PROPOSED IRDAI (OUTSOURCING OF ACTIVITIES BY INDIAN INSURERS) REGULATIONS, 2017
(REVISED DRAFT)

F. No. IRDA/Reg./xx/xx/2017—In exercise of the powers conferred under Section 114A (2) (zd) of the Insurance Act 1938 and Section 14 read with Section 26 of the 1RDA Act 1999 and in consultation with the Insurance Advisory Committee, the Authority hereby makes the following regulations, namely: -

1. **SHORT TITLE AND COMMENCEMENT**

(i) These Regulations may be called IRDAI (Outsourcing of Activities by Indian Insurers) Regulations, 2017

(ii) They shall come into force from the date of their publication in the Official Gazette of the Government of India.

2. **APPLICABILITY**

(i) These Regulations are applicable to all Insurers (including re-insurers) registered with the Insurance Regulatory and Development Authority of India ("Authority").

Provided that the Branch Offices of Foreign Reinsurers and Lloyds India registered with the Authority shall also comply with Regulation 28 (5), Chapter – VI of IRDAI (Registration and Operations of Branch Offices of Foreign Reinsurers other than Lloyds) Regulations, 2015 and Regulation 50 (4), Chapter – X of IRDAI (Lloyd's India) Regulations, 2016, respectively, as amended from time to time while outsourcing their activities.

(ii) These Regulations are applicable to outsourcing arrangements entered into by an Insurer with an outsourcing service provider located in India or outside India.

3.Objective:

(i) To ensure that insurers follow prudent practices on management of risks arising out of outsourcing with a view to prevent negative systemic impact and to protect the interests of the policyholders.

(ii) To ensure sound and responsive management practices for effective oversight, to ensure adequate due diligence with regard to outsourcing of activities by Insurers.

4.DEFINITIONS:

(i) In these Regulations, unless the context otherwise requires;

a) **'Act'** means the Insurance Act, 1938;

b) **'Authority'** or **'IRDAI'** means the Insurance Regulatory and Development Authority of India established under sub section 1 of section 3 of the IRDA Act 1999;

c) '**Core activities'** means all activities pertaining to insurance business as listed in Regulation 5 of these Regulations;

d) '**Outsourcing'** is defined as the use of third party services by the Insurer to perform activities that would normally be undertaken by the Insurer, either now or in future, but does not include services which are generally not expected to carried out internally by the insurers such as Legal services, Banking Services, Courier services, medical examination, f orensic analysis.

e) **Outsourcing Service Provider'** means third party Service Providers who carry out the activities outsourced, for Insurers.

f) **Outsourcing Agreement'** means a written agreement entered into between the Insurer and Outsourcing Service Provider outlining the terms and conditions for services which may be rendered by the Outsourcing service provider;

(ii) All words or expressions not defined in these Regulations but defined in the Insurance Act, 1938, Insurance Regulatory and Development Authority Act, 1999, The Insurance Laws (Amendment) Act, 2015 or any Regulation issued by the Authority shall have the same meaning respectively assigned to them in those respective legislations.

5. CORE ACTIVITIES

a) The Insurer is prohibited from outsourcing any of the following activities (i to viii) in any manner whatsoever:

i. Investment and related functions
ii. Fund Management Including NAV calculations
iii. Compliance with AML and KYC
iv. Product designing, all actuarial functions and enterprise-wide risk management;
v. Decision making in Underwriting and Claims functions, excluding procedural activities related to payment of Survival Benefit claims in Life Insurance;
vi. Policyholders Grievances Redressal;

vii. Decision to appoint Insurance Agents and Intermediaries;
viii. Approving Advertisements

b) Policy servicing

i. Policy servicing remains a core activity for the Insurer who is totally responsible for the services rendered, however the activities that support Policyholder servicing may be outsourced at the discretion of the Insurer and as per these Regulations.

ii. Where collection of premiums is outsourced Insurers shall put in place procedures for issuance of premium acknowledgements instantaneously to the policyholders on collection of premiums through such outsourced Service providers

Provided, Insurers shall remain responsible for the acknowledgements issued and the date and time of such receipt shall be taken into account for considering the underlying benefits of an insurance contract.

