

GUIDANCE ON DETERMINATION OF OUTSOURCING FOR FUND MANAGEMENT COMPANIES

INVESTMENT MANAGEMENT ASSOCIATION OF
SINGAPORE (“IMAS”)

12 OCTOBER 2016

ACKNOWLEDGEMENTS

We would like to convey our appreciation to the IMAS Outsourcing Working Group (“WG”) for their painstaking efforts and time spent over the last 11 months in producing this Guidance. In particular, we would like to express our gratitude to the following individuals for drafting, reviewing, and editing this Guidance:

- Aik Ai Hua (Schroder Investment Management (Singapore) Ltd)
- Paul Pak (PricewaterhouseCoopers LLP)
- Tan Hong Yock (AllianceBernstein (Singapore) Ltd)
- Winson Tan (Eastspring Investments (Singapore) Ltd)
- Tan Xiangyun (First State Investments (Singapore))
- Gillian Ong (Fullerton Fund Management Company Ltd)
- Bin Wern Sern (JWS Asia Law Corporation)
- Andrew Tang (Legg Mason Asset Management Singapore Pte Ltd)
- Mandy Wan (Manulife Asset Management (Singapore) Pte Ltd)
- Travis Chia (Neuberger Berman Singapore Pte Ltd)
- Irene Phua (New Silk Road Investment Pte Ltd)
- Karen Shih (PricewaterhouseCoopers LLP)
- Neo Shi Lin (Schroder Investment Management (Singapore) Ltd)
- Josephine Law (Sidley Austin LLP)

***Investment Management Association of Singapore
Guidance on Determination of Outsourcing for Fund Management Companies***

1. Background

The Monetary Authority of Singapore (“MAS”) issued the revised Guidelines on Outsourcing (“Guidelines”) on 27 July 2016. The Guidelines set out the minimum requirements of outsourcing arrangements expected from the financial institutions including banks, insurance firms, and all holders of capital markets services licences.

The Investment Management Association of Singapore (“IMAS”) formed a working group comprising experienced professionals within the asset management industry to address the common outsourcing arrangements undertaken by Fund Management Companies (“FMCs”) from December 2015 – August 2016. The working group has carefully considered the feedback received and incorporated comments of wider interests in this Guidance on Determination of Outsourcing for Fund Management Companies (“Guidance”).

This Guidance seeks to help FMCs in their application of the definitions of “outsourcing arrangement” and “material outsourcing arrangement” to a non-exhaustive list of common service arrangements for FMCs in Singapore.

This Guidance is not meant to be mandatory or definitive and should not be viewed as a substitute for FMCs to perform their own assessment based on their specific facts and circumstances. IMAS accepts no liability for any errors or omissions, or for any actions or decisions taken or not taken as a result of using this Guidance.

This Guidance should be read in conjunction with the Guidelines issued by MAS as revised from time to time.

2. Key definitions for reference

<p>“customer”</p>	<p>in relation to a CMI, means a person (whether a natural person, legal person or a legal arrangement) –</p> <ul style="list-style-type: none"> (i) with whom the CMI establishes or intends to establish business relations; (ii) for whom the CMI undertakes or intends to undertake any transaction without an account being opened; or (iii) who invests into an investment vehicle to which the CMI provides the regulated activities of fund management and real estate investment trust management;
<p>“customer information”</p>	<p>in the case of FMCs, information that relates to its customers and these include customers’ accounts, particulars, transaction details and dealings with the financial institutions, but does not include any information that is public, anonymised, or encrypted in a secure manner such that the identities of the customers cannot be readily inferred</p>
<p>“outsourcing arrangement”</p>	<p>means an arrangement in which a service provider provides the institution with a service that may currently or potentially be performed by the institution itself and which includes the following characteristics:</p> <ul style="list-style-type: none"> (a) the institution is dependent on the service on an ongoing basis; and (b) the service is integral to the provision of a financial service by the institution or the service is provided to the market by the service provider in the name of the institution
<p>“material outsourcing arrangement”</p>	<p>means an outsourcing arrangement: -</p> <ul style="list-style-type: none"> (a) which, in the event of a service failure or security breach, has the potential to either materially impact an institution’s: <ul style="list-style-type: none"> (i) business operations, reputation or profitability; or (ii) ability to manage risk and comply with applicable laws and regulations, <p>or</p> <ul style="list-style-type: none"> (b) which involves customer information and, in the event of any unauthorised access or disclosure, loss or theft of customer information, may materially impact an institution’s customers
<p>“service provider”</p>	<p>means any party which provides a service to the institution, including any entity within the institution’s group, whether it is located in Singapore or elsewhere</p>
<p>“sub-contracting”</p>	<p>means an arrangement where a service provider which has an outsourcing arrangement with an institution, further outsources the services or part of the services covered under the outsourcing arrangement to another service provider</p>

