Advisory Guidelines of the Financial Supervision Authority

Outsourcing Requirements for Supervised Entities

These advisory guidelines were established by Resolution No 1.1-7/84 dated 25 October 2006 and changed by Resolution No 1.1-7/92 dated 05 August 2019 of the Management Board of the Financial Supervision Authority.

1. Competence

According to § 3 of the Financial Supervision Authority Act (hereinafter FIS), the Financial Supervision Authority conducts state financial supervision in order to enhance the stability, reliability, transparency and efficiency of the financial sector, to reduce systemic risks and to promote prevention of the abuse of the financial sector for criminal purposes, with a view to protecting the interests of clients and investors by safeguarding their financial resources, and thereby supporting the stability of the Estonian monetary system.

According to FIS § 57 (1), the Financial Supervision Authority has the right to issue advisory guidelines to explain legislation regulating the activities of the financial sector and to provide guidance to subjects of financial supervision.

2. Definitions

For the purposes of these guidelines, **supervised entity** means a person treated as a subject of financial supervision under FIS § 2 (1), except credit institution, investment firm, payment institution and e-money institution.

For the purposes of these guidelines, **outsourcing** means the use of a third party's (service provider's) services by a supervised entity under a contract, subject to the special requirements and restrictions arising from legislation, the essence of such use of services being the continued performance of activities and operations necessary for the supervised entity's provision of services to its customers, which under normal conditions the supervised entity would perform itself.

3. Purpose and scope of application

3.1. Purpose

As a rule, outsourcing serves the purpose of achieving greater efficiency of operations and concentrating on the supervised entity's principal operations and/or competence, resulting in the provision of a higher quality service or product to the customers. Outsourcing may also be motivated by a wish to specialise in and dedicate the main resources to a specific service or product in the entity's principal operations.

Outsourcing must not be motivated by regulatory arbitrage, i.e. avoidance of the requirements established for the supervised entity by way of using an external service provider.

Outsourcing may give rise to additional risks such as the risk of losing control of the outsourced activity and the risk of greater dependence on the service provider, loss of control of information essential to one's operations, loss of know-how, loss of flexibility to react to potential changes in the market situation, loss of supervisory control and confidentiality of operations, additional legal risks, etc. Large-scale outsourcing may thus have a negative impact on the risk management and overall corporate management of a supervised entity. This is why a supervised entity has to identify the risks every time when entering into an outsourcing contract and to take necessary, suitable, and adequate measures to reduce such risks.

Efficient identification, management and hedging of outsourcing risks is facilitated by the existence of clear rules, efficient risk management, measures to ensure business continuity, clear and adequate outsourcing contracts, and extensive background studies of the service provider to assess whether the latter has the necessary and adequate resources for providing the service.

The entry into an outsourcing contract for a specific activity, performance of the acts required prior to entry into a contract, and the scope of it (including the scope of these guidelines), as well as day-to-day supervision are at a supervised entity's discretion, based on all the material circumstances and keeping in mind the best interests of the customers, above all.

A supervised entity must take necessary and adequate measures, taking into account all the circumstances, in order to outsource activities only to persons who are able to provide the required services and have taken adequate measures to hedge the accompanying risks.

A supervised entity must be able to prove to the supervision authority, at any time, that the entity has taken necessary and suitable risk management measures, in order to ensure continuous compliance with the requirements applicable to their activities, among other things.

3.2. Scope of the guidelines

These guidelines establish the advisory and general code of practice and guidelines for supervised entities for outsourcing, by explaining the requirements of legislation, taking into account international practice in the relevant area and the recommendations of international organisations[1].

These advisory guidelines are a general mapping of the circumstances relevant to outsourcing.

The importance of the outsourced activity in the supervised entity's operations should be taken into account when applying these guidelines. When a less important activity is outsourced and the accompanying risks are, hence, also less important, the requirements of these guidelines may be applied to a lesser extent; application also depends on the specific service provider, taking into account the relevant circumstances and risks pertaining to the service provider (e.g. the service provider is an undertaking controlled by the supervised entity or is subject to state supervision; in the latter case the nature and scope of such supervision should be taken into account).

Outsourcing may concern individual activities that form a part of the services a supervised entity provides to its customers, or it may cover a group of activities that forms the core of the services provided by the supervised entity to its customers.

The concept also applies to IT services and other activities that directly support the principal operations.

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[1] These guidelines are applicable subject to the requirements of legislation. Special requirements governing outsourcing by supervised entities are laid down in the Investment Fund Act (hereinafter IFS) and the Insurance Activities Act (hereinafter KindlTS).
See also The Joint Forum (Basel Committee on Banking Supervision, International Organization of Securities Commissions, International association of Insurance Supervisors), Outsourcing in Financial Services, February 2005; Technical Committee of the International Organization of Securities Commissions, Principles on Outsourcing of Financial Services for Market Intermediaries, February 2005; Committee of European Banking Supervisors, Consultation Paper, Standards on Outsourcing, April 2006.

Outsourced services may include without limitation: IT software development and maintenance, IT infrastructure maintenance, management of investments, marketing, physical security, cash handling, internal audit, etc.

