

# OCI issues Guidance Note on Outsourcing

## Introduction

Hong Kong's financial regulators have regulated "outsourcing" for many years: the Hong Kong Monetary Authority has a dedicated guidance note on the topic, and both the Securities and Futures Commission and the Mandatory Provident Fund Schemes Authority have covered the topic (on a piecemeal basis) under various codes, guidelines and/or standards.

On 28 September 2012, the Office of the Commissioner of Insurance ("OCI") have added to this regulatory framework by publishing its Guidance Note on Outsourcing (GN14) (the "Outsourcing GN"). This is the OCI's first published guidance on outsourcing arrangements and contains requirements which will impact not only authorised insurers, but also their existing and future service providers.

## Applicability

The Outsourcing GN applies to all outsourcing arrangements of Hong Kong incorporated or based authorised insurers, as well as to the Hong Kong operations of authorised insurers who are neither incorporated nor based in Hong Kong. Whilst the term "outsourcing" is broadly defined in the Outsourcing GN and includes services which are business activities, functions or processes, the OCI does helpfully set out, as further guidance, examples of what it generally does and does not regard as "outsourcing" – to highlight a few, services such as

application processing, policy administration, claims processing and investment management are all generally regarded as outsourcing and will accordingly fall within the ambit of the Outsourcing GN. In relation to investment management, a distinction should be drawn between the appointment of an investment manager to manage the insurer's own portfolios or funds (which should fall within the ambit of "outsourcing"), and an insurer investing into a managed fund (which does not fall within the ambit of "outsourcing").

It is also important to note that the term "service provider" is likewise widely defined to the effect that the Outsourcing GN will apply to both internal and external outsourcing arrangements, wherever the service provider is located.

## The "essential issues" to be taken into account by authorised insurers

The Outsourcing GN sets out ten "essential issues" which authorised insurers are expected to take into account when formulating and monitoring its outsourcing arrangements. These are:

1. **Outsourcing policy.** Authorised insurers should develop an outsourcing policy which includes or addresses, at a minimum, the items prescribed in the Outsourcing GN. Procedures should also be in place to ensure that the authorised insurer's staff are aware of the outsourcing

policy and complies with the same.

2. **Materiality assessment.** Authorised insurers should develop a framework for assessing the materiality of an outsourcing arrangement, taking into account the factors prescribed in the Outsourcing GN. Assessments should be regularly reviewed and in the event that a previously immaterial arrangement is reassessed as material, the authorised insurer should inform the Insurance Authority ("IA") and take practical steps to address all "essential issues" in a timely manner.
3. **Risk assessment.** Authorised insurers should conduct a comprehensive assessment of the risks associated with an outsourcing arrangement before entering into a new arrangement or renewing or varying an existing arrangement. It should also ensure that all risks identified have been addressed before implementing the proposed arrangement or change. Risk assessments should be regularly reviewed.
4. **Service provider assessment.** Authorised insurers should exercise due diligence and care in choosing service providers, taking into account the considerations set out in the Outsourcing GN. Authorised insurers should also conduct periodic reviews (at least

annually) regarding the ability of their service providers.

**5. Outsourcing agreement.**

Outsourcing arrangements should be undertaken in the form of legally binding written agreements. The Outsourcing GN sets out 19 matters which authorised insurers should take into account when negotiating an outsourcing agreement. Where the outsourcing arrangement is an internal arrangement, a memorandum of understanding endorsed by the insurer's board of directors may suffice.

**6. Information confidentiality.**

Authorised insurers should ensure that its outsourcing arrangements comply with all relevant laws and regulations, and that both themselves and their service providers have adequate safeguards in place to protect the integrity and confidentiality of the insurer's information and customer data.

**7. Monitoring and control.**

Authorised insurers should ensure that it has sufficient and appropriate resources to monitor and control its outsourcing arrangements at all times. In this regard, the Outsourcing GN sets out a number of 'action-points' for insurers to follow which includes, for example, the maintenance of a "central list" of all outsourcing arrangements and the conduct of periodic reviews and audits.

**8. Contingency planning.**

Authorised insurers should have contingency plans in place to ensure that its business would not be disrupted in the event of disruptions occurring to its service providers' businesses. Furthermore, authorised insurers should also ensure that its service providers have their own contingency plans.

**9. Overseas outsourcing.**

The OCI recognises that additional risks and considerations will be involved in cases where an authorised insurer outsources services to a service provider located outside Hong Kong. In this regard, the Outsourcing GN sets out a number of considerations (e.g. country risk) which authorised insurers should consider in relation to such arrangements.

**10. Sub-contracting.**

As authorised insurers may be exposed to additional risks where their service providers sub-contract a part of their service to other parties, the Outsourcing GN provides that an insurer should put in place adequate procedures to control and monitor such sub-contracting arrangements. Furthermore, insurers must ensure that their service providers will also take into account these "essential issues" with regard to their sub-contracting arrangements.

## IA's supervisory approach

The Outsourcing GN prescribes a "prior notification" mechanism which effectively requires authorised insurers to obtain the IA's consent (or deemed consent) before entering into (or varying an existing) material outsourcing arrangement. The IA will also regularly monitor insurers' outsourcing arrangements and will require certain information to be submitted to the IA from time to time.

## Commencement date and transitional arrangements

The Outsourcing GN will come into effect on 1 January 2013 ("**Commencement Date**") and will be applicable to all new or renewal outsourcing arrangements to be entered into on or after that date. For outsourcing arrangements existing as of the Commencement Date, the Outsourcing GN provides a transitional arrangement to assist authorised insurers in complying with the Outsourcing GN with regard to those arrangements.

## Contacts

### Hong Kong

#### Mark Shipman

T: +852 2825 8992

E: [mark.shipman@cliffordchance.com](mailto:mark.shipman@cliffordchance.com)

#### Amy Ho

T: +852 2825 8993

E: [amy.ho@cliffordchance.com](mailto:amy.ho@cliffordchance.com)

#### Raymond Fung

T: +852 2826 3532

E: [raymond.fung@cliffordchance.com](mailto:raymond.fung@cliffordchance.com)

#### Roger Denny

T: +852 2826 3443

E: [roger.denny@cliffordchance.com](mailto:roger.denny@cliffordchance.com)

#### Karen Wong

T: +852 2826 3411

E: [karen.wong@cliffordchance.com](mailto:karen.wong@cliffordchance.com)

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