

**GUIDELINE
ON
OUTSOURCING**

Insurance Authority

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1. Introduction

1.1. It has become increasingly popular for financial services institutions to outsource their business activities to other parties as a means of reducing costs and achieving strategic aims. These activities may include customer-related services and back-office activities.

1.2. While outsourcing may bring cost and other benefits, such arrangement may increase an insurer's dependence on other parties and increase its risk profile. An authorized insurer is therefore expected to adopt a sound and responsive management framework in formulating and monitoring its outsourcing arrangements.

1.3. This Guideline is issued pursuant to section 133 of the Insurance Ordinance (Cap. 41) ("the Ordinance"). It sets out the essential issues that the Insurance Authority ("IA") expects an authorized insurer to take into account in formulating and monitoring its outsourcing arrangements for protecting the interests of its existing and potential policy holders. It also sets out the supervisory approach of the IA in monitoring the outsourcing arrangements of an authorized insurer.

1.4. Whilst this Guideline seeks to help authorized insurers to identify and mitigate the risks associated with outsourcing without hindering the efficiency and effectiveness of their operation, it however should not be regarded as a substitute for consultation of professional and legal advice. The IA will not accept any responsibility for any liability which may arise from application of this Guideline.

2. Application of this Guideline

2.1. Subject to paragraph 2.2 below, this Guideline should apply to all outsourcing arrangements of an authorized insurer which is incorporated or based in Hong Kong. For an authorized insurer which is neither incorporated nor based in Hong Kong, it should apply to outsourcing arrangements relating to that insurer's operation in Hong Kong.

2.2. Section 5 of this Guideline sets out the essential issues that the

IA expects an authorized insurer to take into account in formulating and monitoring its outsourcing arrangements. The IA recognizes that outsourcing arrangements may exhibit varying degree of materiality and expects an authorized insurer to manage its outsourcing risks in a manner that is commensurate with the degree of materiality of the arrangements. For material outsourcing, the IA expects the insurer to take into account and address all the relevant essential issues. However, irrespective of the degree of materiality of an outsourcing arrangement, it will not diminish the insurer's ultimate accountability of the outsourced service and obligations to comply with relevant laws, regulations and rules.

3. Interpretation

3.1. In this Guideline, unless the context otherwise specifies:

- (a) “based in Hong Kong”, in relation to an authorized insurer, means that the insurer is incorporated outside Hong Kong with 75% or more of its annual gross premium income for general business pertaining to Hong Kong insurance business; or 75% or more of its annual gross revenue premium income for long term business pertaining to Hong Kong long term insurance business.
- (b) “outsourcing” refers to an arrangement under which the service provider undertakes to perform a service (including a business activity, function or process) which would otherwise be undertaken by the authorized insurer itself. For the purposes of this Guideline, **Annex 1** sets out some examples of outsourcing and some arrangements which would generally not be regarded as outsourcing.
- (c) “material outsourcing” means an outsourcing arrangement, which if disrupted or falls short of acceptable standards, would have the potential to significantly impact on an authorized insurer's financial position, business operation, reputation or its ability to meet obligations or provide adequate services to policy holders or

to conform with legal and regulatory requirements.

- (d) “overseas outsourcing” means an outsourcing arrangement relating to an authorized insurer’s operation in Hong Kong and the service of which is performed outside Hong Kong, irrespective of the place of incorporation of the service provider.
- (e) “service provider” includes a service provider located in or outside Hong Kong, and the service provider can be an independent third party, a party related to the authorized insurer (e.g. a subsidiary or fellow subsidiary of the insurer) or a unit of the insurer (e.g. head office or overseas branch).

4. Legal and Regulatory Obligations

4.1. Whilst an authorized insurer has the flexibility to carry out its operation in the way best suited to accomplishing its corporate objectives, its Board of Directors and management retain ultimate accountability for all the outsourced services. The insurer’s liability shall not be restricted or limited by way of outsourcing.

