

NEW CIRCULAR LETTER ON OUTSOURCING ISSUED BY THE LUXEMBOURG INSURANCE REGULATOR CAA

On 19 August 2022, the Luxembourg insurance sector supervisory authority Commissariat aux Assurances ("**CAA**") issued its Circular Letter 22/16 on the outsourcing of critical or important operational functions or activities ("**CIFA**"). The new CAA Circular Letter, which applies to all Luxembourg (re)insurance undertakings supervised by the CAA, clarifies the requirements for the outsourcing of CIFA and their notification to the CAA. The Circular Letter will apply to all outsourcing agreements newly concluded or amended as of 1 November 2022. In this briefing, we set out an overview of the new rules and requirements.

GENERAL OVERVIEW OF CIFA OUTSOURCING REQUIREMENTS

The Circular Letter applies to 'outsourcing agreements' as defined in section 1 of the Circular Letter, reflecting the definition under Directive 2009/138/CE ("**Solvency II**") (as implemented).

Section 2 indicates the legal and regulatory texts on which the CAA has based its Circular Letter.

The sections 3 to 5 of the Circular Letter provide clarifications on the preliminary assessment and evaluation of outsourcing as well as guidance regarding the application of professional confidentiality ('insurance secrecy') rules in this context.

Preliminary analysis of outsourcing

The CAA requires (re)insurance undertakings to carry out a detailed analysis of the outsourcing of (re)insurance activities or functions, prior to the conclusion of an outsourcing agreement. (Re)insurance undertakings must in particular:

- evaluate the risks linked to the outsourcing agreement;
- verify that the conditions applicable to outsourcing as set out in article 65 of the Luxembourg law of 7 December 2015 on insurance sector, as amended ("**Insurance Sector Law**") are fulfilled;

Key issues

- Clarified regulatory requirements for CIFA and other outsourcing by (re)insurance undertakings
- Guidance regarding outsourcing notification obligations vis-à-vis the CAA
- New notification template (excel sheet) for CIFA outsourcing to be downloaded from the CAA website, filled in and sent to CAA electronic address
- Application to all services outsourcing agreements newly concluded or amended as from 1 November 2022

- take account of the extent of its control or influence over the service provider where the latter is part of the same group; and
- evaluate whether the outsourcing agreement concerns a CIFA and, as the case may be, whether the conditions of article 81(2) of the Insurance Sector Law are fulfilled.

The CAA reminds that (re)insurance undertakings must ensure that the outsourcing complies with all applicable laws and regulations.

Evaluation and documentation of outsourced function or activity

Section 4 of the Circular Letter contains guidance on how to evaluate whether and to which extent an outsourced function or activity is a CIFA, or can become a CIFA in the future. Such assessment must be conducted and documented prior to the conclusion of an outsourcing agreement.

Where an outsourcing agreement covers multiple operational functions or activities, the (re)insurance undertaking needs to take account of all aspects of the agreement for the assessment.

When evaluating whether an outsourced function or activity is a CIFA, the (re)insurance undertaking must take into account whether it would not be able to provide its services to policyholders without the relevant function or activity. Other non-exhaustive criteria to be considered by (re)insurance undertakings in their assessment are listed in the Circular Letter and include (i) the impact of the outsourcing on the business plan, (ii) its impact on control and supervision of the relevant functions and activities, and (iii) its incidence on the (re)insurance undertaking's brand image (including reputational and data protection risks).

A re-assessment of the CIFA nature of an outsourcing must be carried out where a significant change in the nature, scale or complexity of risks inherent to the outsourcing agreement occurs.

The CAA also clarifies that key functions, as defined in Solvency II are always considered as CIFA.

The above evaluation must be properly documented by (re)insurance undertakings and they remain responsible for it.

Insurance secrecy

The Circular Letter specifies certain requirements for (re)insurance undertaking where they are subject to insurance secrecy obligation in order to ensure compliance with such obligation. These requirements are similar to those already provided for under CAA Circular Letter 21/15 with regards to cloud outsourcing specifically.

According thereto, in case of outsourcing involving personal data of the concerned parties (the policyholder, insured person or beneficiary of an insurance contract) or data permitting their identification, the undertaking must:

- carry out an analysis whether it is necessary that the policyholder has accepted the outsourcing in accordance with article 300(2*bis*) of the Insurance Sector Law;

- document and regularly update such analysis in accordance with the evolution or extension of activities or the general and special terms and conditions as well as applicable case-law;
- ensure that the personnel working for the service provider or its outsourcing service providers cannot access personal data of the concerned parties without having obtained prior explicit consent of the (re)insurance undertaking, and not without a monitoring mechanism being made available to the (re)insurance undertaking to control the accesses. In any case, such accesses must remain exceptional;
- verify that the accesses of the service provider are restricted and supervised by preventive and detective measures that are in line with good security practices and audited at least annually; and
- ensure that sufficient safeguards are in place to prevent unauthorised access to their systems. In particular telecommunications should be encrypted or protected by other available technical means to ensure communication security.

FOCUS ON THE NOTIFICATION REQUIREMENTS

Scope of the notification requirements

Sections 6 to 8 of the Circular Letter clarify the notification requirements for CIFA outsourcing set forth in article 81 of the Insurance Sector Law.

Section 6 in particular sets out the scope of the notification requirements. (Re)insurance undertakings are required to notify the CAA of:

- any CIFA outsourcing;
- the outsourcing of key functions as defined in Directive 2009/138/CE ("**Solvency II**") (which are by nature considered as CIFA);
- any subsequent major development of these outsourced functions and activities (see below further indications in relation thereto); and
- any outsourced activity which causes a major change of the business plan.

With respect to CIFA, the CAA considers that core activities of a (re)insurance undertaking which are entirely outsourced must be considered as critical or important. The CAA adds that the existence of control rights, of effective controls or of communications of individual or general instructions to the service provider do not permit to conclude that there is no entire outsourcing in the before-mentioned sense.

The outsourcing of operational tasks of key functions to a third party different from the legal entity concerned is always subject to notification, unless the assessment shows that in case the outsourced function is not or incorrectly provided the efficiency of the relevant key function would not be impacted.

The Circular Letter expressly excludes from its scope of application:

- IT outsourcing arrangements which are exclusively based on a cloud computing infrastructure as defined in CAA Circular Letter 21/15. The latter Circular Letter must apply in those instances;
- the outsourcing by a captive (re)insurance undertaking to a Luxembourg professional of the insurance sector of (i) daily management, or (ii) a key function as defined in Solvency II; and
- the use of intermediaries for the distribution of (re)insurance products.

Nevertheless, the underwriting of contracts or the settlement of claims by an insurance intermediary who is not an employee of the insurance undertaking must be considered as outsourcing if such activity is considered to be critical or important.

Notification Procedure

In Section 7, the CAA provides further guidance on the principle of written notification to the CAA. In particular, the CAA reminds that the notification requirements do not only apply to CIFA outsourcing, but also to any subsequent major development concerning these CIFA, such as:

- a change of service provider;
- adding of a major activity to an existing contract;
- an important reduction of the undertaking's staff;
- a change in fees of more than 20 % (up or down) within one year; and
- an intra-group counterparty becomes extra-group.

While (re)insurance undertakings must formally notify the CAA if an outsourced function or activity previously considered as a non-CIFA becomes critical or important, informing the CAA by simple letter is sufficient if a CIFA ceases to be critical or important.

The written notification of CIFA outsourcing to the CAA must be done prior to the conclusion of an outsourcing agreement, and at least one month before the planned outsourcing becomes effective.

When doing so, the undertaking must download the notification template (excel sheet) on the CAA website, fill it in and send it to the following electronic CAA address: outsourcing@caa.lu.

Section 8 of the Circular Letter provides detailed guidance on the various sections of the template and how they must be completed.

In case an outsourcing agreement covers several CIFA, a separate notification file must be filled in for each CIFA.

The CAA will confirm receipt of the notification in writing within ten business days following the receipt. Such acknowledgement of receipt does not rule out any subsequent measures, notably measures following an on-site inspection if it turns out that the outsourcing does not comply with all applicable laws and regulations.

(Re)insurance undertakings must promptly notify the CAA in case the outsourcing agreement is not concluded or signed.

For each CIFA outsourcing the compliance officer of the undertaking must assess and confirm in writing to the CAA, within two month as of the signature of the outsourcing agreement, that (i) the outsourcing does not violate any law (in particular no rules on data protection), (ii) the outsourcing agreement contains all mandatory clauses foreseen in article 274(4) of Delegated Regulation (EU) 2015/35 ("**Delegated Regulation**"), (iii) due diligence on the service provider has been conducted, and (iv) a regular control of the performance and results of the service provider is put in place.

Documentation requirements

(Re)insurance undertakings must hold an up-to-date registry of outsourcing agreements. The Circular Letter sets a list of mandatory information to be kept

in case of CIFA outsourcing, while in other cases (re-)insurance undertakings have to determine the information to be kept according to the nature, scale and complexity of risks inherent to the outsourced services.

The CAA reminds that (re)insurance undertakings must, upon request, make available to the CAA any information or documents (including copies of outsourcing agreements and outsourcing policies) that are necessary to allow the CAA to proceed with the control of the outsourcing.

Finally, (re)insurance undertakings have to carry out a self-assessment, including the preparation of a correlation table on the compliance of the relevant outsourcing agreement with the Circular Letter, article 274 of the Delegated Regulation and the EIOPA Guidelines on System of Governance.

DATE OF APPLICATION

The Circular Letter applies as of 1 November 2022 to all services outsourcing agreements concluded or amended as from this date.

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