

GOOD PRACTICE

OUTSOURCING TO AUTHORISED AGENTS BY NON-LIFE INSURERS

DISCLAIMER

This good practices document presents non-binding recommendations to insurers for implementation of Solvency II Directive and Regulation, the Financial Supervision Act (*Wet op het financieel toezicht – Wft*), the Decree on Prudential Rules for Financial Undertakings (*Besluit prudentiële regels Wft – Bpr*) and integrity laws and regulations for the management of outsourcing to authorised agents. It sets out our expectations regarding observed or envisaged behaviour in policy practice that reflects an appropriate application of the rules to which this good practices document pertains.

We encourage insurers to take our expectations into account in their considerations and decision-making, without them being obliged to do so, while also taking into consideration their specific circumstances. The good Practices document is only indicative in nature, and therefore does not alter the fact that some financial institutions should apply the underlying regulations differently, and possibly more strictly. It is the institutions' responsibility to take this into account.

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1. INTRODUCTION

Dutch insurance companies sell a significant part of their products through authorised agents. Using authorised agents to distribute products is a far-reaching form of outsourcing involving critical or important primary insurance processes, such as customer acceptance, premium collection and claims handling. In other words, distributing products through authorised agents qualifies as outsourcing within the meaning of the Solvency II Directive (2009/138/EC).

In addition, there are other laws and regulations that are relevant in this context, such as the Directive on insurance distribution Directive (EU) 2016/97 and its supplementing Commission Delegated Regulation (EU) 2017/2359 (together referred to as the Insurance Distribution Directive – IDD)¹, the provisions of the Sanctions Act (*Sanctiewet – Sw*), and, of course, the Financial Supervision Act (*Wet op het financieel toezicht – Wft*) and the Decree on Prudential Rules for Financial Undertakings (*Besluit prudentiële regels Wft – Bpr*).

This good practices document has been developed to provide insight into applicable legislation and regulations in this area, along with insight into our expectations in this regard. It replaces our Standards framework for distribution through authorised agents, published in 2013. For the purposes of this good practices document, the term “insurers” is taken to mean non-life insurers (including income insurers). Where relevant, the good practices described in this document can also be used by life insurers distributing their products through authorised agents.

This document describes good practices for each of the stages in the management process that can support you when setting up your own management process for distributing products through authorised agents.



Figure 1: Five stages of the process for managing product distribution through authorised agents in the first line of defence

¹ The IDD relates to insurance brokers and intermediaries, reinsurers, and firms selling insurance as a supplement to a product or service (e.g. car rental companies and travel agencies). These activities are subject to the AFM's supervision.

While this good practices document targets the first-line function in particular (see sections 2-6), it also includes good practices for second- and third-line functions (sections 7 and 8).

A good practice (recommendation) describes observed or expected behaviour that can support institutions in complying with their regulatory and legislative obligations (e.g. laws, general administrative orders, ministerial regulations, or DNB's supervisory regulations). A good practice provides an example of how a supervised institution can comply with its obligations in actual practice. Our good practices documents are meant to provide guidance to the sector. It should be noted that they are not presented as best practices, since some supervised institutions – depending on their particular circumstances – may have to apply the supervisory rules and regulations differently, and possibly more strictly.

This document is closely related to the good practices document for outsourcing, while the good practices documents for risk management for insurers and Solvency II data quality management can provide additional guidance.

2. STRATEGY

2.1 Strategic considerations and proven added value

An insurer decides to distribute its products through authorised agents based on strategic considerations that match its business strategy. The decision to use authorised agents is based on strategic considerations and has proven added value.

Good practice

1. The insurer is able to demonstrate that the decision to use authorised agents is based on strategic choices and considerations, which are recorded in a strategy document.
2. The strategy document describes the insurer's principles with respect to
 - managing its combined ratio and expense ratio
 - branding of products distributed through authorised agents (generic brands, white labels, 100% underwriting)
 - participation in product pools
3. The insurer has elaborated its strategic objectives in detail, such as the added value and growth rate in the use of authorised agents it intends to realise. Objectives are broken down by target groups, products, returns and revenues. The insurer has specified the resources and actions required to realise the objectives.
4. The insurer demonstrates the added value of distribution through authorised agents based on an analysis of expenses and returns of this distribution channel, taking into account the best interests of the customer group.
5. The strategy document specifies the limits for combined ratio, expense ratio and exposures that an authorised agent is permitted to accept. These limits are derived from the insurer's risk appetite, which is defined at the level of the legal entity holding the licence.
6. The strategy document has been formally approved, by the organisation's policymakers and has been shared with the employees within the organisation. The opinion of the second-line risk management function is an integrated part of decision-making about the strategy pursued with respect to distribution through authorised agents.

Regulatory framework

The insurer authorises an agent to carry out specified activities, such as customer acceptance, administration, premium collection and claims handling. We consider this the most far-reaching form of outsourcing. The insurer ensures that the authorised agent operates in accordance with the outsourcing requirements. The insurer is and remains fully responsible for the activities it has outsourced to the authorised agent.

Article 49 – Solvency II Directive (2009/138/EC)

1. Member States shall ensure that insurance and reinsurance undertakings remain fully responsible for discharging all of their obligations under this Directive when they outsource functions or any insurance or reinsurance activities.
2. Outsourcing of critical or important operational functions or activities shall not be undertaken in such a way as to lead to any of the following:
 - a) materially impairing the quality of the system of governance of the undertaking concerned;
 - b) unduly increasing the operational risk;
 - c) impairing the ability of the supervisory authorities to monitor the compliance of the undertaking with its obligations
 - d) undermining continuous and satisfactory service to policy holders.

