



Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

Consultation Paper 144

Guidance on the Use of Service Companies for Staffing Purposes in the Insurance Sector

August 2021

Contents

1	Introduction	3
2	Consultation process	3
	Schedule 1	4
	Part A: Introduction	4
1	Background	4
2	Application of the Guidance and Proportionality	5
3	Status	5
	Part B: Guidance	6
1	General Governance	7
2	Reporting	15

1 Introduction

- 1.1** This Consultation Paper seeks stakeholder views on the Central Bank of Ireland’s (the Central Bank) proposed Guidance on the Use of Service Companies for Staffing Purposes in the Insurance Sector (the Guidance). It follows on from the publication of [Discussion Paper 9](#) (DP9) - Use of Service Companies in the Insurance Sector – in November 2019, the feedback from which has been considered and incorporated, as relevant, into the Central Bank’s thinking on this matter.
- 1.2** The Central Bank is proposing to introduce the Guidance (as set out in Schedule 1 of this Consultation Paper), in order to communicate its expectations with regard to the use of service companies for staffing purposes in the insurance sector.

2 Consultation process

- 2.1** The Central Bank invites general feedback, via the comments template provided, on the Guidance from interested stakeholders, including firms, representative bodies, industry consultancies, and service providers. When submitting a response via email, the Central Bank asks that respondents include the following subject heading in their email “Consultation on Guidance on Use of Service Companies for Staffing Purposes in the Insurance Sector” and address their response to insurancepolicy@centralbank.ie. We will send an acknowledgement to all responses received by email.
- 2.2** The consultation will remain open for three months from: 6 August 2021 to 6 November 2021.
- 2.3** It is the policy of the Central Bank to publish all responses to its consultations. The Central Bank will make all submissions available on its website. Commercially confidential information should not be included in consultation responses. Information deemed potentially libellous or defamatory will not be published. The Central Bank will accept no liability in respect of any information provided, which is subsequently released, or in respect of any consequential damage suffered as a result.

Schedule 1

Proposed Guidance on the Use of Service Companies for Staffing Purposes in the Insurance Sector

Part A: Introduction

1 Background

The Strategic Plan of the Central Bank of Ireland sets out its Mission, Vision and Mandate. The Mission of the Central Bank is to serve the public interest by safeguarding monetary and financial stability and by working to ensure that the financial system operates in the best interests of consumers and the wider economy. In discharging its functions and exercising its powers, the Central Bank's mandate incorporates a number of statutory objectives. The 'Guidance on the Use of Service Companies for Staffing Purposes in the Insurance Sector' set out herein, is published in the context of a number of these objectives:

- Contributing to the stability of the financial system; and
- The proper and effective regulation of financial service providers and markets, while ensuring that the best interests of consumers of financial services are protected.

The Central Bank has also prioritised five strategic themes, which have been identified as critical to the successful delivery of its mandate. The themes of 'Strengthening Resilience' so that the financial system is better able to withstand external shocks and future crises; and 'Strengthening Consumer Protection' so that the best interests of consumers are protected and confidence and trust in the financial system is enhanced through effective regulation of firms and markets, are of particular relevance to the publication of this Guidance.

The Central Bank has observed a practice within the insurance sector whereby a number of insurance and reinsurance undertakings (undertakings) are seeking to enter, or have entered, arrangements for the use of separate legal entities for the provision of extensive staffing to the undertaking (staffing arrangements). These entities often referred to as service companies or service providers, are usually part of the same group as the undertaking.

The Central Bank is focused on these staffing arrangements due to their potential, if not effectively managed, to threaten the operational resilience of undertakings regulated by the Central Bank. Hybrid arrangements, which involve a combination of the provision of staffing

and other activity outsourcing¹ within the same arrangement, potentially introduce additional complexity and the need for further risk management. Robust and effective governance and risk management within undertakings supports the financial and operational resilience of these undertakings and consequently supports financial stability aims.

The Central Bank views the proper management of risk and the appropriate governance of staffing arrangements as key from both a prudential and conduct perspective. It is the responsibility of the boards of undertakings to ensure that there are appropriate governance structures in place, including appropriate organisational and operational structures and risk management systems and, where this is not the case, to appropriately modify or eliminate inappropriate structures or arrangements.

2 Application of the Guidance and Proportionality

This Guidance is addressed to undertakings authorised by the Central Bank who choose to enter staffing or hybrid arrangements. The Guidance does not apply to arrangements entered into between captive (re)insurance undertakings and captive management companies for the provision of extensive captive management services, due to the specificity of the captive (re)insurance model.

