



MODULE	OM: Operational Risk Management
CHAPTER	OM-3: Outsourcing

OM-3.1 Introduction

OM-3.1.1 This Chapter sets out the CBB's approach to outsourcing by licensees. It also sets out various requirements that licensees must address when considering outsourcing an activity or function.

OM-3.1.2 In the context of this Chapter, 'outsourcing' means an arrangement whereby a third party performs on behalf of a licensee an activity which was previously undertaken by the licensee itself (or in the case of a new activity, one which commonly would have been performed internally by the licensee). Examples of services that are typically outsourced include data processing, **cloud services**, customer call centres and back-office related activities.

OM-3.1.3 Most of the Directives in this Chapter are concerned with situations where the third party provider is outside the licensee's group. Section OM-3.8, however, sets out the CBB's requirements when a service is outsourced to a company within the licensee's group.

OM-3.1.4 The requirements in this Chapter only apply to 'material' outsourcing arrangements. These are arrangements that, if they failed in any way, would pose significant risks to the on-going operations of a licensee, its reputation and/or quality of service provided to its customers. For instance, the outsourcing of all or a substantial part of functions such as customer sales and relationship management, settlements and processing, IT and data processing and financial control, would normally be considered 'material'.

OM-3.1.5 Management should carefully consider whether a proposed outsourcing arrangement falls under this Chapter's definition of 'material'. If in doubt, management should consult with the CBB.

OM-3.1.5A For outsourcing services that are not considered material outsourcing arrangements, licensees must submit a written notification to the CBB before committing to the new outsourcing arrangement.

OM-3.1.6 The requirements in this Chapter only apply to outsourcing arrangements entered into after May 2003. In the case of pre-existing outsourcing agreements, the CBB requires licensees to apply the requirements of this Chapter to the fullest extent possible when these arrangements are subsequently renewed.



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OM-3.1 Introduction (continued)

OM-3.1.7 [This Paragraph was deleted in July 2011].



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OM-3.2 Supervisory Approach

OM-3.2.1 The CBB recognises the benefits that can potentially be achieved through outsourcing an activity to a third party provider. They can include reduced costs, enhanced service quality and a reduction in management time spent on non-core activities. However, outsourcing an activity also poses potential risks. These include the ability of the service provider to maintain service quality levels, reduced control over the activity and access to relevant information, and increased legal and client confidentiality risks.

OM-3.2.2 The CBB's approach is to allow licensees the freedom to enter into outsourcing arrangements, providing these have been properly structured and associated risks addressed.

OM-3.2.3 The CBB expects licensees to have undertaken a thorough assessment of a proposal before formally submitting ~~a notification~~ the request for approval to the CBB. However, the CBB is also willing to discuss ideas informally at an early stage of development, on a 'no-commitment' basis. It especially encourages an early approach when the proposed outsourcing is particularly material or innovative.

OM-3.2.4 Once an outsourcing arrangement has been implemented, the CBB requires a licensee to continue to monitor the associated risks and the effectiveness of its mitigating controls. It will verify this through the course of its normal on-site and off-site supervisory processes, such as prudential meetings and on-site examinations. The CBB also requires access to the outsourced activity, which it may occasionally want to examine itself, through management meetings or on-site examinations.

OM-3.2.5 Fundamental to the CBB's supervisory approach to outsourcing is that the Board and management of the licensee may not abdicate their responsibility for a licensee's business and the way its customers are treated. The Board and management remain ultimately responsible for the effectiveness of systems and controls in outsourced activities.



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OM-3.2 Supervisory Approach (continued)

- OM-3.2.6 The board and senior management are responsible for understanding the operational risks associated with outsourcing arrangements and ensuring that effective risk management policies and practices are in place to manage the risk in outsourcing activities. Outsourcing policies and risk management activities should encompass:
- (a) Procedures for determining whether and how activities can be outsourced;
 - (b) Processes for conducting due diligence in the selection of potential service providers;
 - (c) Sound structuring of the outsourcing arrangement, including ownership and confidentiality of data, as well as termination rights;
 - (d) Programmes for managing and monitoring the risks associated with the outsourcing arrangement, including the financial condition of the service provider;
 - (e) Establishment of an effective control environment at the bank and the service provider;
 - (f) Development of viable contingency plans; and
 - (g) Execution of comprehensive contracts and/or service level agreements with a clear allocation of responsibilities between the outsourcing provider and the bank.