3. Insurance and reinsurance undertakings shall, in a timely manner, notify the supervisory authorities prior to the outsourcing of critical or important functions or activities as well as of any subsequent material developments with respect to those functions or activities.

EIOPA Guideline 60 – Critical or important operational functions and activities (EIOPA-BoS-14/253 EN)
1.113. The undertaking should determine and document whether the outsourced function or activity is a critical or important function or activity on the basis of whether this function or activity is essential to the operation of the undertaking as it would be unable to deliver its services to policyholders without the function or activity.

2.2 Systematic integrity risk analysis

Before distributing its products through an authorised agent, the insurer carries out a risk analysis, including an identification of integrity risks.

Good practice

1. When carrying out the annual systematic integrity risk analysis (SIRA) for the institution as a whole, an insurer also assesses the integrity risks associated with outsourcing activities to an authorised agent, using various scenarios. For example, the insurer assesses the risk of the authorised agent evading sanctions and distribution regulations or acting in other ways that are regarded as socially unacceptable. A possible scenario could be that the authorised agent's integrity policy is less strict compared to the insurer's own integrity policy. The insurer assesses the likelihood of the scenario occurring and the resulting impact, and subsequently assesses whether this matches its risk appetite.
2. The insurance company specifies its risk mitigation and control measures for each of the scenarios. For example, periodic checks at the authorised agent, or supplementary reports from the external auditor. Agreements relating to mitigation and control measures are explicitly recorded in the outsourcing agreement.
3. The insurance company updates its risk SIRA on an annual basis, or more frequently if prompted to do so by incidents.

Regulatory framework

An insurance company ensures sound and ethical operational management Ethical operational management requires you to take measures aimed at preventing your institution from becoming implicated in money laundering, terrorist financing, corruption, conflicts of interests, breaches of the law or other socially unacceptable acts which could damage confidence in your institution or the financial markets in general.

It also requires you to use the SIRA to identify integrity risks and subsequently take appropriate measures to control them.

Integrity risks are defined in that context as “the danger of harming the reputation of a financial institution, or an existing or future threat to the assets or result of a financial institution as a result of insufficient compliance with that which is prescribed under or pursuant to any legal provision.”²

Section 10 - Bpr

1. A payment institution, clearing institution, electronic money institution, special purpose reinsurance vehicle, bank, credit union, premium pension institution, insurer, exchange institution or branch office as

² See also page 7 of our brochure “Integrity risk analysis – more where necessary, less where possible”, which provides guidance in setting up a SIRA.

meant in Section 3:10(1), 3:11, 3:12, 3:12a, 3:13 or 3:14 of the *Wft* must systematically analyse its integrity risks.

2. The financial institution and the branch office must ensure that the policy referred to in Section 3:10(1) of the Act is translated into adequate procedures and measures.

3. The financial institution or branch office must inform all relevant business units of said policy, procedures and measures.

4. The financial institution or branch office is responsible for implementing and systematically testing the policy, procedures and measures.

5. The financial institution or branch office must provide for independent monitoring of the implementation of the policy, procedures and measures to safeguard ethical business operations and must have procedures in place to ensure that identified shortcomings or deficiencies are reported to the officers entrusted with that duty, as referred to in Section 21.

3. POLICY

An insurer's operational management must be tailored to the nature, scale, complexity and risks of its activities. An insurer's sound and ethical operational management is based on its organisational strategy and the SIRA. The insurer's policy describes how it has set up its operational management, but also the risks associated with the use of authorised agents and how it manages them. The policy addresses all stages of the process for distributing products through authorised agents.

Good practice

1. An insurer works out its policy for distribution through authorised agents in the following procedures and control measures:
 - customer acceptance requirements at the authorised agent
 - division of duties with respect to claims handling
 - requirements for compliance with the Sanctions Act and monitoring of compliance
 - requirements for compliance with the IDD and monitoring of compliance³
 - process for selection of authorised agents
 - conditions for sharing customer information with other parties
 - periodic reporting by the authorised agent to the insurer
 - standards framework against which the authorised agent is assessed
 - monitoring of data quality and compliance with agreements
 - procedure to follow if the authorised agent does not comply with agreements made
 - procedure to follow if the authorised agent fails to submit adequate or up-to-date data files required to effectively assess risks and related issues
 - decision-making process: which body is responsible for decision-making regarding the use of authorised agents (entering into and terminating outsourcing agreements)

Regulatory framework

Prior to outsourcing activities to an authorised agent, the insurer establishes an outsourcing policy.

Article 247(1) of the Delegated Regulation 2015/35/EU (Solvency II Regulation) provides that an insurer must establish a written outsourcing policy, which takes into account the reporting and monitoring arrangements to be implemented in cases of outsourcing. The insurer describes the approach and processes applying to outsourcing, with a particular focus on the aspects referred to in Guideline 63 of EIOPA's Guidelines on the system of governance: a materiality assessment, the service provider selection process, contractual requirements, monitoring and evaluation of performance, and the insurer's business continuity process.

EIOPA Guideline 63 – Outsourcing written policy

1.116. The undertaking that outsources or considers outsourcing should cover in its policy the undertaking's approach and processes for outsourcing from the inception to the end of the contract.

This in particular should include:

- a. the process for determining whether a function or activity is critical or important
- b. how a service provider of suitable quality is selected and how, and how often its performance and results are assessed
- c. the details to be included in the written agreement with the service provider taking into consideration the requirements laid down in Commission Delegated Regulation 2015/35
- d. business contingency plans, including exit strategies for outsourced critical or important functions or activities

³ Please refer to the AFM's website for more detailed information.

