Outsourcing – Findings and Issues for Discussion

Irish Life and Canada Life Companies Submission

January 2019

INTRODUCTION

ABOUT IRISH LIFE AND CANADA LIFE

Canada Life was founded as Canada´s first life insurance company in 1847. It has now grown into one of the world´s largest and most financially secure providers of life insurance. Since 2003, Canada Life has been a part of Great-West Lifeco Inc., one of the leading financial service providers in Canada. Great-West Lifeco Inc. cares for more than 28 million clients around the world.

Canada Life operates in Ireland under both the Irish Life and Canada Life brands. Both the Irish Life Group and associated companies and the Canada Life companies based in Ireland have a commonality of ownership and reporting line to the President and Chief Operating Officer for Europe.

Irish Life, empowers its customers to look to the future with more confidence and certainty. We manage the financial needs of more than 1.3 million Irish customers. We think ahead to find opportunities and anticipate challenges to help deliver more security and certainty for their futures. We have over 75 years' experience serving corporate and private customers in Ireland. So we pride ourselves on having a deep understanding of our customers' needs, interests and concerns for themselves and their families.

Irish Life Group (ILG) includes Irish Life Assurance, Irish Life Health, and Irish Progressive Services International (IPSI) as well as its associated companies Irish Life Investment Managers and Setanta Asset Management. We currently have 2,400 people working at our campuses in Dublin and Dundalk, and we continue to grow.

There are three significant businesses operating under the Canada Life brand in Ireland, Canada Life Assurance Europe plc, Canada Life Re Ireland dac and Canada Life International Assurance (Ireland) dac.

Canada Life Assurance Europe plc has been operating in Germany since the year 2000. We draw on the international experience and know-how of our parent company to implement innovative insurance products and solutions in Germany. Our customers come to us through our business partners, who are independent brokers, multi-tied agents and banks. As independent agents, our partners give people access to a wide range of financial service providers and their products Canada Life Assurance Europe plc is regulated by the Central Bank of Ireland and regulated by the German regulator Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) for business conduct purposes.

Canada Life Re Ireland dac forms part of the Reinsurance Division of Great West Lifeco. The primary focus of the Reinsurance Division is on life reinsurance business in Europe and the United States. This is supported by Canada Life Reinsurance Ireland dac, where appropriate, through directly writing the business and through internal retrocessions. The main business lines and divisional business strategies are traditional life, structured life and payout annuities.

Canada Life International Assurance (Ireland) dac sells unit-linked life assurance and capital redemption bonds to UK residents through UK independent regulated intermediary channels. Although the main market is the UK, the company is also licensed to sell to Jersey residents and operates in Italy on a freedom of services basis, although it is no longer seeking new clients in

Italy. Canada Life International Assurance (Ireland) dac is authorised and regulated by the Central Bank of Ireland and regulated by the FCA for business conduct purposes in relation to UK sales.

EXECUTIVE SUMMARY

Irish Life Group and the Canada Life companies welcome the opportunity to participate in this discussion paper with the Central Bank.

The Irish Life Group companies and the Canada Life companies based in Ireland are one of the largest and most diverse financial services groups in Ireland. Focussed on providing a wide range of investment, reinsurance, protection and health insurance products to consumers. As such, we actively seek opportunities to ensure better outcomes for our customers through meeting their needs in a cost efficient, flexible and timely manner.

There are often cases where utilising the expertise and benefits of a specialist service provider, either within the Group or externally, for a particular activity helps us achieve our objectives without materially impacting on our risk profile. In fact, there is often a strong case to use such services in order to further enhance our products and services. Companies within the group also act as an outsourced service provider on behalf of other regulated financial services providers. Therefore we are very aware of the additional risks to which the outsourcing of specific business functions may expose firms and the importance of identifying and managing these risks.

The degree, nature and risk posed by outsourcing can vary extensively in relation to the impact it can have on both consumers and regulated entities. Therefore, blanket governance arrangements on all types of outsourcing may be neither appropriate, proportionate or ultimately beneficial to the customer.

