



**MINISTRY OF FINANCE  
INSURANCE COMPANIES CONTROL SERVICE**

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**EXPLANATORY NOTE ON  
OUTSOURCING OF CRITICAL OR  
IMPORTANT FUNCTIONS OR  
ACTIVITIES**

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## **Introduction**

1. Under the Solvency II Directive, there are specific provisions that apply when insurance and/or reinsurance companies ("insurers") entrust the execution and handling of critical or important functions or activities or procedures to service providers outside their company (external assignment).
2. According to the provisions of article 2 of the Insurance and Reinsurance Business and Other Related Issues Laws of 2016-2022 ("the Law"), outsourcing means an agreement of any form between an insurer and a service provider, whether it is a supervised entity or not, whereby that service provider undertakes a process, provides a service or performs an activity, either directly or by subcontracting, which would otherwise have been undertaken by the insurer itself.
3. The Boards of Directors ("Boards") and senior management of insurers must be aware that when they enter into outsourcing agreements they create a dependency on a third party, which has the potential to affect the operational resilience of their business.
4. The following explanatory note is intended to remind insurers of the requirements of the Legislation in relation to outsourcing, as well as good practices that is expected of insurers to follow, in relation to the various aspects of outsourcing. Additionally, it is a reminder to insurers' boards and senior management of their obligation to take appropriate steps to ensure that the outsourcing framework is well designed, operates effectively and can adequately manage the associated outsourcing risks.
5. In accordance with the provisions of article 50 paragraph 3 of the Law, insurers have an obligation to inform the Superintendent in good time before the outsourcing of critical or important functions or activities, as well as of any subsequent significant developments in relation to these functions or activities. The following legislative and regulatory provisions with which insurers must comply are recalled:

### *The Law*

Article 2 - Definition of outsourcing

Article 41 - Supervision of outsourced responsibilities and activities

Article 43 – General governance requirements

Article 50 - Outsourcing

### *Commission Delegated Regulation EU 2015/35 of 10 October 2014*

Article 258 – General governance requirements

Article 274 – Outsourcing

### EIOPA guidelines

- Regarding the system of governance, Guideline 11 and Guidelines 60 to 64.
- Guidelines on outsourcing to cloud service providers.
- Guidelines on information and Communication technology and governance.

### **Supervisory expectations**

6. Supervisory expectations for outsourcing aim to ensure that:
  - there is effective day-to-day management by senior management or the Board;
  - there is effective oversight by the Board;
  - there is a sound outsourcing policy and there are sound outsourcing processes;
  - insurers have an effective and efficient internal control framework, including with regard to their outsourced functions;
  - all risks associated with the outsourcing of critical or important functions are identified, assessed, monitored, managed, reported and, where appropriate, mitigated;
  - appropriate plans are in place for the exit from outsourcing arrangements of critical or important functions, e.g. by switching to another service provider or by reintegrating critical or important outsourced functions into the business; and
  - the Superintendent remains able to exercise effective control over insurers, including the functions that have been outsourced.

### **What constitutes outsourcing**

7. Outsourcing is the agreement, of any form, between an insurer and a service provider, whether or not subject to supervision, by which that provider undertakes, directly or as a subcontractor, the processing of procedures, the provision of services or the performance of functions that would otherwise be carried out by the insurer itself. Where an insurer provides insurance services to its policyholders and some elements of the provision of those services have been outsourced to the external provider, the arrangement is likely to be outsourcing unless the policyholder has a direct contractual relationship with the external

provider to provide those services. Any reliance on a service provider for functions that enable the insurer to provide insurance services is considered outsourcing.

8. However, the provision of consulting or other related services (e.g. legal) to insurers is not considered outsourcing of essential business operations. Hiring a specialist consultant, for example, to provide one-off technical advice or one-off support for the insurer's regulatory compliance, internal audit, accounting, risk management or actuarial function does not normally constitute outsourcing. However, it may be outsourcing if the insurer then relies on that consultant to manage an internal function or service, e.g. when installed or fully operational. The more substantial or frequent the advice or service provided by the external provider to an insurer, the more likely it is to fall within the definition of outsourcing.
9. It is emphasized that the importance or critical nature, or even the type of arrangement as outsourcing is not static. In other words, a function or service that was previously not considered as outsourcing may become outsourcing due to the reliance on it from the undertaking or the frequency of the service.

