IRDA Issues Draft Guidelines on Outsourcing

November 30 2010

Introduction

On November 8 2010 the Insurance Regulatory and Development Authority (IRDA) issued new draft outsourcing guidelines. These guidelines have been issued in addition to the IRDA's existing guidance on outsourcing and are yet to be finalised.

In August 2009 the IRDA issued guidelines on corporate governance, which prohibited insurers from outsourcing any 'substantive functions' other than those expressly allowed by the IRDA. The IRDA also has wide powers to access the operations of an outsourced entity to the extent relevant to the insurer and for the protection of policyholders.

However, the IRDA did not previously define the substantive and non-substantive functions of an insurer. These functions have now been expressly defined in the draft guidelines as 'core' and 'non-core' activities of insurers.

Core and non-core activities

'Core' activities have been specified to be "important activities which will affect corporate governance guidelines set by both Insurer as well as IRDA, protection of policy holders, solvency and revenue flows of Insurer". They include:

- underwriting;
- product design and all actuarial functions;
- investment;
- premium collections;
- data storage (physical and image);
- cheque pick-up and banking of cheques;
- admission or repudiation of all claims;
- bank reconciliation;
- policy servicing, except registration of complaints, grievances or enquiries;
- approval of advertisements;
- issuing of market conduct;
- appointment of surveyors and loss assessors;
- fund accounting, including net asset value calculations;
- compliance with anti-money laundering and 'know your customer' guidelines; and
- all other activities not specified as non-core activities.

'Non-core' activities include:

- facility management (eg, housekeeping, security);
- provident fund trusts;
- internal, branch, concurrent audit;
- website development and management;
- payroll management;
- human resources services;
- service tax consultancy and support;
- tax deducted at source filing;
- compliance with labour laws;
- data entry, including scanning and indexing of services;
- printing and posting of reminders and other documents;
- pre-employment medical check-ups;
- call centre and outbound calling, for the registration of complaints or the processing of enquiries;
- claim processing for overseas medical insurance contracts; and
- telemarketing.

Guidelines on outsourcing

Core activities shall not be outsourced. A certificate of compliance with this norm is to be filed annually with the IRDA. Non-core activities may be outsourced, subject to:

- the outsourcing policy being approved by the board of directors of the insurer;
- the insurer evaluating the capability of the service provider and carrying out appropriate due diligence; and
- the insurer establishing a comprehensive risk management programme.

No activity (whether core or non-core) can be outsourced to agents or intermediaries, other than those permitted by the regulations governing their licensing and functioning. A report on the outsourcing is to be filed with the IRDA at the end of each quarter in the format specified. It should include:

- details on the amount agreed to be paid;
- the amount already paid;
- whether the vendor is a group entity of the insurer; and
- the percentage of outsourcing payments to operating expenses.

It should be filed 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 or omissions of the third-party service provider.

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

Comment

The draft outsourcing guidelines are clearly aimed at stricter regulation of the insurance sector. Insurers are putting together detailed comments to the IRDA. If notified in their present form, the outsourcing guidelines have the potential to call into question a number of existing third-party contracts, as well as arrangements with agents and intermediaries.

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