The Central Bank acknowledges that these arrangements vary from undertaking-to-undertaking and therefore the specificities of each arrangement should be taken into account in an undertaking's assessment of the appropriate measures needed to align with the Central Bank's expectations as set out in this Guidance. However, undertakings are expected to be able to demonstrate clearly, the rationale for their approach and to provide evidence that this has been considered and approved by the board or an appropriate level of management within the undertaking.

3 Status

The Guidance does not purport to address in detail, every aspect of an undertaking's legal and regulatory obligations with respect to staffing arrangements and should be read in conjunction with relevant European and Irish legislation, regulations, and guidelines. In the unlikely event

¹ For the purposes of this Guidance, "other activity outsourcing" should be considered to mean "outsourcing" as defined under Directive 2009/138/EC12 (Solvency II).

of a discrepancy between the Guidance and relevant legislation, the primacy of the legislation will apply. Where existing legislation, regulations or guidance is less prescriptive or silent on certain matters, it is the Central Bank's expectation that undertakings refer to the expectations set out in this document. With regard to staffing arrangements, which are already in place, the Central Bank expects undertakings to take the necessary steps to review such arrangements and ensure they are updated and augmented, as appropriate, to align with the expectations set out in the Guidance. The Central Bank expects undertakings to have conducted that review and augmentation, where appropriate, within 12 months of the implementation of the Guidance.

The Guidance should not be construed as legal advice or legal interpretation. It is a matter for undertakings to seek legal advice if they are unsure regarding their obligations as they apply to their particular set of circumstances.

The Central Bank may periodically update elements of this Guidance to reflect changes in Central Bank policy or other developments stemming from, inter alia, changes to EU or Irish law.

Part B: Guidance

The central expectation of this Guidance is that where an undertaking uses a staffing arrangement, this should not impair the quality of the system of governance of the undertaking, unduly increase operational risk, nor impair the ability of the Central Bank to monitor compliance of the undertaking with its obligations, nor undermine service to policyholders.

The Central Bank expects undertakings to review the Guidance and adopt appropriate measures to ensure that staffing arrangements are properly integrated in their governance and risk management frameworks, in line with this Guidance, and to be able to demonstrate how they have done this, if requested to do so by the Bank. Supervisors are likely to engage with undertakings in respect of these arrangements as part of their normal supervisory engagement.

1 General Governance

1.1. The role of the undertaking

The Central Bank expects an undertaking to:

- a) Have robust governance arrangements in place which adequately reflect and take the staffing arrangement into account;
- b) Integrate the staffing arrangement appropriately into the risk management system (including, as appropriate, the Own Risk and Solvency Assessment (ORSA) process) and internal control framework of the undertaking to ensure that there is effective oversight, management and control of the staffing arrangement taking into consideration the nature, scale, and complexity of the undertaking and the business being conducted;
- c) Be able to demonstrate how the board has reviewed, considered and become comfortable with the specific arrangement the undertaking proposes to enter, or has already entered, (where it has considered, inter alia, the nature, suitability, etc. of the proposed arrangement) and to provide details on their deliberation and decision in this regard, upon request;
- d) Be able to demonstrate compliance with all relevant requirements, legislation, and other supervisory expectations that are relevant to the arrangement, which include, inter alia, general governance requirements, fitness and probity, and as appropriate, outsourcing requirements; and
- e) Ensure that the arrangement does not create impediments to the supervision and resolvability of the undertaking.

1.2. The role of the board

The board is ultimately responsible for the proper monitoring and oversight of all activities of the undertaking, irrespective of whether staff are directly employed or engaged through a staffing arrangement. Decisions to enter a significant or material staffing arrangement with a service provider are expected to be made at board level and the board is expected to approve the underlying staffing arrangement. The Central Bank expects the board of an undertaking that enters a staffing arrangement to be comfortable that:

- a) The overall governance framework (including, but not limited to, internal controls, internal audit, and compliance procedures) appropriately integrates the staffing arrangement;

- b) The risk management system adequately identifies, assesses, manages, monitors and reports on the risks associated with the arrangement at the outset of an arrangement and on an ongoing basis;
- c) The protections provided for policyholders and other beneficiaries - on an ongoing basis and in stress scenarios - are not adversely affected by the arrangement;
- d) There are appropriate oversight mechanisms in place that provide for board review and consideration of the arrangement, including the associated risks, at appropriate times or intervals, e.g., where there is a material change to the arrangement;
- e) Sufficient substance is maintained in the undertaking at all times, in line with Central Bank expectations in this regard², i.e., ensuring that the undertaking does not become an 'empty shell' or 'letter box entity'; and
- f) Entering into a staffing arrangement with a service provider does not impede the undertaking's ability to meet the conditions with which it must comply in order to remain authorised, including any conditions imposed by the Central Bank.