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OM-3.3 Notifications and Prior Approval Requests

OM-3.3.1 A licensee must ~~formally notify the CBB and~~ seek ~~its~~ **the CBB's** prior **written** approval before committing to a new material outsourcing arrangement.

OM-3.3.2 The above ~~notification~~ **request for approval** must:

- (a) Be made in writing to the licensee's normal supervisory contact;
- (b) Contain sufficient detail to demonstrate that relevant issues raised in Section OM-3.4 onward of this Chapter have been addressed; and
- (c) Be made at least 6 weeks before the licensee intends to commit to the arrangement.

OM-3.3.3 The CBB will review the information provided and provide a definitive response within 6 weeks of receiving the ~~notification~~ **request for approval**. Where further information is requested from the licensee, however, the time taken to provide this further information will not be taken into account. The CBB may also contact home or host supervisors of the licensee or the service provider, to seek their comments – in such cases, the 6-week turnaround is also subject to the speed of their response.

OM-3.3.4 Once an activity has been outsourced, a licensee must immediately inform its normal supervisory contact at the CBB of any material problems encountered with the outsourcing provider. **In exceptional cases,** ~~the~~ CBB reserves the right to direct a licensee to make alternative arrangements for the outsourced activity.

OM-3.3.5 The CBB reserves the right to require a licensee to terminate or make alternative outsourcing arrangements if, among other reasons, the confidentiality of its customer information was, or is likely to be, breached or the ability of the CBB to carry out its supervisory functions in view of the outsourcing arrangement cannot be assured or executed.



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OM-3.4 Risk Assessment

OM-3.4.1 Licensees must undertake a thorough risk assessment of an outsourcing proposal, before formally notifying the CBB and committing itself to an agreement.

OM-3.4.2 The risk assessment must – amongst other things – include an analysis of:

- (a) The business case;
- (b) The suitability of the **outsourcing provider**; including but not limited to the outsourcing provider's financial soundness, its technical competence, its commitment to the arrangement, its reputation, its adherence to international standards, and the associated country risk; and
- (c) The impact of the outsourcing on the licensee's overall risk profile and its systems and controls framework.

OM-3.4.3 ~~This paragraph was deleted in June 2017. In assessing the suitability of the outsourcing provider, the licensee should amongst other things consider its financial soundness, its technical competence, its commitment to the arrangement, and its reputation.~~

OM-3.4.4 Once an outsourcing agreement has been entered into, licensees must regularly review the suitability of the **outsourcing provider** and the ongoing impact of the agreement on their risk profile and systems and controls framework. Such reviews must take place at least every year.

OM-3.4.5 A licensee must nominate a ~~member of senior management~~ **relevant approved person** with day-to-day responsibility for handling the relationship with the **outsourcing provider** and ensuring that relevant risks are addressed. This person must be notified to the CBB as part of the ~~notification~~ **request for prior approval** required under Section OM-3.3 above. **Any subsequent replacement of such person must also be notified to the CBB.**



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OM-3.5 Outsourcing Agreement

OM-3.5.1

The activities to be outsourced and respective contractual liabilities and obligations of the outsourcing provider and licensee must be clearly specified in an outsourcing agreement. This agreement must – amongst other things – address the following points:

(a) Control over outsourced activities

1. The Board and management of licensees are held ultimately responsible by the CBB for the adequacy of systems and controls in outsourced activities. Licensees must therefore ensure that they have adequate mechanisms for monitoring the performance of, and managing the relationship with, the outsourcing provider.
2. A service level agreement (“SLA”) – setting out the standards of service to be provided – must form part of the outsourcing agreement. Where the outsourcing provider interacts directly with a licensee’s customers, the SLA must – where relevant – reflect the licensee’s own standards regarding customer care.
3. Mechanisms for the regular monitoring by licensees of performance against the SLA and other targets, and for implementing remedies in case of any shortfalls, must also form part of the agreement.
4. Clear reporting and escalation mechanisms must be specified in the agreement.
5. Where an outsourcing provider in turn decides to sub-contract to other providers, **CBB’s prior written approval must be obtained**, and the original provider must remain contractually liable to the licensee for the quality and level of service agreed, and its obligations to the licensee must remain unchanged.