SUBMISSION

The Benefits of Outsourcing

It should be noted that entities enter outsourcing arrangements (both intra-group & external) for a number of reasons, namely:

- To manage and control operating costs
- To effectively manage variability in business volumes
- To access skills, expertise and capability which would be uneconomic to develop internally
- To centralise similar capabilities allowing for better training, process improvement and coverage and reduce level of dependency on individuals
- To more effectively deliver the business change including regulatory change
- For smaller companies or start-ups to allow entry into the market at lower costs.

In many cases, these arrangements seek to reduce the levels of operational risk within an organisation, enhance the customer experience and outcome and should not be assumed to always increase the risk profile of a business. In fact, in many cases, such as cyber risk, such arrangements actually reduce risk.

Intra-Group Out-Sourcing Arrangements

Ireland has become a global hub of financial services, attracting a huge number of large international groups to base their European operations within the jurisdiction. These large international groups will always be organised in the most efficient manner to maximise their value and ensure good consumer outcomes. This will often mean pooling resources, capabilities and talent where necessary. Most large financial services companies are generally held by a regulated group entity which sets governance standards throughout the Group (albeit subject to regional regulatory requirements). Hence, when companies within a Group outsource to one another there is already generally a commonality of both ownership and governance in place. While oversight between the entities will still be required this should, be proportionate compared to outsourcing to say an entirely separate third party.

When appropriate, ILG and Canada Life companies outsource specific business activities and functions within the Group to reduce or control costs, to optimise internal resources and capital, and to harness skills, expertise and resources and make these available throughout the Group. There is a significant benefit to both consumers and the regulated entities to outsourcing specific key functions to one key area of expertise consolidated within the Group. Similarly, there are a number of both cost and efficiency benefits to be gained from having a shared services model within a Group rather than replicating these at each individual group company level. However, as previously stated the level of risk is lower compared to external outsourcing and hence oversight required for each should be proportional.

We completely support the position that the Board and senior management retain ultimate responsibility for any functions and activities we outsource and believe it is important that we retain the necessary line of sight and expertise to manage outsourcing risks and to oversee outsourcing arrangements. Clearly as part of any recovery or contingence planning, each regulated entity will need to consider how it would unwind these arrangements if it was to leave the group or if it was deeply unsatisfied with the performance of the service. However, it is important that efforts are proportionate and focussed on arrangements that are material to the regulated entity. Also, fully (or majority) group-owned entities cannot make unilateral decisions to exit or break away from the group.

Therefore, we do not agree that the risks associated with intragroup outsourcing are the same as those for third party outsourcing. There is a very distinct difference in control, management and governance within an intragroup structure with commonality of regulatory obligations, ownership and governance to that of a third party outsource service provider. To enforce the same level of oversight on both would seem disproportionate to two very differing risks.

For example, it is appropriate to fully diligence the ownership, management, financial strength, conflicts of interest and sustainability of an external outsourcer. None of these are necessary for an internal outsourcing arrangement. The regulated entity should diligence the operational capability and quality of service provided for both internal and external outsourcing arrangements. However, the key for intra-group arrangements is the putting in place of service level agreements setting the expectation of service rather than financial penalty clauses.

Similarly, a distinction should also be made in the context of intragroup outsourcing arrangements between outsourcing and the use of shared services. Shared services within a group can span everything from HR and IT, to legal services and company secretarial support each of which carry differing risks to the regulated entity involved. Again as all of these services fall within the context of one regulated enterprise-wide proportionality of the activity and its scope within the Group should be a key considering when putting in place oversight arrangements. It is our view, that internal shared services are not outsourcing and should be treated as being very similar to the entity is carrying out the activities itself.

We would note that EIOPA has stated that it:

> *"will consider….a revision of its Guideline 14 on system of governance, in which a distinction between intra and extra-group outsourcing taking into account the proportionality principle could be made[1]"*

This directly recognises the risk differential between the two outsourcing scenarios and the need for proportionality to apply.

We believe there should be proportionality on the oversight of out-sourced arrangements made within a intra-group structure that has common ownership, common governance standards and is ultimately controlled by another group entity.

[1] EIOPA, 'Peer Review of Key Functions: Supervisory Practices & Application in Assessing Key Functions', p. 15.

