

**OFFICIAL INFORMATION
OF THE CZECH NATIONAL BANK**

of 18 July 2007

regarding the prudential rules for banks, credit unions and investment firms

Outsourcing

The Czech National Bank hereby provides the following information with regard to Articles 11 and 9 of Decree No. 123/2007 Coll., stipulating the prudential rules for banks, credit unions and investment firms (hereinafter the "Decree"):

I. Interpretative opinions regarding the use of outsourcing (Re Article 11 of the Decree)

1. An entity performing on a contractual basis for a bank or credit union (hereinafter the "liable entity") any of the activities that the liable entity would otherwise carry out itself (hereinafter the "outsourcing provider") may be a natural person or legal person. 'Outsourcing provider' is also understood to mean an entity within the consolidated group to which the liable entity belongs, if the former performs activities for the latter that the latter would otherwise perform itself. 'Outsourcing provider' is also understood to mean an entity that performs for the liable entity any activities related to the offer or sale of the liable entity's products or services. However, an entity that supplies standardised or ordinarily offered goods or services (goods and services provider) to the liable entity is not an outsourcing provider.
2. Using outsourcing does not release the liable entity from any of its responsibilities, including the responsibility:
 - a) to comply with legal regulations and the conditions on which it was issued with a licence or permit (hereinafter the "permit") and to proceed prudently¹ in its activities;
 - b) not to harm the interests of its clients or members (hereinafter "clients"), including fulfilling the obligation to protect personal data² and safeguard information that is subject to banking secrecy or in the case of credit unions to protect data concerning the members' transactions with the credit union (hereinafter "banking secrecy"³). The liable entity must take all possible steps to ensure that any such information subject to protection that the outsourcing provider possesses is not wrongfully disclosed or used. On the other hand, clients have a corresponding right to the provision of such protection, or to compensation for damages should the liable entity violate its obligation, causing the client to incur damages.
3. Before starting to use outsourcing the liable entity shall define:

¹ Article 12 (1) of Act No. 21/1992 Coll., on banks, as amended, and Article 1 (5) (b) of Act No. 87/1995 Coll., on credit unions and certain related measures and on an amendment of Czech National Council Act No. 586/1992 Coll., on income tax, as amended.

² Act No. 101/2000 Coll., on the protection of personal data and an amendment to certain acts, as amended.

³ Article 38 of the Act on Banks and Article 25b (1) of Act No. 87/1995 Coll.

- a) a strategy for the use of outsourcing, which encompasses the main goals of and principles for the use of outsourcing (including the principles for managing the related risks and control mechanisms);
 - b) powers, responsibilities and procedures when using outsourcing.
4. The liable entity shall assess and, where appropriate, update outputs pursuant to paragraph 3 above at suitable intervals.
 5. The liable entities shall assess, on a regular basis and through a person or persons with appropriate experience in the given field, the specific application of outsourcing. The following shall be subject to such assessment, for example:
 - a) whether the outsourced activity is constantly performed in compliance with all relevant legal regulations and with the outsourcing contract;
 - b) whether the outsourcing provider continues to be reliable and legally, financially, professionally and technically competent to perform the outsourced activities;
 - c) whether the outsourcing provider regularly checks the efficiency and sufficiency of its internal control mechanisms and risk management, including the management of the risk of the occurrence of extraordinary events that could have a significant negative influence on the proper performance of the outsourced activities;
 - d) whether the protection of banking secrecy and clients' personal data is ensured constantly and sufficiently; as well as
 - e) whether the liable entity's internal principles and procedures for outsourcing are complied with;
 - f) whether the liable entity's internal control mechanisms ensure that any shortcomings in the use of outsourcing are detected in good time and remedial measures are adopted;
 - g) the overall efficiency and effectiveness of outsourcing.

II. The CNB's expectations regarding the use of outsourcing (Re Article 9 of the Decree)

1. The Czech National Bank expects that before starting to use outsourcing the liable entity
 - a) drew up a proposal for the use of outsourcing, in which
 1. it sufficiently described the subject of the outsourcing;
 2. it sufficiently listed the main reasons and expected impacts of outsourcing on the liable entity, including all risk aspects of outsourcing significant from the liable entity's point of view;
 3. it sufficiently assessed whether arranging the outsourcing would not compromise activities' compliance with legal regulations;
 4. it sufficiently defined the conditions for performing outsourcing, including requirements for the quality of the provided activities, the requirements imposed on the outsourcing provider and the criteria for selecting the outsourcing provider;
 5. it sufficiently identified areas of possible conflicts of interests when using outsourcing;
 6. it sufficiently analysed the risks associated with outsourcing and defined principles and procedures and/or methods by which such risks will be managed by the liable entity (i.e. identified, assessed or measured, monitored, reported and possibly mitigated);
 7. it sufficiently elaborated a plan of action covering extraordinary situations, including the (follow-up) procedure should the outsourcing provider be unable to continue to provide the outsourcing in the proper manner (emergency plan).