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OM-3.5 Outsourcing Agreement (continued)

(b) Customer data confidentiality

1. Licensees must ensure that outsourcing agreements comply with all applicable legal requirements regarding customer confidentiality.
2. Licensees must ensure that the outsourcing provider implements adequate safeguards and procedures. Amongst other things, customer data must be properly segregated from those belonging to other clients the outsourcing provider may have. Outsourcing providers must give suitable undertakings that the company and its staff will comply with all applicable confidentiality rules. Licensees must have contractual rights to take action against the service provider in the event of a breach of confidentiality.
3. Licensees must assess the impact of using an overseas-based outsourcing provider on their ability to maintain customer data confidentiality, for instance, because of the powers of local authorities to access such data.

(c) Access to information

1. Outsourcing agreements must ensure that the licensee's internal and external auditors have timely access to any relevant information they may require to fulfill their responsibilities. Such access must allow them to conduct on-site examinations of the outsourcing provider, if required.
2. Licensees must also ensure that the CBB inspectors and appointed experts have ~~has~~ timely access to any relevant information ~~if they~~ may reasonably require under the law. Such access must allow the CBB to conduct on-site examinations of the outsourcing provider, if required.
3. Where the outsourcing provider is based overseas, the outsourcing provider must confirm in the outsourcing agreement that there are no regulatory or legal impediments to either the licensee's internal and external auditors, or the CBB inspectors and appointed experts, having the access described above. Should such restrictions subsequently be imposed, the licensee must communicate this fact to the CBB as soon as it becomes aware of the matter.



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OM-3.5 Outsourcing Agreement (continued)

4. The outsourcing provider must commit itself, in the outsourcing agreement, to informing the licensee of any developments that may have a material impact on its ability to meet its obligations. These may include, for example, relevant control weaknesses identified by the outsourcing provider's internal or external auditors, and material adverse developments in the financial performance of the outsourcing provider.
- (d) Business continuity
1. Licensees must ensure that service providers maintain, regularly review and test plans to ensure continuity in the provision of the outsourced service.
 2. Licensees must have an adequate understanding of the outsourcing provider's arrangements, to understand the implications for its own contingency arrangements (see Section OM-3.6).
- (e) Termination
1. Licensees must have the right to terminate the agreement should the outsourcing provider undergo a change of ownership (whether direct or indirect) that poses a potential conflict of interest; becomes insolvent; or goes into liquidation or administration.
 2. Termination under any other circumstances allowed under the agreement must give licensees a sufficient notice period in which they can effect a smooth transfer of the service to another provider or bring it back in-house.
 3. In the event of termination, for whatever reason, the agreement must provide for the return of all customer data – where required by licensees – or their ~~destruction~~ **destruction of the records.**



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OM-3.6 Contingency Planning for Outsourcing Arrangements

OM-3.6.1 Licensees must maintain and regularly review contingency plans to enable them to set up alternative arrangements – with minimum disruption to business – should the outsourcing contract be suddenly terminated or the outsourcing provider fails. This may involve the identification of alternative outsourcing providers or the provision of the service in-house. These plans must consider how long the transition would take and what interim arrangements would apply.

OM-3.6.2 See Chapter OM-5 for further guidance on business continuity and contingency planning.



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OM-3.7 Internal Audit Outsourcing

OM-3.7.1 Because of the critical importance of an effective internal audit function to a licensee's control framework, all proposals to outsource internal audit operations are to be considered material.

OM-3.7.2 The CBB will not permit licensees to outsource their internal audit function to the same firm that acts as their external auditor.

OM-3.7.3 Licensees who have existing outsourcing arrangements in place with their external auditor relating to the provision of internal audit services are required to find suitable alternatives when the existing arrangements terminate or come up for renewal.

OM-3.7.4 In all circumstances, Board and management of licensees must retain responsibility for ensuring that an adequate internal audit programme is implemented, and will be held accountable in this respect by the CBB.



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OM-3.8 Intragroup Outsourcing

OM-3.8.1 As with outsourcing to non-group companies, the Board and management of licensees are held ultimately responsible by the CBB for the adequacy of systems and controls in activities outsourced to group companies.

OM-3.8.2 However, the degree of formality required – in terms of contractual agreements and control mechanisms – for outsourcing within a licensee’s group is likely to be less, because of common management and enhanced knowledge of other group companies.

