Financial Sector Regulation Act, 2017

Joint Standard [*] of 2021

Outsourcing by Insurers

Objectives, Applicability and Key Requirements of Joint Standard

This Joint Standard sets out minimum requirements for the outsourcing of material functions and activities by an insurer. The requirements are designed to ensure that outsourcing by an insurer does not impair the prudent management and conduct of an insurer's business.

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

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

This Joint 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 the decision to outsource and certain 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 Joint Standard.

Table of Contents

1. Commencement

1.1 This Joint Standard comes into operation on [insert date].

Version number	Commencement date
1	[Insert date]

1.2 Any outsourcing arrangement entered into prior to the effective date of this Joint Standard must comply with this Joint Standard within one year from the effective date.

1.3 Notwithstanding subparagraphs 1.1 and 1.2, an insurer must comply with this Joint Standard within 6 months from the commencement date, during which period an insurer must continue to comply with the *Prudential Standard GOI 5: Outsourcing by Insurers*, as if it had not been repealed.

2. Legislative authority

2.1 This Joint Standard is made under section 107, read with sections 105, 106 and 108(1)(k), of the Act.

3. Application

3.1 This Joint Standard applies to all insurers, including microinsurers (hereinafter collectively referred to as "insurers"), licensed under the Insurance Act, other than Lloyd's and branches of foreign reinsurers.[1]

4. Definitions and interpretation

4.1 In this Joint Standard **"the Act"** means the Financial Sector Regulation Act, 2017 (Act No. 9 of 2017) and any word or expression to which a meaning has been assigned in the Act shall have the meaning so assigned to it, unless a different meaning is assigned elsewhere in this Joint Standard, and –

"Authority" means the Financial Sector Conduct Authority or Prudential Authority as defined in section 1 of the Act, and **"Authorities"** means both the Financial Sector Conduct Authority and Prudential Authority;

"board of directors" has the meaning assigned to such term in section 1 of the Insurance Act, and "board" has a corresponding meaning;

[1] The application of these Standards to insurance groups that have been designated as such by the Prudential Authority, under section 10 of the Insurance Act is addressed in a separate standard, GOG (Governance and Operational Standard for Groups).

“insurer” has the meaning assigned to such term in section 1 of the Insurance Act, 2017 (Act No.18 of 2017);

“material function” means a function or activity relating to an insurer’s business that has the potential to have a significant impact on the insurer’s business operations or its ability to manage risks effectively, should it be disrupted;

“Insurance Act” means the Insurance Act, 2017 (Act No.18 of 2017);

“senior management” has the meaning as defined in section 1 of the Insurance Act; and

“service provider” means a person that provides a function or activity to or for an insurer in terms of an outsourcing arrangement.

4.2 The “Objectives, Applicability and key requirements of Joint Standard” printed in italics at the start of this Joint Standard must not be used in the interpretation of any section of this Joint Standard.

5. Roles and responsibilities

5.1 An insurer’s board of directors is ultimately responsible for ensuring that the insurer complies with the requirements of this Joint Standard.

5.2 An insurer’s board of directors must ensure that –

(a) the most appropriate control environment is established and maintained to review any proposed outsourcing of a material function;

(b) the appropriate control function or, in the case of a micro insurer either the appropriate control function or senior management, regularly reviews that the insurer complies with its outsourcing policy and this Joint Standard; and

(c) the appropriate control function or, in the case of a microinsurer senior management, report to the board or audit committee on compliance or any identified non-compliance with the insurer’s outsourcing policy and this Joint Standard.

5.3 An insurer’s external auditor must, if so requested by the Authorities, provide assurance that the insurer complies with the requirements of this Joint Standard.

6. Principles

6.1 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 Joint Standard.

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

6.3 An insurer must, in order to meet the requirement of section 6.2, undertake an appropriate due diligence for every activity or function to be outsourced, prior to entering into an outsourcing arrangement.

6.4 An insurer may not outsource a function or activity, or maintain an outsourcing arrangement, if such 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 Authorities to monitor the insurer's compliance with its regulatory obligations; or
(d) compromise the fair treatment of, or continuous and satisfactory service to, policyholders.

6.5 An insurer should consider the potential impact, prior to entering into -

(a) multiple outsourcing arrangements provided by the same service provider; or
(b) an outsourcing arrangement with a service provider that has entered into multiple outsourcing arrangements with other insurers, and other parties;

and be able to demonstrate that such multiple outsourcing arrangements are not likely to increase the risk of a consequence referred to in section 6.4.

6.6 An insurer must, when outsourcing any function or activity avoid, and where avoidance is not possible mitigate, any conflicts of interest between the insurance business of the insurer, the interests of policyholders and the business of the service provider.

