



Outsourcing to the cloud and other IT service providers - emerging prudential approaches in the insurance industry

(Forthcoming FSI Insights)

Juan-Carlos Crisanto

Financial Stability Institute

Bank for International Settlements

July 2018



Background

- **Digitalisation** is affecting all areas of the **insurance value chain**



- Some insurance companies are **outsourcing all or parts of the value chain activities** to third-parties as part of innovation business strategies
- Additionally, in order to enhance flexibility, gain scalability, access cutting-edge technologies and reduce costs, insurance companies are **outsourcing core functions to technological third-parties**, including **cloud providers**

Risk management,
actuarial function,
internal audit

Investment & HR
management

IT system
management (data
storage & processing)

Back-office operations

Motivation

- Outsourcing of core functions through cloud computing requires **(re)assessing** whether **traditional (IT) outsourcing framework remains fit for purpose**
- **Outsourcing to IT third-parties**, including **cloud providers** (eg collection, storage, process and analysis of personal data) can bring a number of **benefits** but also introduces/exacerbates **risks** related to, among others:
 - Data security (including cyber)
 - Data location and access
 - Integrity of information systems
- In light of the above, the **prudential oversight of cloud computing is evolving**
- Focus of **forthcoming FSI Insights**:
 - Describe **range of regulatory approaches and supervisory practices** to deal with outsourcing to the cloud and other IT providers in the insurance industry



Current IAIS workstreams on digitalisation that include third-party's risks

- Draft application paper on the **use of digital technology in inclusive insurance**
- Draft issues paper on the **increasing use of digital technology in insurance and its potential impact on consumer outcomes**
- Draft application paper on **supervision of insurer cyber-security**



Forthcoming FSI Insights

- **Scope**

- Reviewed approaches in 13 jurisdictions
 - General/specific frameworks, integrated/non-integrated authorities, geographical representation

- **Methodology**

- Public information, pre-filled surveys and interviews

- **Timeline**

- April – August 2018



Main general observations

- Cloud computing and outsourcing of other IT services to third-parties are generally treated as a form of (IT) outsourcing.
 - Therefore, supervised firms are typically subject to **prudential requirements applicable to (IT) outsourcing**
 - However, some authorities have issued **specific requirements or recommendations** related to third-party cloud computing services
 - Mostly supervised as part of **onsite/offsite frameworks related to operational/IT risks and outsourcing**
 - Nonetheless, in limited cases, **specific reviews** targeted at cloud computing
- With a few exceptions, authorities seem to follow a **principle-based approach** and apply **proportional and risk-based approaches** to their regulatory and supervisory frameworks



Regulatory frameworks

- To complement their **general prudential frameworks for outsourcing** , some jurisdictions have issued **specific requirements or recommendations** for IT outsourcing, cloud computing and/or information security (cyber framework)
- **Specific requirements or recommendations on cloud computing** tend to focus on issues such as:
 - Materiality assessment
 - Risk assessment of data security, confidentiality and availability
 - Rights of information and audit
 - Reversibility of service
 - Business continuity and exit plan
 - Offshoring and sub-contracting
 - Robust legal arrangements

Supervisory approaches

- Most authorities are **notified** about the outsourcing of (material) cloud computing and other IT services either ex-ante or ex-post
 - A few authorities require **authorisation**
- All authorities have **access to information** of outsourced activities mainly through supervised firms
 - A few authorities have **direct powers to supervise** cloud and other IT providers
- Cloud computing is supervised as part of the **offsite/onsite reviews related to IT/operational risk or outsourcing**
 - A few authorities have used **targeted/thematic reviews** on cloud computing
- Most authorities are in the process of applying a systematic approach to monitor the **cross-border dimension** of cloud computing as well as its **implications for financial stability**



Concluding remarks

Although our policy implementation work is still in progress, we could preliminary say:

- **Risks** stemming from outsourcing core functions to cloud providers and other technological third parties **seem not insignificant**
- Insurance authorities are mostly relying on their **general outsourcing rules** but are closely monitoring this issue and several have issued **additional specific requirements or recommendations**
- **Supervisory frameworks** very much rely on approaches to deal **with IT and/or operational risk and/or outsourcing risk** but there is work in progress in several areas including:
 - concentration risk
 - cross-border aspects
 - developing and retaining expertise