6. RESPONSIBILITIES OF THE BOARD OF DIRECTORS

The Board shall be responsible for the following functions under these Regulations:

i. The Board of Directors shall put in place **an Outsourcing Policy** covering the following:

a) Framework for assessment of risks involved in outsourcing, including the confidentiality of data, quality of services rendered under outsourcing contracts
b) Parameters for determining materiality of outsourcing contracts for the purpose of determining enhanced oversight by the Insurer
c) Parameters for determining the cost-benefit analysis for each Outsourced activity
d) Guiding principles for evaluation of the Outsourced Service Provider including its ability and capability to provide the required services
e) Conflict management policy that ensure adherence to the provisions on related party transactions as envisaged in Companies Act, 2013
f) Norms for implementation and review of the Outsourcing Policy Determining the management's responsibility for approving, determining the consideration amount involved and monitoring the outsourcing arrangements, and delegation of authority within the Insurer;
g) The degree of due diligence required for other than-material (non-Core) Outsourcing activities

ii. At least an annual review of the Outsourcing Policy keeping in mind the changes in the internal and external environment impacting the outsourcing arrangements

iii. Annual review of the summary of the outsourced activities of the Insurer

iv. Constitution of an Outsourcing Committee comprising of Key Management Persons and define the Terms of Reference of the Committee

v. Review of exceptions, if any, arising out of the annual review of Outsourcing contracts by the Outsourcing Committee. The Board of Directors may delegate this responsibility to the Risk Management Committee of the Board as constituted under the Corporate Governance Guidelines, 2016.

vi. Approval of material outsourcing contracts as per the threshold limits prescribed in the Outsourcing Policy.

vii. Ensuring that the pricing for related party outsourcing arrangements are consistent with accepted arms' length principles as enshrined in the Companies Act, 2013

7. OUTSOURCING COMMITTEE

The Board of Directors of the Insurer shall constitute an Outsourcing Committee comprising of Key Management Persons of the Insurer, and shall at the minimum include the Chief Risk Officer, Chief Financial Officer and Chief of Operations. The Outsourcing Committee shall inter-alia be responsible for: -

i. Effective implementation of the Outsourcing Policy as approved by the Board of Directors;

ii. Validating the Insurer's need to perform the activities proposed for outsourcing. Evaluation of key risks associated with Outsourcing contracts as envisaged in Annexure-II of these Regulations;

iii. Coverage of the scope of services within the objects clause of the Deed of constitution of the Outsourcing Service provider;

Iv. The decision to outsource a material activity is supported by a sound business case taking into account the cost and the potential benefits of outsourcing against risks that may arise, having regard to all relevant prudential matters as well as short-term (e.g. temporary service disruptions) and long-term (e.g. impact on business continuity) implications.

v. Approval to the Outsourcing arrangements entered into/proposed to be entered into by the Insurer as per the Outsourcing Policy approved by the Board of Directors.

vi. Providing recommendations on Outsourcing contracts which are required to be approved by the Board of Directors

vii. Annual performance evaluation of the Vendors and reporting exceptions to the Board of Directors or Risk Management Committee.

viii. Annual review of Outsourcing Policy and recommending changes, if any, to the Board of Directors for their consideration

ix. Communicating information pertaining to material outsourcing risks to the Board of Directors in a timely manner.

x. Ensuring compliance with the applicable laws and Regulations and Outsourcing Policy

8. OUTSOURCING SERVICE PROVIDERS:

No Insurer shall engage an entity other than the following as Outsourcing service provider for the purpose of outsourcing where the activity outsourced is assessed as Material as per Annexure-I and based on the risks involved as envisaged under Annexure-II

a) Companies Registered under the relevant provisions of the Companies Act,2013, or
b) Limited Liability Partnerships registered under the relevant provisions of the Limited Liability Partnership Act ,2008, or
c) Registered Cooperative Societies registered under the cooperative Societies Act,1912 or
d) Partnership firms registered under the Indian Partnership Act, 1932 or
e) Any other entity as may be approved by the Authority to act as Outsourcing Service Provider.