3. Applying the definitions

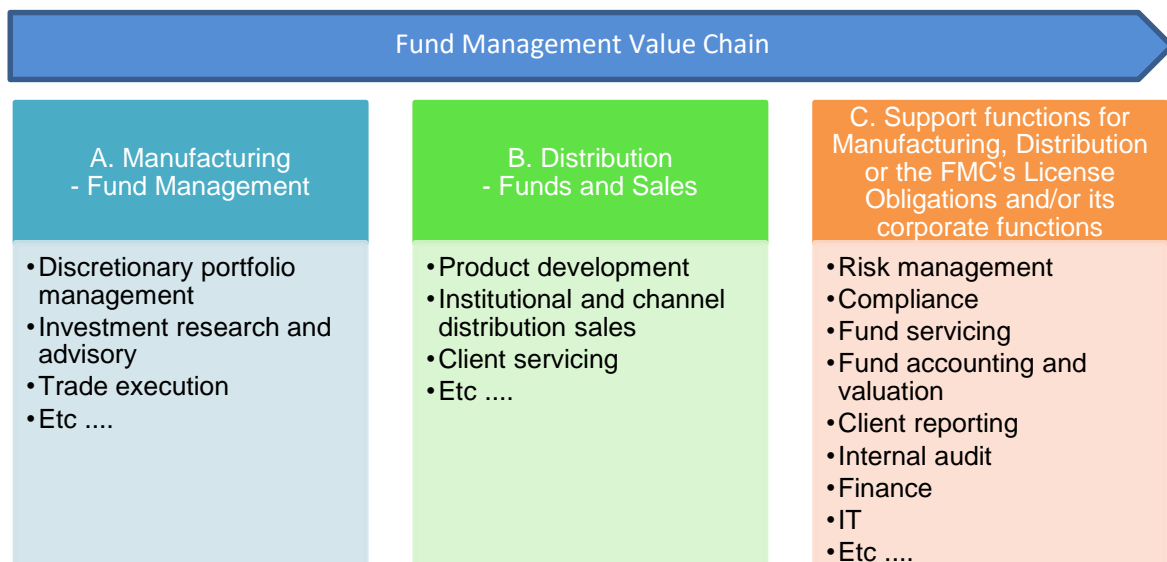
An “**outsourcing arrangement**” means an arrangement in which a service provider provides the institution with a **service that may currently or potentially be performed by the institution itself and** which includes the following characteristics: (a) the institution is **dependent** on the service on an **ongoing basis; and** (b) the service is **integral** to the provision of a financial service by the institution or the service is provided to the market by the service provider in the name of the institution.

Therefore, an “outsourcing arrangement” will typically have the following 3 criteria:

1. The service provider provides a service that may currently or potentially be performed by the institution itself.;
2. There is ongoing dependence; and
3. The service is “integral” to the provision of a financial service. In the context of FMCs, refer below for further guidance on what service is “integral” to the regulated activity of fund management.

What service is “integral” to the regulated activity of fund management?