Outsourcing does not cover the **purchase of goods or services** that a supervised entity does not, as a rule, offer or provide to its customers in the course of its operations and that does not, as a rule, involve the transfer of or ongoing access to a supervised entity's confidential information (including customer information)[2]. At the same time, a supervised entity shall, taking into account the relevant circumstances of the legal relationship arising from such contracts, take the necessary measures to ensure that the purchased service or product is suitable for achieving its goal.

Purchased services may include: real estate management, cleaning, catering, personnel accounting, financial accounting, etc.

The requirements of legislation as well as of other advisory guidelines of the Financial Supervision Authority shall be taken into account in the application of these guidelines. Where the legislation provides for special requirements, these shall be followed.

The "comply or explain" principle should be taken into account in the application of these guidelines: if necessary, a supervised entity must be able to explain why it is not applying or is only partly applying any of the paragraphs of these guidelines.

The guidelines should be applied, and any interpretation problems should be solved, following the principle of reasonability, taking into account the purpose of these guidelines, and acting in good faith with the diligence expected of a supervised entity.

4. Codes and rules of practice

The purpose of outsourcing is usually a better performance of the obligations arising from the financial services provided by a supervised entity to its customers. A supervised entity itself can give an exact assessment of whether this condition is met, taking account of all the relevant circumstances. Such circumstances depend, among other things, on the structure of the entity, the services it provides, the available competence and other circumstances.

Based on the above, and in order to ensure the stability, reliability and transparency of a supervised entity's operations, as well as to reduce the risks inherent in its operations, the supervised entity shall established internal codes and rules of conduct governing the outsourcing process (as described in paragraph 4.2 of these guidelines).

A supervised entity shall take into account the provisions of § 31 (3) of the General Part of the Civil Code Act, according to which the competence of a body of a legal person in private law shall be prescribed by law, the articles of association or the partnership agreement. **The competence of a body of a legal person shall not be transferred to any other body or person.** The general rights and obligations of a legal person in private law arise from the Commercial Code (hereinafter ÄS). These rights and obligations may be specified by specific laws[3].

[2] e.g. the purchase of market information services (e.g. Bloomberg, Reuters); certain counselling services such as legal counselling or investment counselling, if the latter does not include the provision of investment services offered directly to customers, real estate management, cleaning, catering, etc.

[3] The following references to the provisions governing the activities of companies are references to the provisions regulating the activities of public limited companies, since as a rule, specific laws provide for such a classification requirement for supervised entities.

4.1. Outsourcing strategy (general principles of outsourcing) of a supervised entity

According to ÄS § 316, the supervisory board shall plan the activities of the public limited company, organise the management of the public limited company, and supervise the activities of the management board. The supervisory board thus has the management competences of planning the company's activities as well as general organisational competence.

Considering the above, it is reasonable that the supervisory board of a supervised entity approve the strategic general principles for outsourcing the supervised entity's activities, and the criteria for mapping and checking the risks accompanying outsourcing, covering, among other things, the following:

4.1.1. Conditions and procedure for identifying outsourcing needs

Upon establishing these conditions and procedure, the following should be defined, subject to the restrictions provided by legislation:
1) the activities, which the supervised entity considers necessary to outsource, and the extent of outsourcing;
2) the strategic and principal operations which the supervised entity is not planning to outsource to third parties;
3) the criteria for assessing whether an activity should be outsourced, including the criteria for defining the importance of an activity for the supervised entity's operations (the impact of the outsourced activity on the supervised entity's operations);
4) the persons competent to decide on outsourcing.

4.1.2. Identifying the relationship of an outsourced activity to the overall operating strategy of a supervised entity

The relationship of an outsourced activity to the operating strategy of the supervised entity should be identified on the basis of the specific outsourced activity as well as the entire set of outsourced activities (the extent to which the activities of a particular line of business may be outsourced and the overall extent of outsourcing allowed). In the general principles of outsourcing, a supervised entity shall set forth the requirement of establishing the above relation and the permitted scope of concentration of risks in the course of the analysis of outsourced activities.

4.1.3. Requirements for risk administration and management

General requirements for the administration and management of the risks of outsourcing shall be defined, including the structural unit competent to check the outsourced activities, by defining the rights and obligations required for performing the tasks. General requirements for the methods and measures of ensuring compliance with regulatory obligations in the event of outsourcing, as well as ensuring business continuity, shall also be established.

4.2. A supervised entity's internal outsourcing rules

According to ÄS § 306, the management board is a directing body of the public limited company, which represents and directs the public limited company, by acting in the most economically purposeful manner. However, this provision poses limits on the management

board's freedom of decision, as it requires the management board to comply with the lawful orders of the supervisory board. The management board must ensure the implementation, in the supervised entity's operations, of the general principles approved by the supervisory board.

According to ÄS § 306 (7), which provides for the management board's duty of diligence, the management board shall guarantee the application of necessary measures and above all, the organisation of an internal audit in order to detect, as early as possible, any circumstances which are likely to endanger the operation of the public limited company. Compliance with this requirement mainly implies the introduction of an efficient reporting (internal rules) and internal control system and ensuring the availability of information.