Furthermore, the Central Bank expects the undertaking to be able to demonstrate how the board has considered and addressed these points, if asked to do so by their supervisor.

1.3. Basis of the staffing arrangement

The Central Bank expects a staffing arrangement to be governed by a formal written contract or agreement, which is legally binding (written agreement). The written agreement is expected to clearly set out the basis of the staffing arrangement in terms of structure, roles provided and the respective responsibilities of both parties.

The written agreement is expected to include clauses requiring prior notice to the undertaking of any new activities assumed by the service provider that might be understood to potentially affect its service delivery to the undertaking. It should also address issues of prioritisation and commitment to the undertaking in times of stress.

The Central Bank expects that the written agreement should, at minimum:

- a) Include a clear outline of the roles and responsibilities of both contracting parties;
- b) Address how any actual or potential conflicts of interest will be managed;

² <https://www.centralbank.ie/regulation/how-we-regulate/brexit-faq>

- c) Ensure that the necessary fit and proper procedures are applied in assessing persons employed via the service provider;
- d) Pay due regard to the roles and responsibilities of Pre-approval Controlled Functions/Controlled Functions (PCFs/CFs), in particular, in circumstances where such roles are shared across more than one entity to ensure they are able to fulfil their responsibilities to the undertaking(s);
- e) Include appropriate business continuity provisions, which ensure the necessary continuity of services to the undertaking in a stress scenario. These may include:
 - i. Appropriate termination clauses, e.g., clauses to prevent crisis management or reorganisation measures (within the undertaking or service provider) being considered termination events;
 - ii. Adequate pre-funding of the service provider being ring-fenced within the service company to ensure necessary continuity of services, e.g., equivalent to six months' worth of working capital; and
 - iii. A commitment by the service company to, if required, ensure an orderly transition to a new service provider, in a reorganisation scenario (in respect of the undertaking or the service provider), as well as a commitment to continue providing services after such an event for a reasonable period of time.
- f) Appropriately address compliance requirements under relevant applicable legislation (e.g., Solvency II, Insurance Distribution, or domestic requirements).

1.4. Risk management

As part of its normal risk management framework, the Central Bank expects an undertaking to conduct and document an appropriate risk assessment in relation to a staffing arrangement prior to its commencement. This risk assessment is expected to include the identification and assessment of all material risks likely to arise from the specific arrangement proposed and should outline the undertaking's planned approach to the management and ongoing monitoring of those risks. The Central Bank expects the risk assessment to consider the perspective of the undertaking, and the chosen risk management responses to provide for a level of protection that is comparable to a scenario where the staff are employed directly by the undertaking.

1.4.1. Compliance risk

There are certain obligations that will apply in respect of all staffing arrangements, e.g., general governance, fitness and probity, and risk management requirements³. Other obligations may apply in respect of some arrangements, e.g., outsourcing requirements apply in the instance of a hybrid arrangement or Insurance Distribution Regulations⁴, including registration and authorisation requirements, may apply where insurance distribution services are provided by the service provider. It is the responsibility of each undertaking and service provider to identify the obligations that apply to it, taking account of the nature and specificity of its activities and its organisational and operational structures, and to ensure compliance with those obligations.

1.4.2. Due diligence

The Central Bank expects an undertaking to conduct appropriate and proportionate due diligence in respect of a prospective staffing arrangement, before entering into that arrangement. In that regard and in addition to other normal due diligence considerations, the Central Bank expects an undertaking to appropriately consider, and be able to demonstrate consideration of, the following:

- a) The extent of control or influence that may be exercised by the undertaking;
- b) Group policies and procedures, i.e., if the staffing arrangement is subject to group policies and procedures, undertakings should be able to demonstrate that they have reviewed and approved these as being appropriate when considered in the context of the individual undertaking;
- c) Potential conflicts of interest;
- d) The capabilities of the service provider and whether it holds the appropriate authorisation or registration, where required, to perform proposed activities;
- e) Fitness and probity (verification that the relevant staff are sufficiently qualified and reliable);

³ E.g., arising from the European Union (Insurance and Reinsurance) Regulations 2015 (S.I. 485 of 2015), the Central Bank's Corporate Governance Requirements and the Central Bank's Fitness and Probity Regime.