9. Due Diligence of Outsourcing Service Providers:

All insurers shall evaluate the outsourcing arrangements based on the parameters for materiality assessment outlined in Annexure I. All outsourcing arrangements assessed as material shall be subject to evaluation of the risks envisaged under Annexure II and shall be subject due diligence as per (i) &(ii) below. The due diligence may be limited for activities not considered material. Insurers should consider the level of materiality associated with their outsourced activities and implement their enterprise risk management practices as appropriate to the specific nature and circumstances of activities.

i. In considering or renewing an outsourcing arrangement, an insurer should subject the outsourcing service provider to appropriate due diligence which inter alia shall cover the following;

   a) Where the outsourcing service provider is a Company registered under the Companies Act,2013, the main objectives of the company shall include the activities outsourced.
   b) In case of other outsourcing service provider, there shall be a clause in the deeds or bye - laws enabling to undertake the activities outsourced.
   c) Existence of the outsourcing service provider as projected
   d) its competence and experience to perform the activity proposed to be outsourced to it.
   e) Assessing the capability of the outsourced Service Provider to employ standards envisaged, while performing outsourced activities.
   f) Its security and internal controls;
   g) Business continuity management;

h) Where considered necessary, insurers shall obtain independent reviews and market feedback on the service provider to supplement its own findings;

ii. Due diligence undertaken during the selection process should be documented and evaluated periodically as part of the monitoring and control process of outsourcing.

10. OUTSOURCING AGREEMENTS

i. Outsourcing arrangements shall be governed by written agreements that are legally binding for a specified period, subject to periodical renewal, if necessary, that clearly describe all material aspects of the outsourcing arrangement, including the rights and obligations of all parties.

ii. The outsourcing contracts, inter alia, shall have in place certain clauses or conditions listed below, as may be applicable:

a) Information and asset ownership rights, information technology, data security and protection of confidential information;
b) Guarantee or indemnity from the Outsourcing Service Provider towards his commitment including liability for any failure;
c) Contingency planning of the Outsourcing Service Provider to provide business continuity for the outsourced arrangement;
d) Express clause that the contract shall neither prevent nor impede Insurer from meeting its respective regulatory obligations, nor the regulator from exercising its regulatory powers of conducting inspection, investigation, obtaining information from either the Insurer or the Outsourcing Service Provider;
e) The Insurer shall ensure that the Outsourcing service provider shall not sub-contract, whole or substantial portion of any of the Outsourced activity.
f) (f)The Insurers shall factor in the additional risk which flows due to subcontracting at the time of due diligence.

11. **Confidentiality and Security**:

i. The insurer shall satisfy itself that the outsourcing Service Provider's security policies, procedures and controls will enable the insurer to protect confidentiality and security of policyholder's information.
ii. Insurer is responsible in ensuring the confidentiality of the data or information parted to any outsourcing Service provider under the outsourcing agreements.

iii. An insurer shall take into account any legal or contractual obligation to disclose the outsourcing arrangement and circumstances under which their data may be disclosed. In the event of termination of the outsourcing agreement, the insurer should ensure that all customer data is completely retrieved from the service provider.

12. Audit and Inspection:

Based on the Materiality, the insurer shall conduct periodical inspection or audits on the outsourcing service provider either by its internal auditors or by Chartered Accountant firms appointed by the insurer to examine the compliance of the outsourcing agreement while carrying out the activities outsourced. Measure shall be taken to arrest the deficiencies noticed if any in the inspection or audit report.