It arises from specific laws that a supervised entity has to establish, the internal rules or rules of procedure regulating the activities of the managers and employees, which have to ensure that the activities of the supervised entity, its managers and employees are in compliance with legislation and the lawful decisions of the directing bodies.[4]

Considering the above, the management board has to establish, among other things, the internal rules for identifying the need for outsourcing specific activities and for the accompanying risk analysis (risks and expected benefits of outsourcing), for the selection of the service provider (performing the necessary background investigation), for entering into a specific agreement (form and conditions of agreement), for ongoing supervision of the service provider (including the agreed indicators of assessing the service quality), and for ensuring business continuity upon extraordinary events (business continuity plan).

The internal rules and their level of thoroughness shall correspond to the operations and the related risks of the particular supervised entity[5] and the scope of application of these rules depends on the specific legal relationship and the material circumstances thereof (including the importance of the activity for the supervised entity's operations).

5. A supervised entity's acts before outsourcing

5.1. Analysis to identify outsourcing needs

A supervised entity is required to carry out an analysis to identify the need for outsourcing a particular activity, the scope of outsourcing and its relation to the supervised entity's operations, as well as the accompanying risks, and the methods and measures necessary and suitable for hedging such risks.

The greater the (qualitative or quantitative) impact of the outsourced activity on the supervised entity's operations, the more thorough the analysis should be. The assessment should take into account, without limitation, the inherent features of the particular activity (complicacy of the legal relationship), the risks that outsourcing poses to the supervised entity, the potential consequences of default; the supervised entity's ability to control the performance of the outsourced activity and its ability to meet its obligations to customers and competent authorities; the relation of the financial obligations arising from and the cost efficiency of outsourcing compared to the supervised entity's own performance of these activities.

[4] See: IFS § 57; KindlTS § 84; § 63 of the Credit Institutions Act (hereinafter KAS); § 82 of the Securities Market Act (hereinafter VPTS); § 28 of the Electronic Money Institutions Act.

[5] Assessment of activities shall include, without limitation, assessment of the products and services offered; aspects pertaining to the customers to whom the service or product is provided or offered; the structure of internal operations. The supervised entity, its managers and employees are in the best position to assess the entity's operations and the circumstances that may entail various risks.

The scope and depth of the analysis of outsourcing needs may depend, for example, on whether or not the service provider is related to the supervised entity (parent company or another subsidiary of the same parent company), whether the service provider is subject to state financial supervision, and the scope of such supervision.

5.1.1. **The purpose of outsourcing should be a better performance of the obligations arising from the financial services provided by a supervised entity to its customers. Customers are interested in as good as possible services at a price as low as possible. The as high as possible efficiency of the supervised entity's operations helps achieve this goal.**

Considering the above, a supervised entity has to identify the purposefulness of outsourcing an activity, taking into account the benefits, costs, and risks of outsourcing, and their relation to the supervised entity's own performance of the activity.

Considering all the circumstances relevant to the activity, as well as the supervised entity's operating strategy, structure, competence, and other relevant circumstances, it should be assessed whether outsourcing the activity to the service provider is purposeful. It should also be assessed how to most efficiently arrange for the outsourcing, whether to outsource the activity to a related person specialising in such services or to an unrelated service provider, etc.

5.1.2. Outsourcing shall not prevent the operations of a supervised entity and the performance of its duties on the required level, and shall not damage the legitimate interests of its customers. Outsourcing shall not prevent (state) supervision on the required level. Outsourcing shall not release a supervised entity from liability to customers and/or competent supervisory agencies.

Outsourcing shall not prevent the daily operations of a supervised entity or the performance of its duties to its customers, third parties, and competent authorities. This means that outsourcing must not result in damage to a customer's interests in a specific service compared to the situation where the supervised entity would itself perform the relevant duties (considering, among other things, the requirements for enhanced diligence that accompany the provision of financial services). Outsourcing must not restrict a customer's rights or prevent the lawful activities of supervisory agencies in exercising supervision.

5.1.3. Outsourcing must not result in a supervised entity not actually pursuing its operations (providing financial services).

According to this principle, outsourcing must not include a supervised entity's core operations that are an integral part of the services provided to customers, which would have the effect of the supervised entity becoming a legal shell, bearing obligations only, and not having an essential possibility of managing and controlling the services offered to the customers and the quality of such services. A supervised entity shall ensure that upon outsourcing, it remains in actual control of the financial services provided to its customers. Outsourcing shall not become a means of regulatory arbitrage aimed at avoiding specific regulatory commitments.

5.1.4. The outsourcing analysis shall be accompanied by an analysis of the sustainability of services and an analysis of the risks and strategies accompanying the termination of outsourcing.

Under this principle, a supervised entity has to ensure the sustainable provision of services to its customers even if it no longer continues to use a specific service provider or if the latter defaults due to extraordinary events. A supervised entity shall have a business continuity plan in place in order to ensure business continuity in case of extraordinary events, and an exit plan in the event that it terminates the legal relationship of outsourcing.

