

**[ SEC MEMORANDUM CIRCULAR NO. 5, S. 2014,  
February 05, 2014 ]**

**GUIDELINES ON THE OUTSOURCING OF FUNCTIONS BY BROKER  
DEALERS**

*Adopted: 05 February 2014*

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WHEREAS, Section 2 of the Securities Regulation Code ("SRC") declares that it is the policy of State to, among others, establish a socially conscious, free market that regulates itself, and to promote the development of the Philippine securities market;

WHEREAS, Section 28.1 of the SRC provides that no person shall engage in the business of buying or selling of securities in the Philippines as a broker or dealer, or act as a salesman, or an associated person of any broker or dealer unless registered as such with the Commission;

WHEREAS, the Commission recognizes that as the Philippine capital market develops and expands, the volume of activities undertaken by brokers and dealers increases, and it becomes more cost effective for brokers and dealers to outsource certain activities to third party service providers ("service providers");

WHEREAS, the Commission understands that breaches by service providers in their outsourcing arrangements with brokers and dealers may lead to disruptions in the Philippine securities market, with negative consequences to the public;

WHEREAS, the SRC authorizes the Commission to formulate policies and recommendations on issues concerning the securities market, and to prepare and approve rules, regulations and orders to make effective the provisions of the SRC;

NOW, THEREFORE, pursuant to the foregoing provisions of the SRC, the Commission hereby adopts and issues the following guidelines on the outsourcing of functions by broker dealers:

**Section 1. Coverage** - These Guidelines shall prescribe the principles and standards which shall be observed by broker dealers in its outsourcing arrangements with service providers.

**Section 2. Definitions** - The following terms shall have the meaning indicated, unless the context provides otherwise:

- a. **Back office functions** refer to administrative or operational functions other than material activities, such as but not limited to clearing and settlement functions, information technology ("IT"), finance and accounting, marketing and legal services.
- b. **Commission** refers to the Securities and Exchange Commission of the Republic of the Philippines.

- c. **Exit strategies** refer to the procedures that shall be undertaken upon the termination of the outsourcing arrangement for the orderly transfer of the outsourced documents, materials, and activities back to the broker dealer or to another service provider. In case of the latter, the transfer of the outsourced documents, materials and activities to another service provider shall be subject to and in accordance with the provisions of these Guidelines.
- d. **Foreign service provider** refers to a service provider who is not licensed to do business in the Philippines and who performs the outsourced services outside the Philippine jurisdiction.
- e. **Material activities** refers to activities requiring a license from the Commission, such as the buying and selling of securities in the Philippines as a broker or dealer, or acting as a salesman or associated person of a broker or dealer, and other activities of such importance that any weakness or failure in the conduct thereof shall have a significant effect on the entity's ability to comply with its statutory obligations. Factors to be considered shall include, but are not limited to, the following: financial, reputational and operational impact on the broker dealer of the failure of the service provider to perform the outsourced functions; potential impact of outsourcing on the provision of adequate services to the broker dealer's customers; potential losses to the broker dealer's customers in case of the service provider's breach; and the impact of outsourcing the activity on the ability and capacity of the broker dealer to conform with regulatory requirements and changes in requirements.
- f. **Outsourcing** refers to the broker dealer's use of a service provider to perform activities that would normally be undertaken by the broker dealer itself. The term shall exclude purchasing contracts, or the acquisition by the broker dealer of services, goods or facilities without the transfer of non-public proprietary or customer information from the broker dealer.
- g. **Service provider** refers to the entity which supplies goods, services or facilities to the broker dealer, which may or may not be an entity licensed by the Commission to engage in the buying or selling of securities, and which may or may not be an entity which is affiliated or otherwise connected with the broker dealer.
- h. **Sub-contracting** refers to the further transfer by a service provider of the outsourced functions to another service provider.
- i. **Sub-contractor** refers to the third party service provider contracted by the service provider to perform the outsourced functions in a sub-contracting arrangement.

**Section 3. Scope of Outsourcing** - Subject to the outsourcing principles and standards set out below, and without prejudice to pertinent rules and regulations regarding the outsourcing by banks and investment houses with quasi-banking authority, a broker dealer can only outsource its back office functions; *Provided*, further, that broker dealers must not outsource (i) material activities and (ii) any activity which involves any interaction or direct contact with the clients of the broker dealer for the purpose of buying and/or selling securities or the solicitation of investments in securities, except in cases permitted under the Securities Regulation Code, the Anti-Money Laundering Act, as amended, or other law, rule or regulation; *Provided, finally*, that clearing and settlement activities may only be outsourced to service providers who are authorized by the Commission to conduct such activities.

Outsourced activities may further be sub-contracted by the service provider; *Provided*, that the principles and standards set forth below shall be likewise

applicable to the sub-contractor; Provided, further, that the foregoing is without prejudice to the right of the broker dealer to prohibit any further sub-contracting by the service provider; Provided, finally, that any further sub-contracting shall not be implemented without prior notice to the Commission as provided in Section 10 hereof.

#### **Section 4. Service Provider**

- a. In the engagement of a service provider, broker dealers must conduct suitable due diligence processes to ensure that the appropriate service provider is selected, such as, but not limited to, (i) the prior assessment of the service provider's ability and capacity to perform the outsourced activities effectively, reliably and in accordance with the broker dealer's standards; (ii) the service provider's financial condition; and (iii) risk management practices.
- b. In case of a foreign service provider, broker dealers must assess whether the engagement of such foreign service provider is appropriate. Further, broker dealers must conduct an enhanced due diligence, with focus on (i) the ability to effectively monitor the performance of the foreign service provider, (ii) the foreign service provider's ability to maintain the confidentiality of customer and other proprietary information, (iii) the foreign service provider's ability to execute contingency plans and exit strategies, and (iv) an analysis of the economic, social or political conditions that might adversely affect the foreign service provider's ability to perform the outsourced functions.
- c. Broker dealers must monitor the performance by the service provider of the outsourced functions. In particular, broker dealers must establish standards which must be met by the service providers, and measures that will identify non-compliance or unsatisfactory performance by the service providers such as, but not limited to, the annual review of the service provider's processes, performance and compliance with the terms of the outsourcing contract.
- d. Broker dealers must ensure compliance by the service providers with applicable Philippine securities laws and regulations. It shall be the duty of the broker dealer (i) to terminate the outsourcing contract in case of any failure, on the part of the service provider, to comply with Philippine laws and regulations, and (ii) to report such failure and the measures undertaken by the broker dealer to remedy the same to the Commission.

**Section 5. Accountability of the Broker Dealer** - The outsourcing broker dealer, its management and officers retain full legal liability and accountability to the Commission and the relevant self-regulatory organization for any and all functions that it may outsource to a service provider, to the same extent as if the outsourced activity was performed by the broker dealer itself. The broker dealer shall be responsible for ensuring that the service provider complies with the pertinent laws and regulations, and that the outsourcing arrangement does not impair or hinder the exercise by the Commission of its regulatory and supervisory powers.

**Section 6. Outsourcing Contract** - The broker dealer and the service provider shall execute a legally binding written contract which shall contain, among others, provisions on the following:

- a. Limitations or conditions, if any, on the service provider's right to subcontract the outsourced functions;
- b. Firm and client confidentiality, such as but not limited to restrictions on disclosures to agents and employees of the service provider;