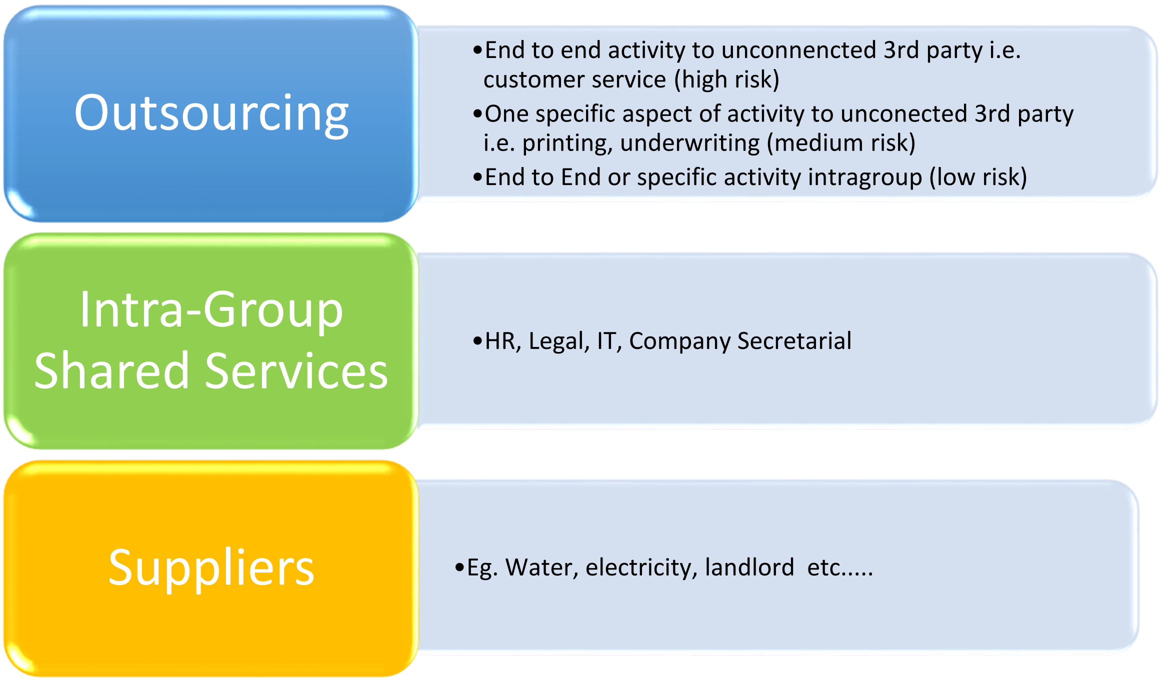
Proportionality

Some criteria that could be considered in assessing the importance of each arrangement would be:

- The materiality and criticality of the outsourced activity to the overall activities of provider.
- Substitutability to replace the provider in the event of an issue arising either through bringing the activity back in house or sourcing an alternative provider.
- The availability of alternative providers in the market.
- Benefits and risks associated with the outsourced arrangement in terms of meeting customer commitments and regulatory requirements.
- And for intra-group, the lack of freedom of the group entity to leave the group.

We feel it is very important for the Central Bank to acknowledge that the wide range of types of outsourcing arrangements in place means that a single governance standard is not appropriate for them all. Governance of outsourcing arrangements should take into account the level of oversight and control that exists between the regulated financial services provider and the outsourced service provider.

In descending level of risk, the main categories of arrangements might be considered as follows:



1. What are the key outsourcing risks?

a. Differences in risk between traditional outsourcing and shared services

When considering the risks associated with an outsourcing arrangement, it is important to consider the governance structure, ownership and regulatory requirements within which the outsourced service provider operates.

When dealing with an external firm, whilst you will be offered the opportunity to review their internal policies, you may have limited ability to influence the specific content other than through a commercial contract. By contrast, when all firms within a group pool a certain activity in a single group company, it is likely that all companies within the group will operate under a consistent set of policies, standards, risk management system and management will have considerably more scope to influence the risk governance arrangements of the outsourced service provider.

As mentioned above, we believe that internal shared services and intra-group outsourcing should be treated proportionally particularly when the regulated entity is being charged for the services provided.

b. Differences in outsourcing risk between in country and outside State and outside EEA.