4.2. Outsourcing does not diminish the obligations of an authorized insurer to comply with relevant laws, regulations and rules. The insurer is obliged to comply with, including but not limited to, the Ordinance, and observe the guidelines promulgated by the IA. Specifically, an authorized insurer must ensure that proper books of account and records are maintained and made available for inspection by the IA in Hong Kong when required, and adequate and up-to-date data can be timely retrieved from the insurer or the service provider. It should not enter into any outsourcing arrangement that would impede the IA’s ability to exercise its statutory responsibilities.

5. Essential Issues

Outsourcing Policy

5.1. Prior to the outsourcing of services, an authorized insurer should develop an outsourcing policy, approved by the Board of Directors, which includes, among other things, the following:

- (a) the objectives of outsourcing and criteria for approving an outsourcing arrangement;
- (b) the framework for evaluating the materiality of outsourcing arrangements;
- (c) the framework for a comprehensive assessment of risks involved in outsourcing;
- (d) the framework for monitoring and controlling outsourcing arrangements;
- (e) the identities of the parties involved and their roles and responsibilities in approving, assessing and monitoring the outsourcing arrangements, and how those responsibilities may be delegated and details of any authority limits; and
- (f) the review mechanism to ensure the outsourcing policy and the monitoring and control procedures are capable to accommodate changing circumstances of the insurer and cater for market, legal and regulatory developments.

5.2. The insurer should have appropriate documentation of its outsourcing policy and ensure that procedures are in place such that all relevant staff of the insurer are fully aware of, and comply with, the outsourcing policy.

5.3. For an authorized insurer incorporated outside Hong Kong, the approval required in paragraph 5.1 above may be delegated to a management committee responsible for the oversight and supervision of

the insurer's operation in Hong Kong.

Materiality Assessment

5.4. An authorized insurer should develop a framework for assessing the materiality of an outsourcing arrangement. The assessment of what is material may involve qualitative judgment and depends on the circumstances of the insurer concerned. Factors that should be considered include, but are not limited to:

- (a) impact on the financial position (e.g. solvency and liquidity), business operation (e.g. provision of adequate services to customers) and reputation of the insurer if the outsourced service is disrupted or falls short of acceptable standards;
- (b) impact on the ability of the insurer to maintain adequate internal controls and comply with legal and regulatory requirements if the outsourced service is disrupted or falls short of acceptable standards;
- (c) cost of outsourcing as a proportion to the total operating costs of the insurer; and
- (d) degree of difficulty and time required to find alternative service provider or to bring the outsourced service in-house, if necessary.

5.5. An authorized insurer should regularly conduct reviews on the materiality of its outsourcing arrangements. An outsourcing arrangement which was previously immaterial may become material due to, for instance, changes in the volume and the nature of the service outsourced to the service provider. If such an outsourcing arrangement is reassessed to be material, the insurer should notify the IA forthwith and take practical steps to address all the essential issues set out in this Guideline in a timely manner. For the avoidance of doubt, an authorized insurer should notify the IA of the information as mentioned in paragraph 6.1 of this Guideline when it is planning to enter into a new material outsourcing arrangement

or significantly vary an existing material outsourcing arrangement.

Risk Assessment

5.6. Before entering into a new outsourcing arrangement or renewing or varying an existing outsourcing arrangement, an authorized insurer should conduct a comprehensive assessment on the risks associated with the proposed arrangement or change. The assessment should take into account all relevant risks including impact on financial, operational, legal and reputation aspects and potential losses to the customers in the event of a failure by the service provider to perform the outsourced service. The insurer should exercise due diligence and care to ensure that all risks identified have been addressed before implementing the proposed arrangement or change.

5.7. After the insurer implements a new outsourcing arrangement or renews or varies an existing outsourcing arrangement, it should re-perform such assessment regularly.