The following illustration represents the typical fund management value chain which outlines the typical core functions and activities (non-exhaustive) in fund management. Broadly, these are aligned to the front office, sales and support functions (i.e. middle and back office) of a fund management operation. Depending on the business model of an FMC, it is acknowledged that the functions and activities set out below may not be representative for every FMC.



The typical core functions and activities in the fund management value chain provide a basis for guiding FMCs in determining which services are integral to the regulated activity of fund management.

“**Integral**”: Services that are **essential** to the regulated activities of fund management companies: -

1. Services that relate to core fund management activities: **Manufacturing (Fund Management)** and/or **Distribution (Funds and Sales)**; and
2. Services that relate to **support functions for Manufacturing and/or Distribution (i.e. core fund management activities)**, or the **FMC’s Licence Obligations and/or its corporate functions**.

Step 1: Determine if an arrangement is an “outsourcing arrangement” based on the definition

Question: -

Is the arrangement an “outsourcing arrangement”?-	Yes	No
a) the service provider provides a service that may currently or potentially be performed by the institution itself; <u>AND</u>		
b) the institution is dependent on the service on an ongoing basis; <u>AND</u>		
c) the service is integral to the provision of a financial service by the institution or the service is provided to the market by the service provider in the name of the institution		
Conclusion (Yes, if ALL criteria are satisfied)		

Step 2: Determine if an outsourced arrangement is a “material outsourced arrangement”

A “material outsourcing arrangement” means an outsourcing arrangement:- (a) which, in the event of a service failure or security breach, has the potential to either **materially impact** an institution’s: (i) business operations, reputation or profitability; or (ii) ability to manage risk and comply with applicable laws and regulations, **or** (b) which **involves customer information** and, in the event of any unauthorised access or disclosure, loss or theft of customer information, may **materially impact** an institution’s customers

Question: -

Is the arrangement a “material outsourcing arrangement”? -	Yes	No
A. which, in the event of a service failure or security breach, has the potential to either materially impact an institution’s:		
(i) business operations, reputation or profitability; <u>OR</u>		
(ii) ability to manage risk and comply with applicable laws and regulations; OR		
B. which involves customer information and, in the event of any unauthorised access or disclosure, loss or theft of customer information, may materially impact an institution’s customers		
Conclusion (Yes, if ANY of the 3 criteria is satisfied)		

4. List of Common Service Arrangements for FMCs

The table below sets out a non-exhaustive list of common service arrangements for FMCs which have been categorised as follows:

- A. Services that relate to core fund management activities – Manufacturing (Fund Management);
- B. Services that relate to core fund management activities – Distribution (Funds and Sales);
- C. Services that relate to support functions for Manufacturing and/or Distribution, or the FMC’s Licence Obligations and/or its corporate functions; and
- D. Services where the FMC is required by law or by market practice to appoint an independent service provider

The assessment on outsourcing and materiality applies the guidance in Section 3 and the Guidelines. This assessment is intended to be general guidance and not mandatory or definitive. FMCs are expected to conduct their own assessment taking into account their specific circumstances and facts. Additional comments have been provided, as needed, to support the assessment.

It is noted that not all services listed below will be relevant to all FMCs depending on their business model and the activities being conducted.

	Service arrangement	Generally considered to be “outsourcing arrangement”?	Generally considered to be “material outsourcing arrangement”?	Comments
(A)	Services relating to Manufacturing – Fund Management			
1.	Discretionary Fund Management	Yes	Yes	Integral to the regulated activity of fund management.
2.	Research & Advisory that is tailored to an investment mandate or fund (if the person is able to exercise direct or indirect control over the management of the investment portfolio)	Yes	No (FMCs retain the discretionary power to make investment decisions)	Integral to the regulated activity of fund management.
3.	Research services (that do not fall within the meaning of “fund management” i.e. as set out in #2 above) and	No	NA	Not integral to the regulated activity of fund management.