4. OUTSOURCING TO AUTHORISED AGENTS

4.1 The selection process

Once the insurer has set up its operational management for outsourcing to authorised agents, it selects the authorised agents with which to enter into outsourcing agreements. The insurer checks whether the authorised agent complies with both the statutory requirements and the insurer's own requirements and preferences.

Good practice

1. The authorised agent selection and assessment process addresses the following aspects (non-exhaustive):
 - the financial position of the authorised agent and its affiliated legal entities, with a view to potential conflicts of interests
 - professional background and expertise of the authorised agent's staff
 - screening of management board members
 - size of the contract in relation to the size of the authorised agent
 - any pending lawsuits involving the authorised agent
 - track record of the authorised agent
 - the authorised agent's compliance with the Risk Management Working Programme⁴ and submission of external expert reports.
 - the authorised agent's policies on information security, compliance, privacy, incident reporting, sanctions, etc.
 - the authorised agent's integrity policy
 - the authorised agent's sanctions policy must at least be equivalent to that of the insurer. The insurer checks whether the authorised agent screens its customers against the national sanctions list and relevant EU regulations. The authorised agent has integrated the NVGA's Guidance document on the Sanctions Act and authorised agents (*Leidraad Sanctiewet Volmachten*) in its policy.
 - the authorised agent's dependence on other insurers
 - applicable law and country of registration of the authorised agent
 - safeguards for the performance of supervisory duties by the relevant supervisory authorities
2. When assessing these aspects, the insurer checks whether the authorised agent complies with all legal and regulatory requirements as well as with the insurer's own requirements and preferences. The insurer does so based on a sound risk assessment, using a uniform set of standards.
3. The insurer documents the authorised agent selection and assessment process in a formal document that can be objectively verified by third parties.

Regulatory framework

The insurer has a process in place for the adequate selection of authorised agents.

Article 274 – Solvency II Regulation ((EU) 2015/35)

3. When choosing the service provider referred to in paragraph 1 for any critical or important operational functions or activities, the administrative, management or supervisory body shall ensure that:

⁴ The Risk Management Working Programme is a tool developed by the Dutch Association of Insurers (*Verbond van Verzekeraars – VvV*) and the Dutch Association of Authorised Agents (*Nederlandse Vereniging van Gevolmachtigde Assurantiebedrijven – NVGA*) that authorised agents can use to demonstrate their internal control over procedures and activities related to the activities outsourced to them. The Working Programme covers the key aspects of an authorised agent's operational management. It allows the insurer acting as the principal to make an adequate assessment of how the authorised agent manages the specific risks associated with this form of outsourcing.

(a) a detailed examination is performed to ensure that the potential service provider has the ability, the capacity and any authorisation required by law to deliver the required functions or activities satisfactorily, taking into account the undertaking's objectives and needs

(b) the service provider has adopted all means to ensure that no explicit or potential conflict of interests jeopardize the fulfilment of the needs of the outsourcing undertaking

(e) the outsourcing does not entail the breaching of any law, in particular with regard to rules on data protection

(f) the service provider is subject to the same provisions on the safety and confidentiality of information relating to the insurance or reinsurance undertaking or to its policyholders or beneficiaries that are applicable to the insurance or reinsurance undertaking.

Article 274 – Solvency II Regulation ((EU) 2015/35)

5. The insurance or reinsurance undertaking that is outsourcing critical or important operational functions or activities shall fulfil all of the following requirements:

(a) ensure that relevant aspects of the service provider's risk management and internal control systems are adequate to ensure compliance with Article 49(2)(a) and (b) of Directive 2009/138/EC

(b) adequately take account of the outsourced activities in its risk management and internal control systems to ensure compliance with Article 49(2)(a) and (b) of Directive 2009/138/EC

(c) verify that the service provider has the necessary financial resources to perform the additional tasks in a proper and reliable way, and that all staff of the service provider who will be involved in providing the outsourced functions or activities are sufficiently qualified and reliable

(d) ensure that the service provider has adequate contingency plans in place to deal with emergency situations or business disruptions and periodically tests backup facilities where necessary, taking into account the outsourced functions and activities.

Article 8(1) – IDD Commission Delegated Regulation ((EU) 2017/2358)

Manufacturers shall carefully select distribution channels that are appropriate for the target market, thereby taking into account the particular characteristics of the relevant insurance products.

The insurer at all times bears ultimate responsibility for compliance with relevant prudential rules and regulations and integrity rules and regulations, including the Sanctions Act.

Section 10 – Sanctions Act 1977

1. The officials or other persons designated by the Minister of Finance are responsible for supervision of compliance with the provisions laid down under or pursuant to this Act.

2. Notwithstanding the first subsection, the Minister of Finance may designate one or more legal entities to supervise compliance with the provisions laid down under or pursuant to this Part with respect to financial transactions by:

f. financial enterprises permitted to operate as an insurer under the Financial Supervision Act (*Wet op het financieel toezicht – Wft*).

Section 2 – Regulation on Supervision pursuant to the Sanctions Act 1977 (*Regeling Toezicht Sanctiewet 1977 – RTSW*)

1. The institution must take measures regarding its internal control structure to ensure compliance with the Sanctions Act and the Regulation on Supervision pursuant to the Sanctions Act.

2. The measures referred to in Section 2(1) must at any rate include adequate checks of the institution's administrative records as to whether the identity of a natural person or legal entity is identical to that of a natural person or legal entity referred to in the sanctions regulations, with an eye to freezing that customer's financial resources or to preventing the provision of financial resources or services to that customer.

Section 3 – Regulation on Supervision pursuant to the Sanctions Act 1977 (*Regeling Toezicht Sanctiewet 1977 – RTSW*)

If an institution finds that a customer's identity matches that of a natural person or legal entity referred to in the Sanctions Act or the Regulation on Supervision pursuant to the Sanctions Act, it must notify the supervisory authority without delay. The notification to the supervisory authorities must include data on the customer's identity.