5.2. Background study of service provider

When choosing a service provider, a supervised entity is require to carry out a study of the service provider's background in order to assess the specific service provider's suitability for performing the duties of outsourcing and the related risks, taking into account, among other things, the qualifications and activities, financial status, reputation and experience, structure, and other internal procedure aspects of the service provider and of the persons belonging to the same consolidation group as the service provider.

The background study shall cover all the material circumstances that may affect the particular legal relationship; the depth of the study conducted by a supervised entity shall depend on such circumstances. For example, the scope and depth of a background study may depend on whether or not the service provider is related to the supervised entity (parent company or another subsidiary of the same parent company); whether the service provider is subject to state financial supervision and the scope of such supervision; the added operational risks inherent with a service provider located in another jurisdiction, which should be assessed adequately.

Persons, who do not meet the criteria set out by legislation or established by a supervised entity, shall not be used for outsourcing.

5.2.1. The service provider shall be qualified to perform relevant tasks.

When choosing a qualified service provider, a supervised entity shall make sure that the person is able to comprehend and perform the obligations arising from outsourcing, that the service provider understands the goals of the outsourced activity and the broader objectives of the supervised entity, and is able to contribute to the achievement of these objectives.

A service provider shall have the necessary and adequate knowledge and experience (competence and experience of the staff if the service provider is a legal person) in order to meet its obligations in the best way for the supervised entity and/or the latter's customers, without damaging the interests of the supervised entity and/or its customers, and applying the necessary and adequate measures to avoid conflicts of interests. A supervised entity shall identify the potential direct and indirect interests of the service provider that may cause conflicts with the interests of the supervised entity and/or its customers upon the provision of the service. Apparent conflicts of interest can prevent the provision of quality services. Specific laws may establish specific prohibitions on the use of service providers in whose case there would be an apparent conflict of interests.[6]

Where a service intended to be provided to a supervised entity established in Estonia meets the criteria of activities for which a state licensing procedure is prescribed, the service provider is required to hold such a licence or, if the service provider is located

[6] According to IFS § 74 (3), the investment of the assets of a fund shall not be transferred to the depositary of the fund or to a third party in a case in which a conflict of interest between the third party and the management company, the fund or the shareholders or unit-holders of the fund may arise.

abroad, have a legal basis for the provision of the relevant service under the legislation of the country of location, if such a basis for activity is recognised under the legislation of the Republic of Estonia. Specific laws may establish more detailed requirements for the qualifications of service providers.[7]

5.2.2. A service provider shall be able to perform its duties in a sustainable manner.

The level of organisation and technical arrangements (technical systems and means) shall be adequate for the provision of a specific service and there shall be no legal, technical or organisational obstacles to the provision of services to the required scope and under the required conditions. A service provider shall have plans of business continuity in place so as to ensure business continuity in case of extraordinary events.

The financial background of a service provider shall be transparent and sufficient to provide the service in a sustainable manner, taking into account the complicacy and scope of the service and the related risks. Specific laws may establish additional requirements for the financial indicators or service providers or requirements for additional guarantees.[8]

Considering all relevant circumstances, it may be justified to require a service provider to provide additional guarantees or other securities to hedge the risks inherent in or arising from the provision of the service.

5.2.3. It must be possible to control and supervise a service provider's activities.

A supervised entity should make sure when choosing a service provider that it has the necessary and adequate legal and technical means to control and assess in terms of quality and quantity the service provider's activities in performing the outsourced tasks. A supervised entity also has to secure a possibility of giving the service provider further instructions for carrying out the outsourced activities.

A supervised entity has to make sure that the Financial Supervision Authority has a possibility of exercising state supervision over the service provider. This requires special attention where a cross-border service provider is used, in which case it should be assessed whether the Financial Supervision Authority has sufficient measures at its disposal to carry out supervisory operations in the relevant jurisdiction, taking into account among other things the legal bases for efficient cooperation with the competent authorities of the relevant jurisdiction and/or the service provider's

[7] According to IFS § 74 (2), the investment of the assets of a fund may only be transferred to a management company, credit institution or investment firm which holds an activity licence for the provision of services specified in clause 43 5) of the Securities Market Act, as well as to a management company, credit institution or investment firm founded in a foreign state which, pursuant to the activity licence thereof, has the right to provide securities portfolio management services. In addition to the above persons, organisation of the issue and redemption of units may also be transferred to the Estonian Central Register of Securities. According to IFS §§ 74 (5) and 120 (2), maintenance of a register of the units of a common fund may be transferred only to a management company founded in Estonia or in a foreign state, the depositary of the fund or another depositary founded in Estonia or in a foreign state, the registrar of the Estonian Central Register of Securities or to another person founded in Estonia or in a foreign state which meets the requirements provided for in IFS § 125 and which, according to the legislation of the home state, are not prohibited from provision of the service of maintenance of a register of securities.

[8] According to IFS § 120 (5), the liability of a registrar arising from provision of the service of maintenance of the register of units shall be insured or guaranteed to the extent established by a regulation of the Minister of Finance, unless the registrar is a credit institution or an insurer.

willingness and/or possibilities of voluntarily subjecting to the Financial Supervision Authority's supervision.