In our opinion, there is no per se difference in the definition of outsourcing that is relevant to the geography in which it is carried out (ie: in country / State and outside of country / State or EEA). However, depending on the chosen location, this will change the assessment of the capability of the outsourcer and its associated risks, particularly in terms of data accessed outside of the EU, governance, which may become arms-length and ease of repatriation if required.

While overseas outsourcing can deliver a cost advantage, some consideration needs to be given to additional oversight costs and operational risk associated with the execution and monitoring the service provided.

c. Differences between outsourcing a regulated activity and non-regulated activity.

Some comfort can be gained to outsourcing to another regulated provided who is subject to regulatory supervision. However this cannot be relied upon and proper oversight needs to be carried out. In intragroup instances from one regulatory company to another, where there is commonality of governance structures, risk management, compliance arrangements and a roll-up on reporting lines then some proportionality on the oversight required should be permissible.

When outsourcing a regulated activity additional care and diligence is required in order to ensure that the risk of non compliance with regulations is minimised.

2. Unwinding outsourcing at different levels and substitutability

While all regulated entities should have proper arrangements in place for the unwinding of their outsourcing arrangements and comprehensive business continuity plans, these should allow for a number of differing options:

- Moving the services to another third party service provider;
- Moving the services to another entity within a group;
- Bringing the services back internally to the company;

- Where the entity is group-owned, replacing/enhancing skill sets and capabilities within the entity.

Which option is implemented will depend on the activity in question and the ease of replication. This needs to be considered on a case by case basis. In some cases, this will be straightforward but in others, more complex options will be needed such as:

- Ensuring that there are alternative providers in the market.
- Having the right recapture the activity, infrastructure and staff of the outsourcer.
- Agreeing service agreement options in the event of corporate activity etc.

Where an outsourcer uses a financial institution's own core technology, this significantly improves one's ability to unwind an arrangement. If an outsourcer's technology is used, it may not be critical / core to the provision of services. Therefore, this is a fundamental consideration. Also relevant is the ability to transfer people, processes and step-in rights within the contract.

There should be no prevailing principle however that the preferred option or the low risk option is to have the capability to bring the activity back internally. To have to maintain any kind of a contingency internally for such an event would significantly limit the benefits of the outsourcing arrangement.

3. Future Proofing – to keep up with technology

One of the key advantages of outsourcing either internally or pooling expertise intragroup is it allows for quick access to new technologies and innovation that would be difficult to deliver within one regulated entity. Within intragroup structures access can be provided to numerous entities with a shared cost base which could be prohibitive otherwise.

Discussion Points

<u>Sensitive Data Risk</u>

- *How are regulated firms ensuring that they have sufficient knowledge/expertise within their own organisation to effectively challenge and gain assurance that their data is being managed securely by OSP, including CSPs (how and where it is being stored, processed used, located etc..)?*

Proportionality also needs to be applied to this question, there is little point in incurring additional costs replicating the expertise of outsourced providers. However, regulated entities should have sufficient controls and oversight to manage all the activities that have been outsourced or be able to get external assurance that same is occurring.

Within an intragroup scenario each regulated entity should be able to take assurance that the enterprise wide controls are being applied consistently and with regular reporting to senior management and the board. However, it would appear disproportionate to require each regulated entity within the group to hold sufficient IT expertise to be able to challenge the Group IT function.

- *What issues/challenges are regulated firms encountering in gaining assurance that their sensitive business and customer data is being managed securely in outsourcing scenarios?*

  This becomes easier within intragroup arrangements where regulatory and reputational risks of any breaches of sensitive business and customer data are well understood throughout the businesses. In addition, the expectation and standards of what is expected are clearly understood within the Group.

<u>Concentration Risk</u>

- ***How are regulated firms seeking to reduce their exposure to concentration risk both from the perspective of providers and geographical locations?***

The use of outsourcing arrangement is often a factor in managing the risks associated with fully carrying out the activity internally including concentration risk. When assessing third party outsourcing risks, concentration should be taken into account with the proper risk mitigation structures put in place. However, this does need to be proportional to the activity involved.