OM-3.8.3 A licensee must ~~formally notify the CBB~~ **seek the CBB’s prior written approval** at least 6 weeks before committing to a material intragroup outsourcing. The request **for approval** must be made in writing to the licensee’s normal supervisory contact, and must set out a summary of the proposed outsourcing, its rationale, and an analysis of its associated risks and proposed mitigating controls. The CBB will respond to the ~~notification~~ **request for approval** in the same manner and timescale as set in Section OM-3.3 above.

OM-3.8.4 The CBB expects, as a minimum, an agreed statement of the standard of service to be provided by the group provider, including a clear statement of responsibilities allocated between the group provider and licensee.

OM-3.8.5 The CBB also expects a licensee’s management to have addressed the issues of customer confidentiality, access to information and business continuity covered above (Section OM-3.5).

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OM-3.9 Outsourcing of Functions Containing Customer Information

OM-3.9.1 ~~Retail banks~~ **Licensees** must seek the CBB's prior written approval for third party and intragroup outsourcing of functions/services containing customer information including but not limited to payment services, debt collection, card and data processing, IT function **including cloud services**, internal audit and electronic/internet banking services but excluding legal services.

OM-3.9.2 For a third party outsourcing of functions/services containing customer information, other than debt collection, IT function, internal audit, cards embossing and cheques personalization, the service providers must be licensed by the CBB and located in Bahrain. If the outsourced service is not available in Bahrain after 30th June 2017, ~~retail banks~~ **licensees** must submit to the CBB a written request, at least within 30 days of the stated deadline. The request must provide details of the circumstances under which the extension of outsourcing activities is being requested.

OM-3.9.3 ~~Retail banks~~ **licensees** must provide to the CBB quarterly progress reports on the steps and procedures taken in implementing the requirements of Paragraph OM-3.9.2. The progress report must be provided to the retail bank's supervisory point of contact at the CBB and the first report must be submitted by 31st July 2016.

OM-3.9.4 For intragroup outsourcing of functions/services containing customer information, the following conditions must **also** be met:

- (a) The outsourcing providers must be annually audited by the group internal audit team and the audit findings must be reported to the CBB;
- (b) The service level agreement must clearly state that the CBB **inspectors and appointed experts** ~~has~~ have the legal right to conduct onsite examinations of the outsourcing provider and such expenses are to be borne by the licensee; and
- (c) Any report by any other regulatory authority on the quality of controls of the outsourcing provider must be submitted immediately by the ~~retail bank licensee~~ **licensee** to the CBB; ~~and.~~

~~This sub-paragraph was deleted in July 2017. Where customer information is shared with the outsourcing provider, prior written customer consent must be obtained.~~

OM-3.9.5 ~~This Paragraph was deleted in July 2017. The CBB reserves the right to require a retail bank to terminate or make alternative outsourcing arrangements if the confidentiality of its customer information or the ability of the CBB to carry out its supervisory functions cannot be assured or executed.~~

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OM-3.9 Outsourcing of Functions Containing Customer Information (Continued)

- OM-3.9.6 In the case of overseas retail bank licensees, the CBB may consider a third party outsourcing arrangements entered by the licensee's head office as an intragroup outsourcing, provided that the head office submits to the CBB a letter of comfort which includes, but not limited to, the following conditions:
- a. The head office declares its ultimate responsibility of ensuring that adequate controlling measures are in place; and
 - b. The head office is responsible to take adequate rectification measures, including compensation to the affected customers, in cases where customers suffer any loss due to inadequate controls applied by the third party service provider.

OM-3.9.7 For the purpose of outsourcing of cloud services, licensees must ensure that, at a minimum, the following security measures are in place:

- (a) Customer information must be encrypted and licensees must ensure that all encryption keys or similar forms of authentication are kept secure within the licensee's control;**
- (b) A secure audit trail must be maintained for all actions performed at the cloud services outsourcing provider;**
- (c) A comprehensive change management procedure must be developed to account for future changes to technology with adequate testing of such changes;**
- (d) The licensee's data must be logically segregated from other entities data at the outsourcing service provider's platform;**
- (e) The cloud service provider must provide information on measures taken at its platform to ensure adequate information security, data security and confidentiality, including but not limited to forms of protection available against unauthorized access and incident management process in cases of data breach or data loss; and**
- (f) The right to release customer information/data in case of foreign government/court orders must be the sole responsibility of the licensee, subject to the CBB Law.**