5.2.4. Where a cross-border service provider is used, the supervised entity has to additionally assess the risks related to and/or arising from the relevant jurisdiction.

When using a service provider located in another jurisdiction, the legal, economic, political, etc. environment as well as the risks of outsourcing should be assessed, among other things, taking into account the peculiarities arising from and/or accompanying the above factors.

5.2.5. The fees and charges for using the particular service provider shall be assessed upon outsourcing.

Upon outsourcing, the amount of fees payable and the scope of expenses to be covered shall be assessed, among other things, taking into account the market and competition conditions related to the specificity of the service. The cost-benefit analysis shall also take into account the costs of the service directly or indirectly paid by the customers, including any agreements between the service provider and the supervised entity (agreements on splitting the costs, soft commissions, etc.).

In the event of financial services, the circumstances directly or indirectly affecting the scope of the customer's financial obligations should be as transparent and comprehensible as possible, so as to ensure the general transparency and reliability of the financial market.

5.3. Analysis of risks related to outsourcing

All the risks of outsourcing shall be assessed and analysed, and the necessary and proportional measures shall be taken to manage such risks. The analysis of risks related to outsourcing covers various factors, including the following.

5.3.1. Strategic risk

The service that the service provider provides to the supervised entity is not in line and does not contribute to the attainment of the supervised entity's strategic objectives. This may be caused, among other things, by insufficient analysis before outsourcing or the insufficient supervision of the service provider.

5.3.2. Reputation risk

Negative publicity for the supervised entity's operations, regardless of the verity of such publicity, may reduce the customer base and income or increase costs of legal assistance. A lower than required quality of the service provider's services, failure to comply with the supervised entity's enhanced operational requirements and diligence, an inadequate standard of customer service, the service provider's reputation, etc., may cause additional reputation risk for the supervised entity.

5.3.3. Risk of non-compliance with operational requirements and financial risk

Upon outsourcing, a supervised entity is liable for the service provider's failure to comply with operational requirements. This risk may be aggravated, among other things, by insufficient protection of confidential information (especially that concerning customers and their economic interests), insufficient IT security,

insufficient management of conflicts of interests, etc. The risk can be materialised, among other things, by insufficient analysis before outsourcing or insufficient supervision of the service provider's performance.

5.3.4. Access risk

Outsourcing may prevent a supervised entity from performing its duties to competent authorities as well as make it more difficult for competent authorities to adequately supervise the service provider.

5.3.5. Credit risk and business continuity risk

Excessive reliance on one service provider, the lack of suitable exit strategies, loss of necessary internal know-how, and the inflexibility of contracts for the application of a quick exit strategy may result in additional credit risks, exit strategy risks and business continuity risk.

5.3.6. Operational risk

Problems in the activities of one undertaking influence the performance of other undertakings and/or the entire financial system. Outsourcing increases the risk of loss arising from inadequate or failed internal processes, people and systems, or from external events.

6. Requirements for the legal relationship of outsourcing

6.1. Requirements for outsourcing contracts

Upon outsourcing, a supervised entity is required to exactly and clearly specify in a written contract the nature and scope of the outsourced activity and all the contractual rights, obligations, and liabilities of the parties so that these can be unambiguously understood, performed, and controlled by the parties. A supervised entity shall pay attention to the following, among other things, when entering into an outsourcing contract.

6.1.1. Defining the outsourced activity and its scope

An outsourcing contract shall specify exactly the outsourced activity and its scope, including the requirements for the service to be provided.

A supervised entity shall establish criteria for the service provider which the latter shall meet at all times, taking into account its competence and ability to perform tasks efficiently, reliably, and in compliance with enhanced diligence standards.

6.1.2. Rights and obligations, remuneration

A contract shall set out and specify the content the material rights and obligations of the parties in sufficient detail (whether aimed at achieving a specific result or making all reasonable efforts to achieve a result), the parties' liabilities and legal remedies, taking into account the outsourced activity and its scope, as well as the good practice applicable to the professional activities of the parties (the service provider agrees to comply with the practice applicable to the supervised entity's profession or operations), as well as the principles of good faith and reasonability.

The contract shall also provide for the service provider's obligation to notify of changes in the material circumstances pertaining to outsourcing, which may give rise

to the termination or amendment of the contract, procurement of licences and/or consent from competent authorities, etc.

A contract shall provide for remuneration for the services, taking into account that the circumstances affecting the financial service aimed at the end consumer should be as clear and transparent as possible in a situation where the outsourcing fee is, as a rule, charged within the fee paid to the supervised entity by the consumer.

6.1.3. A contract must not prevent a supervised entity from meeting its obligations or being subject to state supervision

In a contract, a supervised entity shall establish the necessary and adequate rights and the corresponding obligations of the service provider, which are necessary for the efficient control of the performance of the tasks related to the outsourced activities both by the supervised entity and competent authorities (accountability, the right to audit, etc.). A contract (legal relationship) with a service provider must not restrict the supervised entity in the performance of its legal and contractual obligations. A contract shall also provide for e.g. the supervised entity's right of access to information and data concerning the performance of the tasks related to the outsourced activities, the measures to be taken if the service provider fails to meet its obligations, etc.