13. Legal and Regulatory Obligations:

i. Insurers shall ensure that outsourcing arrangements shall not:

a) diminish their ability to fulfil their obligations to Policyholders and the IRDAI
b) impede effective supervision by the IRDAI.
c)result in their internal control, business conduct or reputation being compromised or weakened

ii. The Regulations apply irrespective of whether the outsourcing arrangements are entered into with an affiliated entity within the same group as the Insurer, or an outsourcing Service Provider external to the group. The Insurer shall comply with the provisions of Companies Act 2013 relating to Related Party Transactions.

iii. Outsourcing shall not diminish the obligations of an insurer and those of its Board and Senior Management to comply with the relevant law/s and regulations. The Insurer is ultimately accountable for all acts of commission and omission of the outsourcing Service Providers. The Insurer's liability shall not in any way be restricted or limited be way of outsourcing.

iv. All the outsourcing Service providers engaged by insurers are subjected to the provisions of the Insurance Act,1938, IRDA Act 1999, the Insurance Laws (Amendment) Act,2015, Rules, Regulations and any other orders issued thereunder.

v. The regulated activities of the Insurance Agents, Insurance Intermediaries including TPAs, Insurance Repositories and other regulated entities, as provided in the Insurance Ac ,1938, IRDA Act 1999, the Insurance Laws (Amendment) Act,2015 and Regulations, guidelines made thereunder are not considered as outsourcing and therefore not covered by these Regulations.

vi. Subject to these Regulations, Insurance Agents, Insurance Intermediaries and other regulated entities of the Authority shall not be contracted for outsourcing any activity other than those activities that are allowed under the respective regulations governing their registration and functioning.

a) Provided these provisions are not applicable in respect of Scheduled Commercial Banks and Post Offices when they are engaged for premium collection and cheque pick- up activities.

a) Provided also that these provisions are not applicable to Insurer involving Senior Agents as faculty in the training sessions purely on honorarium basis.

14. Principles where outsourcing Service Providers are related parties of Insurers or Insurance Intermediaries.

Notwithstanding the above, Insurers shall ensure compliance with the following additional principles where outsourcing Service Providers are the related parties of Insurers or Insurance Intermediaries registered with the Authority.

a) With the objective of avoiding potential conflict of interest, Insurers shall endeavour that the Related Parties of Insurers or Insurance Intermediaries registered with the Authority shall ordinarily not be engaged for outsourcing any of the activities.

b) Insurers shall not outsource any activity that leads to potential conflict of interest with the functions of the Insurer or with the functions of Insurance Intermediaries.

c) Where it is considered necessary to outsource any activity to the related parties of the Insurers or related parties of the Insurance Intermediaries registered with the Authority who are working either with the Insurer who is proposing to outsource or with any other Insurers, there shall be a complete due diligence and the insurer shall be bound by the conflict management policy that is part of its Outsourcing Policy that ensures maintaining arm's length distance.

d) Insurers shall ensure that in respect of all the activities outsourced to the related parties of the Insurer or related parties of Insurance Intermediaries:

The consideration amount agreed upon and modifications thereon, if any, shall be subject to specific approval of the Outsourcing Committee of the Insurer.

i. Provided while determining the consideration amount the outsourcing Committee of the Insurers shall take into consideration the Outsourcing Policy approved by the Board and the risk management principles of these Regulations.

ii. All the activities outsourced to the related parties referred herein shall be reported to the Authority within thirty days of outsourcing.

iii. Payments made in respect of (ii) above, shall be reported separately to the Authority in accordance with the provisions of Regulation (20).

iv. In case, any of the outsourcing Service provider becomes a related party of either the Insurer or Insurance Intermediaries the insurer shall report the fact to the Authority within 30 days of such an event in the format specified in this regard.

v. Norms specified herein shall be followed where an Individual Insurance Agent of any Insurer or close members of his/her family is one of the promoters or one of the Directors of the outsourcing Service provider.

Explanation:

(1) Related party for the purpose of these Regulations shall carry the meaning as defined Section (2) (76) of Companies Act, 2013.
(2) Close Members of his Family for this purpose shall include spouse, sisters, brothers, parents, sons, daughters –in-law, daughters and sons-in-law.