Service Provider

5.8. An authorized insurer should exercise due diligence and care and consider factors such as aggregate exposure to that particular service provider, possible conflict of interest that may arise, and price of the outsourcing vis-à-vis the benefit gained in assessing and selecting a service provider. Besides, when assessing a service provider, it should, among other things, take into account the following factors of the service provider:

- (a) reputation, experience and quality of service;
- (b) financial soundness, in particular, the ability to continue to provide the expected level of service;
- (c) managerial skills, technical and operational expertise and competence, in particular, the ability to deal with disruptions in business continuity;

- (d) any licence, registration, permission or authorization required by law to perform the outsourced service;
- (e) extent of reliance on sub-contractors and effectiveness in monitoring the work of sub-contractors;
- (f) compatibility with the insurer's corporate culture and future development strategies; and
- (g) familiarity with the insurance industry and capacity to keep pace with innovation in the market.

5.9. An authorized insurer should periodically review (at least annually) the ability (including financial strength and technical competence) of the selected service provider to ascertain whether it can continue to provide the expected level of service.

Outsourcing Agreement

5.10. An outsourcing arrangement should be undertaken in the form of a legally binding written agreement. In negotiating the contract with the service provider, an authorized insurer should consider, among other things, the following matters:

- (a) scope of the outsourced service;
- (b) location where the outsourced service will be performed;
- (c) effective period of the outsourcing arrangement;
- (d) contractual obligations and liabilities of the insurer and the service provider;

- (e) performance standards to be attained in respect of the outsourced service. This is particularly appropriate when the insurer has committed a service standard or performance pledge to its customers;
- (f) reporting or notification requirements that the insurer may wish to impose on the service provider;
- (g) the way in which the insurer and the service provider should monitor the performance under the agreement (e.g. evaluation of performance through service delivery reports, periodic self-certification, independent reviews by the insurer's or service provider's auditors);
- (h) information and asset ownership rights, information technology security and protection of confidential information;
- (i) rules and restrictions on sub-contracting, e.g. requiring insurer's prior consent on sub-contracting of the outsourced service. The insurer should retain the ability to maintain similar control over its outsourcing risks when a service provider uses a sub-contractor;
- (j) remedial action and escalation process for dealing with inadequate performance;
- (k) contingency planning of the service provider to provide business continuity for the outsourced service;
- (l) management and approval process for changes to the outsourcing arrangement;
- (m) conditions under which the insurer or service provider can terminate the outsourcing agreement;

- (n) termination agreement, including intellectual property and information rights and clarification of the process to ensure the smooth transfer of outsourced service either to another service provider or back to the insurer;
- (o) guarantee or indemnity from the service provider, e.g. an indemnity to the effect that any sub-contracting by the service provider of the outsourced service will be the responsibility of the service provider including liability for any failure on the part of the sub-contractor;
- (p) requirement for the service provider to hold relevant insurance;
- (q) mechanism to resolve disputes that might arise under the outsourcing arrangement;
- (r) the service provider's agreement to allow access by the auditors and actuaries of the insurer and the IA to any books, records and information which facilitates them to discharge their statutory duties and obligations; and
- (s) governing law of the outsourcing agreement. The agreement should preferably be governed by Hong Kong law.

5.11. Where the service provider is the head office or another branch of an authorized insurer, a memorandum of understanding which has been properly endorsed by its Board of Directors may be acceptable.

Information Confidentiality

5.12. An authorized insurer should ensure that the outsourcing arrangements comply with relevant laws and statutory requirements on customer confidentiality (e.g. the Personal Data (Privacy) Ordinance, Cap. 486 ("PDPO")). The insurer should ensure that it and the service provider

have proper safeguards in place to protect the integrity and confidentiality of the insurer's information and customer data.

5.13. An authorized insurer should take into account any legal or contractual obligation to notify customers of the outsourcing arrangement and circumstances under which their data may be disclosed or lost. In the event of the termination of the outsourcing agreement, the insurer should ensure that all customer data are either retrieved from the service provider or destroyed.

5.14. An authorized insurer should notify the IA forthwith of any unauthorized access or breach of confidentiality by the service provider or its sub-contractor that affects the insurer or its customers.