4.2 Outsourcing agreement

Following the selection of an authorised agent, the insurer draws up a contract in which the agreements made are laid down. This is the outsourcing agreement, specifying the relevant regulatory and legislative frameworks, the nature of the activities, and the duties, powers and responsibilities regarding compliance with the relevant laws and applicable regulations. In carrying out the activities in accordance with the outsourcing agreement, the authorised agent ensures that the insurer meets its statutory obligations. In practice, many insurers use the model agreement made available by the NVGA and the VvV. It is updated on a regular basis and serves as a model for laying down the legal relationship between the insurer and the authorised agent.

Good practice

1. The outsourcing agreement between the insurer and the authorised agent includes the following topics:
 - the activities to be outsourced and the fees to be paid for these activities. The AFM can use this information in its assessment against the standard for “appropriate remuneration” of the legislature and/or the AFM⁵
 - the roles of the parties in the product approval process and the delineation of the target market⁶
 - situations in which the authorised agent must submit additional financial data to the insurer, such as an annual report
 - the conditions under which the insurer can perform an audit with respect to the insurance products offered on behalf of the insurer by the authorised agent
 - a clear term of validity and review frequency
 - DNB's unconditional access to all information and business premises (headquarters and operational centres) for the purpose of conducting on-site inspections (right to examine)
2. The insurer at all times bears ultimate responsibility for the data resulting from outsourcing activities, and the outsourcing agreement includes provisions on the use of data. the authorised agent may use the data created in the context of the outsourcing relationship only for the execution of the agreement, unless other agreements have been made about this. The outsourcing agreement also contains provisions on what happens with the data in the event of regular or early termination of the agreement, and in resolution, recovery and liquidation scenarios.
3. It describes the activities to be outsourced and the terms and conditions of outsourcing, including ongoing compliance with legislation and regulations.
 - It contains a specification of the mutual exchange of information and the authorised agent's control and reporting requirements.
 - The requirements include the authorised agent's duty to notify the insurer of any continuity threats or changes to the authorised agent's ownership structure.
4. The insurer regularly assesses whether the standard agreement it uses is still in compliance with current legal and regulatory requirements.
5. The insurer stipulates that the authorised agent must commit to general legal and regulatory requirements in the context of compliance with the Sanctions Act, and this is part of the authorised agent's sanctions policy. The insurer monitors the authorised agent's ongoing compliance with the Sanctions Act.
6. The outsourcing agreement specifies the party responsible for screening policy holders for whom the insurer bears the risk. If the authorised agent performs the screening, the outsourcing agreement provides that the relations to whom policies are sold are screened against the relevant sanctions lists.

⁵ This good practice follows from the IDD Delegated Regulation.

⁶ This good practice follows from the IDD Delegated Regulation.

It also provides that the authorised agent's sanctions policy must at least be equivalent to that of the insurer, and that the authorised agent must report all "hits" to the insurer.

7. The outsourcing agreement also specifies the party (i.e. the insurer or the authorised agent) responsible for reporting hits to DNB.
8. The outsourcing agreement contains provisions for termination⁷ of the outsourcing agreement:
 - An insurer records the reasons for terminating the agreement, the manner of transition/migration and the liability and best-efforts obligation of the authorised agent. Reasons for termination could include a breach of integrity, or a subcontractor with which the insurer does not wish to be associated.
 - The insurer ensures that it has extensive rights to terminate or dissolve the agreement if the authorised agent's performance is not in line with the agreements about performance and results (quality and quantity).
 - The insurer has a transparent and verifiable exit policy for terminating or refraining from renewing an outsourcing agreement with an authorised agent due to inadequate performance or non-performance (including non-compliance with the protocol for outsourcing to authorised agents of the Dutch Association of Insurers).
9. In principle, an insurer will not permit an authorised agent to subcontract primary processes, such as customer acceptance and claims handling. This is laid down in the outsourcing agreement.
10. If the authorised agent to which the insurer has outsourced activities also fully or partially outsources critical processes (other than primary processes), this qualifies as subcontracting.
 - In the outsourcing agreement, an insurer records that subcontracting is only permitted if the subcontracted activities do not evade supervision.
 - The authorised agent and the subcontractor should inform the insurer well in advance of the proposed subcontracting, in order to allow the insurer to assess it against the agreements made.
 - The insurer does not indemnify itself against responsibility and liability in the agreement (except in cases of intentional unlawful acts on the part of the authorised agent).
 - The insurer records the conditions and agreements of subcontracting, for example the authorised agent's duty to inform the insurer in time to allow the latter to make a risk assessment and take appropriate measures, and any other statutory requirements that apply to subcontracting.
 - In the event of subcontracting, an insurer includes appropriate measures in the agreement to mitigate the risk that a subcontractor is unable to meet its obligations.
 - An insurer stipulates in the agreement that the authorised agent must notify it of any intended major changes with respect to the services described in the original agreement. The notification period is determined in such a way that the insurer has sufficient time to assess the risk ensuing from the proposed changes and if necessary take appropriate measures or terminate the agreement with the authorised agent.
 - The agreement contains provisions on the supervisory authorities' right to examine, and the right to audit of the insurer and its external auditor. If subcontracting is permitted, the agreement also includes a framework agreement in which this is recorded. An insurer demands that the authorised agent unconditionally ensures DNB's right to examine and the insurer's right to audit, and to include these rights in its agreements with subcontractors through the entire chain.

Regulatory framework⁸

⁷ See also the authorised agents protocol (Protocol Volmacht) of the Dutch Association of Insurers of December 2011.

