Prudential Standard GOI 5

Outsourcing by Insurers

Objectives and Key Requirements of this Prudential Standard

Outsourcing of some activities is a growing part of any modern business. This Standard sets out minimum requirements for the outsourcing of material business activities. The requirements are designed to ensure that outsourcing does not impair the prudent management of an insurer's business.

The Prudential Authority requires insurers to have a board-approved policy and related procedures for assessing the risks involved with outsourcing and ensuring compliance with this Standard.

The key premise underlying outsourcing is that the insurer retains responsibility for all regulatory obligations, regardless of whether or not an activity is outsourced. Notwithstanding that retention of responsibility, an insurer may not enter into certain outsourcing arrangements related to material business activities without prior notification to the Prudential Authority.

This Standard sets out the concept of materiality and the conditions that determine when an outsourcing arrangement requires prior regulatory notification. It sets out matters that an insurer must consider prior to an outsourcing decision and legal provisions that must be included in any outsourcing contract. It also sets out requirements for the management and review of outsourcing arrangements so as to ensure the ongoing compliance of such arrangements with the Standard.

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1. Application

1.1. This Standard applies to all insurers licensed under the Insurance Act, 2017 (the Act), other than microinsurers, Lloyd's and branches of foreign reinsurers. The application of these Standards to insurance groups that have been designated as such by the Prudential Authority, under section 10 of the Act is addressed in a separate standard, GOG (Governance and Operational Standard for Groups).

1.2. Unless otherwise indicated, all references to "insurer" in this Standard can be read as a reference to life insurers, non-life insurers and reinsurers.

2. Roles and Responsibilities

2.1. An insurer's board of directors is ultimately responsible for ensuring that the insurer complies with the principles and requirements of this Standard.

2.2. An insurer's board of directors must require the most appropriate control function or functions to review any proposed outsourcing of a material business activity (see section 6.1 below) and the compliance function must regularly review and report to the board of directors or audit committee on compliance with the insurer's outsourcing policy.

2.3. An insurer's auditor must provide assurance to the insurer and the Prudential Authority, if requested, that the insurer complies with the requirements of this Standard.

3. Commencement and Transition Provisions

3.1. This Standard commences on 1 July 2018.

Version Number	Commencement Date
1	1 July 2018
2	1 December 2020 – as amended by Joint Standard 1 of 2020 – Fitness, propriety and other matters relating to significant owners

3.2. Any outsourcing arrangement entered into prior to the effective date of this Standard must comply with this Standard within two years from the effective date.

4. Principles

4.1. An outsourcing arrangement (see definitions in Attachment 1 to GOI 1 (Framework for Governance and Operational Standards for Insurers)) involves contracting for the external provision of a service or activity, which would normally be performed by the insurer.

4.2. An insurer must have a board-approved policy and related procedures for assessing the risks involved with outsourcing, which policy and related procedures must be consistent with this Standard.

4.3. An insurer must, when outsourcing any business activity or function, identify and manage all risks introduced by the outsourcing arrangement.

4.4. An insurer may not outsource a function or activity if that outsourcing may –

a) materially increase risk to the insurer;
b) materially impair the quality of the governance framework of the insurer, including the insurer’s ability to manage its risks and meet its legal and regulatory obligations;
c) impair the ability of the Prudential Authority to monitor the insurer’s compliance with its regulatory obligations; or
d) compromise the fair treatment of or continuous and satisfactory service to policyholders.

4.5. An insurer must when outsourcing any function or activity avoid, and where this is not possible mitigate, any conflicts of interest between the insurance business of the insurer, the interests of policyholders or the business of the other person that performs the outsourcing.

4.6. For the sake of clarity, any arrangement for the provision of a service or activity to an insurer by the insurer’s controlling company, a subsidiary of the insurer, or a related or inter-related party of the insurer, is an outsourcing arrangement.

4.7. Remuneration paid in respect of outsourcing must –

a) be reasonable and commensurate with the actual function or activity outsourced;
b) not result in any function or activity in respect of which commission or a binder fee is payable being remunerated again;
c) not be structured in a manner that may increase the risk of unfair treatment of policyholders; and
d) not be linked to the monetary value of insurance claims repudiated, paid, not paid or partially paid.

4.8. The insurer retains responsibility for all regulatory obligations, regardless of whether or not an activity or function is outsourced.