Monitoring and Control

5.15. An authorized insurer should ensure that it has sufficient and appropriate resources to monitor and control the outsourcing arrangements at all times. For effective monitoring and control of the outsourcing arrangements, an authorized insurer should, among other things:

- (a) ensure the responsibility for monitoring the service provider and the outsourced service to be assigned to staff with appropriate expertise;
- (b) maintain a central list of the outsourcing arrangements that includes the name of each service provider, service outsourced, location where the outsourced service is performed, commencement date and expiry or renewal date of the outsourcing agreement, and contact details of the key persons of the service provider. The central list should also record similar information relating to any sub-contracting arrangement of the outsourced service;
- (c) exercise due diligence and care to monitor each outsourcing arrangement to ensure the service is being delivered in the manner

expected, and to ensure the provisions included in the outsourcing agreement are properly effected; and

- (d) conduct reviews or audits periodically (at least annually) to ensure that the outsourcing policy and the monitoring and control procedures are being effectively complied with.

5.16. Once an authorized insurer implements an outsourcing arrangement, it should regularly review the effectiveness and adequacy of its controls in monitoring the performance of the service provider and managing the risks associated with the outsourced service. The insurer should have reporting procedures that can promptly escalate problems relating to the outsourced service to the attention of the management of the insurer and the service provider. It should take appropriate rectification actions forthwith if deficiencies are identified. The insurer is expected to notify the IA forthwith of any significant problem that has the potential to materially affect its financial position, business operation or compliance with legal and regulatory requirements.

Contingency Planning

5.17. An authorized insurer outsourcing service to a service provider should put in place a contingency plan to ensure that its business would not be disrupted as a result of undesired contingencies (e.g. systems failure) of the service provider. The following issues should be considered and properly addressed in formulating such contingency plan:

- (a) back-up facilities or availability of alternative service provider or possibility of bringing the outsourced service back in-house;
- (b) procedures to be followed and the persons responsible for respective activities if business continuity problem arises; and
- (c) procedures for regular reviews and testing of the contingency plan.

5.18. An authorized insurer should also ensure that the service

provider has its own contingency plan in respect of daily operational and systems problems. The insurer should have adequate understanding of the service provider's contingency plan and consider the implications for its own contingency planning in the event that the outsourced service is interrupted due to undesired contingencies of the service provider.

Overseas Outsourcing

5.19. In addition to the essential issues mentioned above, an authorized insurer should pay particular attention to the following issues in relation to overseas outsourcing:

- (a) Country risk – The country risks associated with overseas outsourcing should be taken into account. Such risks cover the social, economic and political conditions and the legal and regulatory systems of an overseas jurisdiction which may adversely affect the ability of the service provider to carry out the provisions of the outsourcing agreement and the ability of the insurer to effectively monitor the outsourced service and the service provider.
- (b) Information confidentiality – There may be circumstances under which the insurer's information and customer data are subject to the right of access by an overseas authority (e.g. police and tax authority). The insurer should take into account the extent and possibility of such access right and, as considered appropriate, seek legal advice to clarify the position. In case an overseas authority seeks access to the insurer's customer data, the insurer should forthwith notify the IA.
- (c) Notification to customers – Having regard to the additional risks posed by overseas outsourcing, the insurer should consider the need to inform their customers of the jurisdiction in which the service is to be performed and any right of access available to overseas authorities.

- (d) Examination by the IA – The insurer should ensure that, although its service is outsourced to be performed outside Hong Kong, such arrangement would not, in any case, impede the ability of the IA to access in Hong Kong the books and records and other information of the insurer as necessary for the IA to carry out its statutory responsibilities.
- (e) Transfer of personal data – The insurer should pay particular attention to relevant provisions of PDPO if it needs to transfer personal data outside Hong Kong under an overseas outsourcing arrangement.
- (f) Governing law of agreement – The governing law of the outsourcing agreement should preferably be governed by Hong Kong law.

Sub-contracting

5.20. Additional risk will be posed on the risk profile of an authorized insurer if the service provider of the outsourcing arrangement is allowed to further contract the service out to other parties. The insurer should put in place adequate procedures to control and monitor such sub-contracting arrangements and ensure that the service provider will take into account the essential issues set out in this Guideline as if it was the insurer concerned when further contracting out the service.