⁸ https://eiopa.europa.eu/publications/guidelines/final_en_sog_clean.pdf

The insurer and the authorised agent enter into a written agreement in accordance with the model included in Annex A of the Regulation implementing the *Wft* (*Uitvoeringsregeling Wft*). This agreement also includes the outsourcing requirements set out in Section 3:18 of the *Wft* and Sections 27ff of the *Bpr*. An insurer demands that the authorised agent unconditionally ensures DNB's right to examine and the insurer's right to audit, and to include these rights in its agreements with subcontractors through the entire chain. Article 274 of the Solvency II Regulation prescribes the elements that must be included in the outsourcing agreement as a minimum.

Article 274 – Solvency II Regulation ((EU) 2015/35)

3. When choosing the service provider referred to in paragraph 1 for any critical or important operational functions or activities, the administrative, management or supervisory body shall ensure that:

(c) a written agreement is entered into between the insurance or reinsurance undertaking and the service provider which clearly defines the respective rights and obligations of the undertaking and the service provider

(d) the general terms and conditions of the outsourcing agreement are clearly explained to the undertaking's administrative, management or supervisory body and authorised by them

4. The written agreement referred to in paragraph 3c to be concluded between the insurance or reinsurance undertaking and the service provider shall in particular clearly state all of the following requirements:

(a) the duties and responsibilities of both parties involved

(b) the service provider's commitment to comply with all applicable laws, regulatory requirements and guidelines as well as policies approved by the insurance or reinsurance undertaking and to cooperate with the undertaking's supervisory authority with regard to the outsourced function or activity

(c) the service provider's obligation to disclose any development which may have a material impact on its ability to carry out the outsourced functions and activities effectively and in compliance with applicable laws and regulatory requirements

(d) a notice period for the termination of the contract by the service provider which is long enough to enable the insurance or reinsurance undertaking to find an alternative solution

(e) that the insurance or reinsurance undertaking is able to terminate the arrangement for outsourcing where necessary without detriment to the continuity and quality of its provision of services to policyholders

(f) that the insurance or reinsurance undertaking reserves the right to be informed about the outsourced functions and activities and their performance by the services provider as well as a right to issue general guidelines and individual instructions at the address of the service provider, as to what has to be taken into account when performing the outsourced functions or activities

(g) that the service provider shall protect any confidential information relating to the insurance or reinsurance undertaking and its policyholders, beneficiaries, employees, contracting parties and all other persons

(h) that the insurance or reinsurance undertaking, its external auditor and the supervisory authority have effective access to all information relating to the outsourced functions and activities including carrying out on-site inspections of the business premises of the service provider

(i) that, where appropriate and necessary for the purposes of supervision, the supervisory authority may address questions directly to the service provider to which the service provider shall reply

(j) that the insurance or reinsurance undertaking may obtain information about the outsourced activities and may issue instructions concerning the outsourced activities and functions

(k) the terms and conditions, where applicable, under which the service provider may sub-outsource any of the outsourced functions and activities

(l) that the service provider's duties and responsibilities deriving from its agreement with the insurance or reinsurance undertaking shall remain unaffected by any sub-outsourcing taking place according to point k)

Article 3(4) – IDD Commission Delegated Regulation ((EU) 2017/2358)

An insurance intermediary and an insurance undertaking that are both manufacturers within the meaning of Article 2 of this Delegated Regulation, shall sign a written agreement which specifies their collaboration to comply with the requirements for manufacturers referred to in Article 25(1) of Directive (EU) 2016/97, the procedures through which they shall agree on the identification of the target market and their respective roles in the product approval process.

5. MONITORING

After entering into an outsourcing agreement, the insurer monitors whether the authorised agent effectively provides the services as specified in the agreement. The insurer monitors the execution of activities, the operational effectiveness of security and control measures and compliance with laws and regulations. If necessary, the insurer takes immediate remedial measures.

5.1 Periodic progress reports from the authorised agent

The insurer receives performance progress reports from the authorised agent. The insurer can use these reports to monitor the quality of outsourced activities.

Good practice

1. The insurer makes agreements with the authorised agent about the use of the Risk Management Working Programme, the reporting frequency – which should be appropriate to the nature and scale of the outsourced activities – and the auditing of reports by an external auditor.
2. An insurer receives regular progress reports about the authorised agent's portfolio management, including information on the returns of the portfolio (trends in premium income, claims burden, sector distribution, etc.).
3. Every year, within three months after the end of the financial year, an insurer receives the Risk Management Working Programme report. The insurer has access to the full Working Programme.
4. Every year, within six months after the end of the financial year, an insurer receives a report of the external auditor's findings. The external auditor audits a part of the Working Programme and records the findings in a report.
5. An insurer develops a common set of standards to assess the Working Programmes and substantiates whether and why the programme is assessed in full, in part or on a sample test basis.
6. An insurer assesses the Risk Management Working Programme based on its own findings and on those in the external auditor's report. The insurer documents its findings, draws up a risk assessment and makes recommendations to provide direction where necessary. An insurer actively monitors whether the authorised agent follows up on these recommendations.
7. Every year, within six months after the end of the financial year, an insurer receives an external auditor's report on the authorised agent's annual financial statements. Every year, an insurer reconciles the figures received to the authorised agent's financial administration and reports its findings to the authorised agent.
8. Every year, within six months after the end of the financial year, an insurer receives either of the following: the authorised agent's annual financial statements compiled by an external auditor.
 - The annual financial statements meet the requirements for external financial reporting as laid down in the Dutch Civil Code. For example, personnel and indirect costs are fairly allocated, and explanatory notes are added for any pledges and future claims; or:
 - a statement of Financial Key Figures issued by an external auditor.
9. An insurer ensures that a sufficient level of knowledge and expertise is available in the organisation to assess the reports received from the authorised agent, e.g. a multidisciplinary team.