4.9. With the exception of section 5 below, the remainder of this Standard applies to the outsourcing of a material business activity as defined by this Standard (see section 6 below) only.

4.10. Without at least 30 days prior notification to the Prudential Authority, an insurer must not outsource any material business activity.

5. Outsourcing Policy

5.1. An insurer’s outsourcing policy must ensure compliance with this Standard.

5.2. In addition to addressing the principles in section 4 above and the matters identified in sections 6 to 9 below with respect to outsourcing of material business activities, an insurer’s outsourcing policy should set limits on the types and overall level of outsourced functions or activities by the insurer and the extent to which activities can be outsourced to the same person.

5.3. An insurer’s outsourcing policy should establish criteria and procedures for appointing and renewing outsource service providers.

5.4. An insurer’s outsourcing policy should, at a minimum, provide guidance on the following risks to be assessed, monitored and managed in outsourcing:

a) contractual risk;
b) strategic risk;
c) reputation risk;
d) compliance risk;
e) operational risk;
f) exit strategy risk;
g) country risk;
h) access risk; and
i) concentration and potential systemic risk.

Attachment 1 defines the types of risks referred to above.

6. Material Business Activities

6.1. In assessing whether a business activity is material, an insurer should have regard to such factors as:

a) the financial, operational, and reputational impact of a failure of the service provider to meet its obligations;
b) the cost of the outsourcing arrangement as a share of the total cost base of the insurer;
c) the degree of difficulty, including the time taken, in finding an alternative service provider or bringing the business activity back in-house;
d) the ability of the insurer to meet regulatory requirements if there are problems with the service provider;
e) sharing of sensitive customer information and the ability of the service provider to effectively secure data privacy;
f) potential losses to policyholders and other affected parties in the event of a service provider failure; and
g) affiliation or other relationship between the insurer and the service provider.

6.2. For the purposes of this Standard, all functions of senior management and heads of control function as set out in the Governance and Operational Standards for Insurers are material business activities.

6.3. The Prudential Authority may object to any arrangement to outsource a material business activity if it is convinced that the proposed outsource is inconsistent with this Standard.

6.4. The Prudential Authority may provide further guidance on the interpretation of outsourcing or materiality.

7. Notification to the Prudential Authority of an Outsourcing Arrangement

7.1. Prior to entering into any such arrangement, an insurer must notify the Prudential Authority of a proposed outsourcing of a material business activity. A notification must include details about:

a) the proposed outsourcing;
b) the proposed service provider to whom the insurer will outsource the function; and
c) the key risks associated with the outsourcing and the risk mitigation strategies that will be put in place to address these risks.

7.2. The insurer must demonstrate that it has:

a) assessed the costs and benefits and potential risk to its insurance business inherent in the proposed outsourcing;
b) identified potential service providers to undertake the outsourcing through objective procurement and selection procedures;
c) identified any conflicts of interest, or potential conflicts of interest, between the business of the insurer, the interests of policyholders and the business of the service provider that performs the outsourcing – as a general principle such conflicts should be avoided but, where this is not possible, mechanisms should be put in place to mitigate the attendant risks;
d) identified and assessed all material risks, including those relating to data privacy;
e) considered the potential impact of multiple outsourcing arrangements by the insurer and those provided by the service provider to a number of insurers;
f) assessed whether the service provider is fit and proper in terms of meeting the standards of competence and integrity set down in GOI 4 (Fitness and Propriety of Key Persons of insurers);
g) assessed the service provider's governance, risk management, and internal controls and its ability to comply with applicable laws;
h) assessed whether the service provider's operational capability or financial position pose a material risk to the service provider's ability to deliver the proposed outsourced function or activity;
i) developed appropriate management and review procedures for the proposed outsourcing consistent with those set out in section 9 below; and
j) developed appropriate contingency plans to ensure the continuous functioning of the insurance business of the insurer in the event that the outsourcing arrangement is terminated or found to be ineffective.

[as amended by Joint Standard 1 of 2020 – Fitness, propriety and other matters relating to significant owners – effective 1 December 2020]

7.3. The notification must be accompanied by a confirmation that the outsourcing arrangement is compliant with the insurer's outsourcing policy and within the risk appetite set by the board of directors.

