

Solvency II Guidelines on System of Governance

**Informal advice by the
EIOPA Insurance and Reinsurance
Stakeholder Group**

Request

EIOPA has asked the IRSG to provide informal advice on the Guidelines on system of governance. EIOPA intends to decide whether to review the Guidelines, as well as the scope of a review, in Q4 2018, and seeks input to that decision. Any such review would be carried out in 2019, and would include a public consultation.

EIOPA addressed two questions to the IRSG, as follows :

- What is your view concerning a review of EIOPA Guidelines on system of governance?
- Please identify those guidelines to be amended/deleted or new guidelines that could be added and provide short rationale for the amendment/deletion/addition.

These two questions are considered below. Responses, comments and proposals by the IRSG in this document, particularly relating to specific guidelines, are preliminary and have not been fully debated in the time available.

View concerning a review

No time limit is imposed within the Guidelines for a review, with the relevant provision stating that 'The present Guidelines shall be subject to a review by EIOPA.' While it is early in the life of the Solvency II regime, there is considerable experience in the operation of these Guidelines, and their interaction with Level 1 and Level 2 text, which should provide valuable insights to their operation and the need for change.

The Guidelines are addressed to National Supervisory Authorities ('NSAs') to enable them to proceed with Solvency II regulation and NSAs will be a key constituency in any review.

The implementation of these and other Solvency II related guidelines create significant compliance and regulatory costs for (re)insurance undertakings. The burden is most relatively significant for smaller and less complex entities. Any revision of the guidelines should incorporate an assessment of the actions and approaches adopted by NSAs in relation to the application of proportionality.

As part of a review process, EIOPA should aim to answer the following questions, by consulting NSAs and industry participants:

- Do the existing guidelines meet EIOPA's criteria of effectiveness, relevance, coherence and proportionality?
- How have NSAs sought to achieve the application of proportionality in their implementation of the Guidelines?
- Are all the Guidelines necessary for supervisory practice?
- To what extent are guidelines still necessary given the supervisory handbook?
- To which extent have NSAs developed national-specific guidelines, on top of those developed by EIOPA?

The timing of the actual review and proposed changes, both deletions and additions of guidelines, should be considered in light of other workstreams that may ultimately impact the Guidelines. Specifically, in the area of sustainable finance, the recent EC call for advice notes that *"In providing technical advices, EIOPA and ESMA ... may develop guidelines or recommendations that they believe should accompany the proposed measures to better ensure the effectiveness of the integration of sustainability risks in the given framework, i.e. remuneration."*

The Guidelines have brought changes to organisation structures and responsibilities of individuals within undertakings. Any review should consider the most effective approach to governance, balancing the need for a governance body such as the Board/AMSB to collectively assume oversight responsibility with the requirement to appoint individuals to oversee key functions. A particular area of consideration for most companies has been the appropriate organisational design and split of responsibilities across the actuarial and risk management functions. Several years on, this deserves some attention in terms of the breadth of practice and ongoing effectiveness.

The Guidelines are necessarily subordinated to Solvency II rules and, in the absence of changes in these rules, any change in the Guidelines must be consistent with delegated regulation. Furthermore

- reviewing guidelines that do not yet reflect potential updates of Level 1 or Level 2 texts is less efficient than reviewing guidelines after the corresponding Level 1 or Level 2 texts have been updated.
- in order to ensure consistency within the regulatory framework, the individual guideline should be explicitly mapped to the corresponding Level 1 and/or Level 2 articles
- in order to improve readability, there should be a table of contents in the guidelines paper from EIOPA (and the other ESAs)

Regarding the first point above, the IRSG expressed the view in the Joint Statement to Vice President Dombrovskis on the ESA consultation that no draft or preparatory Level 3 measures should be issued before Level 2 is finalized¹. In the same way that changes to the guidelines cannot pre-empt changes to relevant Level 1 and 2 text, the IRSG review of those guidelines cannot anticipate Level 1 and 2 changes.

The IRSG considers that a review of all guidelines (not just those relating to systems of governance) would be welcome, starting with a thorough assessment of existing guidelines and the extent to which they have brought added value to the regulatory and supervisory landscape. A review should also ensure that existing guidelines do not conflict with each other.

We recommend that future such requests to the IRSG should be more defined and focused in order to ensure that the resources of the IRSG can be brought to bear in the most appropriate areas.

Should EIOPA decide to proceed with a review of the Guidelines, the IRSG looks forward to contributing to the debate.

Comment on specific guidelines

Please see below some initial feedback from IRSG members on specific provisions of the Guidelines. These proposals are intended to provide EIOPA with a sense of some topics which may require a more in-depth analysis in due course.

Given the time constraints, these proposals have not been fully debated within the IRSG and they do not represent an exhaustive set of views. Furthermore, the relevance of this feedback will depend on the ultimate approach which is taken to revise the Guidelines.