	Service arrangement	Generally considered to be “outsourcing arrangement”?	Generally considered to be “material outsourcing arrangement”?	Comments
	expert networks			
4.	Trade Execution	Yes	Yes	Integral to the regulated activity of fund management.
(B) Services relating to Distribution – Funds and Sales				
5.	Customer Due Diligence (CDD) checks for anti-money laundering/ countering the financing of terrorism purposes	No, if relying on a regulated distributor as a “third party” pursuant to paragraph 9 of MAS Notice SFA04-N02	NA	Core to distribution and it is a regulatory requirement but permitted under the MAS Notice SFA04-N02 to place reliance.
		Yes, if relying on fund administrator/ other service provider (that is <u>not</u> a “third party” pursuant to Paragraph 9) to carry out all or substantially all of the CDD	Yes (involves customer information)	Core to distribution and it is a regulatory requirement.
6.	Engagement of Distributors to distribute funds	No	NA	Core to distribution but principal-agent relationships are excluded from outsourcing.
(C) Services that relate to support functions for Manufacturing and/or Distribution, or the FMC’s License Obligations and/or its corporate functions				
7.	Fund subscription/ application processing, registrar/ sub-registrar, transfer agent services	No, for an authorised scheme as the trustee is responsible for the appointment of the	NA	Responsibility lies with the Trustee, not the FMC.

	Service arrangement	Generally considered to be “outsourcing arrangement”?	Generally considered to be “material outsourcing arrangement”?	Comments
		registrar		
		Yes, for a recognised scheme if the FMC is required to act as or appoint a sub-registrar	Yes (involves customer information)	Support service for Core Fund Management Activities
8.	Fund accounting/reporting (e.g. maintaining accounting records for the fund, preparing semi-annual and annual reports for the fund)	Yes, if FMC is primary manager of an authorised scheme	Yes (material impact on the fund if this function fails)	Support service for Core Fund Management Activities
		No, for recognised scheme	No	Responsibilities of the foreign investment management companies/ FMCs
9.	Client Reporting (e.g. generating and printing contract statements, contract notes, notices, address labels, inserting customer communications into envelopes)	Yes, if FMC is primary manager of an authorised scheme	Yes, if customer information is disclosed to the service provider in the process	Support service for Core Fund Management Activities
		No, for recognised scheme	No	Responsibilities of the foreign investment management companies/ FMCs
10.	Production of Fund Fact Sheet/ Marketing Materials	Yes	No	Support service for Core Fund Management Activities
11.	Middle/ back office functions such as: <ul style="list-style-type: none"> • trade matching • instructions for trade settlement • trade/portfolio reconciliation (including margin, FX, fixed deposit reconciliation) 	Yes, if a service provider is appointed to carry out the middle office functions	Depends on whether the FMC’s business operations will be impacted if the appointment of the service provider ceases	Support service for Core Fund Management Activities
		No, if the FMC is only using a system (which	NA	

	Service arrangement	Generally considered to be “outsourcing arrangement”?	Generally considered to be “material outsourcing arrangement”?	Comments
	<ul style="list-style-type: none"> • double-checking/ validating prices and values of securities/ investments • currency hedging administrative services • collateral management services 	may be owned or controlled by a third party) to facilitate the FMC carrying out these functions		
12.	Proxy voting processing, pricing and corporate actions, market research on voting patterns for corporate actions, giving voting instructions to custodian	Yes, if FMC is the investment manager	No, if FMCs would be able to handle this manually should the service provider fail	Support service for Core Fund Management Activities
13.	Regulatory reporting such as: <ul style="list-style-type: none"> • reporting of OTC derivative transactions • substantial shareholding reporting • financial reporting to regulator 	Yes	Yes	Regulatory reporting requirements due to Core Fund Management Activities
14.	Risk management i.e. liquidity risks, credit risks, operational risks, investment risks etc.	Yes.	Depends on whether all or substantially all of the risk management function has been outsourced	While these are risk/ control management functions which might be most effectively and efficiently managed at group level, FMC’s board and senior management are expected to have oversight.
15.	Internal audit	Yes	Depends on whether all or substantially all of the internal audit function has been outsourced	While these are risk/ control management functions which might be most effectively and efficiently managed at group level, FMC’s board and senior management are expected to have oversight.
16.	Compliance, including	Yes, but depends on	Depends on whether all	