Regulatory framework

An insurer's internal operational management set-up allows it to monitor the outsourcing of activities to the authorised agent. To this end, the insurer has adequate procedures and measures in place and possesses sufficient expert knowledge and information.

Guideline 63 of the EIOPA Guidelines for the System of Governance also addresses how, and how often the authorised agent's performance and results are assessed.

1.116. The undertaking that outsources or considers outsourcing should cover in its policy the undertaking's approach and processes for outsourcing from the inception to the end of the contract. This in particular should include:

e. how a service provider of suitable quality is selected and how, and how often its performance and results are assessed

Article 274.5 – Solvency II Regulation ((EU) 2015/35)

The insurance or reinsurance undertaking that is outsourcing critical or important operational functions or activities shall fulfil all of the following requirements:

- c. ensure that relevant aspects of the service provider's risk management and internal control systems are adequate to ensure compliance with Article 49(2)(a) and (b) of Directive 2009/138/EC
- d. adequately take account of the outsourced activities in its risk management and internal control systems to ensure compliance with Article 49(2)(a) and (b) of Directive 2009/138/EC

Article 8(4) – IDD Commission Delegated Regulation ((EU) 2017/2358)

Manufacturers shall take appropriate steps to monitor that insurance distributors act in accordance with the objectives of the manufacturers' product approval process. They shall in particular verify on a regular basis whether the insurance products are distributed on the identified target market. That monitoring obligation shall not extend to the general regulatory requirements with which insurance distributors have to comply when carrying out insurance distribution activities for individual customers. The monitoring activities shall be reasonable, taking into consideration the characteristics and the legal framework of the respective distribution channels.

5.2 Data quality assessment

It is essential that the authorised agent submits correct, complete and sufficiently detailed policy and claim data to the insurer. The insurer needs this information for the purpose of risk management reporting, to set the level of premiums, to value the technical reserves and to calculate the requisite amount of solvency under Solvency II.

Good practice

1. In the outsourcing agreement, the insurer and the authorised agent make agreements on periodic submission of data by the authorised agent which allow the insurer to meet its statutory reporting requirements and to obtain adequate information for reinsurance arrangements, product management and portfolio management.
2. An insurer ensures that the data fields of data received match its own information requirements. The authorised agent and the insurer have agreed specific protocols to exchange data in a structured manner.⁹

⁹ The VvV and the NVGA developed a protocol covering the key aspects of policy, claims and financial data. It allows the insurer to access the data on a regular basis.

3. The authorised agent submits the necessary data to the insurer through a dashboard (tooling), possibly supplied by a third party. The insurer is aware of the risks attached to this. The level of security and continuity of data during transfer and storage at the authorised agent and other third parties is at least equivalent to the level required under the insurer's internal policy. This is laid down in the outsourcing agreement and the service level agreement. The insurer monitors compliance with these agreements.
4. An insurer is able to access and use individual policy and claims data from the authorised agent for its reporting obligations, reinsurance, product management and portfolio management.
5. An insurer's first-line staff assess the quality of the authorised agent's data using a common set of standards. The insurer documents any shortcomings identified, draws up a risk assessment and makes recommendations to provide direction where necessary.

Regulatory framework

We expect an insurer to have adequate internal control measures and procedures in place to manage outsourcing to authorised agents. The insurer ensures that it is able to draw up a sound risk assessment, meet its obligations and comply with the relevant statutory arrangements.

Article 258 of the Solvency II Regulation stipulates that insurers must establish, implement and maintain effective decision-making procedures.

Article 258(1), under h, i, and k of the Solvency II Regulation stipulates that an insurer must establish information systems and reporting lines that ensure the prompt transfer of complete and clear information about the internal organisation and the risks to all persons who need it.

Article 266 of the Solvency II Regulation stipulates that an insurer's internal control system must ensure the availability and reliability of financial information and the effectiveness and the efficiency of the organisation's operations.

Articles 82 and 86f of the Solvency II Directive stipulate that insurers must ensure that the data they use to calculate the technical provisions and the SCR are appropriate, complete and accurate. Article 19 of the Solvency II Regulation stipulates that data are only considered to be accurate if they are free from material errors. Data are only considered to be complete if they include sufficient information to assess the underlying risks and to identify trends in the risks.

5.3 Audits at the authorised agent

The insurer performs audits at the authorised agent to effectively establish the reliability of the authorised agent's data and IT.

Good practice

1. An insurer's first-line staff perform random checks on the authorised agent's files in order to establish the effectiveness of the latter's process and management controls (key controls) and its compliance with relevant legislation and regulations, such as the GDPR. The insurer has appropriate procedures and measures in place to perform these audits, so that it is able to draw up a sound risk assessment and fulfil its statutory obligations.
2. An insurer checks that the authorised agent screens all of its business relations against the national terrorist sanctions list upon acceptance, payout and changes to the policy's insurance cover. Apart from these situations, the authorised agent should screen its portfolio on a regular basis, with a frequency that matches its risk profile (see the NVGA's Guidance document on the Sanctions Act and

authorised agents). The aim of periodic audits and on-site file inspections is to establish that screening was performed in accordance with the insurer's policy.