6.7 Remuneration paid in respect of outsourcing must –

(a) subject to regulation 3.20(1)(a) of the Regulations under the Long-term Insurance Act, 1998 and regulation 5.7(1)(a) of the Regulations under the Short-term Insurance Act, 1998, 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 impede the delivery of fair outcomes to policyholders; and
(d) not be linked to the monetary value of insurance claims repudiated, paid, not paid or partially paid.

6.8 An insurer retains responsibility and accountability for all regulatory obligations relating to a function or activity, regardless of whether or not such function or activity is outsourced.

7. Outsourcing policy

7.1 An insurer must have an outsourcing policy that ensures compliance with this Joint Standard.

7.2 In addition to addressing the principles in section 6 above, and the matters identified in sections 8 to 11 below with respect to outsourcing of material functions, an insurer's outsourcing policy must set limits on the types and overall level of outsourced functions or activities by the insurer and the extent to which functions or activities can be outsourced to the same person.

7.3 An insurer's outsourcing policy must establish criteria and procedures for appointing and renewing service providers.

7.4 An insurer's outsourcing policy must, at a minimum, provide guidance on the following risks to be assessed, monitored and managed in outsourcing:

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

Attachment 1 defines the types of risks referred to above.

8. Material outsourcing arrangements

8.1 In assessing whether a function or activity is material, an insurer should have regard to factors such 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 activity or function back in-house;
(d) the ability 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, in accordance with relevant privacy laws;
(f) potential losses to or impact on 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.

8.2 For the purposes of this Joint Standard, all functions of senior management and control functions, including heads of control functions, as set out in the *Governance and Operational Standards for Insurers,* are material functions.

8.3 The Authorities may object to any arrangement to outsource a material function if they are convinced that the proposed outsourcing is inconsistent with this Joint Standard.

8.4 An insurer must, before entering into a material outsourcing arrangement, in conjunction with the due diligence referred to in section 6.3, assess -

(a) the costs, benefits and potential risk to its insurance business inherent in the proposed outsourcing arrangement, and may only enter into the outsourcing arrangement if it can evidence that the benefits outweigh the costs and potential risks;
(b) any actual or potential conflicts of interest as referred to in section 6.6; and
(c) whether the matters referred to in section 8.5 are met.

8.5 An insurer may not enter into or maintain an outsourcing arrangement relating to a material function unless –

(a) the service provider has appropriate governance, risk management, internal controls and the ability to comply with applicable laws;

(b) the service provider has adequate operational capability and financial resources to ensure the ongoing performance of the outsourced material function;
(c) the service provider has appropriate contingency plans; and
(d) the key persons of the service provider meet the fit and proper requirements relating competence and integrity, as provided for in *Prudential Standard GOI 4 (Fitness and Propriety of Key Persons of Insurers)*;

8.6 An insurer must apply objective procurement and selection procedures and processes when deciding which service provider to appoint to provide a material function on behalf of the insurer in terms of an outsourcing arrangement.

9. Notification of an outsourcing arrangement to the Authorities

9.1 Prior to entering into an material outsourcing arrangement, an insurer must, in the form, manner and containing the information determined by the Authorities, notify the Authorities of the proposed outsourcing arrangement at least 30 days prior to entering into such proposed outsourcing arrangement.

9.2 Notwithstanding section 9.1, a notification referred to in section 9.1 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 of the insurer, and include details regarding -

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

10. Contractual requirements

10.1 An outsourcing arrangement in respect of a material function 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 has appropriate governance, risk management, and internal controls in place to perform the outsourced function or activity;
(e) require that the service provider complies 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 Authorities 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.

11. Management and review of outsourcing arrangements

11.1 An insurer must ensure that the risks associated with any outsourcing of a material function are appropriately assessed, monitored and managed on an ongoing basis, and regularly reviewed.

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

11.3 An insurer must develop and maintain appropriate contingency plans to ensure the continuous functioning of the insurance business of the insurer in the event that an outsourcing arrangement relating to a material function is terminated or found to be ineffective.

11.4 An insurer must, in respect of the outsourcing of a material function, regularly assess the service provider's -

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

11.5 An insurer must as soon as is reasonably possible notify the Authorities, in the manner, form and containing the information determined by the Authorities, of any material developments (such as pending termination, material non-performance and the like) with respect to an outsourcing arrangement for a material function.

11.6 In the event that an outsourcing arrangement for a material function is terminated, the insurer must notify the Authorities, within one week of the date of termination, in the manner, form and containing the information determined by the Authorities, of the reasons for the termination.

11.7 When terminating an outsourcing arrangement, an insurer must assess the potential impact, consequences and risks of the proposed termination to policyholders and the insurer's business, and report to the board of directors where a potentially adverse consequence or risk has been identified.

