



EIOPA-CP-16/002  
03/02/2016

**Consultation Paper**

**on**

**the proposal for**

**Guidelines**

**on facilitating an effective dialogue**

**between competent authorities**

**supervising insurance undertakings and**

**statutory auditor(s) and the audit firm(s)**

**carrying out the statutory audit of those**

**undertakings**

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## Responding to this paper

EIOPA welcomes comments on the proposal for Guidelines on facilitating an effective dialogue between competent authorities supervising insurance undertakings and statutory auditor(s) and the audit firm(s) carrying out the statutory audit of those undertakings.

Comments are most helpful if they:

- respond to the question stated, where applicable;
- contain a clear rationale; and
- describe any alternatives EIOPA should consider.

Please send your comments to EIOPA in the provided Template for Comments, by email [cp16-002@eiopa.europa.eu](mailto:cp16-002@eiopa.europa.eu), by 28 April 2016.

Contributions not provided in the template for comments, or sent to a different email address, or after the deadline will not be processed.

### Publication of responses

Contributions received will be published on EIOPA's public website unless you request otherwise in the respective field in the template for comments. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure.

Please note that EIOPA is subject to Regulation (EC) No 1049/2001 regarding public access to documents and EIOPA's rules on public access to documents<sup>1</sup>.

Contributions will be made available at the end of the public consultation period.

### Data protection

Please note that personal contact details (such as name of individuals, email addresses and phone numbers) will not be published. They will only be used to request clarifications if necessary on the information supplied.

EIOPA, as a European Authority, will process any personal data in line with Regulation (EC) No 45/2001 on the protection of the individuals with regards to the processing of personal data by the Community institutions and bodies and on the free movement of such data. More information on data protection can be found at <https://eiopa.europa.eu/> under the heading 'Legal notice'.

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<sup>1</sup> [Public Access to Documents](#)

## **Consultation Paper Overview & Next Steps**

EIOPA carries out consultations in the case of Guidelines and Recommendations in accordance to Article 16 (2) of the EIOPA Regulation.

This Consultation Paper presents the draft Guidelines, explanatory text and a technical annex where relevant.

The analysis of the expected impact from the proposed policy is covered under Annex I (Impact Assessment).

### **Next steps**

EIOPA will consider the feedback received and expects to publish a Final Report on the consultation and to submit the Consultation Paper for adoption by the Board of Supervisors.

# 1. Guidelines

## Introduction

- 1.1. According to Article 12(2) of Regulation (EU) No 537/2014 of 16 April 2014 of the European Parliament and of the Council on specific requirements regarding statutory audit of public-interest entities<sup>2</sup>, EIOPA shall, taking current practices into account, issue guidelines addressed to competent authorities supervising insurance undertakings for the purpose of facilitating the establishment and the maintenance of effective dialogue between competent authorities supervising insurance undertakings and statutory auditor(s) and audit firm(s) carrying out the statutory audit of those undertakings. For the purpose of strengthening the supervision of insurance and reinsurance undertakings and the protection of policy holders, Directive 2009/138/EC of 25 November 2009 of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (hereinafter 'Solvency II Directive')<sup>3</sup>, in particular Articles 68 and 72, set out legal requirements on statutory auditors to report promptly any facts which are likely to have a serious effect on the financial situation or the administrative organisation of an insurance or a reinsurance undertaking. However, in addition to the duty to report such information on serious facts and incidents, supervisory tasks can be supported by effective dialogue between supervisors and statutory auditors and audit firms.
- 1.2. EIOPA, in close cooperation with the European Banking Authority (hereinafter "EBA"), has investigated the current supervisory practices relating to the communication between competent authorities supervising insurance and reinsurance undertakings in the EU and European Economic Area (hereinafter EEA) and statutory auditors and audit firms of those supervised insurance and reinsurance undertakings. The supervisors involved in that assessment all have regular and ad hoc contacts and exchange of views with statutory auditors. However, mostly, that interaction is not based on a formal set of rules or provisions. In order to facilitate a relevant and efficient dialogue - outside the scope of competent authorities' powers to ask for ad hoc information in accordance with Article 35 (2) (c) of Directive 2009/138/EC and outside the scope of the auditor's duty to report according to Article 72 of Directive 2009/138/EC -, EIOPA has developed this set of principle-based Guidelines to support EIOPA's members organisations in developing a consistent, appropriate and proportionate supervisory approach.
- 1.3. These Guidelines are issued in accordance with Article 16 of the EIOPA Regulation<sup>4</sup>.
- 1.4. These Guidelines are addressed to competent authorities supervising insurance and reinsurance undertakings.
- 1.5. If not defined in these Guidelines, the terms have the meaning defined in the legal acts referred to in the introduction.
- 1.6. The Guidelines shall apply from xxx.