6.1.4. Ownership and use of assets related to outsourcing (including intellectual property)

A contract shall specify the ownership, use, and the procedure for and conditions of transfer of any tangible and intangible assets required for the tasks related to the outsourced activity and/or acquired by way of performance of such tasks.

6.1.5. Security of information technology

The parties must agree on requirements for information systems, which are suitable and adequate for performing the tasks related to outsourcing, taking into account the nature and relevant circumstances of the particular legal relationship. The information systems shall meet the operability, integrity and confidentiality requirements arising from the particular activity.

Detailed requirements for information technology solutions are provided in the **Financial Supervision Authority's advisory guidelines "Requirements for the organisation of the field of information technology"**.

6.1.6. Confidentiality

Outsourcing may be accompanied by a need to disclose confidential information to the service provider, which may result in additional risks to the supervised entity and/or the interests of its customers. Therefore, a confidentiality obligation and a prohibition on using any confidential information revealed to the service provider for purposes other than those arising from the contract shall extend to the service provider. These circumstances should be addressed in the framework of the particular contract by establishing a confidentiality clause, potential sanctions, defining the burden of proof, etc. See also paragraph 6.3 of these guidelines for the confidentiality obligation.

6.1.7. Securities and guarantees

A contract shall set out requirements, as needed, for additional guarantees required of the service provider in order to secure the due performance of obligations and compensation for any damage that might occur.

6.1.8. Permissibility and conditions of subcontracting by the service provider

Where subcontracting is permitted, it shall be subject to all the conditions that have been established for outsourcing.

The primary service provider must have the supervised entity's consent for subcontracting (the supervised entity needs sufficient information on the circumstances and risks of subcontracting in order to decide on granting its consent).

6.1.9. Amendment, expiration and termination of contracts

A contract shall set out the bases and conditions of and procedure for amendment, expiration and termination (both regular and extraordinary termination). A relevant precept or other coercive measure of a relevant competent authority shall be included among the bases for termination of the contract. The bases of amendment, expiration or termination may arise as imperatives from legislation. The contract shall also set out the parties' obligations that remain in force after the termination of the contractual relationship (including the confidentiality obligation).

6.1.10. Choice of applicable law

The applicable law shall be chosen, keeping in mind that the chosen law should not prevent the exercise of necessary and adequate supervision over the service provider. The requirements arising from the Private International Law Act (hereinafter REÕS) shall be taken into account in the choice of applicable law.

According to REÕS § 32 (3), the fact that the parties have chosen a foreign law to govern the contract, whether or not accompanied by the choice of foreign jurisdiction, shall not, where all the elements relevant to the contract at the time of the choice are connected with one state only, prejudice application of such rules of the law of the state which cannot be derogated from the contract (mandatory rules).

6.1.11. Settlement of disputes

A contract shall establish an efficient procedure for the settlement of disputes and, where necessary, define the jurisdiction, having particular regard to the protection of the interests of the supervised entity's customers so as to ensure the sustainable provision of quality services.

6.2. Obligations pertaining to control of the service provider

Considering that outsourcing does not release a supervised entity from liability, and with a view to the customer's legitimate interests and expectations for quality and professional financial services, and taking into account the need to secure the stability, reliability and efficiency of the financial sector and to reduce systemic risks, a supervised entity shall ensure the exercise of necessary and sufficient supervision over the service provider's activities.

Outsourcing shall not prevent supervision at the required level over the service provided and/or over the supervised entity. Relevant supervision covers both the supervised entity's own diligence duty of ensuring sufficient control over the outsourced activities and the rights and

possibilities of competent national supervision authorities to supervise the service provider's activities as necessary within the limits of their powers.

6.2.1. A supervised entity shall have rules in place which the provided service should meet, criteria for the assessment of the qualitative and quantitative compliance of the provided service, as well as measures and methods of relevant control.

The relevant code of practice shall include a procedure for continued monitoring of the outsourcing risks; criteria for the qualitative and quantitative assessment of the service provider's activities and for the activity reports of the service provider and the auditing of the service provider, to secure the required quality and quantity of performance. A supervised entity shall appoint a unit or employee in its organisation who is responsible for controlling each outsourcing relationship.

6.2.2. A supervised entity shall ensure that it has adequate legal and technical facilities and resources for supervising the service provider's activities.

A supervised entity shall ensure that the outsourcing contract provides for the supervised entity's necessary and adequate rights to control and assess the service provider's activities and the corresponding obligation of the service provider to subject to such control and to cooperate.

A supervised entity's rights shall include, without limitation, the right to receive exhaustive information on the service provider's activities (the service provider's reporting duty), to give further instructions for performing tasks, and to require compliance with such instructions.

A supervised entity shall ensure that it continues to have sufficient facilities and resources for exercising its rights and that the supervised entity exercises its rights so as to secure the best interests of its customers.