5.21. An authorized insurer should incorporate in the outsourcing agreement rules and restrictions on sub-contracting, e.g. requiring insurer's prior consent for sub-contracting and making the service provider liable for the capability of the sub-contractor. The insurer should ensure that its service provider would not engage in sub-contracting arrangement which may impede its ability to carry out the provisions of the outsourcing agreement with the insurer, in particular, the requirements on information confidentiality, contingency planning and information access right by regulator.

6. Supervisory Approach

Prior Notification of Material Outsourcing

6.1. An authorized insurer should notify the IA when it is planning to enter into a new material outsourcing arrangement or significantly vary an existing one. Unless otherwise justifiable by the insurer, the notification should be made at least three months before the day on which the new outsourcing arrangement is proposed to be entered into or the existing arrangement is proposed to be varied significantly. The insurer should satisfy the IA that it has taken into account and properly addressed all the essential issues set out in Section 5 of this Guideline in the planning stage. The IA, if considered appropriate, may discuss with the insurer on any area of concern on the outsourcing arrangement and require it to take necessary actions to address the concerns. The three-month prior notification period may be extended by the IA if the insurer is not able to address the area of concerns to the satisfaction of the IA within the period. In the event that the three-month prior notification period has expired without the IA having communicated with the insurer on the proposed outsourcing arrangement or significant changes, the insurer may take it that the proposal is acceptable to the IA and proceed to enter into the proposed arrangement or changes.

6.2. The prior notification to the IA should be accompanied with a detailed description of the proposed outsourcing arrangement to be entered into or the significant change proposed to be made. The IA may request any additional information where the IA considers it necessary in order to assess the potential impact on the insurer's risk profile. For overseas material outsourcing, the IA may also communicate with the home or host regulator of the insurer and the service provider to seek clarification or confirmation on relevant issues as considered necessary.

6.3. After entering into a new material outsourcing arrangement or significantly varying an existing one, the insurer should within 30 days submit to the IA information relating to the arrangement. The information to be submitted includes:

- (a) the service outsourced;

- (b) the name of the service provider;
- (c) the location where the outsourced service is performed;
- (d) the commencement date and expiry or renewal date of the outsourcing agreement; and
- (e) a copy of the outsourcing agreement.

The insurer should notify the IA forthwith whenever there is any subsequent change to the information submitted and any renewal or termination of the outsourcing arrangement.

Regular Monitoring

6.4. As outsourcing arrangements have the potential of increasing an authorized insurer's business/operational risk, such arrangements are subject to on-site inspection and off-site review by the IA. An authorized insurer should submit to the IA any supplementary information as required by the IA from time to time to enable it to monitor the insurer's outsourcing arrangements. The IA reserves the right, in extreme case, to require an authorized insurer to take steps to make alternative arrangement for any outsourced service.

7. COMMENCEMENT

7.1. This Guideline shall take effect from 26 June 2017.

June 2017

Examples of Outsourcing

The following are some examples of services that when performed by a service provider may be regarded as outsourcing for the purposes of this Guideline:

- Application processing (e.g. insurance proposals, policy loans)
- Policy administration (e.g. premium collection, invoicing, policy renewals, customer services)
- Claims processing (e.g. claims assessment, claims recoveries)
- Documents processing (e.g. cheques, bill payments)
- Investment management (e.g. portfolio management, cash management)
- Manpower management (e.g. manpower planning, staff recruitment, salaries and benefits administration, training and development)
- Marketing and research (e.g. product development, telemarketing, media relations)
- Information system management (e.g. information system, intranet and website development and maintenance, information technology security, desktop support)
- Risk management and internal control (e.g. compliance, internal audit)
- Professional services related to the business activities of the authorized insurer (e.g. accounting, actuarial)

The following are some examples which would generally not be regarded as outsourcing for the purposes of this Guideline:

- Sale of insurance policies by agents or brokers, and ancillary services relating to those sales
- Ceding insurance business
- Independent advisory and consultancy services