### **When is a function critical or important**

10. In accordance with Guideline 60 of the Guidelines on the System of Governance, insurers must determine and document themselves whether the function or activity ("Function") outsourced to an external provider or associate is critical or important.
11. The criterion for defining a function as critical and important is the necessity of the specific Function for the uninterrupted provision of services by the insurers to the policyholders. Failure to provide the Function or improper provision of the Function would have a negative impact on the insurers' provision of services to the policyholders and would substantially affect the insurers' compliance with the law and the continuity of their normal activities.
12. It is expected that insurers will have a defined policy for identifying critical and important Operations, which clearly sets out the criteria and factors taken into account, and which also takes into account the nature, scale and complexity of the business ("principle of proportionality"). This policy should be applied consistently to all outsourcing decisions.
13. The evaluation of a Function as critical and important should be reviewed periodically to ensure that the categorizations remain appropriate. It is recommended that the periodic review be conducted before signing an outsourcing agreement or when the insurer reviews the use of the external

provider's service, or when data changes in the service provider or even during scheduled review periods.

14. The 4 main functions based on the Solvency II Directive are the actuarial function, the internal control function, the risk management function and the compliance function.

Examples of other critical or important Functions according to the EIOPA Guidelines on the System of Governance Guidelines are as follows:

- the design and pricing of insurance products;
- asset investment and/or portfolio management;
- claims handling;
- the provision of regular or constant compliance, internal audit, accounting services, risk management or actuarial support;
- the provision of data storage;
- the provision of ongoing, day-to-day systems maintenance or support;
- the ORSA process.

15. The following activities cannot be considered critical or important Functions:

- the provision of advisory services to the insurer and other services that are not part of the insurer's insurance or reinsurance activities, such as legal advice, staff training and security of premises and staff;
- the purchase of standardized services, including market information services and the provision of price feeds;
- the provision of logistical support, such as cleaning or catering;
- the provision of elements of human resources support such as the hiring of temporary employees and the processing of payroll.

## **Managing agents**

16. As stipulated in Guideline 61 of the Guidelines on the system of governance, the insurer must ensure that the activities of insurance intermediaries who are not its employees but are authorized to undertake insurance risks or settle claims in its name and on its behalf, are subject to the requirements applicable in the case of outsourcing. An insurance intermediary's typical intermediation activities, introducing, proposing or performing other preparatory work for the conclusion of insurance contracts or entering into such contracts or assisting in the management and execution of such contracts are not subject to the outsourcing requirements.
17. Therefore, for insurance intermediaries authorized to accept risks or manage claims, the insurer should ensure that they comply with the outsourcing arrangements.

## **Intra-group Outsourcing**

18. As stipulated in Guideline 62 of the Guidelines on the system of governance, in case of outsourcing of main functions within the group, the participating insurance or reinsurance undertaking, insurance holding company or mixed financial holding company must record which Functions are outsourced to which legal entities and to ensure that the outsourcing does not impair the performance of these functions of the insurer.
19. In the case of intra-group outsourcing, the degree of flexibility may vary depending on whether the service provider is, for example, in the same country as the insurer or in a different geographical area.
20. However, the insurer must assess whether and to what extent it should rely on Functions provided by its group service provider.
21. Where the service provider is a legal entity from the same group as the insurer, the examination of the service provider may be less thorough provided that, on the one hand, the board of the insurer is more familiar with the service provider and, on the other hand, the insurer has sufficient control or may influence the actions of the service provider.
22. In the case of outsourcing within the group, a written agreement should be concluded, which will define the duties and responsibilities of both parties (the insurer and the provider). However, this could take the form of a service level agreement, since the agreement is not subject to formal negotiations, unlike an outsourcing to an external service provider.

Although the supervisory review process may take into account the group as a whole and the extent to which an entity within the group provides operations for other undertakings in the same group, the onus remains on the individual insurer as it is the authorized entity. While an insurer can outsource Operations to another group member, it cannot absolve itself of responsibility for them and must manage the outsourcing arrangement robustly, for example with appropriate business contingency plans.

