or outsourcing agreement is expected to clearly stipulate the audit requirements and rights of both the service provider and the FRE. At a minimum, it should give the FRE the right to evaluate the service provided or, alternatively to cause an independent auditor to evaluate, on its behalf, the service provided. This includes a review of the service provider's internal control environment as it relates to the service being provided<sup>7</sup>.

In addition, in all situations, irrespective of whether an activity is conducted in-house, outsourced, or otherwise obtained from a third party, OSFI retains its supervisory powers<sup>8</sup>. Accordingly, an undertaking from the service provider or a provision in the outsourcing contract, should give OSFI or the Superintendent's representative the right to:

- exercise the contractual rights of the FRE relating to audit;
- accompany the FRE (or its independent auditor) when it exercises its contractual audit rights;
- access and make copies of any internal audit reports (and associated working papers and recommendations) prepared by or for the service provider in respect of the service being performed for the FRE, subject to OSFI agreeing to sign appropriate confidentiality documentation in form and content satisfactory to the service provider; and
- access findings in the external audit of the service provider (and associated working papers and recommendations) that address the service being performed for the FRE, subject to the consent of the service provider's external auditor and OSFI agreeing to sign appropriate confidentiality documentation in form and content satisfactory to the service provider and the external auditor.



OSFI would provide the FRE with reasonable notice of its intent to exercise its audit rights and would share its findings with the FRE where appropriate. In the normal course, OSFI would seek to obtain information it requires through the FRE itself.

#### **i) Subcontracting**

The contract or outsourcing agreement is expected to set out any rules or limitations to subcontracting by the service provider. In particular, security and confidentiality standards should apply to subcontracting or outsourcing arrangements by the primary service provider. Consistent with the principles of this Guideline, the audit and inspection rights of the FRE and OSFI should continue to apply to all significant subcontracting arrangements.

#### **j) Confidentiality, Security and Separation of Property**

At a minimum, the contract or outsourcing agreement is expected to set out the FRE's requirements for confidentiality and security. Ideally, the security and confidentiality policies adopted by the service provider would be commensurate with those of the FRE and should meet a reasonable standard in the circumstances. The contract or outsourcing agreement should address which party has responsibility for protection mechanisms, the scope of the information to be protected, the powers of each party to change security procedures and requirements, which party may be liable for any losses that might result from a security breach, and notification requirements if there is a breach of security.

OSFI expects appropriate security and data confidentiality protections to be in place. The service provider is expected to be able to logically isolate the FRE's data, records, and items in process from those of other clients at all times, including under adverse conditions.

#### **k) Pricing**

The contract or outsourcing agreement should fully describe the basis for calculating fees and compensation relating to the service being provided.

## I) Insurance

The service provider should be required to notify the FRE about significant changes in insurance coverage and disclose general terms and conditions of the insurance coverage.

### 7.2.2 Location of Records

In accordance with the federal financial institutions legislation, certain records<sup>9</sup> of entities carrying on business in Canada should be maintained in Canada. In addition, the FRE is expected to ensure that OSFI can access in Canada any records necessary to enable OSFI to fulfill its mandate.

### 7.2.3 Business Continuity Plan

An FRE's business continuity plan should address reasonably foreseeable situations (either temporary or permanent) where the service provider fails to continue providing service. The business continuity plan and back-up systems should be commensurate with the risk of a service disruption. In particular, the FRE's business continuity plan should ensure that the FRE has in its possession, or can readily access, all records necessary to allow it to sustain business operations, meet its statutory obligations, and provide all information as may be required by OSFI to meet its mandate, in the event the service provider is unable to provide the service.

### 7.2.4 Outsourcing in Foreign Jurisdictions

When the material outsourcing arrangement results in services being provided in a foreign jurisdiction, the FRE's risk management program should be enhanced to address any additional concerns linked to the economic and political environment, technological sophistication, and the legal and regulatory risk profile of the foreign jurisdiction(s).

## 7.3 Monitoring and Oversight of Material Outsourcing Arrangements

Every FRE engaged in material outsourcing should develop, implement and oversee procedures to monitor and control outsourcing risks in accordance with its outsourcing risk-management policies. The sophistication of the procedures should be commensurate with the size and complexity of the outsourcing arrangement(s) and with the expectations of this Guideline. Management is expected to prepare reports based on the FRE's monitoring and

oversight activities. These reports may outline the success of the outsourcing arrangement and the effectiveness of the risk management program and may be reflected in the documentation delivered to the FRE's senior management or branch management. Reports based on the Canadian branch's monitoring and oversight activities should either be prepared or reviewed by branch management.