Examples:
The liable entity includes the following possible changes or factors in the emergency plan, for example:

- significant changes in conditions, e.g. financial situation, organisational structure or ownership, on the part of the outsourcing provider;
 - significant changes in conditions, e.g. legal conditions, in the country in which the outsourcing provider is based;
 - excessive concentration in connection with outsourcing on the part of the provider (situations where, for example, a single outsourcing provider provides certain ancillary activities to a majority of or even to all liable entities, which constitutes a risk for the given bank and something of a systemic risk) or on the part of the liable entity (situations where, for example, a bank enters into outsourcing contracts for various activities with one and the same entity – should such provider fail, the liable entity would face a greater risk of activities not being provided and therefore, should that come about, it must have an adequate emergency plan for how to re-assign the activities to another (other) provider(s) without disrupting activities and without excessive costs);
 - revocation of a permit, if required, or termination of registration for the performance of the outsourced activity;
- b) sufficiently checked that the outsourcing provider
1. has a licence, if required, or is registered in the country of its registered office for the performance of the activities that are to be provided to the liable entity, and, if the law of the country the outsourcing provider is based in so requires, supervision is exercised over it by the competent authorities;
 2. is reliable, financially stable and legally, professionally and technically competent to perform the activities that are to be provided to the liable entity;
- c) ensured that the outsourcing provider implemented at least such risk management practices and control mechanisms as the liable entity would itself use in compliance with its principles of governance if it were to perform the activity itself;
- d) determined how often and by whom the use of outsourcing would be assessed from the point of view of the liable entity, including assessment of the outsourced activities at the outsourcing provider's premises;
- e) ensured that the outsourcing contract contained:
1. a sufficient and clear description of the subject of the outsourcing;
 2. qualitative and quantitative requirements for the performance of the outsourced activities, and the contracting parties' rights and obligations, including
 - a) the outsourcing provider's obligation to safeguard confidential information and information that is subject to banking secrecy and personal data protection;
 - b) the outsourcing provider's obligation to notify the liable entity in a timely and sufficient manner of all circumstances that could have a negative impact on its ability to perform the outsourced activities properly and of any other significant and relevant circumstances, such as changes in ownership or other changes on the part of the outsourcing provider;
 - c) the liable entity's right to monitor and check the outsourced activity as regards its proper performance at the outsourcing provider's premises and other rights and obligations of the contracting parties to ensure that the other requirements of the Decree concerning the liable entity's use of outsourcing are satisfied.

Examples:

- The outsourcing provider is obliged to enable persons so authorised in writing by the liable entity (e.g. employees of its specialised departments or its parent undertaking's specialised departments) to monitor whether the outsourcing provider performs the outsourced activities correctly.
- If the subject of the outsourcing is the processing of data or other information, the outsourcing provider is obliged to enable the relevant persons to access the primary information as well and to assess whether the information is processed correctly.

- The outsourcing provider is obliged to enable the persons so authorised in writing by the liable entity to perform the function of risk control, check compliance and perform internal audit at the outsourcing provider's premises.
 - The outsourcing provider is obliged to enable persons exercising Czech National Bank supervision to have access to data and other information and facts concerning the subject of the outsourcing.
 - The outsourcing provider is obliged to enable the performance of audit of the liable entity's financial statements and other stipulated checks⁴;
- d) the outsourcing provider's commitment that, if an activity is provided through another entity (chain outsourcing), the contract with such entity will not conflict with the substance of the contract between the outsourcing provider and the liable entity and will not obviate its purpose;
 - e) remedial measures or penalties in the event of a breach of or a failure to fulfil the contractual terms;
 - f) terms of withdrawal from the contract and the contract's termination and provisions on a withdrawal from the contract in the event of this being necessitated by remedial measures imposed on the liable entity by the Czech National Bank.
2. The Czech National Bank moreover expects that the liable entity has not entered into the contract pursuant to Point 1 (e) above on conditions onerous for the liable entity.

III. Closing provisions

1. Section II of the CNB Official Information regarding the use of outsourcing applies in full to the outsourcing of important activities⁵ and mutatis mutandis to the outsourcing of other activities of the liable entity.
2. Within the meaning of Article 9 of the Decree, the Czech National Bank ranks the following among the recognised standards for the use of outsourcing on which this official information is principally based:
 - a) Guidelines on Outsourcing; Committee of European Banking Supervisors (CEBS); December 2006; www.c-eps.org,
 - b) [Outsourcing in Financial Services](#); Joint Forum (JF); February 2005; www.bis.org/bcbs/jointforum.htm,
 - c) Sound Practices for the Management and Supervision of Operational Risk; Basel Committee on Banking Supervision (BCBS); February 2003; www.bis.org.
3. On 3 August 2007 the following become invalid:
 - a) Official Notification of the Czech National Bank No. 12, CNB Bulletin Part 16/2001 of 1 October 2001 regarding the use of outsourcing by banks;
 - b) Official Notification of the Czech National Bank No. 13, CNB Bulletin Part 16/2001 of 10 September 2001, Interpretation with regard to the issue of banking secrecy in the event of the use of outsourcing by banks.

Vice-Governor
Miroslav Singer

⁴ E.g. Article 22 (2) of the Act on Banks.

⁵ Article 216 of the Decree

Banking Regulation and Supervision Department
General Secretariat
Responsible:
Věra Mašindová, tel. 22441 4417