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<sup>2</sup> OJ L 158, 27.5.2014, p. 77.

<sup>3</sup> OJ L 335, 17.12.2009, p.1.

<sup>4</sup> OJ L 331, 15.12.2015, p. 48-83.

## **Guideline 1 – Objectives of the dialogue**

- 1.7. Competent authorities should ensure that the dialogue with the statutory auditor(s) and the audit firm(s) carrying out the statutory audit is open and constructive, as well as sufficiently flexible to ensure it can accommodate unexpected future developments.
- 1.8. Competent authorities should promote the mutual understanding of the roles and responsibilities of the parties involved in the dialogue in line with the requirements on confidentiality and professional secrecy in accordance with Article 34 of Regulation 537/2014 and Articles 64 to 71 of Directive 2009/138/EC. In particular, competent authorities should ensure that any information exchanged in the dialogue remains confidential and does not constitute a breach of any contractual or legal restriction on disclosure of information in accordance with Article 12 (3) of Regulation 537/2014 or Article 68 of Directive 2009/138/EC.
- 1.9. Competent authorities should ensure that the supervised insurance or reinsurance undertaking remains the main source of information for supervisory and statutory audit purposes and that the information gathered in the dialogue does not substitute its work.
- 1.10. Competent authorities should apply a risk-based approach to the frequency and depth of communication to ensure a proportionate approach. The depth of communication can be distinguished between regular dialogue and discussion of current, imminent or urgent developments.
- 1.11. Competent authorities may assess regularly whether the communication and the information exchange meet the objectives of the dialogue as described in this Guideline and adjust their approach accordingly.

## **Guideline 2 – Nature of the information to be exchanged**

- 1.12. Competent authorities should consider exchanging information that is relevant to the parties of the dialogue in terms of their tasks, materiality and impact of the information.
- 1.13. In preparing and conducting the dialogue, competent authorities should address issues and information to be shared that are: undertaking-specific, industry-specific, current and emerging. At the same time competent authorities should promote statutory auditors' or audit firms' active contribution to the selection of relevant issues and information to be shared.
- 1.14. Competent authorities should assess which information is relevant for the supervision of the undertaking and may request relevant information from the statutory auditor(s) or audit firms accordingly. Those areas may cover, but are not limited to, the external environment of the undertaking, corporate governance and internal controls, going concern assumption, audit approach, communication with the administrative, management or supervisory body and the undertaking's audit committee, valuation and the appropriateness of own

funds, investments, financial statements and other audit documentation. Competent authorities should also consider sharing information relating to the individual undertaking from recent supervisory assessments or reviews, regulatory reporting, supervisory measures imposed on the undertaking and issues affecting the undertaking's going concern and issues relating to the industry, such as regulatory or macroeconomic developments. If the undertaking is part of a multinational insurance group, competent authorities, in particular group supervisors, should also consider covering relevant group-audit issues.

- 1.15. Competent authorities should be attentive regarding the form of information available at different stages of the statutory audit cycle when establishing the timing of dialogue with auditors.

### **Guideline 3 – Form of the dialogue**

- 1.16. Competent authorities should consider and choose the most appropriate and most effective means and channels of dialogue in light of the individual circumstances of the dialogue.
- 1.17. Competent authorities should choose an appropriate combination of means and channels of the dialogue, which can be used ad hoc or on a regular basis, namely: written communication, and oral communication, including phone calls and physical meetings. Competent authorities should promote setting up regular physical meetings to facilitate open communication, especially when initiating dialogue with participants for the first time.
- 1.18. Competent authorities should keep a record of the communication to safeguard the succession of the communication.