⁴ European Union (Insurance Distribution) Regulations 2018(S.I. No. 229/2018).

- f) The ability of the service provider to meet its requirements and contractual obligations in relation to service quality and reliability, security and business continuity, in both normal and stressed circumstances; and
- g) Data protection laws.

1.4.3. Conflicts of interest

The use of staffing arrangements may give rise to certain conflicts of interest, e.g., in respect of the duty of fidelity of relevant staff or conflicts of prioritisation/commitment, particularly in circumstances where staff are required to work across multiple entities. The Central Bank expects an undertaking to appropriately address these potential conflicts in its written conflicts of interest policy and in the written agreement between the services company and the undertaking. More specifically, it expects:

- a) Under a staffing arrangement, it to be evident that relevant staff hold a duty of fidelity or responsibility to the undertaking and that they act in the interests of the undertaking at the appropriate times;
- b) Where staff are shared across multiple entities, this does not compromise the staff's ability to properly carry out their responsibilities for the undertaking concerned;
- c) Where the arrangement is a hybrid arrangement and a material element of that relates to other activity outsourcing, the responsibility for overseeing the delivery of that other activity by the services company, as required by Solvency II, is assigned to a person directly employed by the undertaking, i.e., not to a person employed by the service company, to ensure the performance is robustly monitored and, as necessary, challenged; and
- d) An undertaking to implement appropriate measures to mitigate risk of conflict of interest, such as, appropriate segregation of duties, oversight and reporting, designed to prevent undue influence or inappropriate combinations of activities and to ensure disclosure and mitigation of conflicts where identified.

Staffing arrangements that do not align with the above expectations are deemed to present an unacceptable risk of conflict of interest and therefore the Central Bank expects them to be avoided. Furthermore, undertakings are expected to be able to demonstrate how they have considered and addressed these points if asked to do so by their supervisor.

1.4.4. Control risk / Risk of undue influence

In the case of a group service company, many of its policies, procedures, strategies, objectives, etc. may be defined from the group's perspective which could raise concerns about the level of control that the undertaking itself has over the activities the service company staff perform for the undertaking. In the case of a staffing arrangement with a group service company, the Central Bank expects an undertaking to:

- a) Ensure that the staffing arrangement is appropriately aligned to the strategy and objectives of the undertaking;
- b) Use specific and relevant controls to manage this particular risk, e.g., ensuring adequate/active involvement of independent directors in the decision-making processes related to the staffing arrangement; and
- c) Ensure it exerts appropriate influence over the staffing arrangement in terms of the underlying selection and recruitment of staff, performance management, day-to-day operations, and reporting.

1.4.5. Operational resilience

Operational resilience is the ability of a firm to identify and prepare for, respond and adapt to, recover and learn from an operational disruption. Effective risk identification, assessment, mitigation and monitoring is crucial to minimise operational disruptions and their effects.

A staffing arrangement, if not effectively managed, has the potential to adversely influence the operational resilience of the undertaking. Therefore, the Central Bank expects an undertaking to:

- a) Understand whether the staffing arrangement contributes to the delivery of any critical or important business service(s) and ensure that it can remain within its impact tolerance(s)⁵;
- b) Have sufficient controls and procedures in place to identify in a timely manner, vulnerabilities or threats to the operational resilience of the undertaking posed by the staffing arrangement;
- c) Regularly assess the effectiveness of these controls and procedures;
- d) Ensure that the staffing arrangement is adequately incorporated into the overall operational resilience framework of the undertaking including; disaster recovery and

⁵ Impact tolerances quantify the maximum acceptable level of disruption to a critical or important business service.

business continuity planning, recovery and resolution planning, and any other relevant risk management structures of the undertaking; and

- e) Have processes to identify, analyse and report on operational risk events related to the staffing arrangement.

1.4.6. Business continuity planning

An undertaking is expected to provide for appropriate business continuity (i.e., continuity of critical services, activities, etc.) at all times. Therefore, its business continuity planning should adequately consider and include measures related to the staffing arrangement aimed at ensuring continuity of service in all circumstances. The Central Bank expects an undertaking to ensure that the business continuity measures provide for a comparable level of protection to that which would exist if the staff were directly employed by the undertaking.