15. CONTINGENCY PLANS

i. Insurers are expected to establish and maintain adequate contingency plans. This includes disaster recovery plans and backup facilities to support the continuation of an outsourced activity with minimal business disruption in the event of reasonably foreseeable events that affect the ability of an Outsourcing Service Provider to continue providing the service. The contingency plans should be appropriate to the potential consequences of a business disruption resulting from problems at the Outsourcing Service provider and should consider contingency plans maintained by the Outsourcing Service Provider and their coordination with the Insurer's own contingency arrangements. In particular, contingency plans should ensure that the Insurer can readily access all the records necessary to allow it to sustain business operations, meet statutory obligations, and provide any information relating to the outsourced activity as may be required by the IRDAI.

ii. Contingency plans should also be regularly reviewed and tested to ensure that they remain robust, particularly under changing operating conditions.

16. MAINTENANCE OF RECORDS

i. Insurers are expected to ensure that adequate documentation is maintained to support the Insurer's satisfaction of the expectations in these Regulations.

ii. The documentation shall support the following aspects:

a) Materiality assessments

b) Adherence to the Insurer's outsourcing policy
c) Cost benefit analysis
d) Due diligence reviews
e) Pricing assessments; and
f) Risk evaluation
g) The basis used to determine arm's length distance while arriving at the pricing of activities that involve outsourcing with related parties of the insurer or insurance intermediaries.

iii. The documentation should be available for review by the Board and the IRDAI as and when required.

iv. Such documentation shall be maintained for five years from the end of the contract period by the Insurers.

17. REGULATORY ACCESS

(i) Insurers shall, **in all cases**, obtain an undertaking from their outsourcing Service providers or include a provision within the Outsourcing agreement, giving authorised representatives of the IRDAI the right to: -

a) examine the books, records, information, systems and the internal control environment in the Outsourcing Service Provider (or sub-contractor as applicable), to the extent that they relate to the service being performed for the Insurer; and

b) access any internal audit reports or external audit findings of the Outsourcing Service Provider that concern the service being performed for the Insurer.

(ii) In cases where outsourcing of activities is performed by the service providers outside India, the Insurers shall ensure that the terms of the agreement and laws of the country concerned do not impede the regulatory access and oversight by the Authority.

18. APPLICABILITY TO EXISTING OUTSOURCING CONTRACTS

These Regulations shall be applicable to all Outsourcing arrangements in force on the date of coming into effect of these Regulations. However, any existing Outsourcing arrangement to which these Regulations become applicable, shall be appropriately amended to bring such arrangement in compliance with these Regulations within 180 days from the date of coming into effect of these Regulations. All arrangements that do not comply with these Regulations within 180 days of the date of the Regulations coming into effect, shall be automatically treated as terminated and no compensation shall be payable to the Outsourcing Service Provider for continuance of such services beyond the period.

19. PROHIBITION

These regulations shall not be construed to be authorising, any activity which otherwise is prohibited by any law for the time being in force and/or Regulation and Guidelines of the Authority.

20. **Reporting Requirements**:

Insurers shall report all the outsourcing arrangements where annual pay-out per outsourcing service provider is One Crore rupees or more, every half year within 45 days from the close of the half year. The format for reporting is given in Annexure III.

21. POWER OF THE CHAIRPERSON TO ISSUE CLARIFICATIONS

In order to remove any difficulties in the application or interpretation of these regulations, the Chairperson of the Authority may issue clarifications, directions and guidelines in the form of circulars.

(T.S. Vijayan)
Chairman

Annexure-I

KEY FACTORS FOR DETERMINING THE MATERIALITY IN OUTSOURCING CONTRACTS

(i) Generally, an outsourcing arrangement may be considered material if the estimated annual expenditure under an outsourcing contract is likely to exceed 5 % of the total expenditure incurred on all outsourcing activities.

(ii) Notwithstanding the above, an outsourcing arrangement may be considered material if its disruption has the potential to significantly impact an Insurer's business operations, reputation or profitability.