Intragroup outsourcing should also benefit from group wide business continuity plan and there should not be a heighten concentration risk from the intragroup arrangements. This is no different to the entity carrying out the activity itself.

- ***How are regulated firms addressing concentration risk whereby they are outsourcing to OSPs who provide services for a large proportion of their sector? Of particular interest is how regulated firms are dealing with concentration risk where there are limited numbers of providers of niche services such as CSPs?***

Regulated firms should be assessing the resilience of the outsourcing provider on a regular basis and if necessary develop a multi outsourced approach based on the business model adopted.

For intragroup arrangements business continuity and contingency planning will be important, with regular testing to ensure they are appropriate.

- ***Do regulated firms have views, as to how systemic concentration risk related to outsourcing, can be effectively monitored and managed by both regulated firms in all sectors and the Central Bank?***

From a providers perspective this is something that should be considered as part of the initial outsourcer due diligence process. If it is identified that a provider has a very large share of the market, additional mitigation plans will be needed in order to ensure that replacement arrangements can be put in place in the event of a material outsourcer failing.

There is a difference between supplier management and outsourcing that should not be confused. Many of the key systemic concentration risks i.e. electricity, water etc…are supplier management issues rather than outsourcing risks.

In addition, for niche complex services it may not be possible to completely mitigate against systemic concentration risks.

Offshoring and Chain Outsourcing

- ***Given the significant volume of offshoring to the UK what preparations are regulated firms undertaking to prepare for Brexit and what related challenges are envisaged in terms of their outsourcing arrangements?***

  Contractual provisions can be implemented that would required the outsourced services to the UK continue to maintain as a minimum regulatory equivalence with standards within the EU.

- ***What steps are regulated firms taking to ensure they have full sight of any chain outsourcing which may be occurring within their outsourcing arrangements and how are they managing risks associated with this?***

  Contractual arrangements in our case require full visibility and disclosure of any chain outsourcing and sub-contracting that may occur. Dependent on the nature of the activities involved it would also be reasonable in some instances to contractually prohibit any sub-contract arrangements.

  Within intra-group arrangements there is better transparency of the nature and context of any further sub-contracting arrangements.

  Standard contractual terms should require the service provider or the entity to carry out regular audits on both the outsourcer and any sub contractors.

- ***How are firms ensuring that contractual rights of access are the same with all parties to a chain-outsourcing arrangement, as those granted by the primary third party OSP?***

  The primary out-sourcing arrangement should firstly, require disclosure and possibly consent for any further outsourcing and secondly, where this occurs the contract should impose the same level of access and information disclosure as the primary outsourcer.

  Within an intragroup regulated environment the provision of access to any party should be easier as the governance, control and regulatory provisions should be same within the group.

Substitutability

- ***What issues/challenges are regulated firms encountering when assessing substitutability and exit strategies? How are these being addressed?***

  It can be difficult to get credible information on the ability of alternative providers to take on a contract at short notice. An element of expert judgement is needed to assess the validity of external parties.

  Recovery planning process has been useful in assessing how group arrangements could be addressed in such a scenario.

- ***What are the risks/challenges where there is no substitutability or it is not possible to bring the service back in house? How are these being addressed?***

  Initial assessment processes and ongoing monitoring process should address this. If the possibility a problem was to emerge, interim action should be taken. This should be covered in an outsourcing policy. Within an intragroup arrangement the group contingency plan should cater for the risk/challenges of a failure within one of the group entities and have a risk mitigation strategy in place.

Conclusion

The use of outsourcing either intragroup and to external third parties has become the norm within the industry and has assisted in creating efficiencies and reducing costs of customers. Outsourcing also allows regulated entities tap into new and developing technologies that would otherwise be prohibitive to build internally. Outsourcing can assist regulated entities in managing costs and dealing with seasonality without incurring unnecessary costs. However, as with all regulated activities proper systems of governance and oversight are required. The nature and extent of these arrangements however should be proportional both to the activity that is outsourced and the nature of the outsourcer itself. In particular, within large regulated groups there should be no need for similar oversight and governance as with entirely unconnected third parties.

The Irish Life and Canada Life companies would welcome the opportunity to meet with the Central Bank to discuss any of the matters set out above.