### **Guideline 4 – Representatives in the dialogue**

- 1.19. Competent authorities should consider inviting individuals from both parties who are knowledgeable, informed and empowered by their organisation or firm to exchange information relevant to the dialogue.
- 1.20. Competent authorities should consider the appropriate number and role of the participants taking into account the issues to be discussed during the dialogue and the particular nature and circumstances of the undertaking or undertakings subject to the dialogue.
- 1.21. Competent authorities should weigh the number of the participants in view of allowing for a relevant effective dialogue whilst safeguarding the confidentiality of the discussion's content. Competent authorities should ensure that the primary participants in the dialogue are a representative of the supervisory authority acting as team leader and the key audit partner. Competent authorities should consider other relevant participants according to the topics, such as IT experts, accounting experts and actuarial or valuation experts.
- 1.22. Competent authorities should assess whether in particular circumstances and considering the issues to be discussed, trilateral meetings with representatives

from the undertaking, and in particular its audit committee, would be useful to achieve effective dialogue. Similarly, the competent authority may invite, where appropriate, competent authorities dealing with the supervision of financial markets or with public oversight of auditors.

### **Guideline 5 – Frequency and timing of the dialogue**

- 1.23. Competent authorities should consider scheduling regular dialogues as frequently as necessary to ensure the dialogue is effective, taking into account paragraph 1.10 of Guideline 1. Competent authorities should take into account the planning cycle of supervisory inspections and statutory audits to establish the most appropriate timing for dialogue.
- 1.24. Competent authorities should assess whether ad hoc dialogue is necessitated due to important issues that arise and require urgent clarification.
- 1.25. Competent authorities should regularly evaluate whether the frequency and timing chosen are appropriate and proportionate relative to the effect on its supervisory tasks or on the statutory audit in relation to the undertaking. Ensuring a proportionate approach, dialogues relating to insurance undertakings that are highly risky and that have an expected high impact in case of a given failure, competent authorities should consider holding meetings at least on an annual basis.

### **Guideline 6 – Dialogue with auditors or audit firms collectively**

- 1.26. In order to promote a more efficient dialogue at the sectoral and national level, competent authorities should consider setting up regular dialogues with statutory auditor(s) collectively to allow an exchange of views on current and emerging developments, at least annually, where relevant.
- 1.27. Competent authorities should ensure that no undertaking-specific information is shared in such meetings and that the same confidentiality and professional secrecy requirements as in individual dialogues apply.

## **Compliance and Reporting Rules**

- 1.28. This document contains Guidelines issued under Article 16 of the EIOPA Regulation. In accordance with Article 16 (3) of the EIOPA Regulation, Competent Authorities and financial institutions shall make every effort to comply with guidelines and recommendations.
- 1.29. Competent authorities that comply or intend to comply with these Guidelines should incorporate them into their regulatory or supervisory framework in an appropriate manner.
- 1.30. Competent authorities shall confirm to EIOPA whether they comply or intend to comply with these Guidelines, with reasons for non-compliance, within two months after the issuance of the translated versions.
- 1.31. In the absence of a response by this deadline, competent authorities will be considered as non-compliant to the reporting and reported as such.

## **Final Provision on Reviews**

- 1.30. The present Guidelines shall be subject to a review by EIOPA by [date].

## **Annex I: Impact Assessment**

### **Section 1. Procedural issues and consultation of interested parties**

In accordance with Article 16 of EIOPA Regulation, EIOPA conducts analyses of costs and benefits in the policy development process. The analysis of costs and benefits is undertaken according to an Impact Assessment methodology.

The draft Guidelines and its Impact Assessment are envisaged to be subject to a public consultation. Stakeholders' responses to public consultation will serve as a valuable input in order to revise the guidelines.

### **Section 2. Problem definition**

When analysing the impact from proposed policies, the impact assessment methodology is anchored to a baseline scenario as the basis for comparing policy options. This helps to identify the incremental impact of each policy option that was considered during the development of the policies. The aim of the baseline scenario is to explain how the current situation would evolve without additional regulatory intervention.

For the analysis of the potential related costs and benefits of the proposed guidelines, EIOPA has applied as a baseline scenario the effect from the application of the requirements of the Audit Directive and the Audit Regulation.