3. The insurer has segregated its auditing and commercial functions.
4. An insurer performs an on-site inspection at the authorised agent at least once every three years. The insurer may increase the frequency of these inspections if prompted to do so by incidents and shortcomings in the authorised agent's operational management reported in third-party audit reports.
5. An insurer ensures that the audits it performs at the authorised agent are tailored to the agent's specific organisation and supplement the Risk Management Working Programme.
6. An insurer acknowledges the possibilities and limitations of the various types of certification (e.g. ISO). Certification is aimed at the quality of the design of processes at any given time, but it does not provide any assurance as to the ongoing operational effectiveness of controls.
7. An insurer performs its own checks to verify the operational effectiveness of processes. The insurer takes account of the possibility that an external auditor's report on the authorised agent's operational management may not adequately reflect the services received.
8. The insurer draws up periodic internal reports on the findings of on-site inspections at the authorised agent. If the situation so requires, the frequency or scope of the inspections may be increased.

Regulatory framework

The outsourcing agreement stipulates that external auditors, DNB and the insurer have the right to examine.

Article 274.4 – Solvency II Regulation ((EU) 2015/35)

1. The written agreement referred to in paragraph 3c to be concluded between the insurance or reinsurance undertaking and the service provider shall in particular clearly state all of the following requirements:
 - h. that the insurance or reinsurance undertaking, its external auditor and the supervisory authority have effective access to all information relating to the outsourced functions and activities including carrying out on-site inspections of the business premises of the service provider

6. REPORTING AND EVALUATION

An insurer not only evaluates the authorised agent, but also its own outsourcing policy in respect of authorised agents and related procedures and control measures. The insurer checks whether the procedures and control measures effectively reflect the policy and whether the standard for its outsourcing agreements for authorised agents still complies with current legal and regulatory requirements.

The insurer evaluates its policy based on a management report containing a clear performance overview of all authorised agents. Based on the management report, policymakers can decide to adjust or terminate an outsourcing agreement with an authorised agent.

Good practice

1. An insurer annually evaluates its outsourcing policy for authorised agents, in line with the company's overall strategy.
2. An insurer evaluates its own policy based on the outcomes of its authorised agent evaluations. As part of its evaluation of authorised agents, an insurer checks whether the outsourcing still meets the requirements, matches its risk appetite and contributes to achieving the objectives with respect to the use of the authorised agent channel as recorded in its strategy document.
3. As a minimum, the following aspects are evaluated:
 - Returns, i.e. an analysis of expenses paid and premiums received. Claims burden expenses are broken down by claims year and financial year.
 - findings from on-site inspections of e.g. data quality
 - the quality of the customer portfolio
 - the quality of operational management, e.g. with respect to information security
 - the financial situation of the authorised agent and its affiliated entities
 - any pending lawsuits involving the authorised agent
 - the number of screenings and hits and notifications in the context of the Sanctions Act
 - incident reports
 - audit findings
4. An insurer draws up an internal annual report with clear and structured findings of the above for the company's day-to-day policymakers and those responsible for outsourcing to authorised agents. Deviations from the selection policy are substantiated and included in the report. The aim of the report is to enable policymakers to make well-informed choices about strategy and policies regarding outsourcing to authorised agents and to decide whether adjustments are necessary.
5. Based on the outcome of the evaluation, the insurer adjusts its outsourcing policy if necessary and checks whether any existing outsourcing agreements must be adjusted or terminated as a result of adjusting the policy.

Regulatory framework

The insurer evaluates its governance system (organisation of its operational management) on a regular basis.

Article 41 of the Solvency II Directive and Article 258.6 of the Solvency II Regulation stipulate that insurers must evaluate their governance system on a regular basis, including outsourcing. Guideline 63 of the EIOPA Guidelines for the System of Governance also addresses how, and how often a service provider's performance and results are assessed.
EIOPA Guideline 63 – Outsourcing written policy

1.116. The undertaking that outsources or considers outsourcing should cover in its policy the undertaking's approach and processes for outsourcing from the inception to the end of the contract. This in particular should include:

- e. how a service provider of suitable quality is selected and how, and how often its performance and results are assessed

7. SECOND-LINE FUNCTION

7.1 Risk management

In its risk reports, the risk management function addresses the insurer's risk management regarding outsourcing to authorised agents, and it advises policymakers about risk management issues regarding the distribution strategy.

Good practice

1. In its risk reports, an insurer addresses the risks related to the management of outsourcing to authorised agents. For example, concentration risk in the home insurance or car insurance portfolio. The risk report also includes information about the relationship between the risks related to outsourcing to authorised agents and the insurer's risk appetite, its risk tolerance thresholds, its stated risk policy and the possible consequences of exceeding such variables.
2. The risk management function presents its views on the insurer's strategy and policy regarding outsourcing to authorised agents, and gives its opinion on e.g. the quality of the strategy's substantiation. The risk management function's opinion is taken into account in the decision-making on the strategy for outsourcing to authorised agents.

Regulatory framework

The risk management function monitors the risk management system and reports on it and advises policy-makers on strategy-related risk management issues.

Article 44(1) of the Solvency II Directive and Article 259(1), under d, of the Solvency II Regulation stipulate that insurers must have reporting procedures and processes in place to identify, assess, monitor and manage the risks to which they are exposed.

Article 269 – Solvency II Regulation ((EU) 2015/35)

1. The risk management function shall include all of the following tasks: (a) assisting the administrative, management or supervisory body and other functions in the effective operation of the risk management system; (b) monitoring the risk management system; (c) monitoring the general risk profile of the undertaking as a whole; (d) detailed reporting on risk exposures and advising the administrative, management or supervisory body on risk management matters, including in relation to strategic affairs such as corporate strategy, mergers and acquisitions and major projects and investments; (e) identifying and assessing emerging risks.

2. The risk management function shall fulfil all of the following requirements: (a) fulfil the requirements set out in Article 44(5) of Directive 2009/138/EC; (b) liaise closely with the users of the outputs of the internal model; (c) co-operate closely with the actuarial function.