### **Outsourcing policy**

23. The decision to outsource is mainly based on the evaluation of the benefits it will have for the insurers such as e.g. reduced costs, increased efficiency, access to skills, knowledge and technology that could be difficult, time-consuming and expensive to develop in-house. However, the decision to outsource should not be made in isolation or by separate departments within an insurer. It is important that insurers have a single approach and strategy in relation to outsourcing that is aligned with the insurer's business model as determined by the Board, the insurer's strategy and risk appetite and risk management framework.
24. Before deciding to outsource, the insurer should establish a written documented internal outsourcing policy in accordance with the provisions of Article 274(1) of the Commission Delegated Regulation EU 2015/35, as well as Guideline 63 of the Guidelines on the System of governance. The outsourcing policy must be reviewed periodically and approved by the insurer's board if there are any changes.
25. The insurer should define the objectives and factors taken into account that govern the decision to outsource and the conditions that apply, as well as the factors taken into account in terminating the outsourcing of its activities. This policy should cover all aspects of outsourcing and the insurer should involve all relevant departments such as Risk Management, Legal Services, Compliance etc.
26. The following should be considered in formulating the policy: the extent of the Functions to be outsourced, the types of Functions, the risks to the insurer from the outsourcing arrangements, the extent to which the insurer has in-house the ability to monitor, control and evaluate the external provider and the services provided. Insurers should be able to clearly document in their policy how any risks associated with outsourcing are managed and mitigated.

## **Ensuring business continuity**

27. Insurers should draw up appropriate business continuity plans, which are tested on a trial basis periodically, and which can be relied upon in the event that the service provider is no longer able to provide its services.
28. This plan should take into account the possible consequences of not fulfilling the task of executing the critical or important function that is the subject of outsourcing. In addition, the consequences in case of insolvency of the service provider and other risks should also be taken into account.

### **To reduce the risks of outsourcing, before entering into a written agreement or renewing it, the following should be clarified:**

- the duties and responsibilities of both parties;
- the duration of the proposed outsourcing of each Function;
- the integration of the outsourcing agreement into the risk management and internal control system (including compliance procedures);
- the fitness and probity of the relevant individuals in the service provider;
- the reporting to be submitted by the service provider to the insurer;
- the process of monitoring the service provided by the service provider and performance against key performance indicators;
- the obligation of the service provider to inform the insurer of material developments that may affect both the receipt of reports and the assurance of the quality of service provision, the duration of the agreement, possible conflicts of interest, business reputation;
- that the insurer is able to terminate the outsourcing agreement, when necessary, without affecting the continuity and quality of its service provision to policyholders;
- the insurer's contingency plans/exit strategy and how the service provider terminates or defaults on the agreement;
- that the service provider will provide the insurer (including its external auditors) and the Superintendent with access to the data held by it (and premises);



- terms and conditions of any sub-outsourcing and the impact of such arrangements;
- the dispute resolution arrangements including the provisions for remedial measures, punitive measures if required to be taken in the event of a material breach and the indemnification arrangements;
- that the proposed outsourcing will not result in:
  - substantial degradation of the insurer's governance system;
  - undue increase in operational risk;
  - breach of supervisory monitoring or compliance obligations; or
  - undermining the continuous and satisfactory service to the insured.

### **Choice of an external provider**

29. Insurers should conduct appropriate and proportionate due diligence when selecting service providers to perform the Functions. Insurers should ensure that providers have the capabilities and appropriate authorization to perform the critical or important function in a reliable and professional manner to fulfill their obligations during the term of the agreement.