Article 12 (2) of the Audit Regulation contains the request for EIOPA to develop guidance to insurance supervisors for the establishment of an effective dialogue with auditors of supervised undertakings.

In line with the objective and the spirit of the Audit Directive and the complementing Audit Regulation, EIOPA arrived at a view that there is a problem of impaired, or not fully efficient or sufficient, audit quality, for which one of the notable causes is that there is an expectation gap regarding the scope of the audit and the audit report, which affects the perceived role of the auditor, which does not match the expectations of the stakeholders. There are indications that this issue is exacerbated by the experience that there is not sufficient communication between auditors and supervisors of public interest entities, which entails insurance or reinsurance undertaking. Even though supervisory authorities have the right to ask for ad hoc information in accordance with Article 35 (2) (c) of Directive 2009/138/EC and auditors have the obligation to report any fact or decision which is liable to constitute a material breach of laws, affect the ability of the company to continue as going concern or lead to a qualified audit report, according to Article 72 of Directive 2009/138/EC, those measures have not led to an active engagement between auditors and supervisors.

The lack of streamlined and well developed dialogue between auditors and supervisors is often regarded as a missed opportunity to use the auditor's work as a tool for financial stability purposes.

If the current state of communication between the two parties remains as is and would not be regulated at European level, one can imagine that the situation would not improve. That is evidenced by the European Commission's research<sup>5</sup> on the

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<sup>5</sup> See Commission staff working paper Impact Assessment: Accompanying the document Proposal for a Directive of the European Parliament and of the Council amending Directive 2006/43/EC on statutory audits of annual accounts

auditor's stances regarding their role in the financial crisis, which indicates denial of any wrongdoing.

On the other hand, EIOPA noticed that a number of its members are currently developing internal guidance or manuals to facilitate regular and effective communication with statutory auditors, which may, even though the initiatives are well-intended and welcome, lead to widening the gap and increase the current unlevelled playing field within Europe, which is to the detriment of the internal market.

### **Section 3. Objective pursued**

The operational objective of the guidelines is to facilitate the establishment and the maintenance of effective dialogue between competent authorities supervising insurance undertakings and the statutory auditors and audit firms carrying out the statutory audit of those undertakings.

This objective corresponds to the overarching general objective in the Audit Directive to contribute to the efficient functioning of financial and non-financial markets by strengthening the market role of the audit profession: to provide relevant economic agents and the market with more reliable, transparent, meaningful and timely information at an acceptable cost about the veracity of financial statements of companies; these Guidelines are meant to operationalise the objective to clarify and define the role of the statutory auditors generally as well as with specific regard to public interest entities.

This objective also corresponds to the following general and specific objectives of the Solvency II Directive: enhance policyholder protection, advance supervisory convergence and encourage cross-sectoral consistency.

### **Section 4. Policy options**

With the aim to meet the objective set out in the previous section, EIOPA has analysed different policy options throughout the policy development process. Considering current supervisory practices and the baseline as regulated by the Audit Regulation, none of the guidelines proposed are expected to have any material impact compared to the baseline. Nevertheless they are proposed for the purpose of clarification and achievement of a common understanding of the underlying policy.

These are the cases of the general approach of the Guidelines and in particular the requirement of an annual physical meeting in Guideline 5.

The section below reflects the most relevant policy options that have been considered in relation to the approach and Guideline 5. We have also listed relevant options which have been discarded in the policy development process.

#### **Policy issue 1: Principle-based versus rules-based approach**

Policy option 1.1: A principle-based approach sets out the underlying idea, the goal and the objective of a policy and defines a more high-level concept in order to educate the actual approach implementing the provision and the underlying policy.

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and consolidated accounts and a Proposal for a Regulation of the European Parliament and of the Council on specific requirements regarding statutory audit of public-interest entities, p. 24.

Policy option 1.2: A rules-based approach sets out the rules that are to be applied in specific, individual circumstances. The rules themselves implement the underlying idea of a policy, there is no scope for adjusting the treatment if the actual circumstances or the characteristics differ.

Policy issue 2: Determining the frequency of physical meetings

Policy option 2.1: The first option is not to determine the exact frequency of physical meetings.

Policy option 2.2: The second option is to determine the exact frequency of physical meetings.