### 7.3.1 Centralized List of All Material Outsourcing Arrangements

The FRE should maintain a centralized list of all its material outsourcing arrangements<sup>10</sup>. A parent FRE may maintain the list on behalf of its subsidiaries. The list should contain information pertaining to the name of the service provider, the country where the service is provided, the expiry or renewal date of the contract or outsourcing agreement and the estimated value (dollar amount) of the contract or outsourcing agreement. A template of a centralized list that a FRE could use is provided in Annex 4. The list should be updated on an ongoing basis and should form part of the documentation delivered to the FRE's senior management or branch management. OSFI should have access to the list at any time upon request.

### 7.3.2 Monitoring the Outsourcing Arrangement

The FRE should monitor all material outsourcing arrangements to ensure that the service is being delivered in the manner expected and in accordance with the terms of the contract or outsourcing agreement. Monitoring may take the form of regular, formal meetings with the service provider and/or periodic reviews of the outsourcing arrangement's performance measures. Within a reasonable time, the FRE should advise its OSFI relationship manager about any events that are likely to have a significant negative impact on the delivery of the service.

An FRE should review its material outsourcing arrangements to ensure compliance with its outsourcing risk policies and procedures and with the expectations of this Guideline. Reviews of material outsourcing arrangements should be periodically undertaken by the FRE's internal audit department or another independent review function either internal or external to the FRE, provided it has the appropriate knowledge and skills. The FRE's senior management, or branch management when the FRE is a branch, will always retain overall accountability for the outsourcing arrangement.

Reviews should test the FRE's risk-management activities for outsourcing in order to:

- ensure risk-management policies and procedures for outsourcing are being followed;
- ensure effective management controls over outsourcing activities;
- verify the adequacy and accuracy of management information reports; and
- ensure that personnel involved in risk-management for outsourcing are aware of the FRE's risk-management policies and have the expertise required to make effective decisions consistent with those policies.

Management should adjust the scope of the review depending on the nature of the outsourcing arrangement.

### 7.3.3 Monitoring the Service Provider

At least annually, the FRE should review the service provider to ascertain its ability to continue to deliver the service in the manner expected. This review would be commensurate with the level of risk involved and could include an assessment of the service provider's circumstances including its financial strength, prospects (except in cases involving the parent or home office of a Canadian subsidiary or branch), technical competence, and use and performance of significant subcontractors.

## Annex 1 - Examples of Outsourcing Arrangements

The outsourcing domain is diverse and growing. Some examples may include:

- Information system management and maintenance (e.g., data entry and processing, data centres, facilities management, end-user support, local area networks, help desks);
- Document processing (e.g., cheques, credit card slips, bill payments, bank statements, other corporate payments);
- Application processing (e.g., insurance policies, loan originations, credit cards);
- Policy administration (e.g., premium collection, policy assembly, invoicing, endorsements);
- Claims administration (e.g., loss reporting, adjusting);
- Loan administration (e.g., loan negotiations, loan processing, collateral management, collection of bad loans);
- Investment management (e.g., portfolio management, cash management);
- Marketing and research (e.g., product development, data warehousing and mining, advertising, media relations, call centres, telemarketing);

- Back office management (e.g., electronic funds transfer, payroll processing, custody operations, quality control, purchasing);
- Real estate administration (e.g., building maintenance, lease negotiation, property evaluation, rent collection);
- Professional services related to the business activities of the FRE (e.g., accounting, internal audit, actuarial);  
and
- Human resources (e.g., benefits administration, recruiting).

This Guideline generally would not apply to the following:

- Courier services, regular mail, utilities, telephone;
- Procurement of specialized training;
- Discrete advisory services (e.g., legal opinions, certain investment advisory services that do not result directly in investment decisions, independent appraisals, trustees in bankruptcy);
- Purchase of goods, wares, commercially available software and other commodities
- Independent audit reviews;
- Credit background and background investigation and information services;
- Market information services (e.g., Bloomberg, Moody's);
- Independent consulting;
- Services the FRE is not legally able to provide;
- Printing services;
- Repair and maintenance of fixed assets;
- Supply and service of leased telecommunication equipment;
- Travel agency and transportation services;
- Correspondent banking services;
- Maintenance and support of licensed software;
- Temporary help and contract personnel;
- Fleet leasing services;
- Specialized recruitment;
- External conferences;

- Clearing and settlement arrangements between members or participants of recognized clearing and settlement systems;
- Sales of insurance policies by agents or brokers;
- Ceded insurance and reinsurance ceded; and
- Syndication of loans.