6.2.3. A supervised entity shall ensure that competent national supervision authorities have adequate possibilities to perform their supervisory duties.

As a rule, the Financial Supervision Authority's control and assessment of a supervised entity's outsourcing of activities related to the financial services provided by it is essentially follow-up control, which is based on specific contracts and the actual activities of the supervised entity and the service provider.

A supervised entity is required to inform the Financial Supervision Authority of outsourcing, since this is a material circumstance pertaining to the supervised entity's operations[9], which may have a substantial impact on the interests of the supervised entity's customers.

The contract shall ensure that competent national supervision authorities have a reasonable possibility of supervising the service provider, including access, both direct

[9] According to IFS § 73 (4), a management company shall promptly inform the Financial Supervision Authority of the transfer of the duties related to the management of a fund and shall submit a copy of the contract on the transfer of duties. According to KindlTS § 65 (4), an insurance undertaking shall promptly notify the Financial Supervision Authority of the transfer of operations related to insurance activities and submit a copy of the contract for transfer of operations thereto. KAS § 108 provides for the obligation of credit institutions to notify the Financial Supervision Authority. Under specific laws, the Financial Supervision Authority may require the supervised entities to present the information and documents necessary for supervision.

and indirect via the supervised entity, to the documents and information held by the service provider, and of exercising other necessary control over the service provider, and the corresponding right of the service provider to subject to the supervision of a competent authority. This is of particular importance when service providers located in other jurisdictions (especially outside the European Union) are used, in which case the competent supervision authorities' possibility of efficiently supervising the provision of financial services and the activities of the supervised entity and service provider may be restricted.

6.3. Protection of confidential information

The confidentiality of information is a regime applicable in the handling of information, which specifies the extent to which the data is not available or disclosed to unauthorised persons, processes, or other existences.

VÕS § 625 provides for the general duty of confidentiality in mandate relationships. According to this provision, during the performance of a mandate, the mandatary shall maintain the confidentiality of facts which become known thereto in connection with the mandate and which the mandator has a legitimate interest in keeping confidential. The mandatary's duty of obligation continues after the end of the mandate relationship insofar as this is necessary to protect the interests of the mandator. Confidential information may be disclosed with the mandator's permission or in the case and to the extent provided by law.Additional and/or special requirements for using the information on clients that a supervised entity acquires in the course of providing services may arise from specific laws. According to KindlTS § 54 (3), managers and employees of insurance undertakings, persons acting on the authorisation or orders of such persons are required to maintain, during and after their employment or operation and for an unspecified term, the confidentiality of all information which becomes known to them and which concerns the economic status, state of health, personal data or the business or other professional secrets of policyholders, insured persons or beneficiaries, unless otherwise prescribed by law.

The confidentiality obligation of credit institutions is regulated to the greatest extent by a special provision. KAS § 88 considers all data which is known to a credit institution concerning the financial status, personal data, transactions, acts, economic activities, business or professional secrets, or ownership or business relations of the clients of the credit institution or other credit institutions information subject to banking secrecy regardless of the transaction or operation in the course of which such data became available to the credit institution. As a rule, the obligation to keep banking secrets extends without a term to the managers and employees of a credit institution as well as other persons who have access to banking secrets. This confidential data may be disclosed only with the written consent of the customer or in the events and pursuant to the procedure provided by law to the persons entitled thereto by law.

IFS §§ 120–125 further regulates the maintenance of registers of fund units, which among other things is subject to the requirements of the Personal Data Protection Act (hereinafter IKS). IFS § 124 defines the scope of persons who may examine the information entered in the register of units and the extent of their access.

Considering the above and the fact that transferring confidential information or access to it to third parties entails an additional risk to the proprietary and non-proprietary interests of customers, the Financial Supervision Authority maintains that the following aspects need to be considered upon outsourcing where this involves the transfer of confidential information (disclosure to a service provider).

6.3.1. A legal basis for disclosing confidential information to third parties, having regard to the customers' interests and taking into account the requirements of

legislation and the professional practice of the relevant area of activity (principle of lawfulness)

When addressing a supervised entity for services, a customer presumes that the supervised entity will provide the service itself. This presumption is also legalised by VÕS § 622. Considering that a supervised entity is not prohibited from using the assistance of third parties in performing the mandate, the supervised entity may need to disclose the confidential information acquired in the course of providing the service to such third parties. A legal entity needs a legal basis for doing so; the legal basis is usually provided by the customer's expression of will (consent to the communication of confidential information to third parties) or arises from law.

A customer's relevant expression of will may be set out in a contract regulating the legal relationship between the supervised entity and the customer. To ensure that the customer's consent is informed and based on relevant information, the customer must be aware of the circumstances of the consent (preferably specified in the contract).

Considering the above, a customer needs to know, among other things, the purpose for which confidential information may be disclosed to third parties (in the case of outsourcing, for the performance of tasks related to a specific service by the service provider), the persons or categories of persons to whom personal data may be communicated (a specific person or persons meeting specific criteria and/or a list of operations for the performance of which confidential information is disclosed to third parties).