Policy option 2.3: The third option is to require a proportionate approach for all dialogues whilst specifying the requirement to consider meeting physically at an annual basis for high risk cases.

## **Section 5. Analysis of impacts**

Policy issue 1 Principle-based versus rules-based approach

Policy option 1.1: Principle-based approach

Considering that currently there is significant divergence in the communication between supervisors and auditors whereas some approaches are highly regulated and other are very much dependent on the actual circumstances, this option provides supervisors with a common understanding about the goals and objectives of an effective dialogue as envisaged by the Audit Regulation. A principle-based approach provides supervisors to adapt the principles in a way to best address the circumstances that are specific in the legal and regulatory framework. This option mitigates the problem of finding strict regulations in a manner of "one size fits all" and at the same time allows supervisors and EIOPA to further develop best practices in this area. Therefore, EIOPA is convinced that a principle-based approach is probably the best initial step to achieve consistent supervisory practices regarding the regular interaction with auditors.

Analysis according to the expected impact on stakeholders:

EIOPA's analysis covered the effects on both supervisors and auditors. Whilst a principle-based approach allows a more tailored application at the national level, it also slightly increases the uncertainty of actual implementation for the auditors. At the same time a principle-based approach facilitates the further development of the national application on a cooperative basis for both supervisors and auditors.

This analysis came to the conclusion that there are no negative or explicit positive impacts on policyholder protection or any financial impact for stakeholders. Equally, EIOPA does not believe there is any significant impact on insurance undertakings.

Proportionality:

Clearly, a principle-based approach allows for the application of the proportionality principle, yet it does not, just like a rules-based approach, by its very nature determine a proportionate approach.

Policy option 1.2: Rules-based approach

A rules-based approach has the advantage that all known cases can be exactly regulated, yet that is equally its disadvantage as possibly not all cases or circumstances are known. Also, exact regulation of individual cases bears the risk that fairly similar circumstances may be treated differently. A rules-based approach is

most appropriate for settled policy areas in a sense that each individual case can be clearly determined based on past experience. However, that is not necessarily the case for all Member States. Of course, EIOPA does not rule out that these circumstances may change in the future and a rules-based approach may be the most relevant to ensure a fully consistent, prescribed approach.

Analysis according to the expected impact on stakeholders:

EIOPA's analysis covered the effects on both supervisors and auditors. A rules-based approach mitigates the risk of a lack of clarity or the need to further interpret the regulation. However, it decreases the ability of both parties involved to best implement the objective of these Guidelines in a manner that suits the individual circumstances.

This analysis came to the conclusion that there are no negative or explicit positive impacts on policyholder protection or any financial impact for stakeholders. Equally, EIOPA does not believe there is any significant impact on insurance undertakings.

Proportionality:

A well regulated rules-based approach allows for the application of the proportionality principle, yet it does not, just like a principles-based approach, by its very nature determine a proportionate approach. That said, a rules-based approach is prone to be challenged as being disproportionate, as it needs to regulate each case individually.

Policy issue 2: Determining the frequency of physical meetings

Policy option 2.1: not to determine the exact frequency of physical meetings

Considering the previous policy issue on a principle-based or rule-based approach, it may not be meaningful to regulate the frequency of actual physical meetings at all and leave it up to the judgement of both supervisors and auditors to meet when it seems relevant to meet.

Analysis according to the expected impact on stakeholders:

EIOPA's analysis covered the effects on both supervisors and auditors. It may be less intrusive not to set any regulation around the frequency of physical meetings, it would seem inconsistent with the conclusions of the European Commission's research<sup>6</sup>. Stakeholders clearly ask for increased communication, which can hardly be met by this option. This analysis came to the conclusion that there are neither positive impacts on policyholder protection nor any financial impact for stakeholders.

Proportionality:

The option not to regulate the frequency cannot be regarded as proportionate as it does not provide an objective or indication of a benchmark.