(iii) Without limiting their scope, the criteria for assessing the materiality of outsourcing arrangements should have regard to the following key factors:

a) significance of the activity being outsourced (e.g. in terms of contribution to revenue, capital allocations or importance to overall achievement of strategic and business objectives);
b) financial, reputational and operational impact on the Insurer of an Outsourcing Service provider's failure to adequately perform the outsourced activity;
c) potential impact on the Insurer`s continuing ability to meet its obligations to its Policyholders in the event of disruption of services of an Outsourcing Service Provider;
d) consequences of outsourcing the activity on the ability and capacity of the Insurer to maintain internal controls and meet current as well as future changes to regulatory requirements;
e) cost of the outsourcing arrangement in terms of contractual expenditures relative to the Insurer's net assets and annual operating expenditures;
f) interrelationship of the outsourced activity with other activities within the Insurer;
g) aggregate exposure to a particular Outsourcing Service Provider where the Insurer outsources multiple activities to the same Outsourcing Service Provider;
h) degree of difficulty and time required to replace the Outsourcing Service provider or if necessary to bring the activity in-house
i) Availability of alternative Outsourcing Service provider in the market for the same service
j) Any other factor which will have a significant impact on the Insurer or the Policyholders not covered above.

Annexure-II

KEY RISKS IN OUTSOURCING CONTRACTS

i. The Outsourcing Committee (constituted under Regulation 10 of these Regulations) of the Insurer shall evaluate all the key outsourcing risks associated with any outsourcing contract, including, but not limited to, the following risks:

a) Strategic Risk : Activities carried out by Outsourcing Service Provider on its own behalf that are inconsistent with the overall strategic goals of the Insurer:
- Failure to implement appropriate oversight of Outsourcing Service Provider
- Inadequate expertise to oversee Outsourcing Service Provider

b) Reputation Risk: Poor service by Outsourcing Service Provider:
- Customer interaction that is inconsistent with Insurer's standards
- Unethical practices of Outsourcing Service provider

c) Compliance Risk: Prudential and market conduct regulations not complied with:
- Breach of obligation to preserve customer data confidentiality
- Changes in regulations not communicated to Outsourcing Service provider in a timely manner

d) Operational Risk:
- Technology failure
- Inadequate financial capacity of Outsourcing Service Provider to fulfil obligations or provide remedies/restitution
- Fraud or error
- Failure of insurers to undertake inspections of Outsourcing Service Provider (e.g. due to practical difficulty or cost considerations)

e) Exit strategy risk:
- Over-reliance on one Outsourcing Service Provider
- Loss of relevant skills or resources in the Insurer, preventing it from bringing an outsourced activity back in-house
- Contracts which make a speedy exit prohibitively expensive

f) Contractual risk:
- Inability to enforce contract

e) Information risk:
- Reliance on information by Outsourcing Service provider that may be materially inaccurate
- Delay in providing timely data and information to Insurer or regulator.
- Confidentiality of commercially sensitive/customer information may be compromised

g) Concentration risk:
- Reliance on one Outsourcing Service Provider for multiple activities.

ii. A summary of the material risks arising out of Outsourcing contracts shall be reviewed by the Risk Management Committee at least once a year

Annexure-III

Form A (Outsourcing Reporting Format)

i. Outsourcing with Related Parties and Group entities of Insurer and Insurance Intermediaries.

Sl No	Particulars	For the Half year	Up to the Half year	For the Corresponding Half year of the Preceding year	Up to Half year of the preceding year
(1)	(2)	(3)	(4)	(5)	(6)
1.	Activity outsourced (detailed description)				
2.	Name of the Vendor				
3.	Total Amount Agreed				
4	Amount paid so far				
5	% of Outsourcing payments to operating Expense				

ii. Outsourcing to entities other than (i) above:

Sl No	Particulars		For the Half year	Up to the Half year	For the Corresponding Half year of the Preceding year	Up to Half year of the preceding year
(1)	(2)		(3)	(4)	(5)	(6)
1.	Activity outsourced (detailed description)					
2.	Name of the Vendor					
3.	Total Amount Agreed					
4	Amount paid so far					
5	% of Outsourcing payments to operating Expense					