Insurers are expected to consider, as a minimum, the following criteria when conducting the initial and due diligence review of service providers:

- fitness and probity (how the service provider has verified that the relevant personnel at the service provider performing the outsourced function or activity are sufficiently qualified and reliable);
- financial strength, resources and reputation of the service provider;
- internal controls and risk management systems within the service provider;
- cases of potential or actual conflict of interest and how to manage them;
- compliance with the General Data Protection Regulation;
- potential exposure to concentration risk;
- skills of the insurer to supervise the service provider;
- employment and management of subcontractors by the service provider and relevant authorizations of the provider in relation to subcontracting;

- where available, the history of the service provider in arrangements to terminate agreements without affecting the continuity and quality of the Function;
  - where available, the ability of the service provider to meet its requirements and contractual obligations under normal and stressed conditions;
  - the design and effectiveness of the risk management framework, ensuring the privacy of the service provider's information is at least equivalent to that of insurers;
  - protection of confidentiality of information and preparation of adequate contingency plans by the service provider;
  - location of the service provider (e.g. where the service provider is located outside the EU, how any restriction of access to data or facilities has been properly considered and dealt with);
  - details of the service provider's regulatory status, if any (where the service provider is not a regulated entity), how any increased risks that may arise from this have been considered and appropriately addressed;
  - evidence that the service provider is committed to complying with all applicable laws, regulatory requirements, guidelines and policies approved by the insurer and to cooperate with the Service with respect to the outsourced function or activity. Where the service provider is a group company, consideration must be given to the relationship between the parties and the controls or influence the insurer may have over the service provider.
30. Insurers are expected to be able to demonstrate that the above factors have been taken into account. Documentation of the above should be made available to the ICCS upon request.
31. **In addition, it is expected that insurers address the following issues when deciding to outsource:**
- the assessment of the ability to continue to comply with the conditions required to maintain their license to operate;
  - the financial impact of both themselves and beneficiaries/policyholders and reinsurers;
  - the operational impact, the stability of insurers and the continuity of its service to policyholders;

- the insurer's ability to comply with regulatory requirements in the event of problems with the service provider;
- the cumulative impact of many outsourced activities.

### **Effective monitoring and management of outsourcing activities**

32. Boards and senior management of insurers have ultimate responsibility for all activities undertaken by insurers including the effective oversight and internal management of all outsourcing risks and ensuring that appropriate structures are in place. Although during outsourcing the execution of the functions is handled by the external providers, the responsibility remains within the insurers and rests with their Boards and senior management.
33. Effective monitoring, management and mitigation of outsourcing risk requires the development and implementation of an effective risk management framework. Comprehensive risk assessment is a key tool for appropriate and adequate supervision by insurers. In this context, it is expected that insurers:
  - measure the risk of outsourcing in their general risk register;
  - conduct a risk assessment in relation to any proposed outsourcing arrangement (e.g. sensitive data risks, concentration risks, risks of dependence on one provider or a small number of providers that cannot be easily replaced, business continuity risk, reputational risk, non-compliance risk , cyber risk etc.);
  - review and document the controls to be implemented to minimize exposure to identified risks and implement mechanisms to monitor the effectiveness of external providers;
  - review the outsourcing agreements in relation to any changes since they were entered into;
  - review and update risk assessments on a periodic basis to ensure that they continue to reflect their activities including the operational, legislative and regulatory environment;
  - ensure that they have suitably qualified staff with sufficient knowledge to be able to supervise, control and monitor the work, assess the external provider's performance and business continuity measures and possibly carry out an on-site audit of each external provider;
  - take appropriate steps to ensure that any deficiencies likely to be identified during the assessment of services provided can be effectively addressed

and any disputes resolved by taking corrective action or paying compensation.

34. Monitoring the performance of the external provider can be done through:
  - ensuring that appropriate reports are received from the service provider;
  - performance evaluation, (an example of which is given below);
  - assessing the adequacy of service providers' business continuity measures;
  - conducting on-site audits of the service provider.
  
35. The insurer compares the information from the service provider with specified critical risk indicators such as:
  - number of disruptions with an immediate operational impact on service delivery or expected earnings;
  - number of complaints from insured persons;
  - number of incidents with data;
  - level of compliance with statutory and regulatory requirements;
  - level of operational effectiveness (%) of internal control measures implemented to monitor outsourcing risks;
  - concentrations in service providers;
  - timely collection of data and deliverables.
  
36. Insurers should notify their intention to outsource critical or important functions or activities to the Superintendent and to the ICCS by submitting the completed questionnaire in Appendix 1.