It is highly likely that a number of proposals for guidelines (marked below with *) would be appropriate in the context of the policy discussion on sustainability and ESG, taking into account also

¹ <https://eiopa.europa.eu/Publications/Stakeholder%20Opinions/ESAs%20review%20-%20Joint%20BSG%20IRSG%20OPSG%20and%20MSG%20letter%20to%20EC%20web%20version.pdf>

the legal basis provided in Solvency II legislation and the mandate of EIOPA provided in the EIOPA regulation. From a timing perspective, such work should be considered in the context of the upcoming EIOPA preparation of the advice to the European Commission on the integration of sustainability risks and sustainability factors, and also in close relationship with the ongoing level 1 and 2 policy developments on sustainability (eg disclosures, taxonomy).

Guideline/section/chapter	Proposed amendment	Rationale
3 – Significant decisions	Further clarification required, taking requirements of local corporate law into account.	Should the two persons be involved in the decision being made? How involved do they need to be?
5 – Allocation and segregation of duties and responsibilities	Clarification of the definition of ‘segregation’ of duties and responsibilities	To ensure the requirement for segregation does not restrict collective oversight by the Board as a governance body.
8 – Contingency plans	Consider the need for this guideline.	The guideline is not specific and may duplicate activities already required under ORSA and other activities.
11 – Fit requirements	Revise the guideline to incorporate evolving experience requirements, e.g. in change management and/or technology	The guideline covers traditional experience requirements but not some other elements which are essential to running modern businesses.
14 – Outsourcing of key functions	Consider the removal or replacement of “a person”. We would also support a consideration of all key functions in the guidelines instead of addressing “function” (singular) to clarify the purpose and ensure that the Board/AMSB can supervise and to allow its individual members to perform the key functions. Guideline 1.84. (covering independence of the Internal Audit Function) should not be weakened arising out of consideration of the points above.	To enable the Board/AMSB of a smaller or less complex entity to collectively assume responsibilities.

Guideline/section/chapter	Proposed amendment	Rationale
16 – Assessment of the fit and proper requirements by the supervisory authority	Replace ‘within an appropriate timeframe’ with a short and definitive time limit, e.g. ‘within two weeks’.	This guideline deals with urgent and sensitive appointments and, reflecting this, notifications should be required to be dealt with promptly.
24 – Asset-liability management (‘ALM’) policy	Modify to ensure consideration of the benefits of the ALM approaches used.	Practical and academic analysis indicates that undertakings should question the extent to which ALM is truly effective in mitigating risks.
30 – Profitability	Enhance to ensure that targeted returns from investments are to be assessed in conjunction with the associated risks as reflected in the SCR and the ORSA.	In particular for standard formula users, it is important to reflect the true risks of sovereign debt (not shown in the SCR) and other asset types not only in their ORSA, but directly in their investment decisions.
*Section 2 – Remuneration	Further guidance elaborating on Article 275-2(e) (Remuneration policy) of Regulation 2015/35.	<p>Article 275-2(e) provides a basis for a downwards adjustment to variable remuneration for exposure to current and future risk.</p> <p>Remuneration can be a powerful incentive to improve sustainability over varying time horizons. Accordingly, further guidelines on the practical application of this provision would be beneficial.</p> <p>Similarly, an upward adjustment for reducing exposure to long-term risks such as climate change could be valuable.</p>
*Section 4 – Risk management	Modernise this section in light of developments in risk management techniques etc., including in relation to climate risk, and the need to consider short, medium and long time horizons.	Risk management as a discipline is developing and these guidelines should reflect most up to date practices. Insurance undertakings potentially face material financial risks from climate change which should be considered. Insurance undertakings must also be aware of the need to consider risks beyond short term horizons.

Guideline/section/chapter	Proposed amendment	Rationale
Section 11 – Outsourcing	<p>The Guidelines would benefit from a clarification about the difference between the critical decision-making/governance (which cannot be outsourced under Solvency II) and the administrative and technical elements supporting the decision-making process.</p> <p>The guidelines could support the principles described above by clarifying how outsourced key functions and collective supervision/completion by the Board/AMSB as a governance body or by its individual members could be efficiently and proportionally combined.</p> <p>Consider whether the guidelines remain appropriate as companies transform for a digital world and outsource new types of service (internet of things, cloud, blockchain etc.)?</p>	<p>Further support for requirements concerning outsourcing.</p> <p>Ensure that requirements are up to date and reflect commercial developments in outsourcing.</p>
Chapter II – Group governance requirements	<p>Include a more precise list of quantitative and qualitative conditions which help insurance groups to comply with the requirement to establish an effective system of governance, including criteria to be considered by groups in their self-evaluation.</p> <p>Consider also the introduction of a number of governance models (e.g. reinforced, normal and simplified) in the guidelines for consideration by undertakings in their self-assessment.</p>	<p>Further support for requirements concerning Group governance.</p>