Policy option 2.2: determine the exact frequency of physical meetings

EIOPA considered setting an exact frequency of physical meetings, as indicated by the European Commission's research in this area. The European Commission came to the result that one annual meeting would cost 5,400 Euros and two envisaged bilateral meetings 10,800 Euros for the auditors only - not taking into account the costs to be

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<sup>6</sup> See Commission staff working paper Impact Assessment: Accompanying the document Proposal for a Directive of the European Parliament and of the Council amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts and a Proposal for a Regulation of the European Parliament and of the Council on specific requirements regarding statutory audit of public-interest entities, p. 158, 197, 245-246.

expected at the level of the supervisor.<sup>7</sup> The costs for supervisors have been assessed by the European Commission to be covered by general expenses and regular work. That means no additional costs can be expected for the supervisory authority for such a physical meeting to take place. Surely, any costs incurred at the level of the auditor can be expected to be passed-through to the insurance undertaking.

Analysis according to the expected impact on stakeholders:

EIOPA's analysis covered the effects on both supervisors and auditors. The additional costs - additional only if currently there are no annual or bi-annual physical meetings, as it is the case for many Member States - can be expected to be the ones as set out by the European Commission. There is a positive effect on consumer protection to be expected.

Proportionality:

To require an annual or a bi-annual meeting does not leave room for a tailored approach and a fully proportionate application.

Policy option 2.3: require a proportionate approach for all dialogues whilst specifying the requirement to meet physically at an annual basis for high risk cases

There is a third option which requires that there are regular physical meetings, which need to be held at a frequency that is proportionate to the risk assessment of the relevant insurance undertaking. In order to set a benchmark, high risk engagements would trigger at least one annual physical meeting between the relevant participants of both auditors and supervisors.

Analysis according to the expected impact on stakeholders:

The costs of a mandatory annual meeting would be the same as under policy option 2. However, supervisors and auditors could assess whether those costs are proportionate to the needs as determined by the characteristics of the engagement (which are not within the high risk category).

Therefore, the fixed costs of both supervisors and auditors would be potentially lower whilst the positive impact on policyholder protection should remain relatively high. Again, any costs incurred at the level of the auditor can be expected to be passed-through to the insurance undertaking.

Proportionality:

In terms of proportionality, this option provides the opportunity to apply a fully proportionate approach to fulfil the objective with a clearly set benchmark of at least one annual physical meeting.

## **Section 6: Comparison of options**

Policy issue 1 Principle-based versus rules-based approach

The preferred policy option for this policy issue is policy option 1 the principle-based approach because at this stage and considering the diverging circumstances permits a tailored, consistent approach within all Member States. The rules-based approach

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<sup>7</sup> See Commission staff working paper Impact Assessment: Accompanying the document Proposal for a Directive of the European Parliament and of the Council amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts and a Proposal for a Regulation of the European Parliament and of the Council on specific requirements regarding statutory audit of public-interest entities, p. 246.

exhibits too many risks of non-proportionate application which makes it unadvisable at this point in time.

The selection of the preferred option has required a trade-off between the potential of different interpretations and the freedom to choose the most appropriate solution for the national circumstances. More weight has been given to the positive and proportionate application by supervisors and auditors.

The comparison of options against a baseline scenario has been based on the current supervisory practices, which are highly divergent in this area.

Policy issue 2 Determining the frequency of physical meetings

The preferred policy option for this policy issue is policy option 3 to require a proportionate approach for all dialogues whilst specifying the requirement to consider meeting physically at an annual basis for high risk cases. The reasons for that are that such a proportionate approach with the establishment of a relevant benchmark fulfils the needs of supervisors and auditors to regularly meet and to apply a fully proportionate approach at the same time. The impact on consumer protection is equally high as a requirement to meet with all auditors at an annual basis, whilst reducing the financial impact on both parties.

The selection of the preferred option has required a trade-off between the potential of inconsistent application for the not-high-risk engagements and the potential for fully relevant and proportionate approach to the frequency of physical meetings. More weight has been given to the positive and proportionate application by supervisors and auditors.

The comparison of options against a baseline scenario has been based on the current supervisory practices, which are highly divergent in this area.

## **Section 7: Monitoring and evaluation**

EIOPA believes that it is important to increase the interaction and communication between supervisors and auditors. One core indicator for that is the number and frequency of physical meetings between insurance supervisors and auditors of supervised undertakings.

By its very nature, it is hard to measure how much the application of the Guidelines will foster a relevant exchange of views and information between supervisors and auditors. Yet, regular physical meetings and relevant communication will definitely support the goals as set out in these Guidelines.