11.8 Notwithstanding section 11.6, the notification referred to in section 11.6 must also -

(a) explain how the function or activity will be performed following termination of the outsourcing arrangement;
(b) explain when the outsourcing arrangement terminated;
(c) include proof that the board of directors approved the termination;
(d) explain whether there are any outstanding issues that could have a potential impact on the service to policyholders and how these issues will be managed to ensure policyholders are not adversely affected; and
(e) highlight any outstanding fees and how such fees will be paid.

12. Short title

This Joint Standard is called the *Joint Standard on Outsourcing by Insurers*.

13. Amendment of other regulatory instruments

This Joint Standard repeals *Prudential Standard GOI 5: Outsourcing by Insurers* and amends the regulatory instruments referred to in Attachment 2 below to the extent provided for in that Attachment.

Attachment 1: Definitions of the types of risks referred to in section 7.4 above

access risk:	The risk that the insurer may not, at all times, have access to timely data and other information.
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.
contractual risk:	The risk that the insurer may not be able to enforce the contract with the other person.
credit risk	The risk that a financial loss will be incurred if a counterparty to a derivatives transaction does not fulfil its financial obligations in a timely manner.
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.
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.
exit risk:	The risk that appropriate exit strategies (termination clauses) may not be in place or may not be effectively executed.
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.
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.
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.

Attachment 2: Amendments to other regulatory instruments

Standard	Name	Extent of repeal or amendment
Prudential Standard GOB	Governance and Operational Standard for branches of foreign reinsurers	1. By the insertion in section 3.1 the following: Version Number '3' and the corresponding words: 'As amended by Joint Standard [*] of 2021 (Outsourcing by Insurers)'. 2. By deleting the words 'GOI 5 (Outsourcing by Insurers) sets down three general sets of standards for outsourcing by insurers' from section 8.4, and inserting the words 'Joint Standard [*] of 2021 (Outsourcing by Insurers) sets down general standards for outsourcing by insurers'. 3. By deleting the words 'GOI 5 (Outsourcing by Insurers)' from section 8.5, and inserting the words 'Joint Standard [*] of 2021 (Outsourcing by Insurers). 4. By deleting the words 'GOI 5' wherever it may occur, and inserting 'Joint Standard [*] of 2021'.
Prudential Standard GOG	Governance and Operational Standard for Insurance Groups	1. By the insertion in section 3.1 the following: Version Number '3' and the corresponding words: 'As amended by Joint Standard [*] of 2021 (Outsourcing by Insurers)'. 2. By deleting the words 'GOI 5 (Outsourcing by Insurers)' from section 8.1, and inserting the words 'Joint Standard [*] of 2021 (Outsourcing by Insurers).
Prudential Standard GOL	Governance and Operational Standard for Lloyd's	1. By the insertion in section 3.1 the following: Version Number '3' and the corresponding words: 'As amended by Joint Standard [*] of 2021 (Outsourcing by Insurers)'. 2. By deleting the words 'GOI 5 (Outsourcing by Insurers) sets down three general sets of standards for outsourcing by insurers' from section 8.4, and inserting the words 'Joint Standard [*] of 2021 (Outsourcing by Insurers) sets down general standards for outsourcing by insurers'. 3. By deleting the words 'GOI 5 (Outsourcing by Insurers)' from section 8.5, and inserting the words 'Joint Standard [*] of 2021 (Outsourcing by Insurers). 4. By deleting the words 'GOI 5' wherever it may occur, and inserting 'Joint Standard [*] of 2021'.
Prudential Standard GOM	Governance and Operational Standard for Microinsurers	1. By repealing of section 9

Prudential Standard GOI 1	Framework for Governance and Operational Standards for Insurers	1. By deleting the words ‘GOI 5 (Outsourcing by Insurers)’ from section 8.3, and inserting the words ‘Joint Standard [*] of 2021 (Outsourcing by Insurers). 2. By deleting the words ‘GOI 5 (Outsourcing by Insurers) sets down three general sets of standards for outsourcing by insurers’ from section 8.4, and inserting the words ‘Joint Standard [*] of 2021 (Outsourcing by Insurers) sets down general standards for outsourcing by insurers’. 3. By deleting the words ‘GOI 5 (Outsourcing by Insurers)’ from section 12.2, and inserting the words ‘Joint Standard [*] of 2021 (Outsourcing by Insurers). 4. By amending the definition of the term “Standard” in Attachment 1 to “Prudential Standard or Joint Standard”.
Prudential Standard GOI 3	Risk Management and Internal Controls for Insurers	1. By deleting the words ‘GOI 5 (Outsourcing by Insurers)’ from section 9.2, and inserting the words ‘Joint Standard [*] of 2021 (Outsourcing by Insurers). 2. By deleting the words ‘GOI 5 (Outsourcing by Insurers)’ from paragraph K.1 of Attachment 1 and inserting the words ‘Joint Standard [*] of 2021 (Outsourcing by Insurers).