

Central Bank of Ireland draft guidance on cross-industry outsourcing – *the (re)insurance perspective*

On 25 February 2021, the Central Bank of Ireland (CBI) published Consultation Paper 138 on Cross-Industry Guidance on Outsourcing, which included the CBI's draft guidance on cross-industry outsourcing (the **Draft Guidance**).

Our colleagues in the Financial Regulation and Regulatory Risks and Investigations team prepared a general overview of the Draft Guidance and its potential impact on regulated firms, which is available [here](#).

In this note, we highlight some elements of the Draft Guidance that are of particular note for Irish (re)insurers.

The management of outsourcing risk is not a new phenomenon for Irish (re)insurers. The European Union (Insurance and Reinsurance) Regulations 2015 (**2015 Regulations**), Directive 2009/138/EC (**Solvency II**) and Regulation 2015/45/EU (**Delegated Regulation**), along with EIOPA Guidelines and CBI Guidance (**Regulatory Guidance**) set out the obligations (re)insurers have in relation to the outsourcing of critical or important functions or activities.

These key obligations for a (re)insurer include:

- remaining fully responsible for the discharge of all of its obligations when critical or important functions or activities are outsourced
- establishing and maintaining a written outsourcing policy
- ensuring that the outsource of critical or important functions or activities does not materially impair the quality of the system of governance, unduly increase operational risk, impair the ability of the CBI to monitor compliance or undermine the satisfactory service to policyholders
- notifying the CBI before engaging in the outsource of critical or important functions

- cooperating with the CBI in relation to rights of access and audit
- ensuring adequate due diligence is completed regarding the provider of an outsourced function or activity
- ensuring that any outsourcing arrangement complies with certain content requirements.

Scope of the Draft Guidance

The Draft Guidance is broad in nature and applies to all regulated firms, including (re)insurers. The application of the Draft Guidance by a firm will be framed by (i) the criticality or importance of the outsourced function or activity, (ii) the regulated firm's outsourcing risk assessments and controls and (iii) the nature, scale and complexity of the business of the regulated firm.

The majority of the obligations in the Draft Guidance already apply to (re)insurers by virtue of the 2015 Regulations, Solvency II, the Delegated Regulation and the Regulatory Guidance. However, the Draft Guidance does contain certain new obligations and expands existing obligations that are of note for (re)insurers.

New obligations

The new obligations under the Draft Guidance include:

- **Outsourcing register** – the Draft Guidance requires that all regulated firms establish and maintain an outsourcing register. This register should identify and facilitate appropriate oversight and awareness of all current and proposed outsourcing arrangements (including the outsourcing of non-critical or non-important functions or activities)
- **Exit strategies** – the Draft Guidance requires that regulated firms develop defined exit strategies for outsourcing arrangements that are viable, appropriately planned and documented, and periodically reviewed and updated where necessary. The Draft Guidance also requires that regulated firms develop and maintain skills and expertise internally so that outsourced functions or activities can be provided in-house, if required.

Expanded obligations

The Draft Guidance expands certain obligations that already apply to (re)insurers under the 2015 Regulations, Solvency II, Delegated Regulation and Regulatory Guidance. The key expanded obligations include:

- **Governance and ongoing monitoring** – the board of directors and relevant senior management are to be fully responsible and accountable for setting the insurer's strategy and policies in relation to outsourcing, including accounting for outsourcing risks in the firm's risk appetite, risk management framework and risk register. Additionally, the board of directors and relevant senior management must ensure that a regular periodic review of outsourcing arrangements is undertaken to determine if the risk management framework adequately reflects the level of outsourcing undertaken by a regulated firm.

While aspects of the governance requirements set out in the 2015 Regulations are more specific than this, for example the requirement to review an outsourcing policy at least annually, some aspects of the Draft Guidance are slightly more expansive.

- **Content requirements** – any outsourcing arrangement for a critical or important function or activity must comply with certain content requirements under the Delegated Regulation. The Draft Guidance requires additional content be included in outsourcing arrangements including details on (i) the location where the outsourcing will take place, (ii) the (re)insurer's ability to access data held by the service provider in the case of insolvency, (iii) any necessary insurance cover the service provider must have in place and (iv) the financial obligations of the (re)insurer and the service provider.
- **Due diligence** – the CBI expects additional due diligence to be completed by regulated firms when considering a service provider, including (i) reviewing the substitutability of the service provider, (ii) potential exposures to concentration risk and overreliance on one or a small number of service providers, (iii) the managerial skills and capability within the service provider to oversee the outsourced function or activity, (iv) the incident reporting and management procedures in the service provider and (v) alignment of the risk appetite of the service provider with that of the (re) insurer and reviewing the effectiveness of risk management controls in the service provider.
- **Notification to the CBI** – the Draft Guidance continues to require advance notification be made to the CBI before a regulated firm outsources critical or important functions or activities. However, the Draft Guidance requires information, that is additional to the current requirements under the Regulatory Guidance which includes (i) information on the service provider including its corporate number, legal entity identifier, registered address and details of its parent company, (ii) date of, and summary of, the most recent risk assessment conducted in respect of the proposed outsourcing arrangement, (iii) details of any sub-outsourcing that will take place under the outsourcing arrangement, (iv) details of the assessment conducted relating to the substitutability of the service provider and the identity of any potential substitute service provider and (v) details on the estimated annual budget for the outsourcing arrangement.

- **Business continuity management procedures** – the Draft Guidance requires (re)insurers, before outsourcing any critical or important function or activity, to consider and assess their business continuity management procedures as well as those of the service provider.

Consultation period

The CBI invites interested stakeholders to provide general feedback on the Draft Guidance by 26 July 2021. The CBI expects the Draft Guidance to be finalised once the consultation period concludes and is implemented later this year.

As (re)insurers are already subject to extensive obligations in relation to outsourcing, we anticipate that other regulated firms may be more likely to have concerns and raise them with the CBI by way of feedback. However, certain sections of the Draft Guidance place further obligations on (re)insurers, for example the requirement to develop appropriate exit strategies and the increased levels of due diligence expected to be completed before engaging a service provider. (Re)insurers may wish to avail of the opportunity to provide the CBI with feedback to express concerns or suggest alternative approaches in relation to the Draft Guidance.

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