



Outsourcing by an insurer

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REQUIREMENTS REGARDING OUTSOURCING BY AN INSURER ARE COMPREHENSIVELY SET OUT IN THE PRUDENTIAL STANDARD GOI 5 AND ONE WOULD THINK IT IS SIMPLE, BUT IS IT?

Many insurers outsource material and non-material business activities to providers for various reasons. Some of these reasons include an opportunity for Insurers to have access to expert skills without having to employ such a person on a full-time basis or in certain instances, the outsourced party offers various skills to the insurer that do not reside in one person, or such skills are needed on a temporary basis only and would not justify employing a person. Whilst outsourcing provides many benefits to the Insurer, there are also drawbacks, such as the Board retaining the responsibility for all regulatory obligations, and even

more importantly, any kind of outsourcing increasing the Insurer's risk.

To complicate the matter further, binder arrangements are a subsection of Outsourcing and are governed by the Regulations. Many insurers make use of binder arrangements to accept and administer policies (mainly short-term) and in some instances to manage and settle claims. There are very specific requirements when entering into a binder arrangement, quite different from a material or non-material outsourcing arrangement. However, a large overlap in requirements is present, especially in terms of the governance of any such arrangement.

When an Insurer wants to enter into any kind of outsourcing arrangement, the first thing that insurer is required to do is to develop a board-approved outsourcing policy

that addresses the procedures for assessing the risks associated with outsourcing, mitigation of such risks and ensuring compliance, regulatory notification and application processes as well as further compliance with the requirements as set out in GOI5.

WHAT DOES THIS MEAN IN PRACTICE?

An Outsourcing Policy will provide guidance on a high level as to how the company will approach outsourcing with regard to types of functions that may be outsourced, under what circumstances outsourcing will be considered, the risk appetite of the company pertaining to outsourcing, how the arrangement must be set up, service provider selection, due diligence, approvals and the monitoring of the outsourcing arrangement.

In addition to the policy, the insurer has to develop a comprehensive outsourcing process aligned to the outsourcing policy, to be followed



throughout the organisation. The minimum requirements for such process to be followed are:

TYPES OF FUNCTION

Certain functions may not be outsourced, for example:

Where the insurer's risk increases materially, or materially impairs the quality of its governance framework, or very importantly, where outsourcing will compromise the fair treatment of or continuous and satisfactory service to policyholders, to name a few.

It is a further requirement to determine whether the function being outsourced qualifies as a binder function or just a material function. A binder function is defined as:

- Enter into, vary or renew a policy
- Determine the wording of a policy
- Determine the premiums under a policy
- Determine the value of policy benefits under a policy
- Settle claims under a policy

Some insurers provide binder holders (non-mandated Brokers) with an electronic system, to upload policies, change and vary policy benefits and/or remove items and add items. Although this might mean that in principle the insurer is immediately aware of its liability, it is still the binder holder binding the insurer by accepting the risk on behalf of the insurer and therefore a binder agreement must be entered

into. The same is true when a binder holder only performs certain functions in the process of settling of a claim.

DUE DILIGENCE

A due diligence is performed to ensure that the risk the insurer will face when the function is being outsourced, whether this is in terms of a binder function or insurer function, can be assessed, and whether the risk taken on can be managed and that no policyholder will be prejudiced through this agreement. The due diligence will also inform the insurer of the resources that the outsourced party has available to perform the function and whether continuity has been addressed and can be managed.

NEGOTIATE OBLIGATION AND DETERMINE REMUNERATION

Remuneration for binder arrangements are capped per activity as set out in the Regulations, if the function is outsourced to a non-mandated broker, whilst any other outsourcing remuneration may be determined as follows:

Remuneration must be reasonable and commensurate with the actual function or activity outsourced, and not result in any function or activity in respect of which commission or a binder fee is payable being remunerated twice. Further, at all times the risk of unfair treatment of policyholders must be kept in mind. At no time may remuneration be linked to the monetary value of insurance claims repudiated, paid, not paid or partially paid.

A distinction must be made here as to whom the binder function is outsourced to. Although an Underwriting Manager will perform binder functions, remuneration is determined using the usual outsource pricing, whilst a non-mandated broker's remuneration is determined using the binder formula.

MONITORING

All outsourcing agreements, whether it is an insurer function, material or non-material, binder function or any other function outsourced by an insurer must be monitored on an ongoing basis.

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 or a binder function are appropriately monitored, managed, and reviewed. To achieve this an insurer must regularly assess the service provider's:

- governance,
- risk management, and internal controls (including fitness and propriety);
- ability to comply with applicable laws;
- operational and financial capability; and
- level of performance

REVIEW AGREEMENT

The insurer should review all outsourced agreements on an annual basis to ensure that they are relevant and that the outsourced party is performing according to agreed levels.

When an insurer manages its outsourced functions in terms of their outsourcing policy, the risk of outsourcing can be mitigated to an acceptable level.

An outsourced provider brings with it originality, allowing scope for bringing experience and new ways of thinking. But most importantly, an outsourced party brings objectivity to ensure mitigation of risks in the 3rd line of defence.