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**PART A: OVERVIEW****1. INTRODUCTION**

- 1.1 The Guidelines on Outsourcing of Islamic Banking Operations set out the requirements that Islamic banks are required to observe in managing their activities that are outsourced to third party service providers.
- 1.2 The Guidelines supersede all previous circulars on outsourcing of Islamic banking operations.
- 1.3 The Guidelines came into force on 23 June 2003.

**2. APPLICABILITY**

- 2.1 The Guidelines are applicable to all Islamic banks which are licensed under the Islamic Banking Act 1983 (IBA).

**3. OBJECTIVE**

- 3.1 Islamic banks are allowed to outsource their non-core functions as a means to improve operational flexibility, minimise the need for capital investment and enable them to accord greater focus to their core business and enhance their efficiency levels.

**PART B: LEGAL PROVISIONS****4. LEGAL PROVISIONS**

- 4.1 All Islamic banks and third party service providers are required to comply with the secrecy provision pursuant to Section 34 of the IBA.
- 4.2 Pursuant to Section 34(3) of the IBA, with effect from 23 June 2003, blanket approval is granted to Islamic banks to appoint agents for the purpose of outsourcing certain operational functions.

**PART C: POLICY****5. SCOPE OF ACTIVITIES THAT CAN BE OUTSOURCED**

- 5.1 Operational functions that are permitted to be outsourced are confined to those which meet the following criteria:
- (i) Processes which are not integral to the core business of the Islamic banking institution;
  - (ii) Processes which do not take away the critical decision-making function of the Islamic banking institution;
  - (iii) The outsourcing of such process does not threaten strategic flexibility and process control of the Islamic banking institution;
  - (iv) The outsourcing of such functions would not impair the image, integrity and credibility of the Islamic banking institution; and
  - (v) Lower cost for Islamic banking institution to outsource such functions rather than developing the necessary infrastructure and expertise.

5.2 A list of activities that can be outsourced is attached in the Appendix. The list is not meant to be exhaustive and subject to review by Bank Negara Malaysia from time to time.

## **6. RESTRICTIONS**

6.1 In principle, Islamic banking institutions are not allowed to outsource operational functions which meet the following criteria:

- (i) Critical functions of the Islamic banking institution (for example: financing approval administration, trading and investment, provision of fee-based services and internal audit); and
- (ii) Those which involve direct and physical contact with the customers, provision of after-sale services to customers and fraud investigations, except the activities that have been approved by Bank Negara Malaysia as listed in the Appendix.

## **7. CONDITIONS AND SAFEGUARDS**

7.1 Islamic banking institutions are required to comply with the following conditions before they are allowed to outsource their functions:

- (i) They must perform due diligence review on the capabilities and expertise of the outsourcing vendor prior to the selection;
- (ii) Approval from the Board of Directors of the Islamic banking institution to outsource the function must be obtained and documented;
- (iii) The outsourcing vendor must provide a written undertaking to the banking institution to comply with the secrecy provision pursuant to Section 34 of the IBA;
- (iv) The Islamic banking institution must enter into a service agreement with the outsourcing vendor with a clause on professional ethics and conduct in performing their duties. The service agreement should also clearly define the roles and responsibilities of the outsourcing vendor;

- (v) In the service agreement, it must be clearly stipulated that the Islamic banking institution reserves the right to terminate the services of the outsourcing vendor if it fails to comply with the conditions imposed;
- (vi) The Islamic banking institution must put in place proper reporting and monitoring mechanisms to ensure that the integrity and quality of work conducted by the outsourcing vendor is maintained;
- (vii) Regular testing and review of the work done by the outsourcing vendor must be conducted. The outsourcing vendor must also provide regular reports to the management of Islamic banking institutions pertaining to the progress of the work conducted;
- (viii) The external and internal auditors of the Islamic banking institution must be able to review the books and internal controls of the outsourcing vendor. Any weaknesses highlighted during the audit must be well-documented and promptly rectified especially where such weaknesses may affect the integrity of the internal controls of the Islamic banking institution; and
- (ix) The Islamic banking institution must also have a contingent plan in the event that the arrangement with the outsourcing vendor is suddenly terminated. This is to mitigate any significant discontinuity in the work supposed to be conducted by the original vendor. The contingent plan must be reviewed from time to time to ensure that the plan is current and ready for implementation in the event of sudden termination of the vendor. The contingent plan must also be approved by the Board of Directors of Islamic banking institutions.

## **8. SERVICE PROVIDERS**

- 8.1 Islamic banks are encouraged to outsource their non-core operational functions to resident outsourcing service providers.

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8.2 If Islamic banking institutions wish to outsource to outsourcing service providers located outside Malaysia, prior approval from Bank Negara Malaysia must be obtained. Consideration would be given if there is reciprocity in the outsourcing arrangement.

## **PART D: OPERATIONAL REQUIREMENTS**

### **9. NOTIFICATION TO BANK NEGARA MALAYSIA**

9.1 Islamic banking institutions are required to notify Bank Negara Malaysia at least two weeks before entering into any agreement with the outsourcing service provider with the following details:

- (i) The name of the outsourcing service provider;
- (ii) The address of the service provider; and
- (iii) The operational function which is being outsourced.

9.2 Islamic banking institutions must give an undertaking to Bank Negara Malaysia that all safeguards provided in Paragraph 7 are fully complied with.

9.3 In the event that there are any changes to the outsourcing service provider, Islamic banking institutions are required to notify Bank Negara Malaysia with the above details at least two weeks before entering into an agreement with the new service provider.

**PART E: PENALTY FOR NON-COMPLIANCE****10. PENALTY FOR NON-COMPLIANCE**

10.1 Bank Negara Malaysia will closely monitor the outsourcing arrangements of Islamic banking institutions. In the event that there are genuine complaints made against Islamic banking institutions on the conduct of their service providers and such complaints are left unrectified, Bank Negara Malaysia will not hesitate to prohibit the Islamic banking institutions concerned from further outsourcing their banking operations.

**PART F: APPENDIX****ACTIVITIES THAT CAN BE OUTSOURCED**

Activities that can be outsourced are as follows:

- i. Debt collection functions for:
  - Credit card receivables;
  - Purchase of consumer durables (subject to conditions); and
  - Hire purchase loans (subject to conditions).
- ii. Marketing and promotional functions as long as they adhere to the following criteria:
  - Sales agents merely market the banking products, assist the customers in completing the application forms and submit the forms to the banking institutions for processing; and
  - Sales agents do not participate in the decision-making process.
- iii. IT infrastructure and support;
- iv. Disaster recovery services;
- v. Information systems internal audit function;
- vi. Card encoding, embossing and personalisation;
- vii. Delivery of credit cards;
- viii. Cheque printing and processing;
- ix. Printing and mailing services;
- x. Storage and archiving of documents/media;
- xi. Statement printing, mailing and archiving;
- xii. Data input and storage;
- xiii. Purchasing and invoice processing;
- xiv. Off-site ATM services;
- xv. Cash handling;
- xvi. Building infrastructure and maintenance;
- xvii. Trade processing services;
- xviii. Electronic banking;
- xix. Branch accounting;
- xx. Administration of staff payments and benefits;
- xxi. Customer relation assistance and operator services;
- xxii. Lockbox operations;
- xxiii. Security and surveillance services; and
- xxiv. IT security and surveillance services.