## Annex 2 - Sample Questions to Assess the Materiality of Outsourcing

### Arrangements

In assessing the materiality of a specific outsourcing arrangement, an FRE may want to consider the following questions, among others:

- What is the relationship between the business activity and the FRE's core business?
- What is the outsourcing arrangement's potential impact on earnings, solvency, liquidity, funding, capital, reputation, internal expertise and capacity of the FRE, brand value, or system of internal controls?
- What is the outsourcing arrangement's importance to achieving and implementing business objectives, the business strategy and business plans?
- What is the FRE's aggregate exposure to a particular service provider? Is the FRE exposed to additional outsourcing risk as a result of multiple outsourcing arrangements with a service provider?
- What is the size of contractual expenditures as a share of non-interest expenses of the FRE or line of business?
- If the service provider is unable to perform the service over a given period of time:
  1. What is the expected impact on the FRE's customers?
  2. What is the likely impact on the FRE's reputation?
  3. Would it have a material impact on the FRE's risk profile?
  4. Would the FRE be able to engage an alternative service provider? How long would it take and what costs would be involved?

## Annex 3 - Due Diligence of Service Providers

The due diligence of service providers addressed in Section 7.1 may include, but is not necessarily limited to, examining a service provider in light of these factors:

- Experience and technical competence of the service provider to implement and support the outsourced activity (this could include a review of the experience and technical competence of significant subcontractors where feasible);
- Financial strength (e.g., most recent audited financial statements and other relevant information (to the best of the service provider's ability<sup>11</sup>));
- Business reputation, complaints, compliance and pending litigation;
- Internal controls, reporting and monitoring environment;
- The service provider's business resumption and contingency measures, including recovery testing, for ensuring the continuation of the outsourced business activity in the event of problems and events that may affect the service provider's operation such as a systems breakdown, natural disaster, an inability of a significant subcontractor to provide services relevant to the outsourced activity, and situations where extraordinary demands are placed on a service provider.
- Reliance on and success in dealing with sub-contractors;
- Insurance coverage; and
- Business objectives, human resource policies, service philosophies, business culture, and how they fit with those of the FRE.

## Annex 4 – Template Centralized List

Name of service provider	Short description of arrangement	Type of arrangement (e.g., RFIP-group, FRE- group, third party arrangement)	The country or countries from which service(s) are provided	Expiry or renewal date of the contract or outsourcing agreement	The estimated annual spending on the arrangement in the future year	The estimated value (dollar amount) of the contract or outsourcing agreement



- 1 "Significant" as used by OSFI in "Significant Activities" is defined in the Supervisory Framework. Qualitative and quantitative factors are used to assess the significance of an activity to the achievement of the institution's business objectives and strategies.
- 2 In this Guideline, "activity" refers to activity, function or process.
- 3 This includes the principal office and all of its other offices in Canada.
- 4 This includes the chief agency and all of its other offices in Canada.
- 5 See OSFI Guideline E-15 *Appointed Actuary: Legal Requirements, Qualifications and External Review*.
- 6 In respect of multiple outsourcing arrangements provided by the same service provider that, albeit individually immaterial, have an important influence - in aggregate - on the FRE, OSFI expects the FRE to consider the relevant risk management expectations set out under section 7 to the extent feasible and reasonable given the circumstances.
- 7 A CICA 5970 report (Auditor's Report on Controls at a Service Organization) or equivalent may be sufficient. Note that a CICA 5970 report focuses on financial reporting controls and does not intend to provide an audit of operations and other controls (such as business continuity planning).
- 8 Under the federal financial institutions legislation, OSFI has a right to access any records of the FRE; Section 613, 614, 643, 644, 957 and 958 of the *Bank Act*; section 674, 675, 1000, and 1001 of the *Insurance Companies Act*; section 505 and 506 of the *Trust and Loan Companies Act*; section 437 and 438 of the *Cooperative Credit Associations Act*.
- 9 Section 238, 239 and 597 of the *Bank Act*; section 243, 244 of the *Trust and Loan Companies Act*; section 261, 262 and 647 of the *Insurance Companies Act*; section 235, 236 of the *Cooperative Credit Associations Act*.
- 10 In the case of a Canadian branch of a foreign bank or foreign company, the list should contain information pertaining to its Canadian operations. In the case of any other FRE, the list should contain information pertaining to the Canadian operations and foreign operations of that FRE and of its subsidiaries.

- 11 The onus is on the FRE to ensure that it obtains the relevant information to assess a service provider's financial strength. However, OSFI recognizes that the service provider is required to comply with other legislation (such as securities legislation) and might not be in a position to share certain information with the FRE.