- Loss adjusting service
- Independent audit review
- Medical examination by assigned medical and health clinics and centres
- Market information services (e.g. Standard & Poor's, Moody's)
- Purchase of goods and commodities
- Repair and maintenance of fixed assets
- Maintenance and support of licensed software
- Specialized recruitment and procurement of specialized training
- Employment of contract or temporary personnel
- Common network infrastructure (e.g. VISA, Mastercard)
- Banking services
- Printing services
- Transportation services
- Mail and courier services
- Cleaning services
- Utilities and telephone

Prior Notification of Material Outsourcing Arrangement

Checklist of Information to be Submitted to the Insurance Authority for Entering into an Outsourcing Arrangement	“✓” if submitted
<p>A. Basic Particulars</p> <p>A description of the service proposed to be outsourced, name of service provider, location where the outsourced service will be performed, the commencement, expiry and renewal (if any) dates of the proposed arrangement.</p>	
<p>B. Outsourcing Policy</p> <p>A copy of the outsourcing policy of the authorized insurer (or, if the outsourcing policy has been submitted to the Insurance Authority, the date of submission).</p>	
<p>C. Materiality Assessment</p> <p>A summary of the materiality assessment conducted in respect of the proposed outsourcing arrangement, including the factors under consideration and the assessed impact.</p>	
<p>D. Risk Assessment</p> <p>A summary of the key risks identified in the proposed outsourcing arrangement and the risk mitigation strategies put in place to address these risks.</p>	
<p>E. Service Provider</p> <p>A brief account on the background of the service provider and its ability to perform the outsourced service, supplemented with a copy of the latest annual accounts/ report of the service provider, if available.</p>	
<p>F. Outsourcing Agreement</p> <p>A copy of the proposed outsourcing agreement.</p>	

<p>G. Information Confidentiality</p> <p>A summary of the key measures to protect the integrity and confidentiality of the insurer's information and customer data under the proposed outsourcing arrangement.</p>	
<p>H. Monitoring and Control</p> <p>A summary of the key procedures for monitoring and control of the proposed outsourcing arrangement.</p>	
<p>I. Contingency Planning</p> <p>A contingency plan to address the possibility that the outsourced service is disrupted or falls short of acceptable standards.</p>	
<p>J. Sub-contracting</p> <p>A summary of key measures to control and monitor sub-contracting of the outsourced service; or a statement confirming that the service provider is not allowed to sub-contract the outsourced service under the proposed outsourcing arrangement.</p>	

Prior Notification of Material Outsourcing Arrangement

Checklist of Information to be Submitted to the Insurance Authority for Significant Change to an Outsourcing Arrangement	“✓” if submitted
<p>A. Basic Particulars</p> <p>A description of the existing outsourcing arrangement (e.g. the outsourced service, location where the outsourced service is performed, the commencement, expiry and renewal (if any) dates and the proposed change).</p>	
<p>B. Materiality Assessment</p> <p>A summary of the materiality assessment conducted in respect of the outsourcing arrangement if the change is incorporated (“revised outsourcing arrangement”).</p>	
<p>C. Risk Assessment</p> <p>A summary of the key risks identified in the revised outsourcing arrangement and the risk mitigation strategies put in place to address these risks.</p>	
<p>D. Service Provider</p> <p>A brief account on the background of the service provider and its ability to perform the outsourced service under the revised outsourcing arrangement, supplemented with a copy of the latest annual accounts/ report of the service provider, if available.</p>	
<p>E. Outsourcing Agreement</p> <p>A draft of the change or revised outsourcing agreement.</p>	
<p>F. Information Confidentiality</p> <p>A summary of the key measures to protect the integrity and confidentiality of the authorized insurer’s information and customer data under the revised outsourcing arrangement.</p>	
<p>G. Monitoring and Control</p> <p>A summary of the key procedures for monitoring and control of the revised outsourcing arrangement.</p>	

<p>H. Contingency Planning</p> <p>A contingency plan to address the possibility that the outsourced service is disrupted or falls short of acceptable standards.</p>	
<p>I. Sub-contracting</p> <p>A summary of key measures to control and monitor sub-contracting of the outsourced service; or a statement confirming that the service provider is not allowed to sub-contract the outsourced service under the revised outsourcing arrangement.</p>	