7.2 Compliance function

The compliance function assesses whether the measures taken by the insurer are effective in ensuring that the authorised agent complies with the relevant laws and regulations. For example, it assesses the working programme used by the insurer when performing on-site inspections (audits) at the authorised agent.

Good practice

1. The insurer has an extensive inspection programme in place for performing audits at authorised agents. It includes all necessary audit procedures to verify the authorised agent's compliance with

relevant laws and regulations. The compliance function has assessed the inspection programme for completeness and has established that compliance with all relevant laws and regulations is ensured, including the Sanctions Act, the GDPR and the IDD.

Regulatory framework

As the second-line key function holder, the compliance function checks whether the measures taken by the insurer effectively ensure compliance with the relevant laws and regulations.

Article 270 – Solvency II Regulation ((EU) 2015/35)

1. The compliance function of insurance and reinsurance undertakings shall establish a compliance policy and a compliance plan. The compliance policy shall define the responsibilities, competencies and reporting duties of the compliance function. The compliance plan shall set out the planned activities of the compliance function which take into account all relevant areas of the activities of insurance and reinsurance undertakings and their exposure to compliance risk.

2. The duties of the compliance function shall include assessing the adequacy of the measures adopted by the insurance or reinsurance undertaking to prevent non-compliance.

Article 48 – Solvency II Directive (2009/138/EC)

Actuarial function

1. Insurance and reinsurance undertakings shall provide for an effective actuarial function to:
c) assess the sufficiency and quality of the data used in the calculation of technical provisions

7.3 Actuarial function

The actuarial function is a second-line function which plays an important role in the assessment of technical provision calculations. It is responsible for assessing the completeness and quality of the data used in these calculations.

Good practice

1. The actuarial function assesses the quality of the data submitted by the authorised agents and provides advice.

Regulatory framework

Article 48 – Solvency II Directive (2009/138/EC)

1. Insurance and reinsurance undertakings shall provide for an effective actuarial function to:
c) assess the sufficiency and quality of the data used in the calculation of technical provisions

8. THIRD-LINE FUNCTION – INTERNAL AUDIT

The internal audit function independently assesses the effectiveness of the organisational management of outsourcing and the procedures and measures for controlling the risks related to the outsourcing to authorised agents.

Good practice

1. The internal audit function includes the separate assessment of the organisational management of outsourcing to authorised agents in its long-term plan.
2. Segregating this audit from the internal audit of the insurer's own organisation prevents internal auditors from effectively auditing their own activities (e.g. through involvement in the third-line function).
3. The first line is responsible for carrying out on-site inspections (audits) at authorised agents. An insurer assesses the extent to which the authorised agent complies with the provisions of the outsourcing agreement and the procedures regarding customer acceptance and claims payments. Preferably, these audits are not part of the internal audit function.
4. When assessing the organisational management of outsourcing to authorised agents, the insurer's internal audit department assesses the effectiveness of all operational process steps (strategy, policy, outsourcing and monitoring, reporting and evaluation). It checks whether procedures and measures are complied with and assesses follow-up on findings from previous audits. Any shortcomings identified are reported in writing, including recommendations on how to address them.

Regulatory framework

The internal audit function has an independent position in the organisation.

Article 271 – Solvency II Regulation ((EU) 2015/35)

1. The persons carrying out the internal audit function shall not assume any responsibility for any other function.

2. Notwithstanding paragraph 1, and in particular by respecting the principle of proportionality laid down in paragraphs 3 and 4 of Article 29 of Directive 2009/138/EC, the persons carrying out the internal audit function may also carry out other key functions, where all of the following conditions are met: (a) this is appropriate with respect to the nature, scale and complexity of the risks inherent in the insurer's business; (b) no conflict of interest arises for the persons carrying out the internal audit function; (c) the costs of maintaining persons for the internal audit function that do not carry out other key functions would impose costs on the insurer that would be disproportionate with respect to the total administrative expenses.

3. The internal audit function shall include all of the following tasks: (a) establish, implement and maintain an audit plan setting out the audit work to be undertaken in the upcoming years, taking into account all activities and the complete system of governance of the insurance or reinsurance undertaking; (b) take a risk-based approach in deciding its priorities; (c) report the audit plan to the administrative, management or supervisory body; (d) issue recommendations based on the result of work carried out in accordance with point (a) and submit a written report on its findings and recommendations to the administrative, management or supervisory body on at least an annual basis; (e) verifying compliance with the decisions taken by the administrative, management or supervisory body on the basis of those recommendations referred to in point (d). Where necessary, the internal audit function may carry out audits which are not included in the audit plan.

Section 17(4) – *Bpr*: The effectiveness of the organisational structure and the procedures and measures in place must be audited independently at least once a year. The financial enterprise or its branch must have an organisational unit that performs this internal audit function. The financial enterprise or its branch must ensure that all shortcomings identified are resolved.

See also: DNB's Q&A on Key functions with operational autonomy and proportionate set-up (13 December 2018)

The set-up of a Solvency II insurer's key functions, including allocation of the responsibilities for those key functions, must at least meet the following three criteria to safeguard their operational autonomy:

- a) Key functions must be segregated from each other and from other functions.
- b) Key functions must not be structured hierarchically in relation to each other or in relation to other functions, except to a member of the administrative and management body, which is typically the management board.
- c) Key functions must at all times and without intervention by others be able to report to the administrative and management body and, if present, to the supervisory body, which is typically the supervisory board.

If an insurer deviates from criterion a) for reasons of proportionality, meaning it combines a key function with another function or key function, it must at least prevent a key function from auditing its own activities.