8. Contractual Requirements

8.1. A contract for outsourcing of a material business activity must be in writing and must, at least:

a) specify the duration of the contract;
b) specify the type and frequency of the function or activity to be performed;
c) specify the level and standard of service that must be rendered by the service provider to the insurer and, where relevant, to policyholders;
d) require that the service provider have appropriate governance, risk management, and internal controls in place to perform the outsourced function or activity;
e) require that the service provider comply with applicable laws;
f) specify the Rand value of the remuneration or consideration payable by the insurer to the service provider, or, if the Rand value is not fixed or determined on entering into the contract, the basis on which the remuneration or consideration payable will be calculated;
g) provide for the type and frequency of reporting by the service provider on the function or activity performed under the contract;
h) provide that an insurer must monitor the service provider's performance under and compliance with the contract and the manner in and means by which that monitoring will take place;

i) provide for periodic performance reviews of the service provider and the regular review of the contract;
j) specify that the insurer has continued access to information relating to the outsourced function or activity, including access to any information the insurer may require to monitor the treatment of policyholders, where relevant;
k) address confidentiality, privacy and the security of information of the insurer and policyholders;
l) address sub-outsourcing;
m) address ownership of intellectual property;
n) provide for business contingency processes, including the continuity of functions or activities if the service provider is placed under curatorship, business rescue, becomes insolvent, is liquidated or is for any reason unable to continue to render the function or activity in accordance with the contract;
o) specify that the service provider will take the necessary steps, including providing access to its premises and documents, to enable the insurer, and the Prudential Authority if needed, to verify that the requirements of this Standard are being complied with;
p) specify the circumstances under which the insurer may terminate the contract;
q) include indemnity and liability provisions;
r) set out any warranties or guarantees to be furnished and insurance to be secured by the service provider in respect of its ability to fulfil its contractual obligations;
s) provide a process for dispute resolution; and
t) provide for a reasonable termination period, irrespective of the circumstances under which the agreement is terminated (including the lapsing or non-renewal of the agreement), that will allow the insurer's contingency plans to be implemented.

9. Management and Review of Outsourcing Arrangements

9.1. An insurer must ensure that the risks associated with any outsourcing of a material business activity are appropriately assessed, monitored, managed, and regularly reviewed.

9.2. An insurer must maintain an appropriate level of contact with and implement processes for ensuring that the level and standard of service to the insurer and, where relevant, its policyholders, under an outsourcing arrangements for a material business activity are appropriately monitored, managed, and reviewed.

9.3. An insurer must regularly assess the service provider's:

a) governance, risk management, and internal controls (including fitness and propriety);
b) ability to comply with applicable laws; and
c) operational and financial capability.

9.4. An insurer must immediately notify the Prudential Authority of any material developments (such as pending termination, material non-performance and the like) with respect to an outsourcing arrangement for a material business activity. In the event such an arrangement is terminated, the insurer must inform the Prudential Authority, within one week of the date of termination, of the reasons for the termination. The notification to the Prudential Authority must also explain how the activity will be performed following termination of the outsourcing arrangement.

Attachment 1: Definitions of the types of risks referred to in section 5 above

contractual risk:	The risk that the insurer may not be able to enforce the contract with the other person.
strategic risk:	The risk that the totality of the other person's activities may not be consistent with the overall strategic objectives of the insurer and that the insurer may not have the expertise to oversee, manage and monitor the other person.
reputation risk:	The risk that the other person's conduct may not be consistent with the overall standards of the insurer or the stated practices (ethical or otherwise) of the insurer.
compliance risk:	The risk that the other person may not comply with applicable legislation and may not have adequate compliance systems and controls in place.
operational risk:	The risk of loss arising from inadequate or failed internal processes, people and systems or from external events, including legal risk, but excluding risks arising from strategic decisions and reputational risk.
exit strategy risk:	The risk that appropriate exit strategies (termination clauses) may not be in place or may not be effectively executed.
country risk:	This risk that the political, social and legal climate of the country in which the other person operates adversely affect the ability of the other person to fulfil his/her contractual obligations.
access risk:	The risk that the insurer may not, at all times, have access to timely data and other information.
concentration and systemic risk:	The risk that the insurer is over-reliant on a single other person. The insurer should ensure that the other person does not provide the same or similar function to a significant number of other insurers.