A general clause under which a customer grants his general consent to the disclosure of confidential information to third parties is contrary to good practice, unless the customer is aware of all the circumstances of the consent.

Where the right to disclose confidential information arises directly from law or is implied by law, and the supervised entity's disclosure of such information is limited to the scope of the relevant authorisation, the customer need not make an additional expression of will.

6.3.2. Confidential information is used only for the provision of a specific service (attainment of specific goals – the principle of purposefulness)

A supervised entity shall take appropriate measures to ensure that the confidential information disclosed to a service provider is used purposefully for the performance of specific tasks and is not abused. A service provider must not use confidential information given to the service provider in connection with outsourcing for purposes not related to or not arising from the performance of the tasks related to outsourcing in the course of the provision of financial services.

6.3.3. A service provider is not communicated more information than is necessary for the provision of the specific service (*de minimis* principle)

Considering that the communication of confidential information or the granting of access to confidential information to third parties entails an additional risk to the customer's proprietary and non-proprietary interests, information disclosed to a service provider shall be limited to that which is necessary for the due performance of the specific tasks. Such information shall be relevant and complete, in order to prevent distortions that might result in a deterioration of service quality or other threat to the customer's legitimate expectations.

6.3.4. A supervised entity shall take the necessary measures to ensure the protection of the confidential information (pertaining to both the supervised entity and the customers) disclosed to a service provider

A supervised entity shall ensure in an outsourcing contract that the service provider will handle confidentially the confidential information that is disclosed to the service provider and/or becomes available to the service provider in the course of providing the service; the contract shall provide for specific liability in the event of breach of the confidentiality obligation.

A supervised entity shall define the minimum requirements for the service provider's organisational, physical and (information) technological measures to ensure the protection of confidential information. Such requirements shall among other things establish the obligation to ensure the operability and updating of the relevant system. Processing of personal data is subject to the provisions of the Personal Data Protection Act. A service provider is required to give notice of any unauthorised access to confidential information, as well as of the measures taken to prevent and stop such violations.

7. Operational requirements upon termination of legal relationship

7.1. Termination of legal relationship

A supervised entity shall have the right to terminate an outsourcing contract at any time by a reasonable term for advance notice.

It should be kept in mind when entering into an outsourcing contract that a competent supervision authority may have the right to demand the outsourcing contract to be terminated. The parties shall be aware of this when entering into a contract and take appropriate measures to ensure that such a demand can be met. This right shall give the supervised entity the possibility to act in the best interests of its customers if outsourcing becomes unreasonable, given the market situation. The reasonable term for advance notice should also ensure a possibility for each party to organise and secure the continuity of its business when the legal relationship terminates.

7.2. Obligations of the parties upon the termination and further obligations after the termination of the outsourcing contract

The parties shall ensure the transfer of assets (including intangible assets) to the owner, ensure the preservation of the assets and preclude the non-purposeful use or abuse of the assets until their transfer to the owner.

Where a service provider has acquired assets (including intangible assets) in the course of and/or in connection with performing the tasks relating to outsourcing, which are necessary for the supervised entity for the provision of services and/or ensuring business continuity, the transfer of such assets from the service provider to the supervised entity or, at the supervised entity's request, to a third party, shall be guaranteed.

The parties must ensure that the obligation to keep confidential the confidential information that the parties have acquired in the course of or in connection with the provision of services, remains in force and is complied with after the legal relationship is terminated.

7.3. Ensuring business continuity in case of extraordinary events

Besides the general rules on business continuity (business continuity plan), a supervised entity shall have specific operational requirements and plans in place in order to ensure business continuity within the framework of outsourcing. A supervised entity shall assess the consequences of the potential discontinuation of the service provider's operations or of other factors impeding operations. The service provider's business continuity strategy and the supervised entity's business continuity strategy shall be taken into account among other things, and these strategies shall be mutually coordinated. The supervised entity shall periodically check the suitability and adequacy of these strategies.

The requirements for ensuring business continuity are set forth in detail in the **Financial Supervision Authority's advisory guidelines "Requirements regarding the arrangement of business continuity process".**

8 Implementing provisions

8.1. Entry into force

This edition of these guidelines shall enter into force from 30 September 2019.

8.2. Application of guidelines to outsourcing contracts

These guidelines have no retroactive effect on outsourcing contracts already in force at the time of entry into force of these guidelines. Such contracts are not subject to separate review or premature termination. Where a valid outsourcing contract materially deviates from the requirements of these guidelines, a supervised entity may supplement the contract as required. The operations and requirements described in these guidelines shall be taken into account when entering into outsourcing relationships and renewing existing contracts after the entry into force of these guidelines.

Where a valid outsourcing relationship exists between a supervised entity and a service provider as of the date of entry into force of these guidelines, which has not been formulated as required (in a formal contract), such relationship shall be formalised in accordance with the requirements of these guidelines.

8.3. Repealed provisions

Paragraph 11 of the Financial Supervision Authority's advisory guidelines "Requirements regarding the arrangement of operational risk management" is repealed by the adoption and entry into force of these guidelines.