Regulatory Update

## IRDA Draft Guidelines on Outsourcing

9 November 2010

By way of an update, the IRDA has issued draft guidelines on 'Outsourcing activities by Insurance Companies' on 8 November 2010. Comments on these draft guidelines have been invited by 15 November 2010, but no tentative date for finalisation of the guidelines has been specified.

The key features of the draft guidelines are:

- Outsourcing has been defined as: '*Insurer's use of a third party (either an affiliated entity within a corporate group or an entity that is external to the corporate group) to perform activities on a continuing basis that would normally be undertaken by the Insurer itself, now or in the future*.'

- The guidelines will apply in addition to the existing limited norms on outsourcing and are specified to be based on 'best practices' adopted internationally and intended to provide direction and guidance to Insurers to adopt 'sound and responsive' risk management practices for 'effective oversight'.

- The IRDA observes that Insurers have been outsourcing even core activities such as investment, underwriting and policy servicing and that it is not desirable to outsource core and important activities. An Insurer shall ensure that '*outsourcing arrangements neither diminish its ability fulfill its obligations to customer and IRDA nor impede effective supervision by IRDA*' and that the service provider employs the same high standard of care that would have been employed by the Insurer if the activities were conducted in-house and not outsourced.

- The activities of the Insurer have been classified into core and non-core activities:

    - <u>Core activities</u>: (a) underwriting; (b) claims; (c) product design; (d) investment; (e) premium collections; (f) all information technology support (except hardware support); (g) data storage (physical and image); (h) cheque pick-up and banking of cheques; (i) admitting or repudiation of all claims; (j) bank reconciliation; (k) policy servicing except registering complaints, grievances or enquiries; (l) approving advertisements; (m) market conduct issued; (n) appointment of surveyors and loss assessors; (o)fund accounting including NAV calculations; (p) motor insurance services; (q) compliance with AML, KYC, etc; (r) all other activities not specified as non-core activities.

- Non-core activities: (a) facility management i.e. housekeeping, security, office boys, etc; (b) PF Trust; (c) internal audit; (d) website development and management; (e) pay roll management; (f) HR services; (g) service tax consultancy and support; (h) TDS filing; (i) compliance with labour laws; (j) data entry including scanning and indexing services; (k) printing and posting of reminders and other documents; (l) pre-employment medical check-ups; (m) call centre and outbound calling for registering complaints or answering enquiries; (n) claim processing for overseas medical insurance contracts; (o) tele-marketing and all other activities which are not core activities and which do not have any relation to product design.

- Core activities shall not be outsourced. A certificate of compliance with this norm is to be filed annually with the IRDA. Solicitation and procurement of insurance business by agents and intermediaries, the activities of TPAs and surveyors are not covered by these guidelines.

- Non-core activities may be outsourced, subject to (a) the outsourcing policy being approved by the Board of Directors of the Insurer, (b) the Insurer evaluating the capability of the service provider and carrying out 'appropriate due diligence' and (c) the Insurer establishing a comprehensive risk management programme. No activity can be outsourced to agents or intermediaries or their subsidiaries. Further, '*no payment towards any activity shall be made except commission/brokerage…to these entities.*'

- A report on the outsourcing is to be filed with the IRDA at the end of each quarter in the format specified (which includes details on the amount agreed to be paid, amount already paid, whether the vendor is a group entity of the Insurer and the percentage of outsourcing payments to the operating expenses) along with a copy of the outsourcing agreement (which must be a written contract containing the matters outlined in the draft guidelines).

- The third party service provider shall comply with the provisions of the IRDA rules and regulations and other laws in force. The Insurer shall be responsible for all acts of omission or commission of the third party service provider.

- All outsourcing contracts which do not comply with these guidelines are to be terminated before 1st April 2011.

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