	Service arrangement	Generally considered to be “outsourcing arrangement”?	Generally considered to be “material outsourcing arrangement”?	Comments
	portfolio/investment compliance	whether the services being rendered involve taking on a management function or responsibility	or substantially all of the compliance function has been outsourced	
17.	Business continuity and disaster recovery functions and activities	Yes	Depends on whether all or substantially all of the BCP function and activities have been outsourced	While these are risk/ control management functions which might be most effectively and efficiently managed at group level, FMC’s board and senior management are expected to have oversight.
18.	Corporate finance functions like: - - Payment processing e.g., processing of supplier invoices, staff claims, distributor invoices - Fees billing, e.g. generation of management and performance fee invoices	Yes	No	This is assuming there is no customer information involved
19.	General IT Infrastructure Support and Maintenance (e.g., end-user support, local area networks)	Yes	No	This is assuming the service provider has no access to customer information and that there would not be a material impact on business operations in the event of a service failure of security incident.
20.	Datacenter/ information systems hosting (e.g., software-as-a-service, platform-as-a-service, infrastructure-as-a-service)	Yes	Yes (assuming investment and customer information involved)	
21.	Leasing/buying systems/ electronic tools for investment	No	NA	On the basis that customer data is not transferred to vendor for any data processing or hosting.

	Service arrangement	Generally considered to be “outsourcing arrangement”?	Generally considered to be “material outsourcing arrangement”?	Comments
	analytics, reconciliations etc.			
22.	General archival and storage of records, backup tapes, documents	Yes	Yes	These would generally contain customer information, but not does not apply to cases where information is public, anonymised, or encrypted in a secure manner such that the identities of the customers cannot be readily inferred.
23.	IT application development and maintenance	No	NA	On the basis that this requires IT expertise that a FMC would not be expected to have.
24.	Website hosting advertisement maintenance	Yes	No	This is assuming the website has no transactions or customer information online.
25.	HR Function: - - Pre-Employment Screening - Employee payroll processing - Employee benefit administration	Yes	No	Pre-employment screening will <u>not</u> be considered as an outsourced arrangement if FMC makes the assessment internally to determine if employee meets the Fit & Proper criteria.
(D)	Services where the FMC is required by law or by market practice to appoint an independent service provider			
26.	Fund Trustee	No	NA	Trustee is not a function that a FMC may carry out itself.
27.	Custodial services (acting as agent to appoint custodian for clients)	No	NA	Custody is not a function that a FMC may carry out itself.
28.	Valuation Agent	No	NA	As per Reg 13(B)(1)(b) of the SF(LCB)R
29.	External auditors for FMC	No	NA	As required by laws.

	Service arrangement	Generally considered to be “outsourcing arrangement”?	Generally considered to be “material outsourcing arrangement”?	Comments
30.	External legal counsel for FMC	No	NA	
31.	Clearing and settlement arrangements between clearing houses and settlement institutions and their members, and similar arrangements between members and non-members	No	NA	Clearing and settlement are not commonly a function that a FMC carry out itself.
32.	Tax advice/assistance: <ul style="list-style-type: none"> • VAT claim, e.g. processing of VAT claims for submission to overseas tax authorities and to obtain VAT refund 	No	NA	
33.	Telecommunication services and public utilities (e.g., electricity)	No	NA	
34.	Postal & Courier services	No	NA	
35.	Market information services (e.g., Bloomberg, Moody’s, Standard & Poor’s)	No	NA	