Insurance Ireland Response to CBI paper on Outsourcing – Findings and Issues for Discussion

18th January 2019

Introduction

Insurance Ireland welcomes the publication of the paper as a constructive contribution to the outsourcing debate and to the increased visibility and prominence of the issue. This, as the CBI notes, is an evolving area particularly against the background of innovation, Brexit and increasing market fragmentation of the financial sector. We note that the implementation of Solvency II has been helpful in formalising and strengthening insurance industry practice but that this is an area which regulators and insurers need to keep under review. The first part of the paper represents a useful check list of CBI expectations for insurers.

Insurance Ireland does not have an industry position as such on the specific questions raised, many of which are formulated to be answered by regulated entities and we note that our members may respond to these on an individual basis. Therefore, our comments in this response are more in the nature of questions to be considered by the CBI. We look forward to engaging further with the CBI as its thinking develops.

In the paper and the press release that accompany it, the focus is on the risks/problems/concerns which CBI has in relation to outsourcing. There is no acknowledgement that outsourcing can be a very valuable way of reducing operational risk – for example for small companies to be able to access specialist skills/capabilities that they could not justify employing themselves, have access to larger/deeper pools of resource, benefit from scale economies etc. We would suggest that consideration of outsourcing include the advantages that can result as well as the risks.

On a general point, as the discussion paper crosses over a number of sectors, it is very broad and there may be a need for further discussion of e.g. the supplier/ vendor relationship, intra and cross group arrangements and outsourced service providers in an insurance context. In addition, CBI expectations should reflect the size and complexity of the risks involved and there may be scope for some degree of proportionality in relation to smaller insurers.

Feedback from our members would indicate that, despite deriving from the same Solvency II requirements, there are significant differences between the approach of regulators in different countries to outsourcing. We would suggest that there should be greater harmony in approaches, so that inconsistencies and differences in processes/requirements are avoided.

We would also highlight that, as is the case with any new requirements, industry needs adequate time to digest and implement any changes arising.

Our specific observations are below:

Part A – Scale and Scope of outsourcing activity

We note the CBI comments in 3.1 around intragroup outsourcing and would suggest that this area would benefit from further discussion in an insurance context. It is usual / common to have intra-group services provided across areas such as technology or administration systems with a shared platform which may be used by several Group business units across multiple jurisdictions. Similarly having common Group functions provide services is normal - particularly in areas such as corporate finance, internal audit, human resources, information security etc. – with these cross-business services supported centrally often with local representation.

In relation to 3.3, we would suggest a clearer distinction between what is a supplier relationship as opposed to an outsourcing relationship. Applying similar oversight and risk assessment criteria to a telecoms provider or to a document management company is not the same as entering into an outsourced arrangement to deliver core services on behalf of a regulated entity.

Part A: Management of Outsourcing Arrangements – "Chain Outsourcing"

The paper defines chain outsourcing on page 21, "chain outsourcing occurs when OSPs engaged by the regulated firm have themselves outsourced certain related activities to other OSPs". Later on page 27, there is a heading "Contractual provisions for management of Sub-contractors (chain outsourcing)".

We would suggest that there needs to be further discussion around the practical challenges of ensuring transparency around chain resourcing and that prescriptive rules should be avoided at this stage.

In relation to the terminology used, under Solvency II, outsourcing "critical or important operation functions or activities" requires additional levels of consideration and oversight along with notification requirements to the CBI. In the SII text, "sub outsourcing" is a recognised term and must be captured in the written agreement with the service provider where the service provider may sub-outsource any of the outsourced functions and activities while ensuring that the service provider remains fully responsible for the performance of its obligations under the agreement.

We would suggest that introducing the terms "sub-contractors" and "chain outsourcing" and using them interchangeably is unhelpful in an insurance context and that we would point to the SII text on sub outsourcing where the requirements are already clearly set out.

Part A: Risk Management

On page 34, the following is stated as a Minimum Supervisory Expectation "Regulated firms maintain sufficient skills and knowledge within the organisation to effectively oversee and challenge the performance of outsourcing arrangements and to ensure that functions can be taken back in-house by the regulated firm or substituted in an orderly manner, if required".

Whilst there is clearly a need for all insurers to have the ability to effectively oversee outsourcing arrangements, we would query whether the emphasis on being able to bring activities back in-house is always appropriate, particularly for smaller insurers, or practical, in the case of the use of cloud service providers.

For example, captives and managed insurers may operate on a fully outsourced basis and it may not be possible to bring activities back in house in the event of a failure of a critical service provider. Instead, in the event of such a failure, an alternative provider in the local market would be sourced.

BCP testing is a normal business process with the objective of enhancing resilience of the operation under different scenarios if one or more failures occur. These scenarios would include loss of service providers. However, there is a limit to which 'shadow' providers can be realistically built into the process particularly in terms of switching from one provider to another in a stressed situation.

It would be helpful to discuss what level of review is reasonable when assessing a third party's BCP framework (including business continuity planning and testing) and how confidentiality restrictions can be overcome in practice. Service providers may deem business continuity plans and documentation as confidential.

Part B: Key Risks and Evolving Trends for discussion: 1. Sensitive Data Risk – page 40

The use of the term "sensitive data" is generic and the discussion paper notes that sensitive data "is information that is protected against unwarranted disclosure". Whilst relevant for the purposes of retaining appropriate contractual and security arrangements with outsource partners, the use of the term is perhaps misleading.

From a GDPR perspective firms are required to protect "personal data" with specific "special categories" of data noted with associated responsibilities applying to data controllers and data processors.

It would be helpful to have insight from the CBI as to where oversight responsibilities merge with the Data Protection Commission and tease out potential scenarios where the CBI would be deemed the lead regulatory supervisor in this area.

Part B: Key Risks and Evolving Trends for discussion – 2. Concentration Risk – page 44

On page 10, the discussion paper notes the following as an evolving risk and trend - "the significance of concentration risk for some regulated firms, both in terms of concentration of OSPs used by the sector and the geographic locations where these OSPs are located".

We note that the CBI is in the unique position to comment on this risk based on the survey responses. In relation to the issues noted for consideration by regulated firms as set out on page 46, we would be interested in the CBI's views as to how firms should at a practical level map out the concentration risk in relation to sub outsourcing as part of a sound vendor management and procurement strategy.

Customer information / profiles, account size, service agreements etc. are all commercially sensitive to the OSP, so for critical or important functions firms rely on their sub outsource agreement in relation to the disclosure requirement where the OSP must disclose any development which may have a material impact on their ability to carry out the outsourced function and activities in addition to the contractual provision which ensures that the service provider remains fully responsible for the performance of its obligations under the agreement. Given the practical challenges, it would be helpful if the CBI could provide industry with a view on the due diligence they would expect to see in order to evidence this mapping process.

Concentration risk is something that should form part of the profile of a outsourcer/vendor relationship however the mitigation of this risk will depend on the nature of the services and whether there are in-house, intra group or other suppliers available. Having dual arrangements, particularly in terms of outsourced regulated activities, may not be realistic in practice.

Part B: Key Risks and Evolving Trends for discussion – Chain Outsourcing -Sub-Contracting

It would be helpful to have clarification around the extent of due diligence and supervision which is reasonable in relation to ensuring that an OSP oversees and manages the activities of the sub-contracted OSPs (e.g. where these are located overseas). We would suggest that there should be a risk-based approach and that the measures should be commensurate with the risk posed by the outsourcing/sub-outsourcing arrangement in question.

****