When designing and implementing Disaster Recovery (DR) and Business Continuity Plans (BCP), the Central Bank expects an undertaking to:

- a) Regularly review the appropriateness of, and adjust as necessary, the DR/BCP in respect of the staffing arrangement;
- b) Explicitly consider the staffing arrangement when carrying out stress and scenario testing; and
- c) Ensure that the staffing arrangement is considered in the context of, and integrated within, the undertaking's recovery planning.

1.4.7. Resolvability

It is important that the use of a staffing arrangement does not act as a barrier or impediment to the resolvability of the undertaking. The Central Bank expects an undertaking to:

- a) Have appropriate plans and measures in place in order to disentangle arrangements where necessary and provide seamless continuity of service to policyholders in a stressed scenario, e.g. consideration should be given to adequate pre-funding (e.g., equivalent to six months' worth of working capital being ring-fenced within the service company) and contractual obligations that ensure continued service for a reasonable period of time; and
- b) Have contracts, which include the staffing arrangement, that provide for events of resolution and/or failure of the undertaking to be managed in an orderly manner by the relevant authority and/or an appropriately appointed third party.

Parties to contracts with undertakings subject to a failure or resolution event are expected to cooperate fully with the Central Bank and/or an appropriately appointed third party, and where appropriate generally not to trigger any termination clauses as long as the substantive obligations of the contract can continue to be met.

The Central Bank expects an undertaking to ensure that relevant clauses/conditions concerning resolution or failure events are specifically included in the written agreement with the service provider. Such contractual clauses are expected to:

- a) Seek to ensure that, in a resolution or failure event, essential staff/services, systems, and operational assets, etc., remain in place or can be replaced (substitutability) without causing significant disruption to policyholders; and
- b) Remain valid and enforceable during resolution or failure.

However, it should be noted that the precise manner by which undertakings' ensure operational continuity in a resolution or failure event will depend on the nature and specificities of the staffing arrangements they have in place.

1.5. Fitness and Probity

The Central Bank's Fitness and Probity Regime (the F&P Regime) applies to undertakings and, as relevant, individuals, irrespective of the chosen organisational or operational structure. The core objective of the F&P Regime is to ensure that individuals in key and customer facing positions within a Regulated Financial Service Provider (RFSP) (referred to in legislation⁶ as Pre-Approval Controlled Functions (PCFs) and Controlled Functions (CFs)) are competent, capable, honest, ethical, of integrity and financially sound. Where a staffing arrangement includes the provision of staff to perform a PCF/CF and notwithstanding any exemptions allowed under the Central Bank's F&P Standards⁷, the undertaking must ensure they comply with the relevant F&P requirements. In circumstances where the service provider is itself an RFSP and the exemptions permitted under Section 1.5 of the Central Bank's F&P Standards apply, (e.g., in the context of a hybrid arrangement which involves a combination of the

⁶ The Central Bank Reform Act 2010

⁷ Section 1.5 of the Central Bank's Fitness and Probity Standards

provision of staff and other activity outsourcing), the service provider must ensure relevant staff comply with applicable F&P requirements⁸.

2 Reporting

2.1. Internal Reporting

As outlined earlier in this paper, the Central Bank expects appropriate oversight and consideration of staffing arrangements at board level. Therefore, undertakings are expected to have the necessary structures and mechanisms in place to ensure timely and appropriate management information (MI) for the board to facilitate those deliberations.

2.2. Regulatory reporting

The Central Bank expects an undertaking to provide it with appropriate information on a staffing arrangement at both commencement and whenever there is a material change to the arrangement. A staffing arrangement may be entered in to at authorisation stage and therefore the information is expected to be included in the undertaking's business plan, or, if the arrangement is entered into at a later stage, relevant information is expected to be provided as part of the next narrative Regular Supervisory Report (RSR) following commencement of the arrangement. In circumstances where the narrative RSR is not due to be submitted within 12 months of the commencement date of the arrangement, the Central Bank expects an undertaking to include relevant information on the arrangement within the next summary RSR.

⁸ It should be noted that a CF or PCF benefitting from this exemption from the F&P Standards will remain subject to the provisions of Part 3 of the Central Bank Reform Act 2010, and may be the subject of an investigation, suspension, or prohibition notice.



T: +353 (0)1 224 6000
E: insurancepolicy@centralbank.ie
www.centralbank.ie



Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem