DeNederlandscheBank
EUROSYSTEEM

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NAW gegevens

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Re:
Sector-wide feedback on the outsourcing survey for insurers

Date
15 June 2018

Your reference

Our reference
T039-919612099-195

Handled by
Ingrid Talsma

Annexes
1

Dear members of the Management Board,

In 2017, DNB conducted a survey among insurers about their outsourcing activities and the management of outsourcing risks, in the form of a self-assessment. The survey was prompted by the expected increase in the outsourcing of operating activities, including cloud outsourcing. Given that the inherent risks in this area are also set to increase in the coming years, this is an important subject. The aim of this letter is to inform you of the results of the survey and to explain what we expect from you.

Results of the survey
The results of the survey show that there is room for improvement as regards the management of outsourcing and subcontracting risks. Our main findings are as follows:

- There is no structural central registration of outsourcing activities.
- [1]The institution's internal policy fails to meet statutory requirements.
- Management information about outsourcing and subcontracting activities is not provided to the management board on a regular basis.
- There is room for improvement as regards the frequency and quality of service provider reviews.
- Business Continuity Management does not cover activities carried out by service providers on a structural basis.
- The institution has insufficient controls in place to monitor service providers' access to sensitive data.
- Insufficient assurance is available about the quality of services provided by service providers.
- The institution has insufficient insight into the concentration risks related to its outsourcing and subcontracting activities.

We have explained the findings in more detail in Annex I to this letter.

Previous research[2] has shown that significant security risks can arise if a link in the chain fails to bring its security to the required level: *"A chain is only as strong as its weakest link".*

[1]Solvency II Directive 2009/138/EC, Solvency II Regulations 2015/35/EU, EIOPA Guidelines for the System of Governance, 60-64, Section 11, outsourcing, Financial Supervision Act (*Wet op het financieel toezicht – Wft*), Section 3.18
[2]See the sector-wide feedback on the information security survey – Cyber survey 2017 – among insurers and pension funds (Newsletter for insurers, February 2018, www.dnb.nl – in Dutch only)

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An institution's management board must show structural commitment to effectively safeguarding the management of outsourcing risks within the organisation.

Expectations
We expect insurers to be aware of the fact that the ultimate responsibility for managing outsourcing and subcontracting risks at all times remains with them. While we do see that several institutions are implementing improvements in this regard, we intend to devote more attention to this subject in the period ahead. We assume that all insurers will subject their outsourcing processes to a critical review, using the survey results and our final good practices document – which will be published later this year – as a guidance.

Final remarks
In following up on the results of the survey, insurers can use our draft good practices document. The draft good practices document will be up for consultation until 30 June 2018. You can find this document on our website: https://www.dnb.nl/voor-de-sector/open-boek-toezicht-sectoren/verzekeraars/prudentieel-toezicht/governance/good-practice-uitbesteding-verzekeraars/
Until 30 June 2018 you can report your comments and suggestions by email at inventarisatie_uitbesteding@dnb.nl. The final good practices document will be published on our Open Book on Supervision pages.

Please contact your account supervisor if you have any questions about the survey or if you wish to discuss your specific situation. Your account supervisor will provide you with the institution-specific survey results.

Kind regards,
De Nederlandsche Bank N.V.

Thijs van Woerden
Division Director

Jacco Jacobs
Head of Department

Annex 1: Results of the Outsourcing survey

In 2017 we conducted a survey among insurers and pension funds about their outsourcing activities and the management of outsourcing risks, in the form of a self-assessment.

Background
The survey was prompted by the expected increase in the outsourcing of operating activities, for example ICT, asset management pensions and policy administration and accounting systems, and other critical operatinonal processes. The increasing pressure on cost reduction and the influence of FinTech may exacerbate this trend. It may also lead to an increase in outsourcing risks. Cloud outsourcing in particular carries additional risks due to the data storage location and the processing and security of the data.

Survey set-up
The survey was distributed among 59 insurers and 37 pension funds, and focused on the outsourcing of material[3] activities[4] to external service providers and the entire subcontracting chain[5] of these service providers up to and including its final link: data storage and management.

Results
Below we describe the main findings of the survey with respect to insurers in more detail. The results are divided into three categories, in line with the self-assessment:

(1) Inherent risk: the extent of outsourcing and the types of activities that are outsourced.
(2) Management of outsourcing risk
(3) Concentration risk at service providers

(1) Inherent risk: the extent of outsourcing and the types of activities that are outsourced.

Critical operational processes (e.g. policy administration and accounting) are outsourced to an increasing degree, in particular through software as a service (SaaS) applications. Looking at the number of outsourcing agreements, datacentre services are outsourced most often, followed by claims and complaints handling, application management and infrastructural services.

The share of outsourcing of material activities to the cloud is also rising, which means there is a shift in the types of activities that are outsourced. Compared to 2016, the number of reported cloud outsourcing activities doubled in 2017 – amounting to 25% of all outsourcing activities reported to DNB.

Cloud outsourcing often leads to an increase in the number of subcontractors, and hence to an increase in inherent risk. The reason is that longer outsourcing chains entail more complex risk management (e.g. with respect to information security).

[3] "Material" can be read as a synonym for "cr t cal" or "important"; see Guideline 60 of the Guidelines on the system of governance.
[4] "Activity" can also be read as "function" (see Article 49 of the Solvency II Directive), but the survey targeted the outsourcing of activities rather than the outsourcing of functions or key funct ons.
[5] Activities are outsourced to other service providers under the responsibility of a "main service prov der".

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The trends described above are in line with our expectation that the importance of outsourcing is increasing, and hence the potential risks associated with it. The share of outsourcing[6] by insurers expressed in terms of cost has remained stable over the last few years, contrary to our expectations. The insurers who completed the self-assessment also indicated that they expect the share of outsourcing to remain stable, but that the share of ICT outsourcing and subcontracting will increase due to shifting outsourcing strategies and costs.

(2) Management of outsourcing risk

Based on the results of the self-assessment, a considerable number of insurers fail to manage outsourcing risks to a sufficient degree. The main deficiencies identified are the following.

<u>There is no structural central registration of outsourcing activities</u>
The insurers who completed the self-assessment indicated that they had to go to great lengths to obtain the data from their business units and service providers. In some cases, the data could not be obtained. We expect insurers to be able to provide insight into their outsourcing activities within a reasonably timeframe and keep a central register of their outsourcing partners.

<u>The institution's internal policy fails to meet statutory requirements[7]</u>
Some insurers have not sufficiently adjusted their outsourcing policy to reflect the risks related to cloud outsourcing. Several outsourcing agreements appear to lack statutory required clauses (e.g. separate exit provisions, provisions regarding DNB's right to examine and an internal or external audit department's right to audit). We expect these missing clauses to be added as soon as possible. We also require insurers to review and – where necessary – adjust their outsourcing policy on a regular basis.

<u>Management information about outsourcing activities and about main service providers and subcontractirs is not provided to the management board on a regular basis</u>
The frequency with which management boards receive and assess management information and compare this to the institution's risk appetite, is low. One in two insurers indicate that they do not receive management information on a regular basis. Most subontractors only provide such information in the event of an incident. We expect insurers' management boards to receive management information on outsourcing on a regular basis, including adequate information on any subcontracting activities.

<u>There is room for improvement as regards the frequency and quality of service provider reviews</u>
The services provided are not reviewed with a predetermined frequency, and in some cases only at the end of the contract term. Some reviews do not sufficiently address all relevant aspects.. We expect insurers to review the services provided with a predetermined frequency and to address all relevant aspects.

[6] Outsourcing ratio: an insurer's outsourcing costs as a share of the insurer's total general operational costs.
[7] Solvency II Directive 2009/138/EC, Solvency II Regulations 2015/35/EU, EIOPA Guidelines for the System of Governance, 60-64, Section 11, outsourcing

Business Continuity Management (BCM) does not cover activities carried out by service providers on a structural basis
For more than half of all contracts, activities carried out by service providers are not included in business continuity plans (BCPs). Some 30% of insurers do actively involve their service providers in BCPs. Only 25% of insurers draw up a BCM scenario analysis involving the outsourced services.
We expect that the activities carried out by service providers are also part of BCM as a standard.

The institution has insufficient controls in place to monitor service providers' access to sensitive data
The majority of insurers indicate that they have controls in place, but a significant proportion appear not to have access to service provicers' audit trails or security logs.
We expect insurers to be in control of their own sensitive data, also in the case of outsourcing. This goes beyond having controls in place – detailed insight into the effective operation of controls in place at service providers is also essential.

Insufficient assurance is available about the quality of services provided by service providers
The service level reports do not always enable the institution to adequately assess the quality of the services provided. Contrary to what is common in the case of larger contracts, service level reports for smaller (but nevertheless material) contracts are not received on a regular basis.

The survey revealed that assurance reports were not available for almost 40% of contracts. While insurers mostly assess the quality of the available reports as "good", for a substantial share of these reports there is no evidence that their quality is reviewed. Findings are not always followed by action, and an assessment of whether the scope and depth of the reports adequately cover the services provided is also lacking in many cases. Many insurers do not perform their own audits at service providers.
We expect insurers to make sufficient efforts to ensure the quality of outsourced activities, to be able to demonstrate their review of assurance reports and to intervene in the event of quality issues. If adequate assurance reports are unavailable, insurers must have adequate measures in place to review the quality of outsourced activities.

(3) Concentration risk at service providers

Some insurers have insufficient insight into the concentration risks related to their outsourcing and subcontracting activities

Some insurers do not keep a central register of their outsourcing partners, which means that they were unable to report all outsourcing and subcontracting activities and hence could not provide adequate insight into their outsourcing chain. As a result, we are unable to fully gauge the actual size of concentration risk within the insurance sector as a whole and at the individual institution level.

We were able to create an overview of the largest service providers, however. The top ten comprises several traditional players (e.g. infrastructure and datacentre services) followed by several global and national cloud service providers.

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The increase in cloud outsourcing will bring about a shift in the concentration of service providers and the associated risks. We expect insurers to keep a central register of concentrations and to monitor and analyse them at the individual institution level in reviewing their outsourcing strategy.

Final remarks
The survey results show that there is room for improvement as regards the management of outsourcing and subcontracting risks.

While we do see that several institutions are implementing improvements in this regard, we intend to devote more attention to this subject in the period ahead. Given that the inherent risks in this area are also set to increase in the coming years, this is an important subject. We expect insurers to subject their outsourcing processes to a critical review.

In following up on the results of the survey, insurers can use our draft good practices document. The draft good practices document will be up for consultation until 30 June 2018. You can find this document on our website: https://www.dnb.nl/voor-de-sector/open-boek-toezicht-sectoren/verzekeraars/prudentieel-toezicht/governance/good-practice-uitbesteding-verzekeraars/
Until 30 June 2018 you can report your comments and suggestions by email at inventarisatie_uitbesteding@dnb.nl. The final good practices document will be published on our Open Book on Supervision pages.